January 5, 2016

211 Main St
San Francisco, CA 94105

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

Attention: Comments

RE: Notice of Proposed Rulemaking on Assessments (12 CFR §327), RIN 3064–AE40[1]

Dear Mr. Feldman:

Charles Schwab Bank (Bank) appreciates the opportunity to comment on the Federal Deposit Insurance Corporation's (FDIC) proposal to implement the mandate set forth in Section 334(d) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA) that the Deposit Insurance Fund (DIF) achieve a reserve ratio of 1.35 percent by September 30, 2020.[2] Under the FDIC's proposal, an across-the-board assessment surcharge at a flat annual rate of 4.5 basis points would be imposed on depository institutions with total consolidated assets of $10 billion or more (large banks).

The proposed surcharge on large banks' assessments would commence the latter of the calendar quarter after the DIF's reserve ratio first reaches 1.15 percent or the third quarter of 2016 and would continue on a quarterly basis through the earlier of the fourth quarter of 2018 or until a 1.35 percent reserve ratio is achieved. In the event that the DIF's reserve ratio did not reach 1.35 percent by December 31, 2018, the FDIC would impose a shortfall assessment on large banks at the end of the first quarter of 2019, payable on June 30, 2019, in an amount sufficient to increase the reserve ratio to 1.35 percent of estimated insured deposits at year-end 2018.[3]

In lieu of the FDIC's surcharge assessment proposal outlined above, the Bank endorses the recommendation made by the American Bankers Association (ABA) and The Clearing House Association (TCH) in their joint comment letter that surcharges on large banks be scheduled over a 14 quarter period of time to raise the DIF's reserve ratio to 1.35 percent by the end of 2019, with any needed shortfall assessment to be made in first quarter of 2020. The Bank also believes that, regardless of the time period for the surcharge or the exact form that it ultimately takes, any surcharge assessments should be risk-based consistent with the FDIC's regular risk-based deposit insurance assessment system for all insured depository institutions. In

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[1] 80 Fed. Reg. 68,780, Nov. 6, 2015.

[2] The Dodd-Frank Wall Street Reform and Consumer Protection Act, §334(d), 124 Stat. 1376, 1539 (12 U.S.C. 1817(note).

[3] The FDIC is also proposing that the assessment base for the surcharge would be equal to (1) the sum of (i) a large bank's regular quarterly assessment base plus (ii) the assessment bases of any affiliated banks that are not large banks minus (2) $10 billion. 80 Fed. Reg. at 68,782.

other words, rather than imposing a 4.5 basis point or other flat-rate surcharge that would allocate surcharge funding costs equally among all large banks, the FDIC should require higher-risk large banks to pay a proportionally greater share of the total surcharge amount while lower-risk large banks would be assessed a relatively smaller share. The reasoning underlying the Bank's two comments is discussed below:

**Surcharge Assessments on Large Banks Should Be Set on a Schedule to Raise the DIF's Reserve Ratio to 1.35 Percent by the End of 2019**

Under DFA Section 334(e), large banks are responsible for funding the increase in the DIF's reserve ratio from 1.15 percent to 1.35 percent.[4] The FDIC's proposed 4.5 basis point surcharge would take effect the latter of the quarter after the DIF reaches a 1.15 percent reserve ratio or the third quarter of 2016 and would roughly coincide with the new schedule of lower assessment rates for all banks under the agency's February 2011 assessment final rule.[5] Rather than the proposed 4.5 basis point surcharge and the accelerated eight quarter time schedule that the FDIC proposes, the Bank strongly supports the approach recommended by the ABA and TCH – a 14-quarter surcharge schedule for large banks that would enable the DIF's reserve ratio to reach 1.35 percent by the end of 2019.

Utilizing the full amount of time contemplated by Section 334(d) for large banks to fund the increase in the reserve ratio to 1.35 percent would spread out the additional assessments that large banks would be required to pay over a longer period of time, avoiding the spike in assessment expenses that a number of the large banks including the Bank would otherwise experience under the FDIC's eight quarter proposal. These much higher total assessment costs under the FDIC's proposal, especially impacting higher assessment base/lower-risk large banks and imposed on relatively short notice, would likely result in expense increases and earnings swings that would make budgeting for 2016, already well underway when the proposal came out on October 22, 2015, and meaningful year-to-year comparisons of financial performance more difficult for those institutions.[6]

Conversely, the longer period of time recommended by the ABA and TCH would provide much greater consistency and predictability for large banks' assessment expenses over the next four years. The ABA and TCH estimate that if a surcharge time schedule of 14 quarters, through the fourth quarter of 2019, were adopted, the resulting large bank surcharge assessment amounts would be roughly equivalent to the reduction in regular assessments scheduled to go into effect once the reserve ratio reaches 1.15 percent. Thus, the overall impact of the surcharge on large bank assessment expenses, earnings and capital would be limited. In short, the ABA and TCH

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[4] Id.

[5] 12 C.F.R. §327.10(b). For large banks, the reduction would range from two basis points (5 to 3 bps initial base assessment rate) for lower-risk banks to five basis points (35 to 30 bps initial base assessment rate) for higher-risk banks.

[6] As the ABA and TCH noted in their comment letter, the higher expenses and deterioration of performance measures would also mean less earnings and new capital to support credit growth.

recommendation is preferable because it better accomplishes the FDIC's goal, as articulated in the proposal, of "maintaining stable and predictable assessments for banks over time."[7]

The Bank understands and appreciates the FDIC's desire to adopt a surcharge assessment timeframe that is expected to enable the DIF's reserve ratio to reach 1.35 percent by the end of 2018 (or June 30, 2019 at the latest), over a year in advance of the statutory September 30, 2020 deadline. The FDIC's proposal does reduce somewhat the likelihood of future pro-cyclical assessments should the DIF incur large losses before its reserve ratio reached 1.35 percent prior to September 30, 2020. However, the Bank believes that the possibility of large-scale bank failures that would cause the DIF to incur substantial losses is small given (i) the declining number of bank failures over the past three years, (ii) the higher, both quantitatively and qualitatively, levels of capital that insured depository institutions are now required to hold under the agencies' Basel III capital regulations that have gone into effect, and (iii) the improved outlook for the U.S. economy that was an instrumental factor in the Federal Open Market Committee's recent decision in December to increase the fed funds target rate by 25 basis points.

Moreover, it should be noted that the ABA's and TCH's recommended approach would extend the amount of time it would take for the 1.35 percent reserve ratio to be reached by only approximately six quarters (i.e., by December 31, 2019 instead of June 30, 2018). Consequently, the window period during which banks would be exposed to any additional risk of pro-cyclical assessments as a result of losses from future bank failures under the ABA and TCH approach as compared to the FDIC's proposal is a narrow one, further diminishing the advantage cited by the FDIC as the main reason for accelerating large banks' surcharge payments.

For these reasons, the Bank believes that the twin benefits of greater stability and predictability of assessment expenses for large banks resulting from a longer surcharge assessment period clearly outweigh any possible risk of widespread bank failures, losses to the DIF, and pro-cyclical assessments that might arise by extending the surcharge assessment period an additional six quarters through the end of 2019.

**The Surcharge Imposed Should be Risk-Based Consistent with the FDIC's Regular Deposit Insurance Assessment System**

A second goal articulated by the FDIC in its proposal is "ensur[ing] that assessments are allocated equitably among banks responsible for the cost of [meeting the requirement of a 1.35 percent reserve ratio]."[8] In this regard, the Bank believes that the most equitable way to allocate the funding costs associated with increasing the DIF's reserve ratio from 1.15 percent to 1.35 percent among large banks is to make the surcharge risk-based to the same extent as the FDIC's regular deposit insurance assessment system.

Simply put, larger banks that pose a greater risk to the DIF, either in terms of being more likely to fail or exposing the DIF to a greater magnitude of losses in the event of their failure,

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[7] 80 Fed. Reg. at 68781.

[8] Id.

should be required to shoulder a proportionally greater share of whatever special assessment costs are imposed on large banks. Indeed, the Bank respectfully submits that the fixed-rate 4.5 basis point surcharge on large banks proposed by the FDIC, runs counter to, and is inconsistent with, the Congressional intent codified in Section 7(b)(1) of the Federal Deposit Insurance Act (FDI Act)[9] that the FDIC's regular deposit insurance system be risk-based. Accordingly, regardless of whether or not the FDIC adopts the timeframe recommendation made by the ABA and TCH, the surcharge assessment methodology utilized by the agency should calculate the surcharges imposed on large banks in a risk-based manner.

A potential combination of the scheduled regular assessment rate reduction once the DIF reaches a 1.15 percent reserve ratio and the FDIC's proposed 4.5 basis point surcharge is quite likely to produce a number of anomalous total assessment payment results for large banks. As briefly noted above, after the DIF achieves a 1.15 percent reserve ratio, a large bank at the lowest-risk end of the regular assessment spectrum would see its initial base assessment rate fall by two basis points from five to three basis points, while a large bank at the highest-risk end of the spectrum would see its initial base assessment rate reduced by five basis points from 35 to 30 basis points. Thus, once the FDIC's proposed 4.5 basis point surcharge is factored in, a lower-risk large bank could see a substantial net increase in its total assessments, while a higher-risk large bank with the same assessment base as the lower-risk bank could end up paying the same, or even less, in total assessments under the proposed new regular assessment/surcharge regime.

For example, if there were a low-risk and a high-risk large bank, each having the same regular and surcharge assessment bases with the proposed surcharge assessment base adjustments reducing the effective surcharge rate for both banks from 4.5 to four basis points, the lower-risk bank's total assessment rate would increase by two basis points from five to seven basis points (five minus two plus four), while the higher-risk bank's total assessment rate would decrease from 35 to 34 basis points (35 minus five plus four). In that situation, all of the assessment costs associated with increasing the DIF's reserve ratio to 1.35 percent would be essentially borne by the large bank at the low-risk end of the regular assessment range. Similarly in this scenario, the lower-risk large bank's net total assessment expenses would increase by 40 percent, while the higher-risk large bank's net total assessments would decline by slightly less than three percent.

This difference in percentage impacts is even more striking when viewed by reference to the new lower regular initial base assessment rates scheduled to go into effect later this year. From that perspective, a four basis point surcharge would cause the lower-risk bank's assessment rate to increase by over 133 percent from three to seven basis points, while the higher-risk bank's assessment rate would only increase by 13 percent from 30 to 34 basis points. Consequently, the net effect of the proposed flat 4.5 basis point surcharge coupled with the regular assessment rate reductions that are scheduled to go into effect could be to render the combined total assessment rates for many lower-risk large banks either predominantly or at least substantially non-risk-based.

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[9] 12 U.S.C. § 1817(b)(1).

Again, the above example and other potential similar total assessment results stemming from having a flat 4.5 basis point surcharge seem to be at odds with the overarching principle embodied in Section 7(b)(1) of the FDI Act that the FDIC establish a risk-based assessment system. The Bank does not dispute the FDIC's authority to impose an across-the-board flat surcharge on large banks given that the emergency special assessment authority set forth in Section 7(b)(5) of the FDI Act does not explicitly include a risk-based requirement.[10] However, in the absence of a compelling reason to depart from a risk-based approach in imposing a surcharge assessment on large banks – and the FDIC articulated no such rationale in its proposal, the Bank believes that, in keeping with the overall policies underlying Section 7, it would be more fair and equitable if the FDIC were to pattern its surcharge assessment after its regular risk-based assessment system.

One way of accomplishing this objective would be for the FDIC to keep the current large bank regular assessment schedule in place once the DIF reaches a 1.15 percent reserve ratio. This approach would effectively translate into large banks at the low end of the risk spectrum paying an assessment surcharge of two basis points and large banks at the high end paying five basis points, the respective amounts of the scheduled regular assessment rate reductions.

Alternatively, the FDIC could consider imposing an across-the-board percentage increase on large banks' assessment rates, taking into account the funding impact of the surcharge assessment base adjustments set forth in the agency's proposal. For example, the FDIC could levy a surcharge equal to 25 percent or some other percentage of a large bank's regular initial base assessment rate, so that a large bank with a regular initial base assessment rate of eight basis points would pay a total effective assessment rate of ten basis points with the surcharge included. A higher-risk large bank with a regular initial base assessment rate of 20 basis points would pay a total effective assessment rate of 25 basis points.

Either of the above surcharge calculation methodologies would be preferable to the proposed flat 4.5 basis point surcharge and more in keeping with the widely-accepted notion that it is much more fair and equitable for higher-risk insured depository institutions that pose a greater risk of loss to the DIF to pay proportionally more in assessments than lower-risk banks.

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In summary, the Bank endorses the 14-quarter surcharge time schedule recommended by the ABA and TCH because it would minimize the assessment expense and earnings impact of the surcharge and thereby maintain the stability and predictability of all large banks' assessments. At the same time, the Bank believes it is critically important that the surcharge be risk-based rather than a 4.5 basis point or other flat annual assessment rate that would treat all large banks the same regardless of the significantly different levels of risk they may pose to the DIF. Therefore, even if the FDIC decides not to adopt a 14-quarter surcharge timeframe, the agency should nonetheless ensure that any surcharge imposed is risk-based to the same extent as its regular deposit insurance assessment system.

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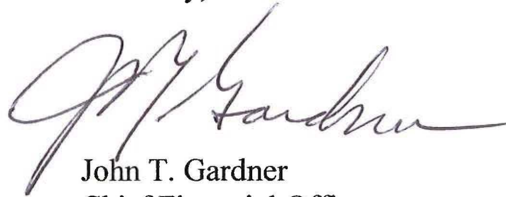
[10] 12 U.S.C. § 1817(b)(5).

Thank you again for providing the Bank with this opportunity to express its views regarding the FDIC's large bank surcharge assessment proposal.

Sincerely,



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