From: Chris Plummer [mailto:Chris.Plummer@herbank.com]
Sent: Wednesday, December 17, 2008 6:41 PM
To: Comments
Cc: Walt Kaczmarek; Larry McGovern; May Wong
Subject: Notice of Proposed Rulemaking and Request for Comment - RIN 3064-AD35 Federal Deposit Insurance Corporation Revision of Deposit Insurance Assessment Rates
Importance: High

December 16, 2008

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 Seventeenth Street, NW
Washington, DC 20429
Via email: Comments@FDIC.gov

Re: Notice of Proposed Rulemaking and Request for Comment – RIN 3064-AD35
Federal Deposit Insurance Corporation Revision of Deposit Insurance Assessment Rates

Dear Mr. Feldman:

On behalf of Heritage Bank of Commerce, I am writing to express my concerns about the Federal Deposit Insurance Corporation's ("FDIC's") notice of proposed rulemaking published in the Federal Register on October 16, 2008, revising among other things, the FDIC's deposit insurance assessment rates. In particular, I wish to express my serious objection to the proposal to charge an assessment premium if a depository institution's ratio of secured liabilities to domestic deposits exceeds 15%, with "secured liabilities" defined to include Federal Home Loan Bank ("FHLB") advances.

At our institution, we use advances to reduce liquidity risk, manage interest rate risk, and lower our cost of funds. Advances are an extremely valuable financial risk management tool that contributes to the profitability and to the safety and soundness of my institution.

Advances Reduce Liquidity Risk
Our institution relies on core deposits, FHLB advances, brokered deposits and other wholesale funding sources to fund loans and maintain sufficient liquidity. In my experience, advances have proven to be a more consistent and reliable funding source than other wholesale funding options. Provided that our institution meets the credit and collateral requirements of our regional FHLB, I can obtain an FHLB advance with a single phone call and receive a wire for the funds that same day. This immediate access to liquidity is always valuable, but is essential in times like these, when other resources have disappeared or have become extremely expensive. In addition, in some phases of the economic cycle, when the "flight to quality" is not so pronounced, or when a strong economy promotes rapid asset growth, it may be difficult to raise core deposits quickly and cost efficiently, if at all. In all phases of the economic cycle, the liquidity provided by advances may be critical to enabling us to continue lending in our communities. Finally, for smaller institutions like ours that don't have access to unsecured funding sources to the degree to which larger institutions do, advances level the playing field and are an essential component of our overall funding strategy.

Advances Help Manage Interest Rate Risk

Advances are an essential part of our asset-liability management strategy. FHLB advances are an attractive interest rate risk management tool because they are simple, precise, and transparent on-balance sheet transactions that help us match the terms and interest rate features of our assets and liabilities more closely. No other retail or wholesale funding source can offer the range of terms available with FHLB advances, and advances can be customized to fit the specific asset-liability management needs of our institution. Advances also assist with long-term, fixed-rate lending - not readily facilitated by short-term funding sources like deposits, for example - which is needed for housing, infrastructure, and community development lending.

As the current credit crisis has shown, there has been a significant decline in the availability of the other financial tools normally used to manage interest rate risk. For example, competition for core deposits has increased, making longer-term deposits scarcer and more expensive; the repo market has frozen; and with the increased scrutiny of the derivatives markets, the availability and application of derivatives is likely to decrease. By increasing the effective cost of FHLB advances through an increase in our deposit insurance assessment, the Proposed Rule effectively discourages our institution from taking advantage of the one remaining tool for effectively managing interest rate risk precisely at a time when we need all the tools available to us to maintain the safety and soundness of our institution in an incredibly challenging environment. Given the instability of the financial markets, it is imperative that our institution has the ability to manage interest rate risk adequately and in a cost-effective manner. We believe it is also in the FDIC's interest to ensure that this valuable risk management tool continues to be readily available to all FHLB members, without any assessment penalty, to reduce the risk of failure among institutions that are already stressed by the downturn in the housing market and the current credit crisis.

Advances Help Keep Funding Costs Low

We also use advances to lower our cost of funds, which contributes to our profitability and to our ability to maintain safety and soundness. Typically, FHLB advances are priced at rates that are very close to Treasuries. Under the Proposed Rule, this pricing advantage would be limited to a small amount of advances. In addition, deposit generation expenses, generally higher than the costs associated with obtaining advances, could increase in our community, as institutions seek other forms of liquidity. Bidding wars for deposits could take place in our market, as institutions face concerns about exceeding the FDIC threshold on advances, directly impacting the margins and the profitability of all of the institutions in the Greater San Francisco Bay Area. While advances can be used to meet a temporary funding need without raising the cost of other liabilities, raising deposit rates to attract new funds also increases our cost for existing deposits, which adjust to the new higher rate as they mature. As a result, heightened competition for deposits would not just increase the cost of the marginal deposits necessary to make up for the shortfall caused by the cap on advances, but would likely lead to a general increase in the cost of the entire pool of deposits in our area, as the institutions impacted by the proposal sought replacement funding from the dwindling supply of retail deposits. This combination of factors could have a devastating effect on our funding costs, our profitability, and, ultimately, our viability. Finally, the proposed rule would also have the perverse effect of increasing our costs even more when we are in an environment where it is difficult or expensive to raise core deposits and we experience deposit outflows, since we would have to reduce our advance borrowings as our deposit balances declined to avoid an increase in our deposit insurance assessment rate.

Advances Support Our Ability to Provide Credit to Our Communities

We use low-cost FHLB advances to help us meet the credit needs of our communities. Charging higher assessments because of our use of advances would impede our ability to provide that credit and create additional stress for communities that are already struggling in the current economy.

Given that advances are a vital and transparent financial management tool, I recommend that the FDIC not include increased premiums for advance use in its Proposed Rule. I believe that such a change could result in undesirable outcomes for our financial institution. Penalizing the use of advances would also be counterproductive to encouraging the flow of credit to our communities and potentially harmful to the economy during these extraordinarily difficult times.

Sincerely,

Christopher P. Plummer
Senior Vice President | Finance
HERITAGE BANK OF COMMERCE
150 Almaden Boulevard | San Jose, CA 95113