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BY ELECTRONIC MAIL

December 16, 2008

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429
Attn: RIN 3064-AD35
comments@fdic.gov

Re: RIN 3064-AD35: Proposed Regulations Regarding Revisions to Deposit Insurance Assessment Rates

Dear Mr. Feldman:

This letter is submitted on behalf of our client, Bank Mutual Corporation and its subsidiary insured bank, Bank Mutual (collectively, hereinafter referred to as "Bank Mutual"). Bank Mutual Corporation, with over $3.5 billion in total assets, is the fifth largest financial institution holding company headquartered in the State of Wisconsin. Its subsidiary bank operates 78 banking locations in the State of Wisconsin and one in Minnesota. Bank Mutual appreciates the opportunity to comment on the proposed regulations of the Federal Deposit Insurance Corporation ("FDIC") relating to the alteration of the way in which the FDIC differentiates for risk in the risk-based assessment system and to revisions contemplated by the FDIC to the deposit insurance assessment rates (the "Proposal").[1] The comments of Bank Mutual are primarily directed toward the secured liability adjustment provisions of the Proposal, and specifically to the inclusion of Federal Home Loan Bank ("FHLB") advances as a secured liability for purposes of this assessment rate adjustment.

Bank Mutual recognizes that recent failures, as well as deterioration in banking and economic conditions, have resulted in a decline in the reserve ratio designated by the Board of Directors under *12 U.S.C. 1817(b)(3)(B)*. Bank Mutual appreciates the efforts of the FDIC in adopting a restoration plan to restore the reserve ratio to 1.15 percent and recognizes that in conjunction with such restoration plan, the FDIC must increase the assessment rates it currently charges. Furthermore, as a well-capitalized Category I bank,

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[1] Notice of Proposed Rulemaking, 73 Fed. Reg. 61560 (October 16, 2008) ("NPR" or "Proposal").

Bank Mutual supports the general intent of the Proposal to change to the assessment system in such a way as to ensure that riskier institutions will bear a greater share of the proposed increase in assessments.

Although Bank Mutual supports the FDIC's efforts to improve the way the assessment system differentiates risk among insured institutions, we respectfully submit that the categorical inclusion of FHLB advances as part of the proposed secured liability adjustment is inappropriate for the reasons set forth below. Moreover, we offer some suggestions with respect to how the FDIC could better balance the gains it hopes to achieve through its proposed restoration plan against the substantial burdens and costs that will result from implementation of the Proposal as currently drafted.

A. **The risk is not in the funding source, but in the assets in which the funds are invested.**

Under the Proposal, a bank, even a well-capitalized, Category I bank like Bank Mutual, will be assessed with an add-on charge to their assessment rate if the ratio of its secured liabilities to domestic deposits exceeds 15% of domestic deposits. Secured liabilities include FHLB advances under the Proposal. With a blanket percentage calculation of this type, the FDIC is making the assumption that simply because a bank has a certain percentage of FHLB advances, said bank poses a greater risk of failure and would cause greater loss to the deposit insurance fund ("DIF"). However, without taking a look at how the FHLB advance funds were used and invested by the institution, how does the FDIC know that said bank poses a greater risk of failure? Even in the example set forth in the Proposal between Bank A and Bank B, in which Bank A has $100 million in insured deposits and Bank B has $50 million in insured deposits and $50 million in secured liabilities, the assumption is made that each poses the same risk of failure and thus it is unfair that Bank B only pays half as much in assessments as Bank A.[2] Bank B, however, may actually pose less of a risk and less of a loss to the DIF if its $50 million of secured liabilities or a portion thereof was in the form of FHLB advances which the bank used to invest in GinnieMae securities or a similar non-risk weighted investment, which remained unpledged for its FHLB or any other borrowings. The result would be that Bank B would have very high-quality, unpledged assets which would ultimately be available to the FDIC and reduce the losses to the DIF in the event of failure.

The basic premise that institutions with greater FHLB borrowings will have only lower quality unpledged assets available to the FDIC in the event of failure is untrue. On the contrary, the institution obtaining the FHLB advance may be using the funds to acquire new, better assets, thus serving to improve the situation for the FDIC by reducing losses to the DIF. The added liquidity afforded by the FHLB advances gives institutions the ability to improve the position of the FDIC by providing a more affordable source of funding which the institution can use to acquire high quality assets. The Proposal does not even entertain the notion that the institution's remaining, unpledged assets could very likely be high-quality securities, as the Proposal does not call for an examination or review of the quality of the assets themselves. A proper risk-based analysis would

[2] Notice of Proposed Rulemaking 73 Fed. Reg. 61570 (October 16, 2008).

evaluate the quality of the institution's assets and not simply entail a mathematical calculation using general assumptions.

As a highly-capitalized institution, Bank Mutual used its FHLB advance funds for sound and secure investments (i.e. high-quality, unpledged securities) which actually places it in a position of less, not greater risk as far as the DIF is concerned. However, under the Proposal, Bank Mutual would incur an additional surcharge of approximately 26% on its premium assessment because of a blanket calculation which does not examine the assets themselves. Bank Mutual will already experience an approximate increase in its premium assessments from 5.2 bps to 10.62 bps prior to the adjustment for secured liabilities. Once the adjustment is applied, Bank Mutual's premiums could be as high as 13.4 bps. For institutions like Bank Mutual, the inclusion (not the exclusion) of secured liabilities like FHLB advances in the assessment calculations can lead to inequity. This goes against the overriding goal of the Proposal and the restoration plan which is to ensure that riskier institutions truly are the ones which bear a greater share of the proposed increase in assessments.

B. Failure to examine the underlying assets associated with the FHLB advances violates the risk-based assessment system required by statute.

The Federal Deposit Insurance Act, as amended by the Reform Act[3] requires that the assessment system be risk-based. The required risk-based system is defined as a system for calculating a depository institutions' assessment based on the probability that the DIF will incur a loss with respect to the institution, taking into consideration the risks attributable to different categories and concentrations of assets and different categories and concentrations of liabilities.[4] These same factors are again repeated as the factors to be considered by the FDIC in setting assessments.[5] The language of the statute requires the FDIC to look to the quality of the assets themselves. A proposal to raise an institution's assessment rate based upon it having a certain percentage of FHLB advances on its books, without actually examining (i) how funds represented by such advances were used and invested by the institution; (ii) the quality of the assets pledged to the FHLB for such advances; and (iii) the quality of the remaining, unpledged assets available to the FDIC, is not a proper risk-based analysis as is required of the FDIC under the statute.

C. Changing the treatment of pre-existing FHLB advances puts institutions in a helpless position.

Banks with existing FHLB advances on their books are put at an immediate disadvantage under the Proposal as there is nothing they can do to avoid the immediate imposition of the add-on assessment under the Proposal. This is due to the fact most FHLB borrowings cannot be prepaid without the imposition of a prepayment penalty. As such, an

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[3] Federal Deposit Insurance Reform Act of 2005, Public Law 109-171, 120 Stat. 9; Federal Deposit Insurance Conforming Amendments Act of 2005, Public Law 109-173, 119 Stat. 3601.
[4] 12 U.S.C. 1817 (b)(1)(C).
[5] 12 U.S.C. 1817 (b)(2)(B).

institution is not able to take any immediate steps to avoid the imposition of the premium add-on by paying off its pre-existing FHLB borrowings without incurring additional expenses in order to do so. For Bank Mutual, prepayment of their FHLB advances would expose them to prepayment penalties in the range of $35-40 million dollars. Incurring more expenses and taking more hits to capital in the form of prepayment penalties is not in the best interest of most institutions in this economy. Therefore, institutions which have pre-existing FHLB borrowings can do nothing to minimize or eliminate their exposure to the new add-on charges, other than simply waiting until pre-existing advances reach maturity and then subsequently refraining from engaging in new FHLB borrowings. The imposition of the add-on charges was something they did not have to consider at the time they made their existing FHLB borrowings.

If the FDIC is not inclined to eliminate the inclusion of FHLB advances from the Proposal, the FDIC should, at the very least, take measures to minimize the unfair impact that the inclusion of FHLB advances will have as explained in this Section C. We would suggest that the Proposal include a grandfather provision to the secured liability adjustment provision so that the add-on charge applies to and only factors in those FHLB borrowings booked subsequent to the effective date of the new regulations. Another option would be to phase-in an institution's pre-existing FHLB borrowings into the Proposal's formula over time to avoid a large, immediate premium increase. The obligation to remit the premium at the higher, increased rate due to the secured liability adjustment could be spread out and/or phased in over a period of several years.

D. The inclusion of FHLB advances in the risk-based formula will discourage banks from taking advantage of FHLB advance products, which products serve as reliable sources for liquidity, can assist banks with better pricing, and allow banks to further their community missions.

The FHLB system was chartered by Congress for the purpose of providing ongoing liquidity to the savings industry in support of residential mortgage lending.[6] Reports on the FHLB system highlight the continued and important role of the system in the United States mortgage market and the fact that the system continues to be a trusted source of liquidity for lenders.[7] The importance of the FHLB system and the liquidity and other benefits it provides to member institutions has been outlined in several reports and studies which provide an analysis of the benefits of the system and its programs.[8]

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[6] Federal Home Loan Bank Act, Public Law 72-304, 47 Stat. 785.

[7] Standard & Poor's Ratings Direct report on Federal Home Loan Banks dated July 16, 2008.

[8] The Impact of Advances on Federal Home Loan Bank Portfolio Lending: A Statistical Analysis dated February 2005 by John A. Tuccillo, Ph.D., Frederick E. Flick, Ph.D., and Michelle R. Ranville, M.A. which summarizes the following studies (a) Gatewood, Colin. 2002, "The Federal Home Loan Bank's Contribution to America's Communities: A Study of the Federal Home Loan Bank of Atlanta's Contribution to Community Economic Development Through Its Members," Planning and Research Department, Federal Home Loan Bank of Atlanta, mimeo; and (b) Thomson, James B., "Commercial Banks' Borrowing from the Federal Home Loan Banks," Federal Reserve Bank of Cleveland Economic Commentary, July 2002.

According to these studies, FHLB advances represent an ongoing accessible liquidity source for member institutions. The advances also allow member institutions to further their community missions in supporting housing, community development, and small businesses through their lending programs. Moreover, the availability of funds from the capital markets via the FHLB system allow member institutions to fund loans regardless of local deposit market conditions, thus maintaining higher ratios of loans to total assets which results in improved profitability for the bank and services to their communities. The FHLB system allows the banks to obtain funds on the margin, when needed, avoiding high marginal costs of re-pricing the deposit base.

Certainly in this market and in this economy, the FDIC would support funding sources for banks which would allow them to price competitively so as to maintain higher ratios of loans to total assets and improve profitability. However, by increasing premium assessments for banks with high levels of FHLB advances, the FDIC is discouraging banks from taking advantage of the benefits which are afforded to the institutions by these very advances. This defeats the primary goal of the restoration plan. Banks which stop making FHLB advances in order to avoid higher premium costs under the Proposal could end up with reduced liquidity as they would be forced to obtain their funds in the local deposit market where they may need to pay more to obtain the funds, thus narrowing their spreads and reducing their profitability. The Proposal serves to place those institutions in areas where local interest rates are high at a competitive disadvantage by dissuading them from taking advantage of the lower cost funding option (i.e. the FHLB advance) due to higher premium costs imposed upon them under the Proposal.

E. **In light of economic conditions, the FDIC should be taking steps to relieve the burdens facing financial institutions by decreasing assessments and the 5-year period for restoration should be extended.**

In light of current economic conditions, this is not the time to be putting banks in a worse position by imposing additional costs and expenses upon them. On the contrary, in designating a reserve ratio for any year, the Board of Directors is to "take into account economic conditions generally affecting insured depository institutions so as to allow the designated reserve ratio to increase during more favorable economic conditions and to decrease during less favorable economic conditions, notwithstanding the increased risks of loss that may exist during such less favorable conditions."[9] The statutes further require that the FDIC "seek to prevent sharp swings in the assessment rates for insured depository institutions."[10] Under the Proposal, most institutions will face a doubling of their premiums at a minimum, which is not in accordance with the intent of the statute.

Moreover, the FDIC does have the discretion to implement their restoration plan and restore the designated 1.15 reserve ratio over a period longer than five years if necessary due to extraordinary circumstances.[11] The current economic conditions should provide the "extraordinary circumstances" in which an implementation period longer than five

[9] 12 U.S.C. 1817 (b)(3)(C)(ii).
[10] 12 U.S.C. 1817 (b)(3)(C)(iii).
[11] 12 U.S.C. 1817 (b)(3)(E)(ii).

years would be warranted. Extending the implementation period of the restoration plan could help to reduce the sharp swings in the assessment rates which insured depository institutions will now face by spreading the burden of the increased premiums out over a longer period of time.

F. **The inclusion of secured liabilities as a premium calculation factor is inconsistent with the treatment of secured deposits.**

While the Proposal includes secured liabilities as a new factor in the premium calculation, it does not address or cover secured deposits such as public and commercial deposits. For some institutions, these secured deposits can be significant and, in general under the current rules, having these types of deposits does not result in an increase in premium on all other deposits. To avoid this inconsistent treatment, an add-on charge for secured liabilities should not be imposed for purposes of increasing premium income.

G. **The Proposal should contain an appeal mechanism pursuant to which an insured depository institution could challenge the calculation of its premium assessment based on specific facts and circumstances.**

If the Proposal itself is not going to require the FDIC to undertake an examination or review of the quality of the assets themselves in conjunction with the imposition of the add-on premium charges, it should contain an appeal mechanism pursuant to which an institution could cause the FDIC to revisit its premium calculation (and specifically any additional premium increase incurred under the secured liability adjustment) through producing documentation about its asset quality. An institution feeling unjustly charged with an add-on premium due to its FHLB advances should be given the opportunity to submit factual data to support the soundness and sufficiency of its assets which would remain and be available to the FDIC in an event of failure in an effort to justify why the imposition of the add-on premium is unfair and unwarranted. If the institution can provide such documentation, the institution should not be subject to this additive factor in its premium assessment since there would be no risk to substantiate the need for the premium increase. An appeal mechanism such as this would serve to promote the fundamental goal of the Proposal and the restoration plan which is to ensure that it is the riskier institutions who bear the greater share of the assessment increases. An appeal mechanism would also help to avoid the inequities which could result through the inclusion of FHLB advances in the assessment calculations as pointed out in Section A above.

H. **The Proposal should be withdrawn or delayed in light of new policy programs which are also designed to reduce the risk of depository institution failures.**

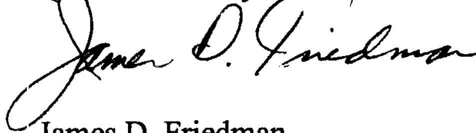
As pointed out by the General Counsel of the Federal Home Loan Bank of Atlanta in her comment letter dated October 28, 2008, it may be prudent to withdraw or postpone the implementation of the Proposal in light of Temporary Liquidity Guarantee Program which was established after the Proposal had been approved. The Proposal has now been

overtaken by these subsequent policy programs and it was based upon a deposit insurance world that no longer exists. As such and in order to permit the new changes in premiums to be considered and addressed within the context of the comprehensive review of the deposit insurance system as a whole which is now being undertaken by Congress and other policymakers, the Proposal should be withdrawn in its entirety and premium increases and the overhaul of the assessment system should be delayed until the end of 2009, once the fates of the new post-Proposal temporary programs are determined. A delay of this nature would be consistent with the implicit message of Congress set forth in the Emergency Economic Stabilization Act of 2008, as it would prevent an increase in depository institution operating costs during this time of crisis.

In summary, while Bank Mutual supports the intended purpose of the Proposal to improve the way the assessment system differentiates risk among insured institutions to ensure that riskier institutions will bear a greater share of the proposed increases in assessments, Bank Mutual is very concerned about the unintended consequences and the inequities which will result by the inclusion of FHLB advances in the risk-based assessment calculation. As we have set forth in great detail above, Bank Mutual strongly believes that the inclusion of FHLB advances as a factor in calculating premiums does not improve the assessment system; but rather has the opposite effect in that it results in sound institutions incurring unwarranted add-on premiums and it may cause reduced liquidity and reduced profitability for institutions. Bank Mutual respectfully requests that the FDIC continue to keep FHLB advances out of its premium calculations. Bank Mutual also respectfully requests that the FDIC consider the withdrawal of the Proposal in its entirety and the delay in any increased assessment rates in light of the new policy programs which have been established subsequent to the approval of the Proposal. In the alternative, we would ask that the FDIC consider a grandfather/phase-in provision, an appeal mechanism, or an extension of the restoration period as outlined in this letter. We appreciate your consideration of our comments on behalf of our client, Bank Mutual, and we thank you for your consideration.

Very truly yours,

Quarles & Brady LLP



James D. Friedman

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