ICBA
INDEPENDENT COMMUNITY
BANKERS of AMERICA®

September 27, 2021

The Honorable Jelena McWilliams
Chairman
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Dear Chairman McWilliams:

The Independent Community Bankers of America[1] (ICBA) urges the Federal Deposit Insurance Corporation (FDIC) to swiftly amend its regulations concerning annual independent audits and reporting requirements under 12 CFR part 363 (collectively referred to as "the part 363 requirements" or "the FDICIA audit and reporting requirements") by permanently raising the asset thresholds that impose unnecessary and costly regulatory burdens upon the nation's smallest community banks.[2] Specifically, ICBA requests that only institutions with total assets of $1 billion or more (currently, the asset threshold is $500 million) be subject to the part 363 requirements regarding audited financial statements. Additionally, we propose that institutions with total assets of $5 billion or more (currently, the asset threshold is $1 billion) be subject to the requirement of having internal control assessments by management and external auditors.

ICBA previously urged the FDIC to utilize its authority, pursuant to Section 36 of the FDI Act, to increase the asset thresholds for the FDICIA audit and reporting requirements because "consolidation in the banking industry and the effects of inflation warrant a significant adjustment."[3] Today, we vehemently renew our request for the FDIC to amend part 363 because

[1] The Independent Community Bankers of America® creates and promotes an environment where community banks flourish. ICBA is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education, and high-quality products and services. With nearly 50,000 locations nationwide, community banks constitute 99 percent of all banks, employ more than 700,000 Americans and are the only physical banking presence in one in three U.S. counties. Holding more than $5.8 trillion in assets, over $4.8 trillion in deposits, and more than $3.5 trillion in loans to consumers, small businesses and the agricultural community, community banks channel local deposits into the Main Streets and neighborhoods they serve, spurring job creation, fostering innovation and fueling their customers' dreams in communities throughout America. For more information, visit ICBA's website at www.icba.org.

[2] Part 363 implements the Federal Deposit Insurance Corporation Act (FDICIA) requirements that banks of a certain asset size (as determined by the FDIC) engage an independent auditor to perform annual audits and assess the effectiveness of internal control over financial reporting and compliance. Section 36 of the Federal Deposit Insurance Act (FDI Act) grants the FDIC discretion to set the asset size threshold for compliance with statutory requirements, but it states that the threshold cannot be less than $150 million.

[3] *See* letter from Christopher Cole, ICBA Executive Vice President and Senior Regulatory Counsel, to the Honorable Chairman Jelena McWilliams dated September 16, 2019.

our concerns about industry consolidation and inflationary effects persist and are exacerbated by the unprecedented large volume of deposits presently held at community banks. Absent changes to (or, at the very least, extensions of temporary relief from) the asset thresholds for the FDICIA audit and reporting requirements, the nation's smallest community banks are fast approaching the current limits for reasons unrelated to intentionally aggressive or even organically moderate growth within these institutions. Instead, small community banks are confronting the asset thresholds for part 363's onerous and expensive requirements because of their participation in COVID-19 related government stimulus efforts and a massive "deposit glut" weighing on the industry. Other macroeconomic factors, including the current inflationary environment and widespread consolidation throughout the banking industry, have added additional pressures to small community banks with balance sheets threatening to exceed part 363's asset limits.

In the first quarter of 2020 and at the outset of the COVID-19 pandemic, total deposits increased by $1.9 trillion, the largest year-over-year growth rate ever reported by the FDIC's Quarterly Banking Profile (QBP).[4] Remarkably, every quarter since then has experienced deposit growth.[5] The FDIC this month reported in the QBP for the second quarter of 2021 that "deposits now total $18.7 trillion - the highest level on record."[6] Because deposit growth has persisted at record-highs and for a much longer period of time than initially anticipated, community banks now need relief from part 363's asset thresholds as these limits were not designed to address the massive swell of deposits presently within the banking system.

While the FDIC generously provided community banks with temporary relief from asset threshold calculations for the FDICIA audit and reporting requirements throughout the COVID-19 pandemic, such relief will soon abruptly expire December 31, 2021.[7] For the reasons outlined herein, ICBA believes a more permanent increase to the asset thresholds for the part 363 requirements will not only provide small community banks with necessary short-term relief from the lingering COVID-19 deposit surplus but will also provide these institutions appropriately tailored long-term relief from stale regulatory requirements designed by Congress nearly thirty years ago and last updated by the FDIC over fifteen years ago.

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[4] *See* FDIC QBP First Quarter 2020, Volume 14 Number 2 (March 31, 2020).

[5] *See* FDIC QBP Second Quarter 2020, Volume 14 Number 3 (June 30, 2020); FDIC QBP Third Quarter 2020, Volume 14 Number 4 (September 30, 2020); FDIC QBP Fourth Quarter 2020, Volume 15 Number 1 (December 31, 2020); FDIC QBP First Quarter 2021, Volume 15 Number 2 (March 31, 2021); and FDIC QBP Second Quarter 2021, Volume 15 Number 3 (June 30, 2021).

[6] FDIC, *Remarks by FDIC Chairman Jelena McWilliams and Director of the Division of Insurance and Research Diane Ellis on Second Quarter 2021 Quarterly Banking Profile* (Sept. 8, 2021).

[7] In October 2020, the FDIC published an interim final rule that allows banks to determine the applicability of part 363 requirements for fiscal year 2021 based on the lesser of their consolidated total assets as of December 31, 2019 or consolidated total assets as of the beginning of their fiscal year 2021. The interim final rule is effective through December 31, 2021, unless extended by the FDIC. *See* FIL 99-2020, *Applicability of Annual Independent Audits and Reporting Requirements for Fiscal Years Ending in 20212* (October 23, 2020).

The FDICIA audit and reporting requirements are both costly and burdensome for small community banks. Our members report that even the lowest cost estimates for independent audits can exceed $100,000; a cost that is prohibitive for the smallest banks in the country to bear. Almost as onerous, particularly for banks located in rural areas, is the part 363 requirement that an audit committee be comprised of a majority of outside directors who are independent of management of the institution. Given the potential liability an outside director may incur, many rural banks struggle to attract and retain board members, and therefore cannot easily comply (or in some instances, cannot ever comply) with part 363's audit committee composition requirements. While part 363 does provide institutions a hardship exemption, many small banks are nevertheless deterred by the supervisory expectation codified in part 363 that institutions with asset sizes exceeding the thresholds for FDICIA audit and reporting requirements retain and recruit a sufficient number of competent outside directors to serve on the audit committee.

Considering these challenges, there is anecdotal evidence some institutions intentionally try to stay under the part 363 asset thresholds because the costs to comply, once the institution is minimally above the asset threshold for the FDICIA audit and reporting requirements, outweigh the benefits of nominal asset growth. The FDIC should avoid saddling small community banks with anti-competitive regulatory burden and instead permanently raise the part 363 thresholds to amounts that appropriately differentiate the small, midsize, large, and systemically important institutions operating in today's environment.

Because the FDIC has not adjusted the size of the asset threshold for internal control assessments since 2005, and because the agency has never changed the asset size threshold for other audit and reporting requirements under part 363, the regulation no longer reflects Congress' original intent in enacting the FDICIA that the FDIC design regulatory requirements that distinguish small community banks from large financial institutions.[8] When the FDIC first implemented the FDICIA in 1993, the agency noted that by selecting $500 million in total assets as the appropriate size threshold, only 1,000 of the largest banks would be subject to the regulation.[9] As a percentage of the total number of institutions in existence at that time, the FDIC's asset threshold captured approximately 7% of banks within the industry. Similarly, when the FDIC

[8] Section 112 of the FDICIA added Section 36(j) to the FDI Act, which expressly codified an "exemption for small depository institutions." 12 U.S.C.A. § 1831m(j). By creating an exemption for small depository institutions, Congress unambiguously expressed a legislative intent that the FDICIA audit and reporting requirements do not apply to small banks. Section 112 of the FDICIA grants authority to the FDIC to prescribe by regulation the asset threshold by which a small depository institution may be defined, thus providing the FDIC the flexibility to appropriately respond to industry changes by periodically updating the asset thresholds for small depository institutions.

[9] In implementing the FDICIA audit and reporting requirements for the first time, the FDIC explained, "The final rule requires reporting by only the 1,000 largest institutions, one-third of those required under the proposal . . . Section 36 left to the FDIC's discretion whether to exempt institutions having total assets in excess of $150 million. The FDIC has exercised its discretion to mitigate the financial burden of compliance by raising the threshold from $150 million to $500 million, thereby exempting from the final rule approximately two-thirds of the institutions that would have been subject to Section 36, but which pose less of a risk to the deposit insurance funds, while bringing approximately 75 percent of the banking assets in the U.S. within the scope of the regulation." 58 Fed. Reg. 31332 (June 2, 1993).

amended part 363 in 2005 by raising the asset threshold for internal control assessments from $500 million to $1 billion, the agency noted about 600 of the largest insured institutions with approximately 86 percent of industry assets would continue to be covered by the internal control reporting requirements of part 363.[10] Once again, the FDIC selected an asset threshold that captured approximately 7% of banks operating within the industry at that time.

However, because the FDIC has not amended part 363's asset thresholds since 1993 and 2005, the size limits for the FDICIA audit and reporting requirements are now distorted given the widespread bank consolidation and inflationary trends that have occurred during the past three decades. As reflected in the chart in Appendix A, fewer than half of the banks operating in 1992 are still in existence today, meaning approximately 35% of banks are now captured by the FDIC's $500 million asset threshold for audited financial statements and approximately 20% of banks are presently subject to the FDIC's $1 billion asset threshold for internal control assessments by management and external auditors. Simply stated, the current part 363 asset thresholds apply to more banks within the industry than ever before, yet only a few large, complex, and systemically important financial institutions control the largest percentage of industry assets.

When the FDICIA was enacted, Congress intended to exempt small depository institutions from the rigors of independent annual audits and reporting requirements, while also requiring the least-cost resolution of insured depository institutions and improving supervision and examinations. Because the FDIC has not made frequent or regular adjustments to the part 363 asset thresholds to keep pace with industry changes, the current limits no longer provide a meaningful exemption to community banks. Since small banks are not responsible for the systemic risk concentrated within the nation's largest, most complex financial institutions, we believe moderate upward adjustments to the asset thresholds under part 363 are long overdue and will achieve meaningful burden reduction without sacrificing safety and soundness or posing risk to the FDIC's Deposit Insurance Fund.

Sincerely,

/s/

Rebeca Romero Rainey
President and CEO

[10] 70 Fed. Reg. 71226 (Nov. 28, 2005).

APPENDIX A

Industry Changes Since the Passage of the Federal Deposit Insurance Corporation Improvement Act of 1991

	Total Number of Insured Depository Institutions	Total Number of Insured Depository Institutions Under $500M	Total Number of Insured Depository Institutions Above $500M and Percentage of Industry Above $500M	Total Number of Insured Depository Institutions Under $1B	Total Number of Insured Depository Institutions Above $1B and Percentage of Industry Above $1B	Total Number of Insured Depository Institutions Under $5B	Total Number of Insured Depository Institutions Above $5B and Percentage of Industry Above $5B
As of 12/31/1992	13,973	12,978	995 or 7%	13,392	581 or 4%	13,830	143 or 1%
As of 12/31/2005	8,845	7,595	1,250 14%	8,211	634 or 7%	8,652	193 or 2%
As of 06/30/2021	4,960	3,219	1,741 or 35%	3,975	985 or 20%	4,688	272 or 5%

Data sourced from FDIC Details and Financials Institution Directory available at https://www7.fdic.gov/idasp/advSearchLanding.asp