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October 28, 2009

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 Seventeenth Street, N.W.
Washington, D.C. 29429

Re: RIN 3064–AD49; Prepaid Assessments; 12 CFR Part 327;
74 Federal Register 51063, October 2, 2009

Mr. Feldman:

The American Bankers Association (ABA) welcomes the opportunity to comment on the proposal from the Federal Deposit Insurance Corporation (FDIC) regarding "prepaid assessments." ABA brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.3 trillion in assets and employ over 2 million men and women.

We appreciate the work that the FDIC has done to consider options for how best to meet the costs of bank failures and to rebuild the Deposit Insurance Fund to its normal operating range. As ABA has stated many times throughout this last year, the banking industry is committed to ensuring the financial stability of the FDIC. Particularly during this time of uncertainty, bankers recognize the importance of maintaining public confidence in the FDIC. The industry has been and continues to be prepared to meet its obligation to the FDIC so that there is no need to use the line of credit at Treasury except for the most exceptional circumstances. How this is accomplished is the critical question.

We believe that the prepaid assessment proposal does strike the right balance at this time to assure that the FDIC has the cash necessary to meet its obligations without impairing banks' ability to meet their obligations to their communities. The financial impact from assessments this year has already been significant, as banks will pay nearly $18 billion in premiums – including the large $5.6 billion special assessment paid in the second quarter. As ABA has noted before, another special assessment would do more harm than good as it would directly reduce bank income, hinder capital growth, and make lending much more difficult. At this critical time, when the economy is just beginning its recovery, having an alternative that is less pro-cyclical

and spreads the cost over time is the right policy. Thus, the prepaid assessment is far superior to another special assessment.

Prepaying three years of assessments is a very large request for cash and does come at a cost to the industry. It impacts the liquidity of the banks, reduces resources available for lending, and would be a non-earning asset and, therefore, has a cost versus other earning-asset options. Banks are holding higher levels of liquid assets for important reasons. First, bank customers have found that the safest place for their money in a weak economy and with a volatile stock market is in the bank – often in an FDIC-insured account. Some of this money will flow back out to the stock market and other investments. Second, banks are preserving cash – with supervisors' support and encouragement – to protect against any further disruptions that may occur in the interbank market. As interbank markets have now returned to pre-crisis spreads, this need is less intense. Third, loan demand is down considerably for most banks, but not all, as a consequence of the recession's impact on businesses' needs for inventories, expansion and merger financing. We expect this to reverse itself as the economy recovers, and banks will quickly redeploy this liquidity by extending new loans. Thus, most banks, but not all, have the liquidity on hand to meet the prepayment request. However, as markets continue to improve, having fewer liquid assets makes it more difficult to meet new demands for credit. Furthermore, as more interest-earning options materialize, the opportunity cost of holding a non-interest earning asset will increase.

Bankers also recognize that there are considerable unknowns about the timing and costs of bank failures. While we all hope that the losses and failures will be considerably less than what is expected, we also recognize that they may be greater than anticipated. If it is the latter, ABA strongly suggests that all borrowing options be reconsidered and public comment solicited. If economic conditions further deteriorate (which is ***not*** our expectation), many banks believe that it may make sense to use the FDIC's Treasury line of credit options rather than impose further costs through additional prepayments, higher quarterly assessments, or certainly additional special assessments.[1]

Because of the large amount of cash requested under the proposal ($45 billion), many banks have questioned whether there is a need for the full 3-year prepayment or whether less would suffice. These banks have suggested a shorter timeframe of two years, with an optional third year only if it is necessary. Such a structure would preserve cash within the bank until needed, and any subsequent draw for cash would be based on the current assessment base and risk category of the institution. This may also allow banks to do tax planning for expenses, which we discuss more fully later in this comment letter.

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[1] It should be noted that while the general consensus within the industry is support for the prepayment, there are banks that believe that drawing on the Treasury line of credit, borrowing directly from the industry, or using a FICO-like option are preferable to the prepaid option.

Prompt return of excess cash should be made at the end of the program; annual "true-ups" to return excess cash should be considered.

Given the current economic situation, it is very likely that the expected premiums over the next three years will differ from the actual premiums.[2] Institutions that prepaid more than the actual billed amount would not receive any return of excess payments until December 2014. We see absolutely no justification for waiting such a long time to return any excess cash after the last actual premium is assessed (December 2012) under this program. This reconciliation should occur soon after that last billing, perhaps with an option provided to banks either to receive a cash refund or to maintain any remaining cash on account with the FDIC to be credited against any future premium period.

In fact, while minor differences would not have a significant impact on banks, large deviations may. Thus, for cases where the actual payments are substantially less than the prepaid amount, bankers have suggested that there be annual true-ups to reconcile those differences. Such annual adjustments for overpayments may make the final reconciliation less complicated and certainly less large.

Banks chartered after September 30, 2009, and those banks excused from the prepayment, should be required to pay premium surcharges for the benefit received.

As noted above, the prepaid asset does not earn interest (as proposed), which carries with it the obvious opportunity cost of the interest foregone had those funds been invested in other assets. Many bankers believe that some discount would be appropriate to reflect this cost. We appreciate the concern raised by the FDIC that this might constitute a borrowing, which would trigger other statutory requirements that must be met. However, the treatment serves to point out an important disparity between banks that do prepay and those that do not. If a discount were provided, those prepaying would receive a benefit for the sacrifice they are making; those excused from the prepayment do not receive that benefit. Without a discount, the opposite situation occurs: those that are excused from paying (which includes banks chartered after September 30, 2009) are advantaged relative to those that do pay and hold the non-earning asset. The impact can be sizable over the three-years for which the prepayments are required. Thus, we believe the FDIC should consider an appropriate method to resolve this inherent inequality.

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[2] For example, we have heard from many bankers that the five percent growth rate for new deposits is considerably higher than what they expect. Slower growth may result from the winding down of the Temporary Liquidity Guarantee Program, anticipated tightening of Federal Reserve monetary policy, and the resurgent investment markets. Moreover, while short-term deposit growth rates can be quite volatile, it is hard to imagine that longer-term rates of growth will exceed the rate of growth of the economy in general. Forecasts for GDP growth expect considerably less than the five percent rate assumed.

We have also heard from community bankers that the use of the September 30, 2009 assessment base will also tend to overstate the premiums due to the significant tax revenue balances in public funds accounts being deposited in the bank in the quarter.

The prepaid premiums assets should receive a zero percent risk weight.

ABA strongly supports the proposal that the prepaid assessments would receive a zero percent risk weight in risk-based capital calculations. We also concur that assets guaranteed by the FDIC under the Temporary Liquidity Guarantee Program (TLGP), including insured deposits in other banks and guaranteed debt should also receive a zero percent risk weight. These assets, like securities issued by the U.S. Treasury, have no chance of default, and therefore pose no credit risk, and therefore should be zero-weighted in computing risk-weighted assets.

Making prepaid assessments transferrable helps alleviate the burden of these non-earning assets.

ABA supports the transferability of prepaid assessments. As with any asset, banks should be able to freely buy or sell prepaid assessments if there is an economic reason to do so. It is likely to be a useful tool for some banks to help manage liquidity, particularly if there is significant variation between what is prepaid (the expected premiums) and the actual assessment. We urge the FDIC to welcome these transfers and design the procedural details of the prepaid assessments in a way that facilitates such transfers among banks.

Banks should be allowed to use remaining assessment credits for prepaid assessments.

According to the proposal, "residual one-time assessment credits would not reduce an institution's prepaid assessment" and would be used to cover quarterly premiums before prepaid premiums (page 51065, footnote 10). For these banks, therefore, the proposed treatment would essentially increase prepaid assessments relative to the actual payments that would be required and thereby increase the burden. This places an unfair burden on these banks. Moreover, while the amount of residual assessment credits is miniscule relative to the $45 billion of prepaid assessments, it is important to the banks that hold these credits. ABA proposes that a fairer treatment would be to allow the amount of assessments to be prepaid to be reduced by residual assessment credits. Given the amount of remaining assessment credits, the effect on FDIC cash flow would be insignificant.

The 8-year recapitalization proposed provides a reasonable balance for rebuilding the fund.

ABA supports FDIC's recommendation to extend the period to eight years to rebuild the insurance fund to 1.15 percent of insured deposits (with no additional special assessments and no change in the assessment schedule through 2010). This longer-term perspective is critical to allow banks to rebuild earnings and capital, and meet credit needs in their communities.

As part of the recapitalization and prepaid assessment plans, the assessment schedule would be raised by three basis points starting in 2011. We would note that many bankers have questioned why this is an across the board – rather than a risk-adjusted – increase.

TLGP fee income should be transferred to the Deposit Insurance Fund.

ABA has consistently urged a transfer of excess funds from the TLGP into the insurance fund. We supported the creation of the surcharge fees on guaranteed debt and are pleased that these monies have already contributed nearly $600 million in support of the insurance fund. As we have stated many times before, we believe the risk of loss under the Debt Guarantee Program is less than the $9.6 billion in fees already collected, enabling a portion of those monies to be transferred into the insurance fund. We were pleased to learn that discussions are already underway between the FDIC and the U.S. Government Accountability Office about how to do this, and we urge quick action to make such a transfer a reality.

The FDIC should structure the payments in a way that facilitates tax planning for banks.

In order to avoid unintended negative tax results, a special invoicing and collection process needs to be established for the prepayments. This special structure is intended to allow for the possibility of attaining a matching of the timing of a portion of the payments with the tax deduction associated with the payments. ABA has written to the FDIC in a separate detailed letter on this specific topic. We have included it as an appendix to this letter for easy reference.

FDIC should work to improve the recoveries in bank failures.

We note that the need for additional assessments comes against a backdrop of higher costs to resolve institutions that have failed recently. ABA fully appreciates the tremendous amount of work facing the FDIC regarding failed and failing institutions. We also recognize that to the extent that the FDIC learns from these operations and is able to make improvements, the costs to the fund and the need for additional resources are reduced.

We believe that certain steps taken during a resolution can inadvertently and unnecessarily increase those costs. For instance, the prompt post-closing sale of real estate in depressed markets, while understandable from the perspective of wanting to conclude a resolution quickly, results in a lower price paid to the FDIC for the assets. This further depresses the market prices obtained by other banks trying to work through problem assets of their own. Managing the release of these assets into the market for optimal return would likely result in greater returns to the FDIC.

The FDIC's costs also appear to be increased as a result of FDIC contractors rejecting reasonable offers for assets and then sending the assets to be sold at auction where they often are sold for a fraction of the earlier offer. While this outcome insulates the contractor from being second-guessed for having sold an asset at a below-market price, it causes the FDIC to receive less for the asset and thereby increases the resolution costs. We urge the FDIC to revisit this issue and clarify as necessary the circumstances in which it is appropriate for a contractor to sell an asset directly without going through an auction.

We have also heard from bankers that the process to acquire a failing bank is much more complicated than necessary, and as a result, discourages healthy banks from bidding. Thus, we encourage efforts to improve methods for resolving failed banks and to make the acquisition process for a failed bank easier and more straightforward.

Finally, ABA appreciates the receptivity of the FDIC to suggestions from bankers on how to improve the resolution practices, and we note that some recommendations that we have supported have already been adopted by the FDIC, such as enabling banks involved in loan participations to work out a purchase agreement before other sales approaches are considered.

Bank examiners should not further penalize banks' liquidity position after the prepaid assessment is made.

Such a large prepayment will have an implication for a bank's liquidity position. We are concerned that bank examiners will criticize banks liquidity position as a result, which could lead to further downgrades on the institution and higher future quarterly premium costs. We believe that examiners should not penalize banks for this prepayment, just as they were asked not to penalize bank earnings in the second quarter as a result of the large special assessment.

ABA appreciates this opportunity to comment on the proposed rule. We would be happy to discuss further any of the recommendations made above.

Sincerely,

James H. Chessen
Chief Economist

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October 26, 2009

The Honorable Sheila Bair
Chairman
Federal Deposit Insurance Corporation
550 17 Street NW
Washington, DC 20429

Dear Chairman Bair:

Our tax counsel and members have identified a tax issue relating to the FDIC premium prepayment proposal that we would like for the FDIC to consider. Based upon our reading of the proposal and the tax regulations, the proposal will result in an unintended negative tax impact for many banks.

As a general matter, a bank may take a deduction for ordinary and necessary business expenses, which would generally include payments for insurance premiums. These are typically deducted in the same period that they are paid to the FDIC, resulting in a close matching of the cash outflows with the tax deductions. However, because of the structure of the prepayment under the proposal, there will be a timing difference between the payments and the associated deductions.

The attached memo from our tax counsel describes a process that could be followed by the FDIC that would allow a closer matching of the cash outflows related to the prepayments with the associated tax deductions. This will result in cash tax savings for banks, from a timing perspective, and help compensate them for a portion the loss of funds that otherwise would be used to generate earnings over the 2010-2012 period.

We would be glad to work with your staff on this issue, who should contact our tax counsel, Fran Mordi (202.663.5317 or fmordi@aba.com), Bob Davis (202.663.5588 or radvis@aba.com) or Donna Fisher (202.663.5318 or dfisher@aba.com).

Sincerely,

Edward L. Yingling

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Memo

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Date: October 23, 2009

To: Bob Davis, EVP – Mortgage Markets, Financial Management & Public Policy

From: Fran Mordi, Tax Counsel

RE: FDIC Premium Prepayment Proposal – Tax Issue

The recent FDIC proposal that would require banks to prepay their insurance premiums for the next three years' coverage[1] raises an important tax issue (discussed below) that needs to be addressed. I have researched the issue and come to the conclusion that, in order to avoid any unintended negative tax impact, the FDIC would need to establish and publish particular procedures to be used for billing and collecting the premium prepayment amounts that banks will be required to pay under the proposal. It is important that these procedures be issued as quickly as possible so that as banks begin to make the payments, the rules applicable to the payments (both tax and nontax) would already be clearly established under published guidelines.

The first step in addressing the negative tax impact of the proposal would be for the FDIC to establish the following billing/payment collection procedure for the prepayment[2]: Separate invoices should be provided for each of the three years of insurance coverage for which the prepayment is being collected. In effect, four invoices should be provided to each bank – one covering the 4th quarter 2009 premium assessment, and the other three covering prepaid assessments for calendar years 2010, 2011 and 2012, respectively. Each invoice will contain the amount due and payment due date. The payment due date for both the 2009 4th quarter premium and calendar year 2010 premium would be December 31, 2009, whereas, the payment due date for calendar years 2011 and 2012 premiums will be revised from the proposed date of December 30 to January 2, 2010. This revision – a 72-hour delay in the payment date for two of the four invoices – should not cause any undue burden on the FDIC or affect the objectives of the proposal. However, it would eliminate

[1] On September 29, 2009, the FDIC Board proposed a Deposit Insurance Fund restoration plan that requires banks to prepay, on Dec. 30, 2009, their estimated quarterly risk-based assessments for the fourth quarter of 2009 and for all of 2010, 2011 and 2012. The proposal is expected to provide FDIC with $45 billion in cash that the agency needs to resolve the increasing number of bank failures, which are expected to cost $100 billion between 2009 and 2013.
[2] The next step, which is beyond this memo, would be guidance issued by the Treasury/IRS clarifying that the separation of the invoices for purposes of billing and collecting the payments under the proposal creates three separate 12-month benefits, one for each of the three calendar years for purposes of the 12-month exception discussed in this memo.

some of the unintended negative tax results that could apply under the proposal. An example of what could be provided to each bank pursuant to the FDIC's billing/payment collection process, based on an annual estimated assessment of $100,000, is provided in the appendix to this memo.

Tax Issue Raised by the Proposal

As a general rule, the tax code would not allow a taxpayer to take a deduction for a payment that relates to a future benefit.[3] Thus, an invoice that requires a lump sum prepayment on December 30, 2009 of the entire premium payment for three years of insurance coverage ($300,000 in the example above) would result in a prepaid expense for a future benefit (i.e., a three-year benefit) that must be capitalized. This would apply regardless of whether the taxpayer is a cash or accrual basis taxpayer and would apply to both C and S corporation banks.

A provision in Treasury's regulations contains an exception to this general rule of capitalization. Under the exception, a taxpayer that incurs a prepaid expense may elect to take a deduction for such payment if it meets certain criteria. This exception, known as the 12-month rule, provides that "a taxpayer is not required to capitalize amounts paid to create (or to facilitate the creation of) any right or benefit for the taxpayer that does not extend beyond the earlier of 12 months after the first date on which the taxpayer realizes the right or benefit; or the end of the taxable year following the taxable year in which the payment is made."

If the FDIC billing/payment collection process separates the invoices for each of the three calendar years, each invoice would represent one separate 12-month benefit. For the 2010 invoice, the billing and payment on December 31, 2009 would fall within the 12-month rule – that is, the benefit created by the prepaid expense would not extend beyond 12 months after the first date on which the taxpayer realizes the benefit (January 1, 2010). In that case, a bank could elect to take a deduction for the $100,000 paid in 2009 (for the 2010 premium) on its 2009 tax return.

For the 2011 invoice, both the billing and the payment would occur on January 2, 2010 rather than on the proposed date of December 30, 2009. This would allow the 2011 premium payment to fall within the 12-month rule – that is, the benefit created by the payment would not extend beyond the end of the taxable year following the year in which the payment was made. In that case, a bank could elect to take a deduction for the $100,000 paid on January 2, 2010 (for the 2011 premium) on its 2010 tax return.

For the 2012 invoice, it would be preferable for the billing and the payment to occur on January 2, 2011 in order to match the deduction with the benefit. However, it is my understanding that this is not an option from the perspective of the FDIC. Thus, the amount that is prepaid on January 2, 2010 for the year 2012 will need to be capitalized and cannot be deducted until 2012.

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[3] See, IRC section 263, which requires a taxpayer to capitalize, rather than take a deduction for, any prepaid expense that creates a future benefit. See, also Treas. Regs. section 1-263(a)-4(d)(3)(i) - A taxpayer must capitalize prepaid expenses.

The fact that the payments for the 2010 and 2011 premiums could be deductible in the same year the payments were made (2009 and 2010 respectively) simply represent a matching in the timing of payments and deductions – i.e., a bank is able to take a deduction on its tax return for the same year that the payment is made. (*Note that a 100% matching cannot be attained under this scenario because the payment for the 2012 benefit will not be deductible in the year paid.*) Nonetheless, the fact that we can attain some degree of matching is more desirable than none. For many banks, especially community banks, these are challenging times, and a prepayment of premiums will impose additional financial burdens, thereby reducing liquidity and loanable funds. While the impact is not as severe as would be caused by another special assessment, the prepayments will represent a loss of funds that otherwise could be used to generate earnings over the 2010-2012 period. This matching of the timing of the payments and deduction would result in banks being able to generate cash tax savings, which would partially compensate for the loss of income that would result from the fact that the prepayment creates non-earning assets for banks.

Please let me know if you have any questions or require any additional information on this issue.

cc: Donna Fisher, SVP – Tax & Accounting
Jim Chessen, Chief Economist

APPENDIX: Example for Billing and Payment of Prepayments[4]

INVOICE A: Statement For 4th Quarter 2009 Premium[5]
Amount due: $25,000[6]

Payment due date: December 31, 2009

INVOICE B: Statement For Calendar Year 2010 (4 Quarters)
Amount due: $100,000[7]

Payment due date: December 31, 2009

INVOICE C: Statement For Calendar Year 2011 (4 Quarters)
Amount due: $100,000[8]

Payment due date: January 2, 2010

INVOICE D: Statement For Calendar Year 2012 (4 Quarters)
Amount due: $100,000[9]

Payment due date: January 2, 2010

[4] For simplicity purposes, the annual premium amount is $100,000.
[5] The tax issue discussed in this letter does not in any way impact the invoicing and payment due date for the 2009 4th quarter assessment as this will be deductible in 2009 and does not constitute a prepaid expense.
[6] This amount would be deducted on the 2009 tax return.
[7] This amount would be deducted on the 2009 tax return.
[8] This amount would be deducted on the 2010 tax return.
[9] This amount would be deducted on the 2012 tax return.