Capital One Financial Corporation
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January 7, 2011

Mr. Robert E. Feldman, Executive Secretary
Attn: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
comments@FDIC.gov

Re: Assessments, Large Bank Pricing NPR
Change in Assessment Base
(RIN No. 3064-AD66)

Dear Mr. Feldman:

Capital One Financial Corporation (Capital One)[1] is pleased to submit comments on two recent proposals issued by the Federal Deposit Insurance Corporation (FDIC). The first proposal (Large Bank Proposal) creates a new assessment rate framework applicable to large insured depository institutions (IDIs or institutions). The second proposal (Assessment Base Proposal) implements the Dodd-Frank Act provision requiring the FDIC to change the assessment base to total assets.[2]

We appreciate the FDIC's efforts to better align FDIC insurance assessments with the risk that an IDI poses to the Deposit Insurance Fund (DIF). However, we believe that the Large Bank Proposal, when coupled with the Assessment Base Proposal, is flawed. In

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[1] Capital One (www.capitalone.com) is a financial holding company whose subsidiaries, which include Capital One, N.A. and Capital One Bank (USA), N. A., had $119.2 billion in deposits and $196.9 billion in total assets outstanding as of September 30, 2010. Headquartered in McLean, Virginia, Capital One offers a broad spectrum of financial products and services to consumers, small businesses and commercial clients. Capital One, N.A. has approximately 1,000 branch locations primarily in New York, New Jersey, Texas, Louisiana, Maryland, Virginia, and the District of Columbia. A Fortune 500 company, Capital One trades on the New York Stock Exchange under the symbol "COF" and is included in the S&P 100 index.

[2] Section 331(b) of the Dodd-Frank Act directs the FDIC to change the assessment base from effectively a domestic deposit base to "the average consolidated total assets of the insured depository institution during the assessment period. . . minus. . .the average tangible equity of the insured depository institution during the assessment period".

failing to adjust sufficiently for the change in assessment base required by Section 331 of the Dodd-Frank Act ("Section 331") and thereby shifting a significant portion of insurance assessments from small to large institutions, the FDIC appears to discount actual risk posed to the DIF. In addition, we have concerns that certain elements of the Assessment Base Proposal and Large Bank Proposal model neither reflect risk nor incent efficient and safe and sound banking practices.

We urge the FDIC to revise the Large Bank Proposal and Assessment Base Proposal to reflect more accurately actual risk posed to the DIF and publish a new notice of proposed rulemaking for public comment.[3]

Risk-Based Assessment System

As the Large Bank Proposal acknowledges, Section 7(b)(1) of the Federal Deposit Insurance Act (FDIA) requires that the insurance assessment system be risk-based, taking into account the potential of IDI failure and the likely amount of any loss upon failure. Despite Section 331's mandate to change the assessment base, it does not nullify FDIA's "risk-based assessment system" requirement. Rather, the aggregate framework - the assessment rate calculated using the large bank assessment model, as then applied to the revised assessment base – must still be risk-based, as required by both the FDIA and public policy. Indeed, departing from a true risk-based approach by effectively discounting assessment rates for small banks and failing to account for distortions caused by the assessment base change could create the very moral hazard to take on too much risk that Section 7(b)(1) was designed to prevent.[4]

We have concerns that the Large Bank Proposal in conjunction with the Assessment Base Proposal fails to satisfy the FDIA's risk-based requirement. The Large Bank Proposal was changed in only modest ways from the large bank assessment rate model proposed in April 2010 ("Original Proposal"),[5] seemingly without sufficient adjustment for the fact that the assessment rate generated by the model would be applied against a very different assessment base. And the FDIC has provided no evidence that its proposed aggregate framework (*i.e.,* assessment rate applied to the revised assessment base) aligns assessments paid by large IDIs with risk posed. In short, we do not believe that the Large Bank Proposal has been properly calibrated for the change in assessment base.

We believe it is critical for the FDIC to understand the impact that the Large Bank Proposal and Assessment Bank Proposal will together have on large IDIs, particularly in

[3] Like others, we do not understand the aggressive timeframes for proposal and implementation of these two proposals. As the FDIC is aware, the Dodd-Frank Act imposes no timing requirements on the implementation of Section 331 and the Large Bank Proposal is not required by statute.
[4] The provision was designed to "significantly moderate the risk taking of insured financial institutions". H.R. Rep. 504-54(I), 1989 (U.S.C.C.A.N. 86).
[5] 75 FR 23516 (May 3, 2010)

light of the FDIA's risk-based mandate.[6] As described in the letter of The Clearing House Association on this topic ("Clearing House Letter"),[7] The Clearing House retained McKinsey & Co. to conduct analysis of the Large Bank Proposal's impact on the U.S. banking industry. Such estimates demonstrate that the Large Bank Proposal would increase average assessment costs by approximately 50% and 25% for highly-complex and large banks (as each is defined in the Large Bank Proposal), respectively.

FDIC staff stated in a call with the American Bankers Association on December 20, 2010 that assessment increases estimated by large institutions were generally due to the change in assessment base mandated by Section 331. However, we do not believe that it is appropriate, nor consistent with the FDIA, for the FDIC to simply ignore the distortions that Section 331 creates in the assessment system. Rather, if the estimated increases are not consistent with risk posed to the DIF, *i.e.,* insured deposit amounts that the FDIC must pay out upon failure, the FDIA would require the FDIC to make changes to how assessment rates are calculated.[8]

Specific Elements of the Proposals

In addition to the overarching concern above, we agree with many of the detailed comments raised by The Clearing House, the Financial Services Roundtable and the American Bankers Association. In particular, we direct your attention to the following concerns with the Assessment Base Proposal and the Large Bank Proposal:

Assessment Base Proposal

- *Goodwill in Assessment Base* – We urge the FDIC to either exclude goodwill from the assets making up the assessment base or provide for a goodwill-based adjustment that would permit institutions to reduce their assessment rate based on the amount of goodwill in their assessment base. These changes would avoid penalizing institutions for assets that pose no additional risk of loss to the DIF and avoid creating a disincentive for acquisitions through which goodwill may be created.[9] We note that bank regulatory capital ratios exclude goodwill from both the capital base and total assets, and that approach seems equally appropriate here.

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[6] We note that the FDIC's statement in the Large Bank Proposal that large IDIs "would pay assessments at least 5 percent higher than currently", although perhaps technically accurate, seems in spirit to underestimate the impact of the proposals.
[7] Clearing House Letter Re: RIN 3064-AD66: Notices of Proposed Rulemaking – Deposit Insurance Assessment Base and Rates and Large Bank Pricing, dated January 3, 2011
[8] *See, e.g.,* Clearing House Letter, which estimates that overall assessment costs for Highly Complex IDIs under the Original Proposal were generally aligned with assessment costs under the current methodology, in contrast to the current proposals, which show significant increases. It is difficult to understand how both (i) the Original Proposal and (ii) the Large Bank Proposal together with the Assessment Base Proposal, could both be appropriately risk-based in aggregate. Note that we do not dispute the FDIC's ability to establish different risk-based assessment systems for large and small institutions, as permitted by Section 7(b)(1)(D) of the FDIA.
[9] In particular, health institutions may be less likely to acquire distressed institutions, which could pose *additional* risk to the DIF.

- *Inter-Bank Lending Between Affiliates* – Under the Assessment Base Proposal, inter-company lending between sister banks would effectively double count assessment base assets, since both banks would pay insurance assessments based upon the assets relating to such transaction. Although we know that the FDIC has historically conducted assessment analysis only on an individual IDI basis, continuing to do so with the modified assessment base creates a double-counting issue not previously present.

Large Bank Proposal

- *Brokered Deposits Adjustment* – First, we do not believe that IDIs that would be categorized as Risk Category I under the current methodology should be automatically subjected to the brokered deposit penalty rate simply because they have over $10 billion in assets (as opposed to similarly situated smaller banks that would not be subject to the Large Bank Proposal and thus the brokered deposit penalty). Such treatment unfairly penalizes large banks relative to small banks without any justification by the FDIC.

  Second, the FDIC inappropriately uses an overbroad definition of "brokered deposits" in the brokered deposit penalty adjustment. While we understand the FDIC's desire to restrain a weak bank's ability to attract additional deposits by raising rates, the adjustment should not discourage healthy banks from participating in programs that deliver stable deposits, *e.g.,* brokered longer term time deposits or brokered deposits facilitated through exclusive agents, affinity arrangements or risk-mitigating contractual commitments. Indeed, the Dodd-Frank Act requires the FDIC to review in detail the distinction between core and brokered deposits and the impact of these definitions on assessments and the DIF.[10] Penalizing all brokered deposits before studying the issue sufficiently is imprudent and seemingly counter to the intent of Congress, particularly since the Dodd-Frank Act imposes no timing requirements on the implementation of Section 331 and the Large Bank Proposal is not required by statute.

- *Unsecured Debt Adjustment* – We understand the FDIC's desire to provide a powerful incentive for banks to issue long-term unsecured debt. However, instead of denying the benefit of the unsecured debt adjustment when the instrument has a remaining maturity of less than one year, we believe that the definition of "long-term unsecured debt" should focus on the instrument's *original* maturity. Such a change would provide an efficient benefit throughout the life of the instrument and properly incent institutions to issue instruments that absorb loss upon failure.

- *FAS 166/167 Impact on Growth-Adjusted Portfolio Concentration* – We urge the FDIC to exclude the impact of FAS 166/167 asset consolidation on the growth-

[10] Dodd-Frank Act Section 1506.

adjusted portfolio concentration element of the concentration measure. The asset "increase" relating to FAS 166/167 was simply the result of a one-time accounting rule change and did not reflect actual growth rates of particular business lines or portfolios that may evidence risk.

- *Sub-Components of the Concentration and Credit Quality Measures* – We believe that using an average of the sub-components for each of the concentration and credit quality measures would better reflect the actual risk posed by an institution. An institution with high scores for two sub-components clearly poses more risk than an institution with one high score and one low score. However, under the Large Bank Proposal, two such banks would be treated as posing the same risk and face the same impact to their assessment rate.

- *Agency MBS in Liquidity Ratio* – We believe that in addition to the assets currently included in the Large Bank Proposal, agency mortgage-backed securities should be permitted in the composition of the balance sheet liquidity ratio. The market for such assets is large and highly liquid and during the recent crisis, such assets provided a very stable source of funding.

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Capital One appreciates the opportunity to comment on the Large Bank Proposal and the Assessment Base Proposal. If you would like to discuss our comments, please contact me at (703) 720-1000.

Sincerely,

Stephen Linehan
Executive Vice-President, Treasurer