NYBA

Michael P. Smith
President & CEO
New York Bankers Association
99 Park Avenue, 4th Floor
New York, NY 10016-1502
(212) 297-1699/msmith@nyba.com

November 12, 2008

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
Attn: Comments
550 Seventeenth Street, NW
Washington, DC 20429

RE: 12 CFR Part 327; RIN 3064-AD 35

Dear Mr. Feldman:

In response to the notice of proposed rulemaking published in the October 16 Federal Register, the New York Bankers Association (NYBA) is submitting these comments on the Federal Deposit Insurance Corporation's (FDIC's) proposal to alter the way in which it differentiates for risk in the risk-based assessment system and to recapitalize the insurance fund. Our Association supports changes to the premium calculation that reflect the true risk of loss to the FDIC, but is concerned that as written, the proposal may be too aggressive, and therefore could impede banks' ability to meet local credit needs. We also are suggesting several amendments to the risk-based premiums classification system proposal, particularly with respect to the impact the proposal could have on the Federal Home Loan Bank (FHLBank) system and financial institutions' use of reciprocal deposit-taking systems such as the Certificate of Deposit Account Registry Service (CDARS). The New York Bankers Association is comprised of the community, regional and money center commercial banks and thrift institutions doing business in New York State. Our members have aggregate assets in excess of $9 trillion and more than 300,000 New York employees.

Overview

Under the Federal Deposit Insurance Act (Act), the FDIC, absent extraordinary circumstances, must establish and implement a plan to restore the deposit insurance reserve ratio to 1.15 percent of insured deposits over a five-year period at any time that the FDIC fund falls below that level. In the October 16 Federal Register, the FDIC published a restoration plan designed to replenish the deposit insurance fund over a period of five years and to increase the deposit insurance reserve ratio (which stood at 1.01 percent of insured deposits on June 30, 2008) to the statutory minimum of 1.15 percent of insured deposits by December 31, 2013.

In order to implement the restoration plan, the FDIC issued this proposal to change both its risk-based assessment system and its base assessment rates. Assessment rates would increase by 7 basis points across the range of risk weightings of depository institutions. Changes to the risk-based assessment system would include increasing premiums for institutions that rely on excessive amounts of brokered deposits (including reciprocal deposit systems such as CDARS) to fuel rapid growth; increasing premiums for excessive use of secured liabilities (including Federal Home Loan Bank advances); lowering premiums for smaller institutions with very high capital levels; and adding financial ratios and debt issuer ratings to the premium calculations for larger banks (over $10 billion), while providing a reduction for their unsecured debt.

Re-capitalization of Insurance Fund/New Assessment Rates

NYBA supports the goal of the FDIC to restore the deposit insurance reserve ratio by the end of the time period set forth in the Act. The Association appreciates that the FDIC, taking into account the current health of the banking industry, has incorporated the full five-year range authorized by Congress in its restoration plan. Attempting to restore the reserve ratio in a shorter time, when the industry is suffering significant earnings and liquidity difficulties, would have imposed a major financial burden on a number of institutions. Nevertheless, we note, that the FDIC is authorized to take an even longer time to rebuild the fund to 1.5% of insured deposits, when there are “extraordinary circumstances” and that the five year time frame, coupled with the significant increase in premium assessments set forth in the proposal, would aggressively recapitalize the insurance fund to over 1.25% of insured deposits. We are concerned that such an aggressive plan, though well intended, could unnecessarily negatively impact banks’ ability to lend in what clearly are “extraordinary circumstances”. This unintended result would be counter to the recent efforts by Congress and Treasury to stimulate lending. We therefore urge the FDIC to modify its proposal to ensure that the banking industry is spared unnecessarily high premiums which will limit and/or postpone our economic recovery.

Risk-Based Assessment System

We have several comments on revisions to the current assessment system proposed in this rulemaking.

Federal Home Loan Bank Advances: One provision of the proposal would increase premiums for excessive use of secured liabilities, including FHLBank advances greater than 15% of deposits. The FHLBanks provide advances in a consistent, reliable, and safe manner for their members. The availability of FHLBank advances as a means of wholesale funding is especially important to the community banks that represent the vast majority of the FHLBank System's 8,100 members. These smaller institutions often lack reliable access to other sources of cost-effective funding and rely on the availability of FHLBank advances as a critical tool for managing their balance sheets and implementing their business plans. In fact, in 2007, FHLBank advances increased 36.6 percent to $875 billion, and increased further to over $913 billion by the end of the second quarter of 2008 – clearly indicating that the FHLBanks are playing a vital role in alleviating the current shortage of liquidity in the mortgage markets.

Under this proposal, financial institutions that use FHLBank advances will be faced with several undesirable outcomes. First, operating costs will go up as a result of increased premiums. Second, FHLBank members could increase their focus on attracting less stable retail deposits by bidding up these accounts. If banks throughout the country turn to this method, it will drive up the cost of funds as they attempt not only to attract new deposits, but also to retain their existing deposit base. Third, institutions may choose to decrease lending in their communities. These results would be contrary to the current efforts by the Administration, Congress, and the Federal Reserve to restore liquidity and bolster confidence in the financial system. At a minimum, delaying the rule's implementation as it relates to FHLBank advances until markets settle makes the most sense. The facts that motivated the creation of the rule in the beginning may no longer be relevant.

It should be noted that since 1990, the FHLBanks have contributed 10% of their prior year's income to fund the Affordable Housing Program ("AHP") – the largest source of private funds available to serve the affordable housing needs throughout the country. An unintended consequence of the FDIC's proposed treatment of advances will be a reduction in the availability of AHP funds as FHLBank income declines. In addition, the FHLBanks' Community Investment funding provides access to the lowest cost advances to finance lending activities, while simultaneously strengthening Community Reinvestment Act performance and fostering local relationships through community involvement. Thus, the proposed rule could have the unintended consequence of discouraging members from accessing advances for these types of community reinvestment programs, at a time when such programs are particularly critical.

Brokered Deposits: Another provision of the proposal would increase premiums for institutions that rely on excessive amounts of brokered deposits (currently defined to include reciprocal deposit-taking systems such as CDARS) to fuel rapid growth. Our Association does not believe that reciprocal deposit-taking systems such as CDARS should be treated as brokered deposits and thereby be potentially subject to surcharges.

It is important to recognize that currently, 35 percent of the FDIC depository institutions in New York are members of the Promontory Interfinancial Network and can offer CDARS reciprocal deposits to their customers. These institutions rely on these deposits as a stable source of core funding totaling billions of dollars. (The CDARS service allows banks to place customers' funds in FDIC-insured certificates of deposits at other banks and, at the same time, receive an equal sum of deposits from the customers of other banks in the CDARS Network.) The FDIC's justification for an additional premium for brokered deposits - including reciprocal deposit-taking systems such as CDARS - is stated as follows: "Significant reliance on brokered deposits tends to increase an institution's risk profile, particularly as the institution's financial condition weakens." We do not believe, however, that the use of such reciprocal deposit-taking systems increases an institution's risk profile and thus they should not warrant an increase in FDIC premiums for those banking institutions who rely on them.

Specifically, for example, CDARS deposits share three characteristics that define core deposits. One, CDARS CDs have a high reinvestment rate. This year, the average reinvestment rate for CDARS deposits across the network has exceeded 83 percent. Two, CDARS deposits are overwhelmingly gathered within a bank's geographic footprint through established customer relationships. Eighty percent of CDARS placements are made by customers within 25 miles of a branch location of the relationship institution. Three, banks set their own rates on CDARS deposits, rates that reflect a bank's funding needs and local market. As a result, depending on maturity, CDARS deposits are gathered at a significant discount to the cost of traditional brokered deposits, and should be viewed as the functional equivalent of a core deposit, the most stable form of deposit, which do not increase an institution's risk profile beyond what any core deposit would. Therefore, a broad-brush approach to defining CDARS reciprocal deposits (and other similar systems) as brokered deposits under the assessment proposal would unfairly penalize banks that offer the service and unnecessarily and inappropriately discourage their use. We therefore believe that reciprocal deposit-taking systems such as CDARS be exempt from the definition of brokered deposits in its proposed assessment rule.

<u>Reduction for High Levels of Capital</u>: NYBA supports the FDIC's proposal to reduce deposit insurance premiums for smaller institutions with very high levels of capital. The current financial crisis demonstrates, if there were ever any doubt, that high levels of capital tend to protect the deposit insurance fund from potential loss. It is appropriate to reward institutions which have

foregone earnings opportunities in order to build their capital with lower levels of deposit insurance premiums. We question, however, the FDIC's decision to propose lower premiums only for smaller institutions with very high levels of capital. The same factors that support reducing deposit insurance premiums for very high levels of capital for smaller institutions operate in larger institutions as well. We would therefore urge the Corporation to make these adjustments available to all size institutions.

Use of Long-Term Debt Issuer Ratings: In comments filed in 2006 on the Corporation's last rulemaking that established the current deposit insurance assessment system, NYBA expressed concerns over the use of bond rating agencies to determine a portion of an institution's deposit insurance assessment rating. This proposal would incorporate adjusted long-term debt issuer ratings into the rating system for larger institutions with outstanding rated debt. Recent developments have amply underscored NYBA's concerns about the accuracy of ratings. Because it can be reliably anticipated that the rating agencies will respond to recent disclosures by dramatically tightening ratings of financial institutions, we would urge great caution on the FDIC in using such ratings until they have had the opportunity to be tested in the market over time.

Conclusion

NYBA supports the FDIC's goal of restoring the deposit insurance reserve ratio to 1.5% of insured deposits over a five-year period, if practicable. We are concerned, however, that the restoration plan, as currently proposed, though well intended, could unnecessarily negatively impact banks' ability to lend in what clearly are "extraordinary circumstances", and therefore urge the FDIC to modify its proposal to ensure that the banking industry is spared unnecessarily high premiums.

We also urge the FDIC not to define FHLBank advances as secured borrowings subject to increased deposit insurance premiums, to exclude reciprocal deposit-taking systems such as CDARS from the definition of brokered deposits, to make available to all size banks the opportunity for a reduction in deposit insurance premiums for very high levels of capital, and to proceed cautiously in adopting long-term debt ratings as part of any deposit insurance premium assessment system.

We thank you for the opportunity to comment on these important issues.

Sincerely,

Michael. P. Smith