Bank of America Corporation
Legal Department
NC1-002-29-01
101 South Tryon Street
Charlotte, NC 28255

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BY ELECTRONIC MAIL

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: Proposed Regulations regarding Deposit Insurance Assessment Rates and FDIC Deposit Insurance Fund Restoration Plan

Dear Madams and Sirs:

Bank of America Corporation appreciates the opportunity to comment on the proposed regulations of the Federal Deposit Insurance Corporation relating to changes to deposit insurance assessments and the FDIC's proposed restoration plan to replenish the Deposit Insurance Fund. Bank of America, with over $1.8 trillion in total assets and over $800 billion in worldwide deposits, operates the largest and most diverse banking network in the United States with full-service consumer and commercial operations in 33 states and the District of Columbia. Bank of America, through its subsidiary banks, operates over 6,100 retail branch locations and over 18,700 ATMs.

Bank of America agrees that deposit insurance assessments should be risk-based and that well-capitalized and well-run institutions should pay premiums at lower rates than institutions that pose a greater risk of failure. Bank of America, however, has serious concerns about the FDIC's restoration plan and the FDIC's proposed methodology for measuring risk.

Timing

While we will not dwell on the issue, Bank of America shares the concerns of many observers about the proposed schedule for returning the fund to its target reserve ratio. By statute, the fund must be fully replenished within five years, absent "extraordinary circumstances." The current circumstances certainly would qualify as extraordinary. Credit is tight, and increasingly funded by deposits. Banks are being urged to lend, but paying record deposit insurance premiums will

only diminish the amount of lending that occurs.[1] As the time comes to finalize the rule, we urge the FDIC to consider and consult with other economic policymakers on the state of credit markets and the broader economy, and reconsider whether current circumstances merit a slower build.

In this context, it is worth noting that the proposed rule dramatically underestimates the cost of the proposed assessment increase. Even for stronger institutions, increased assessments, even at the minimum base rates proposed by the FDIC, will substantially reduce earnings and capital. As a hypothetical example, assume a large bank that has $600 billion in assessable domestic deposits. Every basis point of deposit insurance assessment would cost that bank $60 million per year. The FDIC's proposed minimum assessment rate for the first quarter of 2009 is 12 basis points, which equates to $720 million per year. Once the risk-based assessments apply, even the safest institution would pay no less than 8 basis points, which equates to $480 million per year. Based on the risk adjustments and FDIC discretion, assessments for a category I institution can go as high as 21 basis points, which would equates to $1.26 billion per year in assessments.

The proposed rule states that it is expected that 56% of *profitable* institutions would pay assessments that are less than 8% of income. The median reduction of income for *profitable* institutions is projected to be 7.3 percent, with a weighted average of 4.4 percent. There is no specific discussion about the impact on institutions that are *not* profitable today, other than to say that the entire financial industry would be projected to lose 11% of its income per year due to the proposed assessments. Increased assessments on less profitable institutions further deepen the losses and exacerbates efforts at recovery. These amounts are far from *de minimus*, as the proposal seems to imply.

The FDIC's Proposal Does Not Adequately Measure Risk

Our greater, longer-term concern is that the proposal does not adequately measure risk, and therefore will encourage banks to engage in perverse behavior, as well as making less risky banks pay a greater percentage of deposits than is appropriate.

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[1] The FDIC rationalizes that banks can bear this increased assessment burden for two reasons, both of which we believe are ill founded. First, the FDIC states institutions will be able to offset the increased assessment costs by passing them on to customers in the form of increased fees, higher lending rates and lower deposit interest rates. In a competitive market, the ability to pass through costs is limited; however, even if banks could pass through those costs, current economic conditions does not appear to argue for raising the costs of credit any more than they call for restricting its availability.

Second, the FDIC states that FDIC assessments are tax deductible and therefore will offset taxable income. This is not a dollar for dollar offset, but only would mitigate the expense by the effective tax rate. Those tax benefits may not be available in the short term based on earnings pressures and at best provide an offset for later periods. Of course, if the cost of assessments truly were passed through to the U.S. Treasury in the form of reduced tax revenue, that would be the economic equivalent of having Treasury directly fund the DIF.

The FDIC's exposure to an institution is its probability of default multiplied by its loss given default. The latter is determined by (1) the amount of insured deposits (not assessable deposits) over (2) the unencumbered assets of the institution that are available to pay those insured deposits.

In sum, we strongly urge the FDIC to base its assessments on those two factors. Most weight should be given to the probability of default, with particular emphasis on the liquidity strength of the bank, as reflected in its CAMELS. If a bank has low probability of default, assessments should be low and risk adjustments based on potential FDIC losses are not justified. The FDIC should reconsider whether risk adjustments beyond the core measures of risk (debt ratings, CAMELS and capital ratios) should be used at all. To the extent that risk adjustments are to be used, the current proposal gives too much weight to risk adjustments based on arbitrary measures and ignores the probability of default. Additionally, the FDIC's proposal uses proxies for unencumbered assets – the amount of a bank's secured liabilities (which have a call on assets), and the amount of a bank's unsecured liabilities (which have no such call). Both of those measures, particularly with limitations placed upon them under the proposal, are flawed substitutes.

It is also worth noting that in some cases there can be a tradeoff between the probability of default and loss given default. A bank that uses assets to obtain stable, long-term secured funding will increase its loss given default but diminish its probability of default – as compared, for example, to a bank that funds itself through unsecured, short-term borrowings and is subject to a run. The measures that the proposed rule includes accentuate rather than lessen this tension.

Long Term Unsecured Debt Adjustment is too Limited

The FDIC has proposed to reduce the assessment rate based on amounts of unsecured debt obligations issued by the institution. The rationale is that these obligations, which are subordinate to deposits, provide a cushion to absorb losses that reduces risks to insured depositors and the FDIC. Bank of America agrees with the concept that unsecured debt obligations reduce risk and therefore should reduce assessment rates. The FDIC's proposal, however, is too limited and undervalues the risk mitigation of other unsecured obligations.

First, the FDIC applies a multiplier for the ratio of long-term unsecured debt to total domestic deposits of 20 basis points. This means that the FDIC is discounting the risk mitigation effect of unsecured debt by 80%. This multiplier seems arbitrary, and excessively low. The FDIC further dilutes the benefit of unsecured debt by not measuring unsecured debt against only insured deposits, which is the true proxy for FDIC funds at risk. There is simply no justification for discounting the full value of unsecured debt under this approach.

Second, the FDIC should not limit the benefit to long term unsecured debt instruments, defined as 1 year or longer of remaining maturity. The FDIC appears to have borrowed this standard from the definition of Tier 1 or Tier 2 capital, but the two cases are different. Here, the question

is not the extent to which the instrument insulates the bank against unexpected loss but rather whether the obligation would be junior to a domestic deposit at the time of a bank failure and therefore would be paid after FDIC claims. Short term debt absorbs losses upon failure just as well as long-term debt. Since the assessments are updated quarterly, the FDIC should use the full balance of unsecured debt (senior or subordinated) as of that quarter end, regardless of maturity.

Third, due to the distinction that the FDIC has artificially drawn about qualifying long-term debt, the proposal cannot work properly without changes to call and thrift reports. Rather than delay the implementation of the proposal until it is feasible, the FDIC proposes to penalize banks by limiting the availability of the long-term debt reduction to only subordinated debt until call report forms are updated. This will materially undervalue the amount of unsecured debt that should reduce assessments and would effectively overcharge banks and overstate risks based purely on the FDIC's own technical reporting problems rather than actual measurements of risk. If anything, the FDIC should err on the side of undercharging banks, given that the financial impact of assessments at all is so great.

Fourth, the proposal caps the benefit of assessment rate reductions to 2 basis points. There is no legal or economic basis for such a cap. The more unsecured liabilities that are subordinated to deposits, the lower the risk of a loss borne by the FDIC. It is logically and practically possible that a bank could present effectively zero risk to the FDIC. Exacerbating this issue is that there is an imbalanced cap on rate increases for secured obligations, meaning that the FDIC is more likely to increase rates based on secured debt, even though there may in fact be more unsecured debt to offset it. The deck is unfairly stacked in favor of higher assessment rates, regardless of risk.

The Secured Debt Adjustment is too Broad

The proposal increases assessment rates if an institution's secured liabilities exceed 15% of its domestic deposits. This premium adjustment would be capped at 50% of the adjusted base assessment rate (meaning it could be as high as 7 basis points for a Category I bank with the highest assessment rate). Unlike the downward unsecured adjustment, this upward adjustment is not discounted. Among the specific secured obligations that the FDIC would penalize a bank for holding are Federal Home Loan Bank advances, securities sold under repurchase agreements, secured federal funds purchased and "other secured borrowings.. This proposal is objectionable for several reasons.

First, the FDIC's penalties for secured debt are inappropriately disproportionate to the risk reducing adjustment for unsecured debt. If the risk adjustments are not changed entirely to reflect a true loss given default calculation, the impacts of both categories should be equally and fully included in the calculation.

Second, the FDIC's proposal reduces the benefits of critical sources of bank funding and liquidity. In particular, the proposal would impose a deterrent and higher costs to borrowing

from the FHLBs and thereby impair the mission of the FHLBs to support residential home lending. It would also impair the development of a covered bond market for mortgage loans, which the FDIC has been instrumental in developing. As the current financial crisis demonstrates, reliance upon off-balance sheet financing, such as securitizations, may not always be available. Similarly, unsecured funding has its limits and in some markets and for some institutions may be costly. Secured borrowings are therefore essential for affordable and sustainable funding. The securities repo market is also substantial, particularly for large banks. The FDIC should not be taking actions that excessively limit or raise the cost (directly or indirectly) of obtaining sources of liquidity.

Third, the proposal does not take account of the fact that while secured funding may increase loss given default, it may also decrease the probability of default. A safe and sound bank with little probability of failure should not be charged up to 7 basis points (using the earlier hypothetical, up to $420 million per year) because it has substantial secured debt. This is why a true risk-based approach should assess the real loss given default and factor in the probability of default to further discount or increase assessments. The current model ignores the benefits that funding provides in reducing probability of default.

Practical Examples

The points above are illustrated through a couple of hypothetical examples.

Assume a hypothetical bank that has $100 billion in total deposits, of which $50 billion are insured. This bank has total assets of $300 billion, secured debt of $50 billion and unsecured debt of $50 billion. In this scenario, the FDIC bears no risk of loss if the bank were to fail because the $50 billion in insured deposits are supported by $250 billion in unencumbered assets. In this fact pattern, both the probability of default and the loss given default risk to the DIF are virtually non-existent. Nevertheless, the FDIC's proposal would assess this bank at the base rate of 12 basis points. The unsecured debt adjustment would subtract 2 basis points (the maximum permitted). Note that the FDIC's calculation, without applying the cap, would have applied a 10 basis point reduction (i.e., ratio of $50B debt over $100B total deposits (50%) times 20 basis points). The secured debt adjustment would add back 3.5 basis points (i.e., ratio of $50B secured debt over $100B total deposits (50%) minus .15% multiplied by adjusted assessment rate of 10 basis points). The end result is that this bank would pay an assessment rate of 13.5 basis points or $135 million per year.

In a second example, assume a hypothetical bank that has $100 billion in total deposits, of which $50 billion are insured. This bank has total assets of $300 billion, secured debt of $150 billion and unsecured debt of $150 billion. In this scenario, the FDIC bears no risk of loss if the bank were to fail because the $50 billion in insured deposits are supported by $150 billion in unencumbered assets. In this fact pattern, while the probability of default is higher, the loss given default risk to the DIF is still virtually non-existent. Nevertheless, the FDIC's proposal would assess this bank at the base rate of 12 basis points. The unsecured debt adjustment would

subtract 2 basis points (the maximum permitted). Note that the FDIC's calculation, without applying the cap, would have applied a 30 basis point reduction (i.e., ratio of $150B debt over $100B total deposits (150%) times 20 basis points). The secured debt adjustment would add back 5 basis points (i.e., ratio of $150B secured debt over $100B total deposits (150%) minus .15% multiplied by adjusted assessment rate of 10 basis points, but capped at 5 basis points). The end result is that this bank would pay an assessment rate of 15 basis points or $150 million per year.

Unencumbered Assets

Bank of America recommends that the FDIC abandon the separate risk adjustments for debt for the reasons described above. Instead, the FDIC should make a risk adjustment based on a formula of unencumbered assets relative to insured deposits. This be a more accurate measurement of risk to the DIF in the event of failure and it would avoid the inequities of the current proposal. If this test were adopted, it would be appropriate to have lower assessment rates based on the higher margin of cushion that unencumbered assets has over insured deposits. Furthermore, the potential reduction in assessment rates using such a methodology should not be capped. In other words, there is no justification for a safe bank that demonstrates little or no risk of loss given default to pay exorbitant assessment rates like 10 bps as a minimum. Such assessments are nothing but a subsidy to other institutions that are the real risk to the DIF.

The Proposal Improperly Discriminates Among Large Banks

The commentary of the proposed rule states that, under the current system of risk calculation methodology and as of June 30, 2008, 45 percent of large banks would have been charged the minimum assessment rate, versus 28 percent of small banks. The commentary of the proposed rule states that the anticipated impact of the new risk measurements will be that only 25% of large banks may qualify for the minimum rate, consistent with the same percentage for smaller banks. The proposed rules clearly make it more difficult for a large bank to be eligible for the lowest assessment rates.

The Deposit Insurance Reform Act of 2005 states that "No insured depository institution shall be barred from the lowest-risk category solely because of size".[2] The FDIC's proposed rules appear structured to make sure that fewer large banks can meet the lowest assessment category. Structuring the rules with a goal to maintain parity between large and small banks would be in violation of this statute. Arbitrarily establishing targets for percentages of institutions that fall into a given assessment rate is inconsistent with not only with the governing statute but the whole concept of risk-based pricing. Every institution should be eligible for the lowest rate or no rate if it meets the governing standard. The fact that, under objective criteria, large banks may have a greater percentage of institutions that qualify for the lowest rate is not an indication that the rule

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[2] 12 U.S.C. §1817(b)(2)(D).

is flawed and needs to change, but may just be a factual representation of the strength of large banks.

Brokered Deposits Should Exclude Affiliated Sweeps

Bank of America does not have a material amount of brokered deposits and does not have a general comment on the treatment of brokered deposits in the proposal, with one exception. Bank of America believes that the FDIC should not consider deposits that are swept from affiliates (including affiliated broker dealers) to be brokered deposits for purposes of risk adjustments. The FDIC has considered a large concentration of brokered deposits to demonstrate risk because brokered deposits generally are "hot money", meaning they are not relationship based and may not be a stable source of deposits for the bank. Many banks have affiliated broker dealers that manage investments for clients. These are well established and stable relationships with customers. A common investment option for these customers (whether for idle funds or as a safe investment) is to sweep cash from brokerage accounts into FDIC insured bank deposits. This type of deposit is not hot money as it represents a product choice of an established relationship from the affiliate and balances are relatively stable. Unlike a common brokered deposit where the depositor may only be chasing the highest rate, deposits swept by a broker dealer customer is part of the suite of financial management services that the bank and its affiliates offer.

The FDIC Discretionary Risk Adjustment is too Large

The FDIC has proposed to permit the FDIC to increase an institution's assessments on a discretionary basis by as much as 1 basis point (up from the current ½ of a basis point). As Bank of America and the financial industry at large stated in the original FDIC reforms several years ago, this provision allows the FDIC to override objective risk measurements of risk and the views and experience of the primary regulator supervisory. This discretion gives rise to unpredictability in planning for assessment costs and disparate treatment among similarly situated institutions. Bank of America's concerns in the existing structure remain and the proposal to double that discretion magnifies that concern, especially in light of the significant costs that already will be imposed for assessments in the proposed rules.

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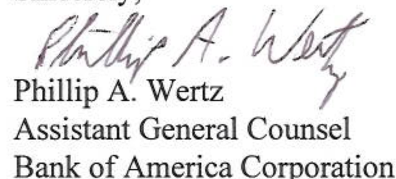
Bank of America appreciates the opportunity to comment on the FDIC's proposed regulations, and we thank you for your consideration of our comments.

Sincerely,



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