Joseph R. Alexander
Senior Vice President and Senior Counsel
Phone 212.612.9234
joe.alexander@theclearinghouse.org

October 28, 2009

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429

Attn: Comments

Re: RIN 3064-AD49: Notice of Proposed Rule Making–Prepaid Assessments

Dear Mr. Feldman:

The Clearing House Association L.L.C. ("The Clearing House"), an association of major commercial banks,[1] appreciates the opportunity to comment on the Federal Deposit Insurance Corporation's (the "FDIC") notice of proposed rulemaking to amend the FDIC's assessment regulations to require insured institutions to prepay their quarterly risk-based assessments for the fourth quarter of 2009, and for all of 2010, 2011 and 2012 (the "Proposal"). 74 Fed. Reg. 51063 (Sept. 29, 2009). In connection with the Proposal, the FDIC also adopted an Amended Restoration Plan to allow the Deposit Insurance Fund (the "DIF") to return to its statutorily mandated minimum reserve ratio of 1.15 percent within eight years.[2] At the same

1 The members of The Clearing House are: ABN AMRO Bank N.V.; Bank of America, National Association; The Bank of New York Mellon; Citibank, N.A.; Deutsche Bank Trust Company Americas; HSBC Bank USA, National Association; JPMorgan Chase Bank, National Association; UBS AG; U.S. Bank National Association; and Wells Fargo Bank, National Association.

2 12 U.S.C. § 1817(b)(3)(E).

time, the FDIC adopted a three-basis point increase in risk-based assessment rates beginning January 1, 2011.[3] The Clearing House understands the FDIC's need to address the decline in the reserve ratio of the DIF in light of recent and anticipated failures of numerous small- and medium-sized FDIC-insured institutions. Our member banks also recognize the importance of strengthening the DIF's liquidity to allow the FDIC to meet its projected needs in near-term failures of depository institutions.

Our member banks support the FDIC's decision to adopt the basic structure set forth in the Proposal — prepayment of risk-based assessments. We appreciate the FDIC's recognition that its approach must take into account the current strength of the financial services industry and its related rejection of the alternative of a special assessment on depository institutions. To ensure that the FDIC's final rule fairly balances the FDIC's objective to rebuild the DIF without unduly straining the financial system, we offer the following comments and suggestions on the issues described in the Proposal. Our principal suggestion for a revision relates to the relevant time period (Section 5 below).

1. <u>As an alternative to prepaid assessments, should the FDIC meet its liquidity needs by imposing one or more special assessments?</u>

Our member banks strongly oppose the imposition of a special assessment on depository institutions. In comment letters to the FDIC earlier this year on the notice of proposed rulemaking for the emergency special assessment,[4] The Clearing House expressed its concerns about the impact of such assessments. We continue to believe that a special assessment will have a powerful depressant impact on bank earnings and capital at a time when the industry continues to remain under stress. During the meeting that adopted the Proposal, several FDIC Board members expressed a similar view, observing that a special assessment in the current economic environment would be "counterproductive" and would "impose a burden on an

---

[3] 12 U.S.C. § 1817(b)(2).

[4] 74 FR 25639 (May 29, 2009). Copies of those comment letters are attached for your convenience.

industry that is already struggling to maintain positive earnings overall". Our member banks urge the FDIC not to repudiate the Proposal in the final rule by instead imposing a special assessment in lieu of prepaid risk-based assessments.

2. Should the FDIC pursue one or more of the other alternatives to prepaid assessments, such as borrowing from Treasury or the Federal Financing Bank?

Although The Clearing House would support a decision by the FDIC to borrow from the Treasury and/or Federal Financing Bank in appropriate circumstances, we believe that this alternative should not currently be the preferred approach. Our member banks recognize their obligation to maintain a strong deposit insurance system, and bank premiums have funded the system since the FDIC's creation. We are concerned that implementation of the borrowing alternative at this time could create an inaccurate public perception of a Treasury or taxpayer bailout and that the DIF is not industry funded. In addition, as the Proposal notes, this alternative would in no way relieve the banking industry of its support burden because it would require the industry to repay these borrowings through future assessments. As discussed above, our member banks believe that the prepayment of assessments contemplated by the Proposal is the most efficient alternative to provide the FDIC with the liquidity it needs to meet the near-term demands on the DIF.

3. Should prepaying assessments be voluntary rather than mandatory as currently contemplated, and, if so, how would the FDIC ensure that it receives sufficient cash to fund resolutions of failed insured depository institutions?

The Clearing House recommends that the FDIC retain in the final rule a mandatory prepayment arrangement. In light of the FDIC's projections in the Proposal that depository institution failures will peak in 2009 and 2010, our member banks are concerned that a voluntary prepayment system would be insufficient to meet the FDIC's immediate objectives of strengthening the DIF's liquidity to meet the demands of such anticipated failures.

We recognize that the Proposal allows the FDIC to exercise its discretion as supervisor and insurer to exempt an institution from the prepayment requirement if the FDIC determines that the prepayment would significantly impair the institution's liquidity or would otherwise create significant hardship. Although our member banks support this flexibility, we strongly agree with the suggestion by Commissioner Bair that exemptions be applied only in rare cases. Prepaying assessments will have a direct impact on banks' liquidity and earnings because it will replace a liquid earning asset with a prepaid expense. As a result, a lenient exemption policy for prepaid assessments would be widely used and therefore both reduce the DIF's liquidity and create inequities among financial institutions.

4. For purposes of calculating the prepaid assessment, should the FDIC estimate the growth in assessment base at a rate other than 5 percent for 2009, 2010, 2011 and 2012? Should the FDIC use different assessment rate assumptions than those proposed?[5]

Our member banks request that the FDIC reconsider the assumption set forth in the Proposal that the assessment base will grow 5% annually. The Proposal does not describe the methodology used by the FDIC to derive the assumption, and we believe that it is premature to predict the improvement of economic conditions on which we believe such a growth assumption must rely. With the recent volatility in the financial markets, deposit levels at many financial institutions have been subject to wide fluctuations. Recent events in the money market industry and consumer reliance on safer deposits in lieu of riskier investments may have distorted and exaggerated historic growth rates to levels that may not be sustainable. Accordingly, we request that the FDIC adopt a more conservative assumption in the final rule.

---

[5] The Clearing House acknowledges that several small- and medium-sized institutions commenting on the Proposal have advocated that the FDIC should base the calculation of any prepaid assessments on an institution's total assets as opposed to total deposits. While our member banks believe that the underlying argument is wrong on its substance, we are not commenting on this suggestion because it is not part of the Proposal or the issues presented by the FDIC for comment in the Proposal. If the FDIC were to consider such a change in the assessment base, we believe it would be necessary for the change to be the subject of a separate notice of proposed rulemaking with an opportunity for comment.

5. Should the FDIC require prepayment of assessments over a different time period or in installments?

The Clearing House acknowledges the FDIC's immediate need to restore the DIF's liquidity. Moreover, as noted above, we support prepaid assessments as the alternative chosen by the FDIC.

Nonetheless, requiring depository institutions to prepay the full amount of assessments through 2012 on December 30, 2009 will have a significant impact on our member banks' income and liquidity. Prepaying assessments will replace cash on hand to invest and collect interest income with a prepaid expense, depressing an institution's liquidity and earnings. Accordingly, The Clearing House respectfully recommends that the FDIC revise the Proposal to allow depository institutions to prepay assessments through 2012 in installments that match the FDIC's projected liquidity needs.

In addition, and of importance to our member banks from a tax perspective, the Clearing House would urge the FDIC to treat the prepaid assessments allocable to 2010, 2011, and 2012 as separate and distinct amounts, with three separate payments or invoices. If prepaid assessments for each of 2010, 2011 and 2012 are not separately documented, financial institutions may face considerable uncertainty in determining annual allowable tax deductions with respect to the prepaid assessments. If payments are made in the year preceding the benefit created (e.g., a payment made in 2009 for prepaid assessments allocable to 2010), taxpayers may be able to accelerate deductions for such prepaid expenses in accordance with current regulations of the U.S. Department of the Treasury.

With these considerations in mind, the Clearing House recommends that the FDIC amend the Proposal to require 2010 prepaid assessment to be due on December 30, 2009, and require 2011 and 2012 prepaid assessments to be due at the times in 2010 and/or 2011 that would match the FDIC's projected liquidity needs. Doing so would enable the FDIC substantially to achieve its objectives, which we share, while mitigating the tax, earnings and liquidity impact of

the prepaid assessments on financial institutions. Allowing depository institutions to keep a portion of the cash needed for prepaid assessments on hand will enhance earnings and liquidity.

6. Should the FDIC's Amended Restoration Plan incorporate a provision requiring a special assessment or a temporarily higher assessment rate schedule that brings the reserve ratio back to a positive level within a specified time frame (one year or less) from January 1, 2011, when the FDIC projects industry earnings will have recovered?

Our member banks are heartened by the FDIC's projection that earnings will sufficiently recover in 2011 to allow the industry to absorb higher assessment rates at that time. We also support the FDIC's amendment to the Restoration Plan to allow the DIF to return to its statutorily mandated minimum reserve ratio of 1.15 percent within eight years. However, we respectfully submit that any assumption about the industry's profitability in 2011 inherently lacks sufficient certainty to impose higher or special assessments.

Our nation is struggling to rebuild after the most severe economic crisis it has experienced in many decades. There does not appear to be a consensus view on when the economy will begin to recover from this recession. Because the earnings of depository institutions, including those of our member banks, rely in large part on a healthy economy, we believe that it is premature to include in the Amended Restoration Plan any special assessment or temporarily higher assessment rate schedule.

7. Other comments

(a) Risk Weighting of Prepaid Assessments

In the Proposal, the FDIC suggests that the prepaid assessments contemplated by the Proposal would qualify for a zero risk weight for purposes of the federal banking agencies' risk-based capital rules, and the FDIC also undertakes to review reducing the risk weight on insured deposits to zero percent consistent with the treatment of other government-backed

obligations.[6] The Clearing House agrees with the FDIC's position on the risk-weighting of prepaid assessments. These assets have no risk whatsoever and, at a minimum, they are akin to claims on U.S. Government agencies. Our member banks also are supportive of applying a zero percent risk weight to insured deposits; indeed, we believe it should be extended to TLGP-guaranteed obligations. We urge the FDIC to engage the other federal banking regulators on this aspect of the Proposal, and hope that all the agencies will join in taking this long-overdue step.

(b) Increase in Risk-Based Assessments

The FDIC adopted in the Proposal a three-basis point increase in risk-based assessment rates beginning January 1, 2011.[7] The Clearing House respectfully requests that the FDIC reconsider adopting this future increase in assessment rates at this time. Our member banks appreciate the FDIC's need to restore the DIF to its statutorily mandated minimum reserve ratio, and we support the FDIC's extension of the time period in which to accomplish this to eight years.

Nonetheless, as we note above, any assumption about the industry's profitability in 2011 inherently lacks sufficient certainty at this time to impose higher assessments. The Clearing House suggests that the FDIC revisit the issue of whether a higher risk-based assessment rate is necessary at a later time when more data is available about the overall level of the fund and the losses incurred by future failures of depository institutions. This flexibility would give the FDIC the ability to raise the rate only as needed and to respond to changing economic and regulatory conditions.

* * *

---

6 74 Fed. Reg. at 51064-51065.

7 12 U.S.C. § 1817(b)(2).

Thank you for considering the views expressed in this letter. If you would like additional information regarding this letter, or if it would be helpful to meet with representatives of our member banks, please contact me at (212) 612-9234.

Sincerely,

JRA:kp
Attachments

Norman R. Nelson
General Counsel

450 West 33rd Street
New York, NY 10001
tele 212.612.9205

norm.nelson@theclearinghouse.org

March 31, 2009

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429

Attn: Comments

Re: RIN 3064-AD35: Notice of Proposed Rulemaking–Assessments

Dear Mr. Feldman:

The Clearing House Association L.L.C. ("The Clearing House"), an association of major commercial banks,[1] appreciates the opportunity to comment on the Federal Deposit Insurance Corporation (the "FDIC") notice of proposed rulemaking (the "Proposal") that would impose a 20 basis point emergency special assessment (the "Special Assessment") on June 30, 2009. 74 Fed. Reg. 9338 (March 3, 2009). The Clearing House appreciates the FDIC's need to address the decline in the reserve ratio of the Deposit Insurance Fund (the "DIF") in light of recent and anticipated failures of FDIC-insured institutions, and we agree that a financially sound DIF is essential to support the country's financial system.

Nonetheless, we submit that the FDIC should balance its efforts to rebuild the DIF against the procyclical consequences of an additional large assessment that would significantly

[1] The members of The Clearing House are: ABN AMRO Bank N.V.; Bank of America, National Association; The Bank of New York Mellon; Citibank, N.A.; Deutsche Bank Trust Company Americas; HSBC Bank USA, National Association; JPMorgan Chase Bank, National Association; UBS AG; U.S. Bank National Association; and Wells Fargo Bank, National Association.

depress bank earnings and reduce the capacity of depository institutions to meet customer credit needs.[2] As we discuss below, we believe that the Proposal should be revised to minimize these negative effects while achieving our shared goal of maintaining confidence in the DIF.

Set forth below are our comments on three of the issues described in the Proposal. We offer our basic recommendation in the first response.

1. Should the June 30, 2009 special assessment be at a rate other than 20 basis points?

Our member banks recognize the FDIC's need to rebuild the DIF through additional assessments. In our view, however, of the current economic climate and other relevant considerations, we urge that the Special Assessment should be implemented over time and be subject to the FDIC's periodic reassessment. This approach would mitigate the adverse impact of the Special Assessment on depository institutions, their customers and confidence in the banking system, without compromising the FDIC's need to address the decline in the DIF reserve ratio.

Particularly in the current economic environment, the Special Assessment will have a powerful depressant impact on bank earnings. Assume, for example, that a bank was able to earn 50 basis points (pre-tax) on its deposit base. The Special Assessment, at 20 basis points, would reduce that bank's pre-tax earnings by 40%. The impact would be even more severe in the case of a bank with little or no earnings. For a bank that would have earned 10 basis points (pre-tax) on its deposit base, the Special Assessment would throw that bank into a significant loss position.[3]

This loss of earnings, which directly reduces equity capital, would severely curtail the lending capacity of this country's depository institutions. Assuming a 10x multiplier (loans to equity), the Special Assessment could reduce available loans by as much as $145 billion in 2009. In addition, credit availability will be further depressed by a likely decline in deposits

---

[2] The Federal Deposit Insurance Act explicitly urges the FDIC to seek to "prevent sharp swings in the assessment rates". 12 U.S.C § 1817(b)(3)(C).

[3] The loss would be magnified if it resulted in a required writedown of the bank's deferred tax asset or goodwill.

caused by the Special Assessment. Such an impact would undermine the numerous and unprecedented Federal programs that are being directed at "restoring the flows of credit necessary to support recovery" and to "support lending to creditworthy borrowers during an economic downturn."[4]

Moreover, such a decline in earnings could have a substantial negative impact on the DIF itself. Banks that report losses or sharply reduced earnings would be at an increased risk of loss of funding and, ultimately, failure. The reduced capital position of other banks would make it more difficult for them to bid aggressively—or bid at all—for failed banks. Potential equity investors will be discouraged. More generally, there will be a loss of confidence in the banking system that could well outweigh any direct loss of confidence in the DIF.

Although the cost of the Special Assessment could, in theory, be passed on to depositors in the form of lower rates on deposit accounts, The Clearing House believes that such an approach is not practical. Interest rates on insured deposit accounts are at historic lows as a result of the current interest rate environment, which severely limits institutions' ability to pass on the Special Assessment's cost to customers. In addition, competition between deposits and deposit-like alternatives (in particular, money market funds) is intense, making the demand for deposits highly sensitive to changes in offered interest rates. At the very least, efforts to pass through these costs to bank customers would reduce the spending power of those customers and result in a reduction in the insured deposit base.

The Clearing House submits that the following recommended revision of the Proposal would enable the FDIC substantially to achieve its objectives, which we share, while significantly mitigating the adverse effects of the Special Assessment. Under our proposed revision (the "Revision"), the FDIC would announce its intention to collect up to a 20 basis point emergency special assessment if current conditions and expectations do not change, but that the FDIC would implement the assessment in stages through the end of 2011 in order to enable the

---

[4] Joint Statement by Secretary of the Treasury Timothy F. Geithner, Chairman of the Board of Governors of the Federal Reserve System Ben S. Bernanke, Chairman of the Federal Deposit Insurance Corporation Sheila Bair, Comptroller of the Currency John C. Dugan, and Director of the Office of Thrift Supervision John M. Reich regarding the Financial Stability Plan (February 10, 2009).

FDIC to review the most current conditions and expectations and adjust the assessment accordingly. Such periodic review and assessment are particularly appropriate because of the highly volatile nature of the economy. Adjustments could be in terms of timing, amount or both.

Under one example of the Revision, the FDIC would adopt a first stage assessment of 5 basis points for the quarter ending June 30, 2009 and a preliminary plan to impose an additional assessment of 5 basis points on March 31, 2010 and 10 basis points on March 31, 2011. The subsequent assessments would, however, be subject to a quarterly reassessment by the FDIC beginning with the first quarter of 2010. In each quarter, the FDIC would reconsider its original plan and make a new determination, based on the reserve ratio of the DIF, borrowings available to the FDIC and the various relevant conditions in the banking industry and the overall economy. For example, in the reassessment during the first quarter of 2010, the FDIC could determine, based on those factors, to take one of the following actions: (a) impose a 5 basis point assessment on March 31, 2010 as originally planned; (b) accelerate some or all of the planned 2011 assessment and impose up to a 15 basis point assessment; or (c) determine that no (or a reduced) assessment is necessary at that time. The FDIC could also revisit the issue of whether an additional 10 basis point assessment is needed. This flexibility would give the FDIC the ability to impose the Special Assessment only as needed and to respond to changing economic and regulatory conditions.

Alternatively, the FDIC could preliminarily adopt a quarterly phase-in of the Special Assessment that would impose an assessment of 2 basis points for each remaining quarter of 2009 beginning with the quarter ending June 30, 2009, followed by an assessment of 2 basis points in each quarter of 2010, and 1.5 basis points in each quarter of 2011. This phase-in approach would be subject to quarterly review by the FDIC, based on the factors outlined above, to determine whether no assessment is necessary in that quarter, whether an acceleration is necessary and/or whether an additional 10 basis point assessment is needed.

Such a phase-in approach also would enable the FDIC to evaluate the effect on the DIF of recent and future efforts by Congress, the Department of the Treasury (the "Treasury"), the Federal Reserve and the FDIC itself to support the DIF, bank liquidity and

lending. In particular, it would provide the FDIC with a more informed view of the contribution to the DIF of the fees charged under the Temporary Liquidity Guarantee Program.

In addition, and of particular importance to our member banks, the Revision will allow depository institutions to account for any assessment in the period in which a final determination as to the amount of that assessment is made. As a result, the accounting impact will not automatically be concentrated in any one quarterly earnings report. In contrast, under the Proposal, the entire Special Assessment will be reflected in depository institutions' financial statements for the second quarter of 2009. That also will be the case even if the Special Assessment were assessed as of June 30, 2009 but the payments were spread over time.

The Clearing House recognizes and appreciates Chairman Bair's public statements indicating the FDIC's willingness to adjust the Special Assessment from 20 basis points to 10 basis points if Congress passes pending legislation that would raise the FDIC's authority to borrow from the Treasury. This potential development highlights the rapidly changing legislative and regulatory landscape and reinforces The Clearing House's position that the Special Assessment should be implemented over a period of time and subject to periodic reassessment so that such changes can be taken into account.

The Clearing House also appreciates that depositor confidence in the DIF is essential to maintaining confidence in the banking system, and we recognize the banking industry's responsibility to restore the DIF over time. Nonetheless, The Clearing House recommends that the FDIC adopt a periodically reviewable phase-in of the assessment schedule as a more appropriate approach. Our Revision would assure that the FDIC resources are strengthened, but in a way that is less procyclical and that provides greater credit availability.

2. Should special assessments be assessed on assets or some other measure, rather than the regular risk-based assessment base?

The Clearing House strongly urges the FDIC not to depart from its consistent and logical approach to imposing assessments. The FDIC should impose any special assessment on the deposit base of depository institutions, as it has done in the past and in the Proposal, and not on the basis of some previously unused measure, such as assets. Any deviation from the

standard assessment base would be inconsistent with the purpose of the DIF, which is to protect insured deposits and not assets.

Moreover, any deviation from a deposit-based assessment would further exacerbate the existing penalty imposed on larger institutions, such as our member banks. This penalty exists because the assessment is based on all domestic deposits, and not just insured domestic deposits, and the largest banks have a relatively higher percentage of uninsured domestic deposits.

Although the issue is many-faceted, we submit there is no legitimate basis for concluding that large banks, as a class, pose a greater risk to the DIF than smaller institutions. The FDIC should not use the Special Assessment as a vehicle to reject its prior determinations and introduce a new factor —size — as a special risk factor.

3. Should FDIC assessments, including emergency special assessments, take into account the assistance being provided to systemically important institutions?

The Clearing House respectfully submits that the FDIC should not take into account the assistance being provided to systemically important institutions when imposing assessments. As discussed in response to the prior question, we believe that assessments on individual institutions should continue to be imposed on the basis of the deposits of the institution.

We note, however, that there is an important relationship between the assistance being provided to systemically important institutions (and for that matter non-systemically important institutions) and the Special Assessment. As discussed above, the significant increase in assessments contemplated by the Proposal works at cross-purposes with Federal Government efforts to improve bank capital and bank liquidity under various Federal programs. If the Proposal goes forward as drafted, the Federal Government would, in essence, be providing institutions with liquidity and lending capacity with one hand and taking it away with the other.

4. Additional Views

The Clearing House believes that the FDIC should, as a matter of the highest priority, consider various actions that could reduce the potential demands on the DIF and thereby the need for special assessments. Specifically, we urge the FDIC to propose that the Capital Purchase Program and Capital Assistance Program under the Troubled Asset Relief Program be made available to institutions that are deemed to be viable *after* giving consideration to the TARP capital injection. This approach could prevent the failures of scores of banks and prevent losses of tens of billions of dollars by the DIF. It was this approach that contributed to the success of the Reconstruction Finance Corporation and the fledgling FDIC during the 1930's. We also recommend that the FDIC consider utilization of open bank assistance programs as urged by Congress in Section 143 of the Federal Deposit Insurance Corporation Improvement Act.

* * *

Thank you for considering the views expressed in this letter. If you would like additional information regarding this letter, or if it would be helpful to meet with representatives of our member banks, please contact me at (212) 612-9205.

Sincerely,

Norman R. Nelson
General Counsel

450 West 33rd Street
New York, NY 10001
tele 212.612.9205

norm.nelson@theclearinghouse.org

May 21, 2009

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

Re: RIN 3064-AD35: Notice of Proposed Rulemaking–Assessments

Dear Mr. Feldman:

In view of press reports regarding the Federal Deposit Insurance Corporation (the "FDIC") Interim Rule (the "Interim Rule")[1] providing for an emergency special assessment (the "Special Assessment"), The Clearing House Association L.L.C. ("The Clearing House"), an association of major commercial banks,[2] wishes to provide supplemental comment on the Interim Rule. On March 31, 2009, The Clearing House submitted a comment letter (the "March 31 Letter") in response to the Interim Rule. These supplemental views respond to recent press reports that the FDIC is considering a radical departure from 75 years of assessment practice by calculating the Special Assessment on the basis of an insured depository's total assets (less Tier 1 capital) rather than total domestic deposits as provided in the Interim Rule.[3]

---

1 74 Fed. Reg. 9338 (March 3, 2009).

2 The members of The Clearing House are: ABN AMRO Bank N.V.; Bank of America, National Association; The Bank of New York Mellon; Citibank, N.A.; Deutsche Bank Trust Company Americas; HSBC Bank USA, National Association; JPMorgan Chase Bank, National Association; UBS AG; U.S. Bank National Association; and Wells Fargo Bank, National Association.

3 *See* Damian Paletta, *FDIC Weighs Fee That Would Hit Big Banks Harder*, The Wall Street Journal (May 19, 2009).

The Clearing House reiterates its appreciation of the FDIC's need to address the decline in the reserve ratio of the Deposit Insurance Fund (the "DIF") in light of recent and anticipated failures of numerous small- and medium-sized FDIC-insured institutions. We agree that a financially sound DIF is essential to support the country's financial system.

With all due respect, however, we believe strongly that it would be highly inappropriate to depart from the FDIC's long-standing practice of calculating assessments with respect to the DIF based on domestic deposits rather than any other measure, such as assets. Such a change would be inconsistent with the FDIC's stated position that assessments should be more directly tied to risk and would constitute a fundamental shift in the nature of the deposit insurance regime. It would also be inconsistent with the purpose of the DIF, which historically has been to protect insured deposits and not assets.

An asset-based approach may reflect numerous public comments submitted in respect of the Interim Rule that have erroneously and misleadingly suggested that the decline in the reserve ratio of the DIF is the result of failures caused by large institutions, which typically have a higher proportion of assets to deposits than do smaller institutions. In fact, however, nearly all the depository institutions that have failed in the past 18 months have been smaller institutions, and it is the aggregate effect of ***these*** failures that has put pressure on the reserve ratio.

We also note that the Federal Deposit Insurance Act (the "FDIA") has provided for only one situation in which losses to the DIF were to be recouped by assessments based on assets, which is in the event of an emergency situation involving systemic risk.[4] The purpose of the Special Assessment, however, is to recapitalize the DIF, and not to recover systemic losses, and we therefore submit that the use of an emergency systemic risk assessment base is wholly inappropriate in this context.

---

[4] *See* 12 U.S.C. § 1823(c)(4)(G), amended yesterday by The Helping Families Save Their Homes Act of 2009.

We also believe that the FDIC should not depart so radically from the historical assessment base for the DIF without first setting forth the policy rationale for doing so and providing a meaningful opportunity for public comment. Given the significant impact of such a change, we submit that fundamental principles of fairness require that all interested parties be permitted to present meaningful comment on a specific, detailed proposal.

For these reasons, we urge the FDIC not to depart from its long-standing practice of calculating assessments for the DIF on the basis of total domestic deposits held by the insured depository institution being assessed. If the FDIC proposes to do so, we believe that the details of the new assessment should be published with notice and opportunity for comment.

I. Decline in the DIF Reserve Ratio Is Not Attributable Primarily to Large Institutions

The Clearing House is aware that the FDIC has received numerous comment letters on the Interim Rule encouraging the FDIC to calculate the Special Assessment on the basis of an institution's total assets or some other measure of size, rather than domestic deposits as regular assessments are calculated.

The primary argument advanced by these commenters is that the decline in the reserve ratio of the DIF results from payments made from the DIF in the context of recent resolutions of large financial institutions, and therefore smaller institutions are disproportionately paying the cost of the current financial crisis. Because large institutions have a higher proportion of assets to deposits than do smaller institutions, these commenters assert that the regular assessments based on deposits impose a disproportionate cost on smaller institutions in a time of stress on the DIF, and therefore any special assessment should be based on assets rather than deposits to correct this imbalance.

The Clearing House submits that the premise behind this argument—specifically, that the strain on the DIF has resulted from the failure of large institutions—is, without question, fundamentally flawed. Since January 2008, only one of the 58 depository institution resolutions has involved an institution with over $50 billion in assets, and the FDIC has estimated that it will suffer ***no*** loss in that resolution. The average asset size of the other 57 institutions that failed

since January 2008 is $1.5 billion, and it is the failure of those 57 smaller institutions that directly caused the depletion of the DIF that the FDIC now seeks to correct. Moreover, the average loss on failure rate for smaller institutions has moved from the mid-teens to the twenties, as a percentage of a failed institution's assets, and, in recent resolutions, the average estimated loss to the FDIC has been a staggering 30% or more of the failed institution's assets.

These data demonstrate that large financial institutions have not created a strain on the DIF. Rather, the numerous failures of smaller institutions have combined to exert increasing pressure on the DIF reserve ratio. Therefore, a sudden shift away from the long-standing practice of imposing DIF assessments on the basis of deposits cannot be justified by a need to make large institutions pay their "fair share" by disproportionately allocating the burden of the Special Assessment to them.

II. Intent of the Deposit Insurance Scheme Is to Insure Deposits

The basic risk that the DIF seeks to insure is the risk of a failure by an institution to pay insured deposits to its depositors.[5] Any premiums assessed on an institution, whether large or small, for the purpose of funding insurance against such risk should be calculated on a basis that appropriately reflects the relative level of risk. Although the factors that go into a determination of such risk are complex, we submit there is no legitimate basis for concluding that large banks, as a class, pose a greater risk to the DIF than smaller institutions by virtue of their size. Certainly, neither the Interim Rule itself nor any of the comments submitted in response thereto provides such a basis. Risk to the DIF arises from insured deposits, not assets, and the greater proportion of assets to deposits of large institutions relative to smaller institutions does not increase this risk. Indeed, using assets as an assessment base could have the unintended consequence of creating moral hazard by suggesting that assets are insured.

The use of assets as an assessment base would have the peculiar result of penalizing institutions for diversifying their funding base, which banking supervisors have encouraged institutions to do. A large institution that submits itself to the discipline of the

---

[5] 12 U.S.C. § 1823(c)(4)(E)(i).

capital and wholesale funding markets would pay substantially more as a result of this change. For example, a large institution that engages primarily in wholesale business and holds relatively few deposits, but has a banking charter for payment system access, would be irrationally assessed a substantial amount if the Special Assessment were based on total assets. Indeed, such action by the FDIC may give financial institutions a perverse incentive to shrink assets on their balance sheets and move those assets into non-bank entities, with the result that such assets would no longer be available to provide a cushion in the event of a failure and thereby prevent a loss to the DIF.

Furthermore, a disproportionate allocation to large banks would be inconsistent with at least the spirit of the Deposit Insurance Reform Act of 2005, which states that "[n]o insured depository institution shall be barred from the lowest-risk category solely because of size."[6] This statutory provision was intended to prevent the discriminatory assessment of a higher relative premium on large depository institutions merely because of their size. To base the Special Assessment on total assets would in effect place large institutions into a separate, discriminatory risk category solely on the basis of size.

In addition, as we stated in the March 31 Letter, larger institutions already face a penalty under the existing statutory assessment regime because regular assessments are based on all domestic deposits, and not just insured domestic deposits, and the largest banks have a relatively higher percentage of uninsured domestic deposits.

We understand that the FDIC, if it uses assets as the assessment base, may be considering imposing a cap on the Special Assessment as a percentage of an institution's deposits. We do not believe that such an approach addresses the fundamental issue of the unsuitability of using assets as an assessment base. In fact, introducing the two different measures into the calculation of the assessment amount would underscore that such an asset-based approach is inappropriate and would evidence the ad hoc and inadequately considered nature of the departure from past assessment practice.

---

[6] 12 U.S.C. § 1817(b)(2)(D).

For these reasons, a Special Assessment not based on deposits that further imposes disproportionate costs on large banks with no evidence of a corresponding increase in the relative risk they present to the DIF would represent an unjustified and arbitrary shift in the FDIC's historical approach to calculating assessments. Moreover, we believe that such a shift would be fundamentally at odds with the FDIA's purpose of insuring the risk of failure to pay insured deposits.

III. The Systemic Loss Repayment Authority Approach Is Not Applicable

The FDIA has provided for assessments based on total assets in only one specific context. Prior to the enactment yesterday of the Helping Families Save Their Homes Act of 2009, Section 13(c)(4)(G) of the FDIA permitted the FDIC to recover losses to the DIF resulting from action taken or assistance provided to an institution in order to avoid or mitigate systemic risk through emergency special assessments based on insured institutions' total assets less average total tangible equity and average total subordinated debt. As evidenced by the fact that such extraordinary action or assistance requires a determination by multiple agencies, including the Secretary of the Treasury, Congress intended this approach to loss recovery to apply only in situations of true emergency. In such cases, the loss to the DIF would result not from its intended function as an insurer of deposits, but rather from an extraordinary use for the purpose of avoiding or mitigating systemic risk.

In contrast, the Special Assessment is being imposed under the FDIC's general authority to recapitalize the DIF when the reserve ratio drops below its designated level. The purpose of the Special Assessment is to strengthen the DIF, which has been weakened as a result of an increasing number of bank failures and greater loss on failure, so that it can continue to function as a solid insurer of deposits. Given this purpose, we believe it is highly inappropriate to impose the Special Assessment using an assessment base historically established by statute for systemic risk emergencies.

Accordingly, for the reasons mentioned above, the Special Assessment should continue to be based on deposits in order to reflect the risk against which the DIF is intended to insure.

IV. A Fundamental Shift in Assessment Base Should Be Done After Public Notice and Comment

The Interim Rule did not focus in any detail on the use of assets as the basis for the Special Assessment. Instead, the issue was only presented in one of several supplemental questions posed at the end of the Interim Rule, which requested comment on whether another measure, such as assets, should be used for the Special Assessment. As described above, we believe that an asset-based approach would represent a fundamental shift away from a consistent, historical approach based in logic and grounded in sound public policy and, therefore, should not be adopted without a thorough understanding of the policy rationale of such a proposal and meaningful public debate on its consequences.

Accordingly, if the FDIC proposes to make this basic change, we urge the FDIC to republish the details of such a proposal and provide a meaningful opportunity for public comment. This would allow all institutions to consider the effects of such a shift and to address appropriately in a public forum any specific concerns about the proposal or its consequences. Additionally, public comment responding to a specific proposal set forth by the FDIC would allow the FDIC to shape the final rule to mitigate any adverse unintended consequences.

* * *

Thank you for considering the views expressed in this letter. If you would like additional information regarding this letter, or if it would be helpful to meet with representatives of our member banks, please contact me at (212) 612-9205.

Sincerely,