Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 Seventeenth Street, N.W.
Washington, D.C. 20420

Attention: Comments (RIN: 3064-AD35)

Dear Mr. Feldman:

We are writing in response to your agencies "request for comments" regarding the FDIC's proposed "risk-based assessment system" and appreciate the opportunity to comment on your proposal. Our comments are based upon the following four premises:

1. Funding, regardless of the source or the amount, does not cause a bank to fail. Banks fail due to the quality and return on loans and investments made with those funding sources.
2. The FDIC's assessment base (domestic deposits) is shrinking in relationship to its increased risk (asset growth). Increasing assessments on brokered deposits and FHLB advances is not the long-term answer to addressing assessment income.
3. Domestic deposits as a percent of assets have been declining for over two decades forcing banks to seek alternative funding sources. Banks will need a variety of funding sources to fund future asset growth and the FDIC should eliminate "labels" that differentiate between those funding sources.
4. Funding "risks" should be predicated more upon the price, maturity and required collateral of the funding source, not the funding source itself.

Funding Sources Do Not Cause Banks to Fail

The basic premise of the FDIC's proposed "risk-based assessment" is that:

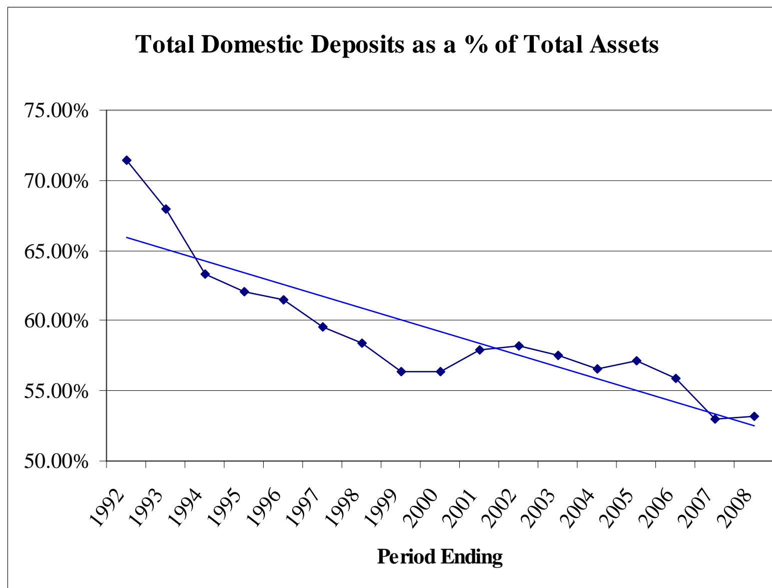
1. Banks with high levels of non-traditional (wholesale) sources of funding pose additional risks to the system, and
2. Recently failed institutions experienced rapid growth that was funded with non-traditional (wholesale) sources of funds.

While we agree that recent bank failures have depleted FDIC reserves that must be replaced, we strongly disagree that the cause of these failures were the funding strategies that the failed institutions employed. We believe that Mr. William Seidman, past Chairman of the FDIC said it best in his 1989 testimony before the Subcommittee on General Oversight and Investigations of the House Committee on Banking, Finance and Urban Affairs, when he said "*A dollar deposited in an insured institution is the same whether obtained directly from a local depositor or through the intermediation of a deposit broker. There may be differences in the cost and stability of that dollar deposit depending on its source. However, losses in banks do not occur, generally speaking, by virtue of the source of their deposit liabilities. Instead, the losses arise from the quality of*

and return on loans and investments made with those funds. Consequently, the focus of attention should be on the employment of brokered deposits rather than their source."

The FDIC has in place today ample regulations to deal with both loan and investment activities and regulations that address rapid growth strategies. The assumption that placing an increased assessment on certain funding sources will reduce or eliminate inappropriate lending and investment activity or curtail rapid growth is in our opinion misguided.

A Shrinking Deposit Base Puts Pressure on Fee Assessments



As evidenced by the adjacent graph, domestic deposits in FDIC insured institutions, as a percent of assets, is in a long-term decline. This decline is effectively eroding the traditional "assessment base" of the FDIC. As pointed out in Chairman Bair's 3rd Quarter "Letter to Stakeholders", the amount of insured deposits as of 9/30/08 were $4.54 trillion compared to total assets in the industry of $13.61 trillion or 33.4%.

If one compares the same numbers to numbers from just 5 years ago, the 3rd quarter 2003 numbers were as follows: insured deposits were $3.41 trillion or 38.1% of a total asset base of $8.95 trillion. If one projects forward the potential increase in the total asset base of FDIC insured institutions, as a result of increased banking powers from financial giants such as Morgan Stanley, Goldman Sachs, American Express and others, the pressure on the FDIC's assessment base (insured deposits) is most likely to increase even further.

If one agrees with the Mr. Seidman's statement above that the risk in financial institutions is the result of the employment of funds (total assets) not the source of funds (funding base) then trying to assess higher fees on specific funding sources will not truly address the risks in the system and may have the unintended consequence of slowing lending and asset growth at a time when such growth is being trumpeted by the FDIC, the Treasury Department, the Federal Reserve and the Congress. For the FDIC to be adequately compensated for the risks it assumes, a risk-based asset strategy needs to be considered.

A Variety of Funding Sources will be Needed to Fund Future Asset Growth

As stated above, domestic deposits as a percent of asset growth has been in a long-term decline. From information available today, this decline in domestic deposits (as % of assets) is likely to accelerate as significant asset growth is expected to out pace deposit growth as a result of increased banking powers from financial giants such as Morgan Stanley, Goldman Sachs, American Express and others.

To fill the "funding gap" created by the lack of domestic deposit growth, the growth in non-traditional sources such as FHLB advances, brokered deposits, internet programs, listing services, CDARS, etc. are well documented. For the FDIC to differentiate between these various "wholesale" sources of funds (listing services are good, brokered CDs are bad) and implement higher "assessment fees" on certain of these funding sources today and potentially others in the future, will inhibit the growth of such instruments today and the innovation of new instruments in future at a time when increased funding sources are needed to support lending activities and drive the industry forward.

In our opinion, the more appropriate approach for the FDIC today is to recognize as Mr. Seidman did that "A dollar deposited in an insured institution is the same whether obtained directly from a local depositor or through the intermediation of a deposit broker." The industry would be well served if the negative connotations attached to labels such as "brokered deposits", "hot money", "core deposits", etc. were removed and the FDIC's most recent guidance on Liquidity Risk Management (FIL-84-2008), which encourages the use of diverse funding sources, contingency funding plans, etc., was strictly enforced.

For the FDIC to encourage the use of listing services or other "non-brokered" sources of funds based solely on the legal characterization, not the cost, stability, maturity or other key funding considerations unique to the individual institution makes no sense. The FDIC needs to eliminate these "safe havens" and view all funding sources as Mr. Seidman did, i.e. "A dollar deposited in an insured institution is the same".

The Funding Source is not the Key to Determining Risk

In the FDIC proposed risk-based assessment, brokered deposits and FHLB advances have been singled out as funding sources that potentially pose additional risks to the system. We disagree with this assumption and embrace the opinion that "A dollar deposited in an insured institution is the same" regardless of the source. In our opinion, if one is to think about "deposit risk," the price, stability and required collateral are more efficient metrics to measure than simply the funding source.

In determining price, one tends to look simply at the "book rate" paid by the institution that originates the funds but this alone can be very misleading. For example, retail deposits which look to be very "cheap" on the surface, have an additional cost of 90-150 basis points (based on various studies) depending on branch networks to acquire the funds, and overhead to originate and maintain the funds. Listing Services have annual

fees that are not reflected in the rates paid to acquire funds, same is true with the "CDARS" program. FHLB advances require institutions to purchase stock and pledge collateral, costs that are not reflected in the "posted rate". In contrast, rates paid for "brokered deposits" or funds raised from our eTN platform are quoted as "all-in" rates which include any origination fees.

Deposit stability is an issue that has been debated for years. It is generally assumed that regulators believe direct "retail" deposit are more stable than wholesale sources of funds but "wholesale" providers have their own arguments as well. Brokers point to the depth and the diversity of their market for stability. The "CDARS" program points to their origination engine (originating bank has relationship with large depositor and insures it through the CDARS program). Listing services point to renewal statistics and FHLB's point to available collateral but each of these assumptions has its flaws.

As we have seen several times this year, retail deposits seem to be secure until asset problems arise as in the case of Washington Mutual or Indy Mac. The fact that most retail deposits are short-term in nature (mature in less than 1 year) and have early redemption features, what seems to be a stable funding base can go out of the door quickly under certain circumstances. The same is true with wholesale funding sources. Wholesale funds are generally placed either under the insurance limit or on a fully secured basis. More and more of the providers of unsecured wholesale funds (deposit brokers, CDARS) are using external rating services such as IDC or the LACE rating service. If the issuer drops below a designated "ratings level," the source of funds is interrupted. For secured wholesale providers (FHLB, Federal Reserve, Repo lines) funding is available only if sufficient collateral is available, so each funding source has its' limitations.

The only real source of "stable" funds in the industry are long-term (maturity beyond 1-year) non-callable funding sources. As of the 9/30/08 call report, total domestic deposits were approximately $7.2 trillion. Of this amount, $5.9 trillion or 82% of all domestic deposits matured within three months or less (total includes savings deposits, various transaction accounts and short-term time deposits). Time deposits with maturities of one year or more totaled only $466 billion, or 6.5% of all domestic deposits. In our opinion, these statistics show how "unstable" the funding base is today and also identifies a long-term asset liability problem. As a result, for the FDIC to assess an additional fee on funding sources such as brokered deposits and FHLB advances, two potential sources of longer-term, non-callable funding, seems to increase the risk in the system not reduce it.

Conclusions

We fully support the FDIC's intent to increase assessment fees to replenish losses incurred by the FDIC insurance fund but we do not believe the proposed "risk-based assessment system" is the way to accomplish this goal or to discourage risky asset strategies in the future. Risky asset strategies can be implemented with or without brokered deposits or FHLB advances. To assess fees on an isolated portion of the funding base for risks that are solely asset related seems to be short-sided, and the problem is expected to only worsen as the total asset base of FDIC insured institutions increases as a

result of increased banking powers granted to financial giants such as Morgan Stanley, Goldman Sachs, American Express and others. While we understand that FDIC insures deposits and therefore assessment fees have traditionally been linked to the deposit base, the risks assumed by the FDIC are on the asset side of the balance sheet and these risks (assets) are outpacing the growth in insured deposits. If we have learned anything from the recent credit crisis, it is that all financial companies want the stability of an FDIC insured deposit base. In our opinion, the stability of this insurance guarantee can only be secured with an asset based, risk assessment strategy.

Finally, we strongly believe that "A dollar deposited in an insured institution is the same regardless of the source." As a result, we strongly encourage the FDIC to "level the playing field" and eliminate nuances that differentiate one funding source from another. Your recent guidance on "Liquidity Risk Management" (FIL-84-2008) provides the required framework for all institutions to operate and we believe that each institution should develop a funding plan that best fits their organization. For the FDIC to promote one funding source over another through regulation will inhibit free market growth and the innovation of new instruments in the future that will be needed to support future lending activities and drive the industry forward.

Sincerely,
Community Bank Funding Company