From: Patrick Straka
Sent: Thursday, June 25, 2009 5:52 PM
To: Comments
Subject: RIN#3065-AD37

June 25, 2009

Attention: Comments
Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429

RE: RIN#3064-AD37. Notice of Proposed Rulemaking regarding Possible Amendment of the Temporary Liquidity Guarantee Program to Extend the Transaction Account Guarantee Program with Modified Fee Structure

Dear Mr. Feldman,

I would like to thank the FDIC for the opportunity to comment on the proposed rule making.

I am supportive of the second proposed alternative (i.e., the TAG program would be extended) for the reasons outlined below; in addition I have included suggested changes as well.

REASONS TO EXTEND: The primary reasons to extend the program are in the interest of the positive aspects to the program on the insurance fund both in general and specifically, and on the economic recovery. The following reasons are put forth:

1) The current unlimited guarantee on checkable deposits has helped to preserve franchise values in banking institutions both through customer retention and reduction of a likelihood of bank deposit runs which raises the system liquidity risks for all banks. The affect of this is fewer bank failures, a delay in bank failures, and increased deposit premiums the FDIC has attained when selling failed bank deposit franchises. Higher deposit premiums achieved by the FDIC are arguably the result since a bank with more non-interest bearing checking accounts typically has values significantly higher than those without on a per unit of deposit basis. Continuation of the program will extend these benefits.
2) Given current FDIC reports regarding asset quality in the banking industry there is substantial amount of risk of future bank failures and the prospect for additional resulting capital market turmoil and continued heightened threat of bank panics should FDIC insurance coverage be reduced.
3) The current programs influence on overall economic stability and the progress towards economic recovery are arguably net positive for a

number of reasons, including: 1) limiting the impact on business and household customer losses in principal due to otherwise uninsured balances at failed banks, 2) improving credit availability and competition by lowering the cost of funds and retaining more active participants, 3) more rapidly restoring capital with higher earnings (i.e., customers holding more of their large deposit balances in non-interest bearing checking versus interest bearing accounts for safety reasons than they might otherwise hold), and others. The program does have a negative affect in the form of moral hazard, but this problem is mostly foregone – the program has already been put in place and the hazard engaged.

4) As a result of retention of deposits at failed banks due to the program, it is plausible the cost to the insurance fund has not been as high as would be assumed when merely comparing the amount collected in fees from the program with the balances of checkable accounts fully insured that have been paid out by the fund. By way of example, to show this consider Bank A participating in the program and Bank B not. Assume both start with $100 in assets comprised of $50 in cash and $50 in loans with a book value of $50 and a fair value of $25; and 5 deposits accounts, 4 $12.5 time deposits fully insured and 1 $50 non-interest bearing deposit customer fully insured. A reasonable assumption might be that the time deposits can be sold for a 0% deposit premium and the non-interest bearing deposits for a 10% premium. Also, it is not unreasonable to assume Bank B losses the non-interest bearing deposit customer prior to seizure and pays out to the customer 100% of the balances in cash, this is because bank problems are well publicized in local papers well before failure and customers with large uninsured deposits at risk (and especially in this environment) may withdraw their funds in fear of losing uninsured portions. In this oversimplified hypothetical example, the comparative results of the bank failure on the insurance fund are:

i. Bank A: Liquidated Assets $75 ($50 Cash, $25 Loans), Deposits Paid Out $100, <u>Loss to Insurance Fund $20</u> ($25 loss reduced by $5 due to deposit premium on the noninterest bearing checking account).

ii. Bank B: Liquidated Assets $25 ($25 Loans, no cash since the cash paid out the withdrawn non-interest bearing checking account prior to seizure), Deposits Paid Out $50, <u>Loss to Insurance Fund $25</u> (no premiums on sale of deposit franchise since CDs have not value as stated).

This would suggest that having the program has a manner of positive affect on the losses to the insurance fund. Although the measurement may be conceivably trivial in derivation to determine whether this create a net positive affect on the fund, it may be difficult to execute the calculation due to the significant amount of data potentially available only at a high cost to derive it. As a result, it is plausible that the program has not had as adverse a direct impact on the fund.

SUGGESTED CHANGES: I also would like to suggest changes to the proposed rule making to more reasonably limit the exposure to the insurance fund and balance the risks versus rewards:

1) Extend the insurance to only completely non-interest bearing checking accounts; specifically, excluding NOW accounts. This will assist in the phase out process.
2) Extend the program for 3 years through the end of December 31, 2012. Issues in the banking industry will likely persist for an extended period as indicated by strained asset quality measures in a large segment of the banking industry. In addition as the regulatory environment evolves out of Washington DC the extended period will create an opportunity for the industry to address potential volatile outcomes with respect to their affects on the industry; hence reducing the potential adverse impact on the industry arising from new regulations.
3) Limit the insurance on non-interest bearing checking accounts to $1,000,000 effective May 1, 2010. The delay will assist customers and banks with planning for the limit. In addition, this will assist in addressing a number of issues:
   a. This acts as a trade-off for extending the program over a longer period.
   b. Reduce the adverse policy affect of moral hazard for the future (i.e., customers supporting a banks funding at a reduced cost that they would not otherwise without the deposit insurance fund backing).
   c. Limit the exposure to the insurance fund in the event of bank failures compared to the current program.
   d. Provide a focus of stability and full protection for the vast majority of small and mid-sized business checking accounts which makes up the substantial majority number of checking accounts in the economy between $250,000 and $1,000,000.
   e. Cause larger deposit customers to potentially diversify their deposit holdings across banks and into other assets, hence reducing the impact to any one customer from a bank failure causing potential secondary affects on businesses and the economy from bank failures (i.e., causing non-bank customers of banks to fail or weaken due to the loss of their deposits at a failed bank).
   f. Reduce the benefits to largest of banks. Their benefits from the program are arguably much higher now relative to small and mid sized banks since they would most likely have the largest non-interest bearing checkable deposits in excess of $1,000,000. In addition, this will appropriately incent larger banks to take appropriate actions to restore confidence in their credit standing (i.e., increase capital, take less risk, etc.). This will incent significantly larger non-bank businesses with deposits in excess of $1,000,000 to re-engage the money markets in a more significant way (e.g., commercial paper, repo, money market mutual funds and other short term investments) assisting in re-establishing the markets ability to create credit for companies off the bank balance sheet, thereby assisting the recovery

and the support the government and the federal reserve are providing to these programs.

4) Reduce the revenue objectives due to a change to a $1,000,000 limit.

5) Vary the fees assessed on banks by Risk Category currently assigned in FDIC insurance assessments for banks. This will encourage broader participation in the program by the vast majority banks which are in Risk Categories 1 and 2, but more fully assess the cost per deposit at banks with higher Risk Categories. Consider a per annum fee scale based on total non-interest checkable deposits as follows:
   a. Risk Category 1 - 7 basis points
   b. Risk Category 2 – 10 basis points
   c. Risk Category 3 – 15 basis points
   d. Risk Category 4 – 25 basis points

6) Calculate the fee based on the full sum of non-interest bearing balances in excess of $250,000; not just on the amount in excess of $250,000 but less than $1,000,000 as might be suggested based on our proposal to limit the insurance coverage to $1,000,000. This will keep the fee base sufficiently broad and assign a higher cost to banks with higher inherent liquidity risk due to larger sized deposit customers.

7) Permit banks that enroll or participate at the onset to have a 1 year opt out opportunity each of the 2 subsequent years as proposed; with such designation made prior to October 15th each year and the opting process requiring a noticing to all non-interest bearing checkable deposit customers.

8) Restrict banks that opt out from opting in at a later date; hence, incenting a higher rate of participation and reducing the affect of adverse selection.

9) Require all banks to participate the first year as is done with the $250,000 insurance limit on interest bearing deposits. This will create more consistency with the other program, reduce the affects of adverse selection on the fund and cause banks that have not opted in under the current program to assist in the payment of the maintenance of the insurance fund which they ultimately critically depend to manage their banking business in the current manner of operation. Alternatively, permit a future opt-in for banks ONLY if they then pay the full amount of fees that would have paid through the full duration of the program at the time they opt-in.

Again, thank you for the opportunity to express our support for the second proposed alternative and to suggest changes.

Warm regards,

Patrick Straka

Senior Vice President

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