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1120 Connecticut Avenue, NW
Washington, DC 20036

1-800-BANKERS
www.aba.com

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Edward L. Yingling
President & CEO
Phone: (202) 663-5328
Fax: (202) 663-7533
E-mail: eyinglin@aba.com

April 1, 2009

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

Re: RIN 3064–AD35; Interim Rule on Assessments; 12 CFR Part 327; 74 Federal Register 9338, March 3, 2009

Mr. Feldman:

The American Bankers Association (ABA) welcomes the opportunity to comment on the Interim Rule from the Federal Deposit Insurance Corporation (FDIC) on "emergency special assessments." ABA brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $14 trillion in assets and employ over 2 million men and women.

In formulating this comment, ABA formed two special task forces, one comprised of bankers from ABA's Government Relations Administrative Committee and America's Community Bankers Council and a second comprised of executives representing state bankers' associations around the country. ABA also sought advice from the ABA Securities Association, and we have received considerable input from banks of all sizes and charters across the country. The goal was to find reasonable alternatives to ***any*** special assessment in order to provide the FDIC with the short-term funding it may require, yet minimize the financial impact on the banks at the very time that they are making every effort – in the midst of a major economic downturn – to provide credit in their communities.

What we heard first and foremost from bankers is a firm commitment to ensuring the financial stability of the FDIC insurance fund. Particularly during this time of uncertainty, bankers recognize the importance of maintaining public confidence in the FDIC. The industry has been and continues to be prepared to meet its obligation to support keeping a positive balance in the fund – so that there is no need to use the line of credit at Treasury except for the most exceptional circumstances.

How this is accomplished is the critical question. The FDIC needs to strike the right balance to assure there are adequate funds to meet its obligations without impairing banks' ability to meet their obligations to their communities. With industry earnings under stress and the economy struggling, this is not the time to undermine banks' ability to lend and support economic recovery. Therefore, it is absolutely critical to look for alternatives that would provide the FDIC with an extra layer of protection without creating huge expenses in the second quarter of this year for banks. This timing issue is particularly acute, in as much as many hope and believe we are at or near the turning point in the economy and banks want to be ready to fund that turnaround.

This comment letter looks critically at whether there is an underlying need for any special assessment and the impact on banks and their communities of any such assessment. We also provide two alternative options that could provide a buffer against losses – ***without having to impose any special assessment now or in the future***.

Our main thoughts on the Interim Rule, which are discussed in more detail below, are as follows:

- The proposed special assessment would be a significant, unexpected expense at the worst time in the business cycle.
- A 20-basis point special assessment is far in excess of what is reasonably needed for an adequate buffer for the FDIC, given the current and expected resources of the FDIC.
- Several developments support a significant reduction of the proposed 20 basis points special assessment.
- The FDIC should not have authority – in advance – to charge additional special assessments.
- Options should be considered in lieu of a special assessment, such as an equity investment structure and/or FICO-like bonds.
- The FDIC should establish a reasonable recapitalization period.
- The FDIC should limit expenses and be transparent in the use of its resources.
- When examining banks, examiners should consider earnings prior to assessments, particularly with regard to risk-based premium categorization.

I. The proposed special assessment would be a significant, unexpected expense at the worst time in the business cycle.

The Interim Rule imposes a 20 basis point emergency special assessment on all insured depository institutions on June 30, 2009, to be collected on September 30, 2009. Moreover, the Interim Rule provides authority to charge additional special assessments in future quarters of up to 10 basis points (each occasion) if the FDIC Board believes that the insurance fund will fall to a level that could adversely affect public confidence.

The proposed special assessment would pull over $15 billion from the industry in the second quarter of this year. This is a significant and unexpected cost to all banks, and is on ***top*** of the regular risk-based quarterly premium paid by the industry, which will be nearly $3 billion on average each quarter. The FDIC expects to collect $11.6 billion from the quarterly premiums this year – nearly 72 percent of the industry's pre-tax earnings for all of last year and about four times last year's premiums revenue. Thus, the combination of higher quarterly premiums and the proposed special assessment would ***extract nearly $27 billion*** out of the industry and local economies for 2009.[1]

The money to pay these assessments cannot be created out of thin air. Even if the special assessments were half as much, which the FDIC has suggested is likely if Congress expands the agency's authority to borrow up to $100 billion from Treasury, it still will impose a substantial burden on banks at the very time that they are making every effort to get credit into local communities.

In fact, bankers indicate that the FDIC's estimates (provided along with the Interim Rule) grossly understate the distressing impact of the assessment on earnings and capital. Where the recession is particularly severe, the state bankers' associations have told us that even an 8 to 10 basis point special assessment on top of the increase in regular quarterly premiums will be larger than the total expected income for banks in their state. Such a special assessment could, therefore, create additional problems for many banks in distressed areas, and may even be the tipping point that could push a viable institution into an untenable position. For any bank, the cost comes at a steep price, not only to the institution but the community at large, as the available resources to facilitate an economic recovery would be diminished.

We would also note the substantial, unintended impact of the special assessment on the funding decisions of depository institutions. As an example, banks that issued term certificates of deposit (CDs) prior to the effective date of the Interim Rule are not able to factor the cost of the special assessment into their original wholesale funding decisions. Knowledge of the special assessment would, in fact, almost certainly have resulted in different and less costly funding choices on the part of banks, including the broader use of alternative, short term funding opportunities.

Moreover, there is also a significant risk of a negative feedback loop. A special assessment would impair earnings and capital at some banks, ***leading to deterioration in financial ratios and potentially CAMELS ratings – both of which would make the regular risk-based premium even higher.*** ABA recommends that any final rule adopted should provide an adjustment in risk based calculation (e.g., on net income and capital ratios) and clear instructions to field examiners not to downgrade banks' examination ratings as a result of any special assessment to assure there is not an added cost to any bank.[2]

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[1] We note that most institutions also pay 10 basis points (for 2009) for the additional deposit insurance coverage under the Temporary Liquidity Guarantee Program that protects depositors with non-interest bearing transaction accounts.

[2] According to FDIC's own analysis, the special assessment in 2009 would result in year-end 2009 capital for the industry being approximately 0.7 percent lower than in the absence of a special assessment. According to the Interim Rule, the special assessment in 2009 for profitable banks would result in pre-tax income that would be between 10 percent and 13 percent lower than if the FDIC did not charge the special assessment. For unprofitable institutions, pre-tax losses would increase by an average of between 3 percent and 6 percent. Bankers and state association executives believe that these estimates far understate the true impact on banks.

For some troubled institutions, the economic stresses may already be too great even without the costs of the special assessment.[3] ABA suggests that a careful evaluation be conducted regarding the impact on institutions that are struggling but still viable, so that whatever final decision is made, it does not exacerbate the situation and create additional losses for the FDIC. In these cases, special consideration for these viable institutions should be considered. No bank should have to be closed because of its payment of the special assessment. Moreover, we reiterate the concern that the special assessment can create a downward spiral that only compounds the problems over time with earnings and capital. Thus, the FDIC should look carefully at the ***secondary impacts*** of any special assessment.

Banks are already dealing with a deepening recession, accounting rules that overstate economic losses and unfairly reduce capital, regulatory pressure to classify assets that continue to perform, and a significant increase in regular quarterly FDIC premiums. Each of these is a big challenge on its own – but collectively, they are a nightmare. Adding another huge one-time cost compounds this burden dramatically.

In fact, the special assessment is completely at odds with banks' efforts to help communities rebuild from this economic downturn. This assessment makes the cost of raising new deposits much higher, and therefore, acts as a disincentive to raise new deposits. Fewer deposits will hinder banks' ability to lend. The reduction in earnings will make it harder to build capital when it is needed the most. Given that $1 of capital supports up to $7 in bank lending, the full impact on the economy is many multiples of the reduction in capital and earnings from the assessment.

Banks will also be forced to look at ways to lower other expenses, which may limit their ability to sponsor community activities or make charitable donations – something most banks have done year after year. Some banks have told us that they may even have to consider reducing staff in order to pay for this high cost. One small bank with 11 employees told us that the special assessment is larger than the cost of a full-time employee and may require a reduction in staff as a result. For many banks, the cost is many multiples of the cost per employee and could trigger sizable layoffs or other employment actions that might otherwise be avoided.

II. The 20-basis point special assessment is far in excess of what is reasonably needed for an adequate buffer for the FDIC

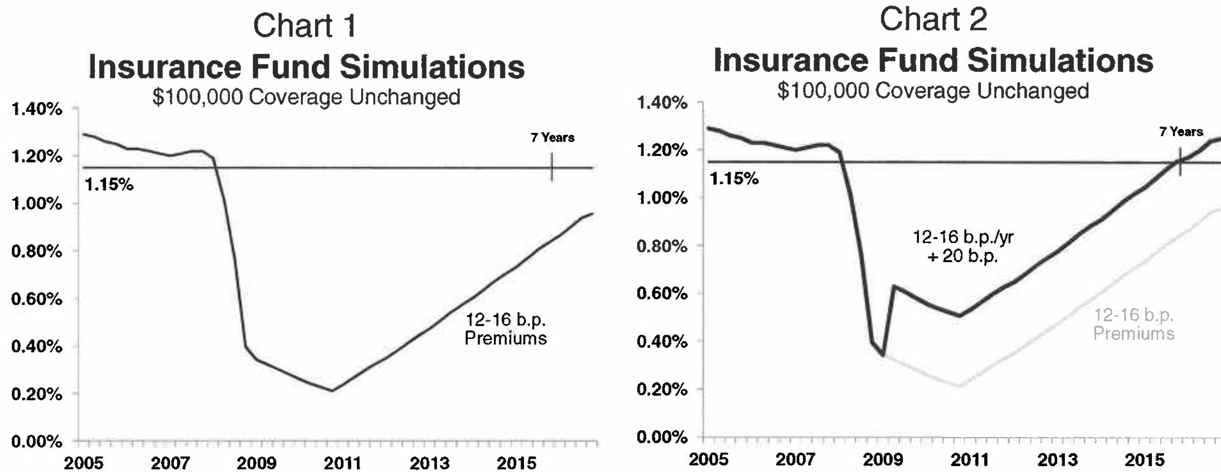
We appreciate the concern of the FDIC that losses may be greater than anticipated. With the economy slow to recover and credit losses increasing, the desire for an abundance of caution is understandable. However, the balance between the negative impact on lending and strain on financial institutions versus the additional abundance of caution is delicate. A key question is how much buffer is reasonably required given expectations for losses and access to the Treasury's line of credit. A second question is how the buffer could be obtained without imposing such a significant one-time cost in the second quarter. This section deals with the first of these two questions.

The question of an appropriate buffer is really a question of timing and accounting for possible losses and future cash flows. At the end of 2008, the fund balance was about $19 billion – ***excluding*** more

[3] We note that the 2009 assessment rate, with a 20-basis point special assessment, could be as high as 95 basis points for some institutions. It is unlikely that any institution could survive this, especially those that are sufficiently troubled as to be in the highest risk classification category.

than $22 billion set aside as reserves for possible bank failures for ***all*** of 2009. Thus, the total available resources to cover losses is over $41 billion. Quarterly premium payments will total around $12 billion this year, without the special assessment and without counting revenue from the TLGP or Legacy Loan Programs.[4] In fact, the premium payments in the first quarter were larger than the actual losses from bank failures in the first quarter. The combination of the revenue from quarterly premiums, revenue from the TLGP and Legacy Loan Programs, the reserves already set aside for expected failures and the $19 billion fund balance provide considerable protection to cover losses even greater than anticipated in the quarters to come.

In fact, using the first quarter 2009 data and the FDIC's assumptions for revenues and expenses,[5] ABA estimates that the fund's reserve ratio will not fall below 0.24 percent this year – ***without any special assessment*** (see Chart 1 below)



Our simulations suggest, even without a special assessment, that insurance expenses might have to be 40-50 percent higher than expected to exhaust the insurance fund this year. The proposed 20 basis points special assessment, as the FDIC rule describes, would raise the reserve ratio considerably – above the current (year-end 2008) level of 0.40 percent(see Chart 2 above). While this provides an added buffer against unexpected failure costs, it would come at an enormous cost to banks and their communities.

We would note that part of the rationale for the special assessment (in addition to booking significant revenue in the second quarter) is to facilitate the rebuilding of the reserve ratio to 1.15 percent within seven years.[6] As Chart 1 above shows, under the current quarterly assessments, the recapitalization is far longer. As we argue below, it is far better to stretch out the recapitalization ***– which the FDIC has authority to do –*** in order to minimize the procyclicality of the payments. The most pressing question

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[4] The benefits of these revenues are explained in Section III.

[5] FDIC, 74 Federal Register 9525, March 4, 2009. These simulations do not include any revenue from the TLGP or Legacy Loan Programs, which could add several billion dollars in revenue this year.

[6] The FDIC exercised its authority to extend the recapitalization period from five to seven years, and we urge that an even longer period be set.

is whether there is an adequate buffer for greater-than-expected losses, ***not*** the speed with which the fund is recapitalized.

Assessing an appropriate buffer in the short-run is complicated by the uncertainty surrounding the ***timing*** of the failures and the costs associated with them. More problematic is the fact that the FDIC has to set aside reserves for failures that are likely over the next year – which immediately reduces the reserve ratio. Yet the expected cash flow from quarterly premiums – ***which is far more predictable every quarter than bank failure costs*** – is not reflected in the reserve ratio until the quarter it is assessed. This accounting-cash-flow problem makes the FDIC's ability to pay for costs look far worse than is actually the case. This anomaly is not well understood by the media or the public, as the focus has been on the unobligated fund balance and not the reserves set aside for losses or the premium income expected. We urge the FDIC to delineate these resources more clearly and emphasize the protection being provided.

We appreciate the difficult situation the FDIC faces with the timing of failures and their associated uncertain costs. We understand that the costs may be greater than is currently expected and appreciate the desire for an abundance of caution that a special assessment would provide. However, the current resources – together with added sources of revenue and an extension of the FDIC's line of credit at the Treasury (discussed in the next section) – make the need for a special assessment far less intense.

III. Several developments support reduction of the proposed 20 basis point special assessment.

The previous section questions the original level of the special assessment given the expected losses and buffer with the current quarterly assessments. Since the special assessment was proposed on February 27, there have been several developments that make the need for a special assessment even less pronounced.

First, there appears to be strong Congressional interest in expanding FDIC's $30 billion line of credit to the Treasury to $100 billion.[7] ***ABA strongly endorses expanding this line of credit.*** We understand the importance of raising the credit line to ensure that the FDIC has access to sufficient working capital for any contingency, considering the restrictions in the Federal Deposit Insurance Act §15(c) (12 U.S.C. 1824(b)). Importantly, if the line of credit is expanded, the need to draw funds from the industry to help cover working capital needs is significantly reduced. In fact, it has been suggested by the FDIC that the special assessment could be cut in half. However, even a 10 basis point special assessment would still be too great a burden to bear, particularly for those banks serving deeply troubled economies.

Second, on March 17, the FDIC Board instituted an Interim Rule to alter the Temporary Liquidity Guarantee Program (TLGP) ***that will produce revenues for the insurance fund.***[8] ABA has

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[7] In particular, on March 5, Senate Banking Committee chairman Chris Dodd (D-CT) and Senator Mike Crapo (R-ID) proposed S. 541, "The Depositor Protection Act of 2009," which would raise the limit on FDIC's borrowing from Treasury from $30 billion to $100 billion ($500 billion through 2010).

[8] As proposed, the TLGP Debt Guarantee Program will be extended by four months and surcharge premiums will be assessed on participating institutions that issue guaranteed debt during the period: 25 basis points annually for insured depository institutions and 50 basis points annually for non-insured depository institutions. ABA will submit comments on

advocated for use of TLGP revenues to support the Deposit Insurance Fund (DIF), as the banking industry is obligated to pay for any losses emanating from either the insurance fund or the TLGP program. While the surcharges are directly applied to the DIF, we believe it is also appropriate to apply additional funds if the FDIC determines that the revenue is exceeding the expected losses of the guarantees.

Similar to the TLGP surcharge, a third source of revenue is the transfer of fees collected under the Public-Private Investment Program (PPIP) Legacy Loan Program (announced on March 23, 2009, by the FDIC and the Department of the Treasury).[9] The decision by the FDIC to create this program once again obligates the industry for losses, should any be suffered. Thus, it is appropriate that a significant amount of fees support the DIF.

Fourth, on March 18 the Financial Accounting Standards Board proposed changes in how "other than temporary impairment" (OTTI) is recognized for investment securities. These important changes should allow both banks and the FDIC to reflect genuine economic losses better, as opposed to mark-to-market losses, on investments. Bankers indicate that this change can greatly reduce write-downs and thus would have a nontrivial effect on their capital. Similarly, more appropriate valuations for assets the FDIC assumes in bank failures will potentially reduce resolution costs and have a positive effect on the capital of the insurance fund.

Clearly, all of these developments have occurred since the Interim Rule was proposed, and they reduce the immediate needs for a significant buffer to protect against losses greater than currently expected. As we have noted above, the 20 basis point special assessment is designed to provide a buffer to protect against the possibility that actual and expected losses are greater than currently anticipated. The combination of an expanded line of credit (and its associated working capital line), the additional revenue from the TLGP and Legacy Loan program, and the more appropriate valuations, means that there may not be an immediate need for a special assessment, or that it would be far less than originally proposed – certainly less than five or six basis points. As noted, however, even at this rate, significant hardship will occur with a special assessment. This is why the ABA offers two important alternative ways for the FDIC to obtain a capital buffer without imposing significant hardships all in the second quarter (discussed in Section V, below).

IV. The FDIC should not have authority – in advance – to charge additional special assessments.

In addition to significantly higher premiums and a special assessment in the second quarter, the FDIC is proposing that it have authority to impose additional emergency special assessments up to 10 basis points in future quarters, should it judge that the insurance fund may fall to a level near zero or that endangers public confidence. ***ABA objects to this provision and believes strongly that no special assessment should be assessed without giving banks the standard opportunity to comment***

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that Interim Rule. We note further that the unaudited FDIC financial statements dated March 4 (released March 26) indicate that TLGP funds are already being transferred to the insurance fund to cover losses from failed banks for coverage on the non-interest bearing transaction accounts.

[9] As proposed, private entities along with Treasury will establish Public-Private Investment Funds to purchase "legacy assets" from FDIC-insured institutions. To leverage these equity investments, the PPIFs will be able to issue debt guaranteed by the FDIC under a new debt guarantee program. ABA will submit comments on this proposal.

through the normal proposal and comment procedures. The FDIC already has considerable power in setting premium rates, and having such a broad authority at such a high level is not appropriate without first giving the affected institutions and the general public an opportunity to comment on the impact of the assessment.

Optional assessments pose a significant problem for banks as the unexpected nature makes it impossible to plan and budget for the cost. The FDIC should recognize that bank management needs to be able to plan expenses in order to make sound business decisions and allocate capital to lending and other activities.

The unexpected impact on earnings and disruptions in investor expectations can be a significant problem. It could even limit banks' ability to attract investment funds to build capital. Investors' will be unwilling to invest in banks if the earnings may be drawn off by the FDIC at any time with little notice. Undermining banks' ability to raise capital would have grave implications for the industry, the insurance fund, and the economy.

Should the insurance fund suffer such high losses that another special assessment would even be considered, the FDIC should use the line of credit available from the Treasury rather than imposing another huge immediate expense on banks.

V. Options should be considered in lieu of the special assessment.

ABA believes that, before imposing ***any*** special assessment, the FDIC should consider reasonable alternatives that can provide near-term funding for the insurance fund while avoiding a spike in banks premiums and the consequent immediate major financial impact on the banks. We have vetted a range of options with our membership and believe that two warrant consideration: equity investments by banks in the insurance fund and a structure like the Financing Corporation to issue bonds and invest the proceeds in the fund. We encourage the FDIC to consider these and other funding vehicles that may be relevant.

Bank Equity Investments in the Insurance Fund

In lieu of a special assessment, an alternative option to help recapitalize the FDIC insurance fund is for FDIC-insured institutions to make equity investments in the fund. The FDIC appears to have authority under current law to do this.[10] Moreover, there is precedent, for example, in the requirement that banks that are members of a Federal Reserve Bank must subscribe in the stock of that District Bank.

Equity investments would reflect the hybrid nature of the FDIC insurance fund, which is funded solely by member institutions and retains elements of mutuality in that credits and future dividends are based upon historic contributions. Issuance of equity by the FDIC would not change the mutual nature of the insurance fund, since the equity instrument would only be issued to FDIC-insured institutions.

[10] The Federal Deposit Insurance Act §14(d)(5)(A) (12 U.S.C. 1824(d)(5)(A)) provides that "... any insured depository institution may purchase and hold for investment any obligation issued by the [FDIC] under paragraph (1) without limitation, other than any limitation the appropriate Federal banking agency may impose specifically with respect to such obligations."

If the FDIC decides to pursue this approach, ABA believes that some level of equity investment should be compulsory for all FDIC-insured institutions. This approach would provide capital for the FDIC just as effectively as a special assessment. Moreover, such an equity investment is easily understood by the public and adds to the sense of confidence that the industry stands behind the agency.

For banks, this approach is attractive in that the equity investment would be treated as a financial asset, and the cost of carrying this asset is much less than a hefty one-time expense that reduces earnings and capital. This investment would be expensed only if the insurance fund balance falls below the aggregate of bank equity investments. The equity would be non-voting.[11]

A number of issues need to be resolved, and it would be appropriate for the FDIC to seek public comment regarding the details. This could be done as an Interim Rule, so that the FDIC could be assured of obtaining the buffer of capital that it seeks. Some of the decisions to be made include rights of withdrawal, conditions under which dividends would be paid, callability and tradability. It could be structured so that when the reserve ratio exceeds some level (perhaps at 1.15 percent, the designated reserve ratio, or some other appropriate level) a dividend could be paid, thus making this an earning asset for the banks.

Moreover, the FDIC would need to clarify the priority of the aggregate equity investment in covering insurance fund expenses, to allow appropriate accounting for the investment on banks' books, considering that there would be no benefit if the equity investments, at the outset, have to be written off as "other than temporarily impaired." Also, bankers feel that equity investments would be due a zero risk-weighting for regulatory capital purposes.[12]

Beyond the immediate needs for capital, how such a capital program might work in the future should also be considered. For example, there could be an initial or minimum capital investment required of new banks in order to assure that they have a sufficient financial stake in the FDIC from the outset. There might also be additional capital purchase requirements as the institution grows and redemptions at par if the institution shrinks or if a bank charter is discontinued.

None of these issues are insurmountable and in fact, are much simpler to resolve than some of the new programs instituted by the FDIC, such as the TLGP and Legacy Loan programs. The ABA would be pleased to work with the FDIC to develop the details of this type of program.

Financing Corporation Structure

Another alternative to provide capital to the FDIC is to use a structure like the Financing Corporation (FICO) to issue bonds and invest the proceeds into the insurance fund. Perhaps even the FICO itself could be used, since the FDIC administers the FICO. Such a method of funding would provide a lower upfront payment, and would represent an investment in an asset, rather than an expense against earnings.

As the FDIC knows, the FICO was created by the Competitive Equality Banking Act of 1987 for the sole purpose of issuing bonds to finance a rebuilding of the now-defunct Federal Savings and Loan

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[11] Many bankers believe, however, that the FDIC should establish an advisory board of bankers. Given the expansion of the FDIC's role and the obligations that it places on the banking industry – particularly the four occasions where the systemic risk exception has been declared – there should be a voice representing the members of the FDIC.

[12] Federal Reserve Bank stock has a zero risk weighting.

Insurance Corporation (FSLIC).[13] From 1987 through 1989, the FICO issued $8.2 billion of 30-year bonds. Separate means were provided for in the legislation to pay off the principal and interest on the bonds. For the principal, $3 billion was taken from the Federal Home Loan Banks and used to purchase zero-coupon U.S. Treasury bonds with maturities equivalent to the FICO bonds. For the interest, the FICO was authorized to draw funds from premiums paid by FSLIC-insured institutions. After much regulatory reorganization during 1989–1996, the FDIC now assesses all FDIC-insured institutions for the annual interest and then transfers the monies to the FICO. FICO securities outstanding are not backed by the full faith and credit of the U.S. government. However, since the principal is defeased by U.S. Treasuries, the FICO bonds are generally seen as very secure.

The original FICO bonds were sold directly to the public, issued through the Federal Financing Bank (like U.S. Treasury securities). The bonds under consideration could similarly be publicly issued, or could be sold directly to banks by the FDIC. For example, the FDIC could assess each bank the price of the bonds, which would be issued proportionately to all banks. Individual banks could then re-market their bonds, if they choose to do so, although not necessarily to other banks.

As with an equity investment vehicle, ABA recommends that, should the FDIC consider using a Financing Corporation structure to obtain capital, then the plan should be put out for public comment before it is initiated.

For Either Structure

ABA believes that either the equity investments or Financing Corporation structure could be designed to provide capital for the FDIC. Both would allow banks to record asset purchases instead of premium expenses. It is important to note that banks would be solely responsible for all of the funds in either vehicle; no public monies would be involved. The nature of the banks' financial obligation to fund the Deposit Insurance Fund would not be lessened, but the method would be far less pro-cyclical.

It is possible, however, that some banks in areas that have been less affected by economic problems may prefer simply to pay up-front instead of add equity investments or FICO-like bonds to their balance sheets. It would suit the FDIC's needs if institutions were given the option to pay a premium instead of participating in either program. To the extent possible, ABA recommends that individual banks be allowed to choose to pay a premium instead of participate, in order to meet their obligations to the FDIC. This would allow the institution to make the best business decision given the current environment that it faces. Those that elect not to participate would not be a part of any future dividends under the equity investments structure, or bond interest under the Financing Corporation structure.

VI. The FDIC should establish a reasonable recapitalization period.

ABA recommends that the FDIC assess premiums to recapitalize the insurance fund over a reasonable period of time, keeping in mind the present need to keep capital in the banks to increase stability and bolster lending. If extending the recapitalization period by a few years can reduce current assessments, it would certainly help in the current environment. Since banks will ultimately bear the full cost of all

[13] The Financial Institutions Reform, Recovery and Enforcement Act of 1989 chartered the Refunding Corporation (RefCorp) in a similar fashion as the FICO. RefCorp issued $30 billion in bonds from 1989 through 1991.

FDIC expenses and recapitalizing the fund, it is a question of ***timing of the payments and balancing the impact*** of any payment against the ability of banks to lend in their communities during the economic recession.

If the insurance fund and its reserve ratio are growing, and public confidence in the FDIC remains strong, the FDIC ***does not have to set premium rates inordinately high*** to recapitalize the fund quickly. We support the recent decision – which ABA had encouraged in previous comments to the FDIC – to extend the recapitalization period for the insurance fund to return to 1.15 percent from five years to seven years. ABA supports extending the recapitalization period further. In the early 1990s, Congress had established a 15-year time period to recapitalize the insurance fund to 1.25 percent. The pace of recapitalization far exceeded expectations – meeting the goal in less than a third of the allowable time – and the same scenario may well play out in this recovery as well. Having the longer-term flexibility allows a more measured and reasonable pace for rebuilding, which is consistent with improvement in the economy.

The time period for recapitalization takes on particular importance should the $250,000 level of FDIC insurance coverage be made permanent – which ABA endorses. It may be appropriate in this case to extend the recapitalization period to ***10 or 15 years*** in light of the impact on the insurance fund reserve ratio of the permanent change in coverage.

VII. The FDIC should limit expenses and be transparent.

Over the last few years, competitive pressures and strains from the current economic turmoil have forced banks to cut costs assiduously. For example, employee, plant and equipment costs for the industry were only 1.4 percent higher last year than two years prior. With the FDIC facing serious erosion of its capital, bankers feel that the FDIC should do the same thing.

ABA recommends that the FDIC should continue to seek genuine least-cost resolutions of failed banks, as required in statute. We note that the loss rate on failed bank assets spiked last year (aside from the Washington Mutual resolution) to a nine-year high and has remained elevated so far this year. In disposing of the assets of failed banks, we urge the FDIC to act in a judicious manner, weighing the consequences of holding assets for some short but reasonable time-period instead of quickly dumping them. Bankers operating in markets where banks have failed report that the current process of online auctions has produced some extremely low – "fire-sale" – prices for loans sold; the low prices have depressed asset values and destabilized local markets. We recommend full transparency in the bank resolution process so that the banking industry and public understand the costs incurred.

ABA further recommends that the FDIC should reduce all other unnecessary expenses, keeping in mind that every dollar the FDIC spends comes out of the insurance fund. To restrain costs, the FDIC should restrict its activities to those relevant to its charter function of insuring bank deposits.

We note that, during the current financial turmoil, the FDIC has extended its role to guarantee debt issued under the TLGP and PPIP Legacy Loan Program. To protect the insurance fund, ABA believes that the costs of such programs should be fully covered by fees and other revenues generated by those programs alone in order to avoid passing their costs on to the entire industry.

VIII. Bank examiners should consider earnings before assessments in rating institutions.

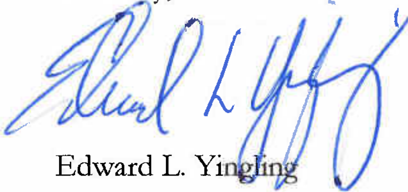
We want to reiterate a point that is of particular concern to bankers. FDIC's special assessment will negatively impact the earnings and capital positions of banks, even the healthiest institutions. ABA is concerned about the insidious cycle where elevated premiums and even an emergency special assessment result in downgrades of banks' CAMELS ratings, especially the Capital and Earnings components, causing the banks to transition to higher risk categories and much higher premiums – reinitiating the cycle. ***ABA encourages the FDIC to make clear to its bank examiners – and to work with the other banking agencies to make clear to <u>all</u> examiners – that they need to distinguish (in evaluating earnings and capital) between the impact of elevated assessments and the decisions made by the bank's management.***

IX. Conclusion

ABA appreciates this opportunity to comment on the Interim Rule. We believe that there are viable alternatives to any special assessment that would provide the FDIC with the short-term capital cushion that it seeks yet not impose an enormous cost on the industry. We appreciate the steps the FDIC has already taken that would reduce significantly the outlook for a one-time assessment and believe these steps reduce considerably the capital that would be required in the short-run. Nonetheless, even a special assessment in the 5 to 8 basis points range would impose significant costs on banks – particularly in economically stressed areas – and therefore we urge that alternatives such as the equity investment or FICO bond funding be considered in lieu of any one-time assessment.

As a final note, ABA emphasizes the importance of the proposed rule change by the Financial Accounting Standards Board to allow OTTI write-downs for firms' assets to better reflect economic losses. We believe that this change will lead to much more realistic financial statements for financial institutions and clearer, more optimistic supervisory evaluations of banks. We strongly encourage the FDIC to voice its support for these changes.

Sincerely,



Edward L. Yingling