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December 17, 2008

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

Re: RIN 3064-AD35
Notice of Proposed Rulemaking – Deposit Insurance Assessments
E-mail: Comments@FDIC.gov

Dear Mr. Feldman and the Federal Deposit Insurance Corporation:

Darling Consulting Group, Inc. (DCG) is an asset / liability management advisory firm that assists over 300 financial institutions nationwide. Our firm is in a unique position to offer insights from a very diverse cross section of community banks that range in size and complexity ($50 million in assets to $17 billion). We do not sell any products or services other than the advice we offer based on the financial modeling and analyses we perform. We are completely independent of other firms and/or services that could call into question one's intent when offering balance sheet management advice.

This letter is written in response to the FDIC's request for comments regarding the potential liquidity risk assessment grading system and allocation of increased insurance premiums to banks that hold secured funding (e.g. FHLB advances, repurchase agreements, Fed borrowings) > 15% of total deposits, or experience four year asset growth > 20% combined with brokered deposit levels > 10% of total deposits.

The inference in this draft policy is that all banks that use even a fairly modest level of wholesale funding pose, by definition, a greater threat to the FDIC insurance fund. And as a result, these banks should shoulder a greater share of the increased deposit premiums the FDIC is planning to assess in the wake of the current banking industry financial crisis. We question the merits of this theory.

While we respect the FDIC's need to strengthen the insurance fund, we also caution the FDIC about the many potential unintended consequences of their proposed assessment calculation and related assessment increases; especially at this particular time.

Presumption of Risk

There is a clear core hypothesis underlying the proposed risk-based assessment: brokered deposits and secured borrowings increase risk. While we are sure this will come as no surprise, we take exception with the FDIC's key underlying assumption. In fact, we are convinced that overall industry risk is lower because of the existence of the brokered markets and funding sources such as the FHLB and Federal Reserve. Unnecessary Bank failures have been avoided and troubled banks have been able to garner important time to manage asset problems or arrange for acquisitions because of their ability to access these sources of liquidity.

In fact, when the capital markets thumbed their noses at community banks this past year it was the Federal Home Loan Bank System that stepped up to the plate and ensured ready access to liquidity for all but a very few banks. In the latter cases, it was highly unusual for the FHLB to do anything other than curtail additional lending as opposed to not renewing outstanding loans to banks. Compare this to high rate CDs and money market accounts at banks with serious financial problems. Over-reliance on this type of funding increases the probability of systemic uncontrollable deposit-run risk. How many banks have experienced FHLB-induced liquidity runs?

Similarly, most banks with any meaningful level of brokered deposits utilize the DTC (Deposit Trust Certificate) programs which preclude early withdrawal for any reason other than death. Accordingly, our experiences reflect that banks will extend brokered maturities in times of financial stress; thereby reducing liquidity risk. Comparatively, high rate CD specials produce lower profitability and increase liquidity risk. In essence, the primary difference vs. brokered deposits is their zip code; as well as the questionable implied comfort level of being deemed "core deposits" simply because of their call report classification. As relates to this latter point, we doubt that franchise values are aided by overpriced, rate-sensitive, single product "relationship" deposits.

Furthermore, it is *impossible* to manage interest rate risk through the local retail deposit market. Both the FHLB Banks and the brokered markets provide a broad array of products enabling banks to manage the inherent interest rate risk associated with their core banking business activities.

Unintended Consequences?

We believe that as currently proposed, the Restoration Plan is counterproductive to many of the other programs the Treasury and Federal Reserve have launched to unfreeze the capital markets. As an example, we find it inconsistent for the FDIC to impose a de facto "penalty" that serves as a disincentive for Banks to use secured funding to facilitate liquidity management and lending; when at the same time the Federal Reserve is encouraging Banks to utilize its secured lending facilities.

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Since the last real banking crisis in the very late 1980's and early 1990's, the FDIC has acknowledged (in both internal and external communications) the important role that wholesale markets play in supporting bank liquidity risk and interest rate risk management strategies. The proposed assessment metrics send a *clear message* that both borrowings and brokered CDs are looked upon negatively by the FDIC. Notwithstanding the bright-line "over-reliance" thresholds, the perception by too many banks and their Boards will be that wholesale funding "is bad" in the eyes of the regulatory community; and this will create a very real impediment to the prudent use of these funding sources. Our concern has been supported by discussions we have had with many of our clients and other industry participants. The result will be higher industry risk and lower, more volatile earnings. Certainly not a formula for attracting much needed capital into the banking industry.

Increasing assessments and adding penalties at a time of extreme industry earnings pressures seems counterintuitive to us. By definition, this cannot help facilitate increased lending. Higher funding costs will reduce profitability, result in higher loan rates to customers, and/or lower the willingness of banks to lend if lending cannot be supported by cost-effective local market deposit growth. And the scenario of local market deposit growth meaningfully lagging non-speculative loan growth has become the norm throughout the industry, especially for the vast majority of community banks.

The implication of the assessment formula appears to be that a 4.7% compounded annualized growth rate (20% over 4 years) is "rapid" (or certainly not low); or by inference at a level that exceeds expected average deposit growth levels (5% per FDIC assumptions). Presumably, this in turn implies a level of growth above which the likelihood of wholesale funding utilization increases. We suggest that if deposit growth is examined by asset size, the deposit growth rates (excluding brokered) for other than the top 100 or so Banks have been at much lower levels than the industry average (i.e. a disproportionate amount of the growth in last 5-10 years has been at the larger banks).

In reality, most community banks (especially under $1 Billion) will struggle to grow deposits even 2-3%. Given that most banks will remain dependent on net interest income for earnings growth, investors will require annual growth rates in excess of these levels (even 5% is inadequate for most over any meaningful time horizon, even for mutual institutions). Accordingly, by the FDIC sending a message that wholesale funding (especially brokered) is bad and that >5% growth, in effect, reflects "rapid growth", we cannot help being concerned that this (along with other variables such as FASB's market value accounting push) may very well be reflective of the early stages of the demise of the community banking industry.

These concerns transcend the explicit increased insurance cost; and point more to the message that is being sent to the industry regarding FDIC attitudes and, therefore, likely supervision/examination issues community banks can look forward to in the not too distant future.

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Root Problem Not Being Addressed

The underlying problem with the industry has far more to do with loan underwriting and asset quality issues than it does with where banks obtain their funding. It is difficult to believe that Indy Mac, for instance, would have had a liquidity problem had it not been for the rapid deterioration in its asset quality; real or perceived.

In a case such as Indy Mac, many bankers can sympathize with the FDIC who is faced with having to unwind a pool of poorly underwritten and constructed assets that are encumbered by secured liabilities. The resulting hit to the fund from Indy Mac and some of the other larger bank closures will no doubt will be significant and require increased assessments for banks.

However, to date the problem in nearly all of the bank closures and with banks deemed by the market to be "on the brink of failure" relates to asset quality issues; primarily from non conforming residential lending practices and construction / land speculation lending. These banks found themselves in a precarious liquidity position due to bad lending and investing; not by their funding strategy. Although a wholesale funding strategy may have "better enabled" the problem banks to make bad loans, it was not the root cause. Accordingly, we question the fairness of an insurance assessment process that is based fundamentally upon a "guilty by association" doctrine; regardless of whether a bank is prudently using wholesale funds to make good quality loans under a conservative decision-making umbrella.

These latter banks are rightfully asking why they are being unfairly painted as enablers of risky asset strategies when their conservatism on credit quality mandates they raise funds in as cost effective fashion as possible. This often requires accessing secured liability and brokered deposit funding sources at a utilization level in excess of the "arbitrary" caps presented in the FDIC exposure draft. The issue is not the level of these funding sources, so much as it is the management processes and alternative funding capacities that exist at any individual bank; including the relevance of their contingency liquidity plans. Penalizing a bank that meets one or both of the bright-line wholesale funding thresholds seems unfair; especially if they are able to demonstrate a clear understanding of and ability to manage the risks associated with wholesale funding.

The Need for Wholesale Funds

Cost effective funding growth has become one of the most problematic issues facing community banks (current credit issues notwithstanding). The reality is that while the households and businesses in a particular community continually look to their local banks for borrowing money, they regularly invest their incomes/profits/wealth outside of those very same local community banks. This is largely a result from increased competition for financial instruments that resulted from technology (e.g. the internet); the growing importance of self directed retirement programs

(e.g. 401k); increased competition from non-banks (e.g. brokerage, insurance, mutual fund) and credit unions; branching/marketing activities of the large bank sector; etc.

While these factors no doubt were a benefit for consumers, the reality is that they contributed to lower depositor loyalty and higher required rates of interest to be paid on many classes of deposits. The resulting tightening of margin drove more banks to turn to funding sources outside their local market in order to facilitate the cost-effective funding of asset growth at volume levels necessary to remain relevant. Please note that the majority of these funding sources continue to be available to the vast majority of banks even in light of the current environment. And as discussed later, these sources of funds continue to be far more cost effective and reliable than the local deposit market in many, if not most, cases.

The ability to utilize wholesale funds provides the "liquidity backstop" comfort needed to avoid relying on purely "price-oriented" deposit retention and generation strategies. Without this backstop, many banks would feel the need to pay up to the top end of the CD market or MMDA Specials (the price of which all too often is driven by "distressed" banks, irrational competitors, competitors playing by a different set of rules, etc.). Without comfort in their ability to utilize the wholesale markets, banks would be forced to pay what amounts to "bribes" to retain/access funds; an act that places the bank into a vicious cycle whereby the only reliable variable is their need to continually pay a premium rate for monies that demonstrate little, if any, reliability. It serves to raise the cost of funds of all players with little net gain in composite liquidity.

How is it fair that a "well run" bank currently paying an all in cost to the brokered CD market of 3.30% to fund for 6 months is penalized by higher insurance assessments when their alternative cost of funds is the 4.50% rate set for the same term CD by a problem bank one block over? The price differential is even wider when comparing to similar term FHLB advances.

Conclusion/Summary

We understand that the FDIC faces the unenviable task of replenishing an insurance fund that is feeling the pressure from a popping of the mortgage asset quality bubble. And it is appreciated that the FDIC is examining ways to see that the riskier institutions pay a higher share of the increased insurance assessments.

Notwithstanding, we do not believe that a risk-based assessment should be based on the funding side of the balance sheet. Risk of loss to the FDIC is driven by the asset side. Accordingly, we would not add any additional assessment for "above threshold" brokered deposits or secured borrowings.

At the very least, we would exclude surrogate customer deposits from any of the calculations. CDARS deposits (two-way) that reflect the management of larger customer deposit balances

should not be deemed brokered deposits; since they simply are not. Similarly, customer repos should not be considered borrowings, since they simply are not.

Given the first quarter increases already enacted and the higher level of insured deposits subject to insurance fees (increased limit to $250,000; deposits covered under the Transaction Account Guarantee Program), we would not add any additional burden to the banking industry. We would undo the Q1 increases and defer any additional assessments until 2010. In the interim, why wouldn't the FDIC be a worthy recipient of TARP investment to the extent the insurance fund became insufficient during 2009? Will the incremental fees really make that much of a difference if the problems worsen materially?

Finally, and most importantly, we reiterate our caution regarding the above mentioned unintended consequences; especially the very real negative and in our opinion, unsuitable signaling to the industry regarding the role and use of the wholesale funding markets.

We have presented here for your consideration a number of reasons as to why the levying of a higher risk premium on banks that use wholesale and secured funding is not only unfair, but will also be counter productive to efforts other agencies are making to stabilize the financial system and allow the economy to gain traction.

We hope that our reasoning compels you and the policy makers at the FDIC to reconsider this draft. Thank you for your time and attention to this important matter. We would welcome the opportunity to discuss our comments and related thoughts with you.

Sincerely,

Darling Consulting Group, Inc.

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