DECISION
OF THE
ASSESSMENT APPEALS COMMITTEE

CASE NO. 2008-02

Bank X (Bank), filed an appeal with the Assessment Appeals Committee (Committee) of the Federal Deposit Insurance Corporation (FDIC) by letter dated February 4, 2008. The Bank is appealing a determination issued by the FDIC's Division of Insurance and Research (DIR) on January 24, 2008. In that decision, DIR denied the Bank's request to upgrade its capital evaluation from "Adequately Capitalized" to "Well Capitalized" for the July 1 to *****, 2007 assessment period. The requested upgrade would place the Bank in Risk Category I for the relevant assessment period, subject to an assessment rate of five to seven basis points. With DIR's denial, the Bank remained in Risk Category II, subject to an assessment rate of 10 basis points. The Bank's quarterly deposit insurance assessment was $147,577.75, approximately $65,000 higher than it would have been if the Bank had not fallen below the Well Capitalized threshold. This appeal followed.

At its meeting held on March 12, 2008, after carefully considering all of the written submissions and facts of this case, the Committee has determined that the Bank's appeal must be denied.

BACKGROUND

The Bank became a publicly traded company on ******, 2007. Prior to the public offering and within the last 10 days of ****** 2007, the Bank indicates that it received $59 million from customers for stock purchases. According to the Bank, these monies were held in a deposit account and invested in Federal funds. The deposits could not be transferred to equity until the public offering was completed on ******, 2007. This temporary influx of deposits, the Bank claims, caused the Bank's Total risk-based capital ratio to drop to 9.69 percent as of *****, 2007. The Bank maintains that if the capital calculation excluded the $59 million in additional assets, its Total risk-based capital ratio would have been above the 10 percent threshold. A review of the Bank's Thrift Financial Report (TFR) indicates, however, that the dilution of the Total risk-based capital ratio was largely attributable to the Bank's growth in non-deposit liabilities by approximately $100 million during the respective assessment period and the investment of those funds in higher risk-weighted assets.

On December 31, 2007, the Bank requested review by DIR of its capital evaluation for the July 1, 2007 assessment period, as provided for under 12 C.F.R. § 327.4(c). The Bank asserted that its Total risk-based capital ratio fell below the regulatory Well Capitalized threshold (10 percent – see 12 C.F.R. § 327.9(b)(1)) as of *****, 2007, due to the influx of deposits resulting from the Bank's public stock offering process. The Bank claims that it remedied the situation in *****, 2007.

By letter dated January 24, 2008, DIR denied the Bank's request for a change to its capital evaluation. DIR addressed the FDIC's regulations, specifically 12 C.F.R. § 327.9(b), which governs assignments of capital evaluations. DIR determined that the Bank did not satisfy the capital ratio standard for a Well Capitalized institution as of *****, 2007, that the capital evaluation assigned for the assessment period beginning July 1, 2007 was correct, and that denial of the Bank's request was "consistent with the treatment of similarly situated institutions."

By letter dated February 4, 2008, the Bank timely appealed to the Assessment Appeals Committee. In its appeal, the Bank emphasizes that timing circumstances related to the Bank's public stock offering process caused the Total risk-based capital ratio to fall below the Well Capitalized level to Adequately Capitalized. The Bank seeks a change in its capital evaluation for the assessment period ending *****, 2007, and requests that approximately $65,000 in assessment payments be returned to the Bank.

ANALYSIS

The Bank asks the Committee to elevate it from Risk Category II to Risk Category I for the assessment period beginning July 1, 2007.

Determination of Risk Categories is governed by 12 C.F.R § 327.9(a). Risk Category I institutions must meet a specified supervisory evaluation and a specified capital evaluation. 12 C.F.R § 327.9(a)(1). To be in Risk Category I, an institution must be assigned to Supervisory Group A, which is defined as a financially sound institution with only a few minor weaknesses. 12 C.F.R. § 327.9(c)(1). The Bank was correctly assigned to Supervisory Group A for the July 1, 2007 assessment period.

A Risk Category I institution must also be Well Capitalized. The issue presented turns on whether the Bank satisfied the regulatory standards required of Well Capitalized institutions.

To be Well Capitalized, an institution must satisfy three regulatory capital ratio standards: a Total risk-based capital ratio of 10 percent or greater; a Tier 1 risk-based capital ratio of 6.0 percent or greater; and a Tier 1 leverage capital ratio of 5.0 percent or greater. 12 C.F.R § 327.9(b)(1)(i). These capital evaluations are made "on the basis of data reported in the institution's … Thrift Financial Report … dated as of ***** for the assessment period beginning the preceding July 1 …." 12 C.F.R § 327.9(b). The FDIC's regulations require a Well Capitalized institution to meet all three of these capital standards. AAC Case No. 2004-06 (January 13, 2005).

The Bank's *****, 2007 TFR indicated that it met the second and third of the Well Capitalized standards but fell short on the first: its Total risk-based ratio for the period in question was 9.69 percent, just under the 10 percent Well Capitalized threshold.

With a Total risk-based capital ratio of 9.69 percent (that is, lower than 10 percent but higher than 8 percent), the Bank was evaluated as Adequately Capitalized for the period in question. 12 C.F.R § 327.9(b)(2)(i). Adequately Capitalized institutions in Supervisory Group A are assigned to Risk Category II (12 C.F.R. 327.9(a)(2)) and pay a higher deposit insurance assessment rate than Risk Category I institutions. 12 C.F.R. 327.10(b) (10 basis points versus 5 to 7 basis points). The Bank seeks reassignment to Risk Category I for the July 1, 2007 assessment period.

In considering past requests for similar relief, the Committee has looked to whether unique circumstances (generally, circumstances beyond the bank's control) prevented the bank from complying with the regulations or whether application of the capital regulations to the facts of the case would be inequitable. AAC Case No. 2004-06. The Bank bases its claim to relief on the grounds that it became Adequately Capitalized due to timing circumstances related to the Bank's public stock offering process. DIR staff confirmed that the Bank had full discretion in setting the date for the stock offering, and that the decision to go public on *****, 2007 was not based on any regulatory constraint. The Bank's approximately $100 million growth in non-deposit liabilities and investment of these funds in higher risk-weighted assets significantly contributed to its Total risk-based capital ratio declining below the Well Capitalized threshold. The Bank had full discretion concerning the investment of funds received during the quarter, and could have invested these funds in assets that have on average a sufficiently lower risk weighting to prevent the decline in the Total risk-based capital ratio below 10 percent.

As this Committee has previously ruled, risk-based capital is vitally important to the safety and soundness of the industry and to the FDIC; it provides a cushion against unexpected losses, reduces the risk of failure, and mitigates the FDIC's losses in the event of failure. The Committee has been - and remains - reluctant to sanction an exception to the Board's capital regulations for a bank's inadvertent failure to comply. AAC Case No. 2004-06.

To its credit, the Bank has a long history as a Well Capitalized institution and notes that it quickly regained its status as a Well Capitalized institution after the completion of the public stock offering. As the Committee has observed, that is one purpose of the regulation: to give banks an incentive to maintain strong capital levels. AAC Case No. 2004-06. We recognize that the Bank moved to restore its Well Capitalized status soon after the *****, 2007 TFR date. But that does not excuse the Bank's failure to comply with the regulatory requirements for Well Capitalized institutions for the July 1, 2007 assessment period.

After considering all of the facts and arguments presented by the Bank in its appeal, the Committee finds that the circumstances presented are not unique nor is application of the capital evaluation regulation in this instance inequitable.

CONCLUSION

The Bank's capital evaluation for the July 1, 2007 assessment period was based on data reported in its *****, 2007 TFR. The Bank was correctly evaluated as Adequately Capitalized and assigned to Risk Category II for that period. While the Committee is sympathetic to the Bank's position and appreciates its efforts to return quickly to Well Capitalized status, no basis for granting relief from application of the FDIC's regulations is presented here. Accordingly, for the reasons set forth in this decision, the Bank's appeal is denied.

By direction of the Assessment Appeals Committee, dated April 4, 2008.

Valerie J. Best
Assistant Executive Secretary