THE FINANCIAL SERVICES ROUNDTABLE

Impacting Policy. Impacting People.

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Via www.regulations.gov

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

Re: Notice of Proposed Rulemaking: Processing of Deposit Accounts and Insurance Determination Modernization

Dear Mr. Feldman:

The Financial Services Roundtable[1] ("Roundtable") appreciates this opportunity to comment on the Federal Deposit Insurance Corporation's ("FDIC") notice of proposed rulemaking ("NPR") on the processing of deposit accounts and insurance determination modernization.[2]

The Roundtable is encouraged by the improvements made to this proposal relative to the FDIC's earlier proposals on this issue. Some examples of these improvements include the FDIC's revised requirement regarding broker deposits, which now requires that institutions link files to obtain customer information only if there is a customer information file. The FDIC does not require institutions to produce information that it currently does not have on the account. However, the Roundtable continues to have serious concerns with other aspects of the FDIC's proposal, specifically in terms of the cost and burden this proposal would have on the banking industry with little or no meaningful financial benefit to the FDIC. Accordingly, the Roundtable continues to believe that the finalization of this proposal should be postponed until the FDIC evaluates how to relieve such cost and burden on the industry.

Covered Institution

The NPR applies to large FDIC-insured institutions, defined as having at least $2 billion in domestic deposits and either: 1) more than 250,000 deposit accounts or 2) total assets over $20 billion, regardless of the number of deposit accounts. The Roundtable *recommends* that specialized banking institutions with fewer than 250,000 deposit accounts be excluded from the definition of a "Covered Institution."

[1] The Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $66.1 trillion in managed assets, $1.1 trillion in revenue, and 2.5 million jobs.
[2] The Roundtable has previously commented on the FDIC's Advanced Notice of Proposed Rulemaking on the large-bank deposit insurance determination modernization proposal on March 10, 2006 and March 7, 2007. The Roundtable's comments on this proposal can be found on its website at http://www.fsround.org/policy/regulatory/fdic.htm.

This reflects the small number of deposit accounts which these firms maintain, their relatively low levels of insurance coverage and the disproportionate costs that would accrue relative to any potential FDIC benefit. Should the FDIC nonetheless choose to include specialized banking institutions with fewer than 250,000 deposit accounts within the scope of its rule, it should develop an approach that acknowledges these firms' materially different business, operational and informational profiles.

Cost and burden to industry still remains.

Changes to computer platforms and deposit systems

Financial institutions, specifically the large financial institutions included within this proposal, utilize various computer platforms and deposit systems based on the different types of accounts or the customer's geographic location. The FDIC's proposal seems to suggest a "one-size fits all approach that would create additional cost and burden on the industry. Large banks would need to adjust the current platforms and perhaps, develop new platforms in order to comply with the FDIC's proposal. Such adjustments, no matter how simple or complex, would result in costs related to new development, training of existing or new staff, and the testing and implementation of the system. Such costs may total up to $8-10 million, plus numerous hours of work, for each institution. This cost and burden due to the financial institutions' computer systems further offset the FDIC's assumptions that 100 of the 159 affected institutions "would have reduced implementation costs due to the use of software or services from a vendor" and that each covered institution has just one deposit accounting system it must modify to implement this NPR.

As such, the Roundtable *urges* the FDIC to re-evaluate the necessity of its proposal and weigh the cost of such a proposal against the benefits of such a proposal. If after such an evaluation, the FDIC continues to recommend changes to the current structure, the proposal should be modified in a way that promotes flexibility for large banks to maintain compliance, without significant costs or burdens.

Sweeps and Foreign Accounts

Another example of the additional cost and burden the proposal creates on the industry is the proposed treatment of sweeps and foreign accounts. One can interpret the NPR to permit the FDIC to create a different limit for each country. This would create additional cost and burden on the industry since most financial institutions maintain one operational system for all international accounts. As such, under the current interpretation of the NPR, financial institutions would be required to develop a different program for each country based on the limits issued by the FDIC. The Roundtable *encourages* the FDIC to set a specific limit for all foreign accounts, based on discussions with foreign bank supervisors.

Since the issues of sweeps and foreign accounts have not proposed in prior FDIC ANPRs and given the complexity of such issues, the Roundtable *recommends* that these issues be removed from this current rulemaking. Instead, the FDIC should include these issues in a separate rulemaking.

Single, arbitrary cut-off time

The FDIC proposal recommends a single, arbitrary cut-off time for the FDIC to make its insurance determination in the event of a large bank failure. This cut-off time would apply to all customers, regardless of the customers' geographic location or the type of transaction. Establishing a single cut-off time is problematic since most operational systems at large banks are not capable of changing the current cut-off time limitations when immediately directed by the FDIC. Additionally, this arbitrary cut-off time may theoretically precede normal business days or intraday transfers by customers.

As such, the Roundtable *recommends* that the FDIC utilize the established cut-off times used by banks in their normal business hours, keeping in mind the flexibility applicable to international banks.

The proposal regulation offers no financial or non-financial benefit to the FDIC.

The FDIC has not quantified its financial benefit from this modernization proposal. Instead the FDIC states:

> However, even if the likelihood of a failure among *Covered Institutions* is perceived to be low, it is not zero. The FDIC should have in place a credible plan for resolving the failure of an institution of any size with the least possible costs. The ability to determine the insurance status of depositors in a failed institution in a timely manner is a critical element for ensuring a least-costly resolution.[3]

One can interpret this statement to imply that if a *Covered Institution* fails, the FDIC will not be able to execute a least-costly resolution unless the NPR is implemented as proposed. The Roundtable does not agree and rather, believes that the FDIC can execute a least-costly resolution of large insured depository institutions even if this modernization proposal is not implemented. One example of this was cited in the Roundtable's comment letter on the prior ANPR.[4] In this letter, we explain that there are many stages that a large bank and its supervisor go through before the bank reached the point where it would be deemed to be a 'failed' institution. These stages could include recapitalization, downsizing, management changes, strategic redirection, acquisition by a healthy bank, supervisory interventions, and other actions that would steer the institution away from failure long before it became a failed institution. The point we made in our March, 2007, comment letter – and reiterate here – is that given these stages, the probability of a large bank failing at a cost to the FDIC is so low and the cost upon failure is so low, that the additional benefit provided by the proposed rule, relative to the FDIC's procedures, is essentially zero.

No financial benefit

The proposed rule offers no financial benefit to the FDIC because the FDIC does not pay out the full amount of an uninsured deposit's recovery from a failed institution until several years after the failed institution is closed. Hence, the FDIC has ample time after an institution is closed to properly aggregate deposit accounts to ensure that no uninsured depositor obtains an excess recovery from the FDIC. Since the deposit-account aggregation process under the proposed rule will not be foolproof, the FDIC must still conduct a post-failure review of all deposit accounts in a failed institution to ensure that they have been properly aggregated for deposit-insurance purposes. The only way the FDIC will pay out too much to an uninsured depositor is if its initial dividend payment to uninsured depositors cannot be recovered

[3] Federal Register, Vol. 73, No. 9, p. 2383.
[4] Roundtable's Comment Letter to the FDIC, dated March 7, 2007.

through (1) an offset against future dividend payments or (2) if offsets against subsequent dividend payments do not fully recover the overpayment, court actions or other collection procedures.

Two examples further illustrate the point that the proposed rule offers no meaningful financial benefit to the FDIC because of the time the FDIC takes to make a final liquidating payment to uninsured depositors.

> Example 1 A depositor has three accounts in a failed bank totaling $600,000, for an average account balance of $200,000 ($600,000/3). Those accounts have not been aggregated. Therefore, the FDIC would treat $300,000 of these deposits as insured ($100,000 x 3) and $300,000 as uninsured ($600,000 - $300,000) even though, under law, only $100,000 was insured and $500,000 was uninsured. Upon closing the bank, the FDIC pays to depositors or transfers to another bank all of the depositor's insured deposits plus 50% of the uninsured deposits. In this case, the FDIC would have made an initial overpayment of $100,000 (($500,000 - $300,000) x .5)). That overpayment equals 20% of the depositor's actual uninsured deposits ($100,000/$500,000). This is a lower percentage than the likely pay-out percentage in subsequent liquidating dividends paid by the FDIC, even after charging interest on the overpayment.

As a point of reference, for the thirteen bank failures since the beginning of 2000 in which the FDIC has paid a final liquidating dividend, dividends paid to uninsured depositors after the initial payment averaged approximately 30% of the amount of uninsured deposits; the final liquidating payment on average was made 38 months after closure. Further, of the 28 banks with uninsured deposits that have failed since the beginning of 2000, the average time between closure and an initial payment to uninsured depositors was approximately four months with immediate payments to depositors made upon the day of closure or shortly thereafter in only three cases – Douglas National Bank, Bank of Honolulu, and NetBank. In one case (NextBank), the first liquidating payment was made more than eighteen months after the bank was closed. Therefore, the FDIC usually has ample time, after a bank has been closed to properly aggregate deposit accounts for the purpose of determining the amount of its initial payment to uninsured depositors.

> Example 2 A large corporate depositor has seven accounts in the same failed bank with a total balance of $7 million, or an average account balance of $1 million. Those accounts have not been aggregated. Therefore, the FDIC would treat $700,000 of these deposits as insured ($100,000 x 7) and $6,300,000 as uninsured ($7,000,000 - $700,000) even though, under law, only $100,000 was insured and $6,900,000 was uninsured. Upon closing the bank, the FDIC pays to depositors or transfers to another bank all of the depositor's insured deposits plus 50% of the uninsured deposits. In this case, the FDIC would have made an initial overpayment of $300,000 (($700,000 - $100,000) x .5)). That overpayment equals just 4.3% of the depositor's actual uninsured deposits ($300,000/$6,900,000), which is a far lower percentage than the likely pay-out percentage in subsequent liquidating dividends.

These two examples illustrate a critical point – the likelihood that unintentional initial overpayments on uninsured deposits cannot be recovered through offsets against subsequent liquidating dividends declines rapidly as the average size of account balances increases. Given that average balances in accounts with uninsured balances are quite large in the proposed "Covered institutions", the likelihood that the FDIC cannot fully offset initial overpayments of uninsured deposits against subsequently liquidating dividends is essentially nil.[5] That factor, multiplied by the low probability of a *Covered Institution* failing strongly indicates that, as a practical matter, the proposed rule will generate no financial benefit to the FDIC and certainly much less of a benefit to the FDIC than the cost of the proposed rule to the affected institutions.

Two additional factors further mitigate any possible loss to the FDIC if it does not adopt the proposed rule. First, every insured depository institution already is required to aggregate deposits for the purpose of providing an estimate of its uninsured deposits on its quarterly Call Report or Thrift Financial Report (TFR). Presumably, this aggregation process accomplishes most of what the FDIC intends under the NPR, thereby greatly reducing the potential benefit of the additional aggregation required under the proposed rule. That is, existing procedures already provide the bulk of the aggregation benefit the FDIC is seeking.

Second, while the FDIC rejects the proposal that a *Covered Institution* should not be required to aggregate deposit accounts as proposed in the NPR until the institution becomes a problem institution, as evidenced by a CAMELS 3 rating, experience repeatedly shows that large institutions exhibit serious problems known to the FDIC long before the institution fails. While it is true that “a period of financial or operational stress is not the opportune time to make the proposed system enhancements” (p. 2384), nonetheless this is the time when the FDIC should be preparing to close the institution, including aggregating accounts where they have not already been aggregated for Call Report or TFR purposes.

The facts surrounding the handling of Fremont Investment and Loan further illustrate this point. Fremont met the definition of a *Covered Institution* as of June 30, 2007 (p. 2368) – its domestic deposits exceeded $2 billion and it had more than 250,000 deposit accounts. Fremont has been under regulatory scrutiny for a sufficiently long period of time to permit a complete aggregation of its accounts for deposit insurance purposes. According to a Supervisory Prompt Corrective Action Directive the FDIC entered against Fremont on March 26, 2008, the FDIC sent a letter on May 24, 2007 - ten months earlier - “notifying [Fremont] of its undercapitalized capital category” and requiring Fremont “to submit an acceptable capital restoration plan to the FDIC by July 9, 2007.” Given that Fremont failed to comply with that deadline and is under an order either to be sold or recapitalized by May 26, 2008, even now the FDIC has sufficient time to ensure that Fremont’s deposit accounts are properly aggregated should Fremont be closed.

No non-financial benefits

The NPR offers five supposed non-financial or qualitative benefits in support of the NPR. Upon close examination, these non-financial benefits also do not justify the proposed rule.

Meeting the FDIC’s legal mandates: If upon making its final liquidating payment to uninsured depositors the FDIC has recovered, through dividend offsets or other collection methods, the entire amount, with interest, of any initial overpayment to uninsured depositors, the FDIC will have met all of its legal mandates with regard to executing least-costly resolutions.

[5] That being said, however, the Roundtable is not urging the FDIC to place excessively conservative holds on non-insured deposits or suggesting that it should not act as quickly as possible after a failure to release both insured and noninsured deposits. While the Roundtable emphasizes the importance of the FDIC accuracy in its insurance determinations, the two examples illustrate that should these holds be inaccurate, overpayments can be recovered at a later date.

Providing liquidity to depositors: Maintaining its present account-aggregation procedures will permit the FDIC to continue to provide liquidity to depositors, including uninsured depositors, given that the FDIC has never tried to pay uninsured depositors, all that they are likely to collect upon closing a bank. Abandoning the proposed rule would have no impact on the FDIC's ability to promptly provide liquidity to both insured and uninsured depositors.

Enhancement of market discipline: Recovering initial overpayments on uninsured deposits, with interest, will maintain the same degree of market discipline by uninsured depositors in *Covered Institutions* as would be obtained under the proposed rule.

Equity in the treatment of depositors of insured institutions: Recovering initial overpayments on uninsured deposits, with interest, will insure equity in the treatment of depositors in *Covered Institutions* versus smaller institutions.

Preservation of franchise value in the event of failure: The FDIC has presented no convincing evidence that implementing the proposed rule will enhance the franchise value of *Covered Institutions*.

The combination of the extremely low probability of the failure of a *Covered Institution*, the ample time the FDIC has before the failure of such an institution to aggregate accounts for deposit-insurance purposes, and the extremely low probability that the FDIC will not later offset or collect any initial overpayments inadvertently made to uninsured depositors strongly indicate that the proposed rule does not offer any meaningful financial or non-financial benefit to the FDIC, and certainly no benefit exceeding the cost of this proposed rule to the affected institutions.

In conclusion, the Roundtable again appreciates the flexibility that the FDIC has demonstrated in drafting this NPR. However, we remain concerned that the FDIC proposal does not provide any financial or non-financial benefits to the FDIC that outweigh the costs and burden to the industry. The FDIC should not move forward with this proposal until it further evaluates how to relieve such cost and burden on the industry.

Thank you again for the opportunity to share our views with you on this subject. If you have any questions, please feel free to contact me or Melissa Netram at 202-289-4322.

Sincerely,

Richard M. Whiting

Richard Whiting
Executive Director and General Counsel