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Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
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ATTN: Comments

VIA E-mail to Comments@FDIC.gov, Re: RIN 3064-AD35

Ladies and Gentlemen,

On behalf of the Utah Association of Financial Services, we appreciate the opportunity to submit the following comments relating to the proposed changes in deposit insurance assessments set forth in 12 C.F.R. Part 327, published in the Federal Register on Thursday, October 16, 2008 (the "Proposed Changes").

The Utah Association of Financial Services ("UAFS") is a trade association based in Salt Lake City, Utah that represents federally insured depository institutions in Utah, Nevada and California, particularly industrial banks. There are currently 30 insured depository members of the UAFS that collectively hold 186,759,680 billion in assets and 149,291,549 billion in deposits. Virtually all of those deposits would be deemed brokered deposits and subject to premium increases under the Proposed Changes.

Overall the UAFS believes the FDIC has made many reasonable and acceptable proposals to deal with the losses the insurance fund has incurred and is likely to incur in the future. We understand that the insurance fund needs additional revenues to replenish its reserves. Our primary concern relates to surcharges on brokered deposits and our comments below will be limited to the Proposed Changes that would impose additional charges for banks with more than 10% brokered deposits and the specific questions regarding brokered deposits in the request for comments.

At the outset, the point we want to stress is this: ***Brokered funds by themselves present no inherent risk to the insurance fund. The risks arise from how the funds are used and how the institution manages its liquidity. It is emphatically not the case that every bank holding more than 10% brokered deposits presents an added risk to the insurance fund, and often presents less risk. Surcharging institutions that pose no added risk to the insurance fund would be arbitrary and capricious.***

That being said, we understand that brokered deposits present certain unique concerns that are appropriate to address both in the assessment formula and in supervisory policy generally. These concerns arise in two respects.

The first is a liquidity risk. A bank that is highly reliant on a single source of deposits has less latitude to deal with sudden and unanticipated liquidity events that threaten the institution. A bank that primarily relies on core retail deposits is at risk as its depositors can create a "run" on the bank threatening its ability to fund its business. Without FDIC approval, a bank highly reliant on brokered deposits (while immune to bank "runs") could be denied access to new brokered funds if it ceases to be well capitalized due to losses or if it is placed under a written agreement or order from its primary federal regulator, or it cannot accept new brokered funds if it falls below adequately capitalized threshold. For that reason, it is prudent for a bank holding a large proportion of brokered deposits to have a reliable source of new capital if needed and access to back up sources of funding.

Second, we recognize that some banks have failed, when utilizing brokered deposits to grow unusually fast. In that context, core retail deposits can act as a restraint on imprudent growth. As stated in the narrative preceding the proposed rule, the banks that have failed primarily fit the following profile:

> . . . (1) Those with large volumes of subprime and nontraditional mortgages, particularly those heavily reliant on securitization; and (2) those with heavy concentrations of residential real estate and construction and development loans in markets with the greatest housing price declines. Within each of these groups, those heavily reliant on non-core funding incur additional risks should the availability of these funds decline as conditions deteriorate.

These failures are comprised of community banks heavily concentrated in residential and commercial real estate development loans. The failed banks in these groups imprudently underwrote development loans when there seemed little limit to the demand for new homes, particularly in high growth areas such as Florida, California, Nevada and Arizona. When housing prices finally declined, community banks with high levels of brokered funds faced liquidity problems as soon as loan losses outstripped capital cutting off access to the brokered deposit market. This forced the closure of some banks due to speculative and risky lending practices; not due to prudent use of brokered deposits.

As the narrative further explained:

> The FDIC is proposing this new risk measure for a couple of reasons. A number of costly institution failures, including some recent failures, have experienced rapid asset growth before failure and have funded this growth through brokered deposits. Moreover, statistical analysis reveals a significant correlation between rapid asset growth funded by brokered deposits and the probability of an institution's being downgraded from a CAMELS composite 1 or 2 rating to a CAMELS composite 3, 4 or 5 rating within a year. A significant correlation is the standard the FDIC used when it adopted the financial ratios method in the 2006 assessments rule.

These reasons clearly explain the rationale for imposing added premiums on banks that fit this risk profile. But this discussion ignores a large and well established class of banks that have primarily relied on brokered deposits for many years with no significant failures, no declines in their consistently high CAMELS ratings, and no concentrations in real estate development lending or limited geographical areas. The explanation also clearly indicates that these institutions are quickly identified and moved to a lower CAMELS composite rating - hence they face a higher premium quickly due to their risky activities. Their real risk profile is speculative with risky lending activities combined with the use of brokered deposits; their risk *is not* just the use of brokered deposits. The reasoning and profile does not apply to many banks that hold high levels of brokered deposits, particularly include wholesale, limited purpose, industrial and credit card banks ("non traditional banks"). Many non traditional banks rely primarily on brokered deposits for funding and have done so for many years. Yet, none have failed at the expense of the insurance fund, many have maintained high CAMELS composite ratings since inception, and none have concentrations of speculative sub-prime real estate loans, acquisition and development loans, or loans concentrated in areas that have experienced high housing price declines. Non traditional banks don't fit the risk profile of the failed community banks described above. With a more than 20 year operating history, non traditional banks have proven to be better capitalized, more profitable and generally stronger financially than other banks. Surcharging non traditional banks that pose less risk to the insurance fund than other banks would be arbitrary, unjustified and inappropriate.

Industrial banks in particular fit this lower risk profile. In Utah, the industrial banks have operated for over 20 years oftentimes relying almost entirely on brokered deposits and have had no significant liquidity or regulatory problems to date. The same would largely be true for any bank serving a regional or national customer base without a branch system such as most large credit card issuers. These banks cannot rely on core deposits because it would not be possible to obtain sufficient deposits through a single office or at a single location to support a nationwide business. In addition, some of these banks are not primarily reliant on deposits for funding and hold only small amounts of deposits relative to their total assets but would end up paying higher insurance premiums than riskier banks holding much larger proportions of deposits.

The industrial banks in Utah can be roughly divided into two categories based on deposits.

1. Banks affiliated with broker dealers that obtain deposits through sweeps of idle funds in brokerage accounts. These banks do not pose liquidity or unnatural growth risks (although many have grown rapidly due to the nature of their market and customer base). In many cases their greatest challenge is deploying all of the funds available to them. Some have very low loan to deposit ratios and invest most of their deposits in low risk and highly liquid investments. These banks generally do not pay above market rates on their deposits and are not at risk of having access to these deposits cut off if they enter into a written agreement with their regulator.

2. Banks primarily reliant on brokered funds for their operations. Because industrial banks do not offer checking accounts and few offer any significant amount of transaction accounts, liquidity is less of an issue than for a bank that has a larger

proportion of transaction accounts. In many cases, industrial banks primarily match fund their operations bringing in brokered certificates of deposit to match terms and durations of loans funded with those deposits. Liquidity is ensured by maintaining substantial back up funding lines that can be drawn down if brokered funds are interrupted for any reason. In many cases the bank is a subsidiary of a much larger holding company that can provide added capital and credit lines if needed. Recently, many IB holding companies have guaranteed the bank's liquidity and capital through contracts with the FDIC. These institutions have better access to capital and backup lines of liquidity than the profile group noted in the proposed rule. While they frequently use brokered deposits for a high percentage of funding their returns and capital are higher and their supervision by regulators more rigorous than the profile group cited above. Most importantly, these institutions have not engaged in sub-prime or speculative real estate lending - clearly differentiating themselves from the recent failures among traditional institutions using brokered deposits.

During the past 20 years, the brokered deposit market has performed very reliably. No soundly operated bank has had difficulty obtaining the funds needed to support its operations at any point in time. These funds have also proven to be more stable than core funds in the event the bank or its parent became the subject of adverse publicity. Depositors of brokered funds may not know the name of the Bank where their funds are deposited and cannot redeem those deposits prior to maturity (early redemption is permitted only in the event of depositor death or declaration of incompetence). The depositors know the deposits are federally insured. Brokered deposits are controlled by competent financial personnel that understand the deposits are insured and hence an emotional "run" on these deposits cannot occur. Runs by depositors following adverse press reports triggering recent bank failures would not have happened if those banks had only held brokered funds.

Additionally, brokered deposits are less expensive to a bank than traditional retail deposits when the cost of maintaining the brick and mortar and systems is included. Currently, brokered deposits are up to 100 basis points less expensive than the coupon rates associated with raising deposits through national campaigns.

Non traditional and other banks that serve customers nationwide often grow more than 20% per year, particularly during the first ten years of their existence. This type of growth has not presented undue risks because these institutions are designed and managed to be that size and are large because of their national market. Unlike the higher risk community banks, growth in a non traditional bank is typically not due to loan programs feeding a developing bubble i.e. sub-prime or speculative lending. The non traditional banks are tightly regulated by their state and federal regulators and carry adequate capital to support the more rapid growth.

In most cases, the FDIC reviewed and approved the growth and funding plans for non traditional banks and neither their rate of growth nor the use of brokered deposits was found unduly risky in examinations of these banks over the years.

We understand that the number of insured bank failures has jumped significantly this year. Most of those banks were apparently heavily concentrated in residential real estate finance and commercial real estate development, particularly in areas experiencing the highest declines in housing prices. But we note that few if any of those banks were highly reliant on brokered funds. This clearly establishes that imprudently

managed loan programs, not brokered deposit programs, present the principal risk of failure. These banks were overwhelmingly caught up in the housing bubble in one way or another and *that* is the reason they failed. Other banks not involved in the housing bubble pose average to below average risks of failure even though they may rely entirely on brokered funds for their operations. There simply is no inherent link between reliance on brokered funds and a high risk of failure. A high risk of failure is solely a function of a bank's loan programs. A high degree of brokered deposits can increase the potential cost of failure of a community bank, but is not a risk in itself. As such, increasing premiums for banks outside an appropriate high risk class is unfair and unjustified.

For these reasons, we believe the assessment formula should not impose added premiums on banks that hold high proportions of brokered funds if they primarily serve customers nationally or regionally and do not maintain branch networks throughout those markets. Indeed, we do not believe it is appropriate to include brokered deposits in the assessment formula at all. Imprudent sub-prime and speculative growth will be reflected in lower supervisory ratings regardless of whether a bank is using brokered funds to fuel its growth. Higher premiums charged to the institutions with lower CAMELS rating adequately cover the speculative use of brokered deposits.

With that background, we will now respond to the request for comments relating to brokered deposits.

<u>Should sweep accounts be excluded from the assessment definition of brokered deposits?</u> Yes. Sweep deposits may be the most reliable, efficient and inexpensive source of funding available to a bank, or at least to the Non-traditional banks that utilize them now. There is no instance we are aware of where a bank utilizing sweep deposits has failed, has suffered significant CAMELS ratings declines over any period of time, has become concentrated in real estate loans, acquisition and development loans, or areas suffering housing price declines, or otherwise fit the type of problem risk profile described above.

Excluding these deposits can be done in one of two ways. The best way is to not surcharge brokered deposits at all but instead surcharge banks whose lending activities fit the problem risk profile. A less desirable option would be to exclude brokered funds received through a sweep program, especially when the funds are swept from accounts with an affiliated broker dealer.

<u>Should deposits received through a network on a reciprocal basis be excluded from the assessment definition of brokered deposit?</u> Again, yes. There is no evidence that deposits of this type pose a greater risk of failure when held in a bank that has safe and sound loan programs and doesn't fit the problem risk profile.

As before, the best way to accomplish this is to not surcharge brokered funds generally but instead classify banks that fit the problem risk profile as in lower supervisory categories.

<u>Should high cost deposits be included in the definition of brokered deposits?</u> We do not believe deposits in themselves should be classified in different risk categories for purposes of assessing premiums because the risks primarily lie in how the deposits are used, not where they came from. Some deposits are more volatile than others and high

rate deposits obtained through a broker or over the internet may be less sticky than deposits in checking accounts, but that is a liquidity issue and can be effectively managed as such. It is not a risk issue warranting a premium surcharge. Additionally, brokered deposits represent the lowest cost deposits so it would require a new definition of high cost deposits.

Adjustment ratios. We believe all of the proposed adjustment ratios for brokered deposits are inherently arbitrary when applied to institutions outside the problem bank risk profile. The evidence is clear that many banks holding high proportions of brokered deposits pose no more risk to the insurance fund than banks holding lower percentages of brokered funds, and in some instances banks with high proportions of brokered deposits are less of a risk. Many of the lower risk banks hold 100% brokered funds. That makes any percentage of brokered funds as a threshold for imposing a premium surcharge arbitrary and unfair.

Similarly, non traditional banks often grow at rates much faster than traditional commercial and community banks and yet pose no added risk to the insurance fund solely because of higher capital and more rigorous regulatory oversight. A bank serving a nationwide market will typically grow at a much higher rate than one serving a particular community simply because of the size of the market. In anticipation of that growth, the bank will develop adequate systems and management from the outset. This capacity must be demonstrated to the regulators' satisfaction in the initial applications and in subsequent annual examinations. For most non traditional banks, higher than normal growth and reliance on brokered deposits has not resulted in any operational or regulatory problems over a long operating history. Some of the safest banks operating today grew several hundred percent in a single year with no compromise of safety and soundness, and that growth has not been criticized by the bank's regulators evaluation of the CAMELS ratings. In the face of this evidence, setting any particular growth rate as an assessment trigger for every institution regardless of its record would be clearly arbitrary and inequitable.

Again, the thresholds in the proposed assessment rule may be reasonable as applied to a community bank meeting the high risk profile described in the narrative of the proposed rule, but that is a limited group of banks that cannot be reasonably compared to non traditional banks.

We strongly believe the FDIC should not impose incremental premiums based on maintaining brokered deposits except as individual banks warrant an increase due to specific activity.

This will conclude our comments. We hope you found them informative and helpful.

Sincerely,

Frank R. Pignanelli
UAFS Executive Director