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THE CLEARING HOUSE
Advancing Payment Solutions Worldwide

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]

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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.

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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. <u>A Fundamental Shift in Assessment Base Should Be Done After Public Notice and Comment</u>

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.

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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