Triune

July 1, 2010

VIA E-mail: comments@FDIC.gov

Mr. Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429
Attn: RIN 3064–AD57
comment@fdic.gov

Re: FDIC Proposal for Large Bank Insurance Assessments

Dear Madams and Sirs:

We appreciate the opportunity to add our voice to the comments on the proposed Large Bank Insurance Assessments. Triune is an advising company for the banking industry. We provide regulatory services, strategic vision, valuation, and consulting services.

We admire the massive effort put into this Proposal. As economists, we are fully qualified to add our thoughts on the mathematics of this proposal. But as so many are reviewing this now, we prefer not to be just another voice in the wilderness. Rather, upon a review, we reflect not on the fine detail, but on the larger picture. We ask is this truly insurance, and is there a better alternative?

As to the first point, is this insurance several, thought spring forth. While it is true large banks have had recent troubles, there have been no deposit losses and no claims against the Insurance Fund. Further, America has had a statement of Too Big to Fail. This can be interpreted as a guarantee by one branch of the government. If the goal insurance is to offload a risk to a third party in exchange for consideration, what risk is being assumed when there is no history of loss, and a guarantee. While it is clear this concept of Too Big to Fail may be rapidly ending, at the moment it is the order of the day. At Triune we provide valuation services, but valuing a premium under the aforementioned conditions would strain even our creativity.

We then are puzzled by the disparity between the large bank and all other premiums. We have read that some of the smaller institutions may see a decline in premiums. We have conducted a survey of the Insurance Fund loss, as many others have. We conclude the risk of loss is much greater in the smaller banks than large. The mismatch between loss history and premium computation make no sense. The conclusion we move to is one bordering on predatory and discriminatory pricing. Because the pricing is so skewed and misaligned relative to risk, we again ask if this is still insurance. We believe there is a significant chance of a legal challenge to this proposal.

A few other observations follow. In the background of the Proposal is a call for the use of "long-term debt issuer rating". A subject of much debate in the past has been the effectiveness and independence of these ratings. As an example, the writer lives in the Los Angeles area of California. Budgetary considerations are so poor for the city and state that a former Mayor in a public address indicated that bankruptcy for either is a real possibility, yet both are seeing recent increases in bond ratings. Again, one can ask how accurate and reliable are these ratings?

Chart one of the Proposal and the related narrative states

> "…the proposed measures were useful in predicting long-term performance of large institutions over the 2005 to 2009 period. The chart contrasts the predictive values of the proposed measures with weighted-average CAMELS component ratings and with the existing financial ratios method."

We have two final concerns here. The phrase long-term is listed as a five year period. It seems that using five years of data as a means to validate a model of long-term performance may be a bit dubious. We would feel more confident in in using a more substantial data set, say ten years.

Lastly, by general agreement, the economic meltdown was in full force by 2008. So of the cited five year population for model validation, only three years pre-date the point of meltdown. By general acclaim, we can accept the crisis did not just happen, but was the result of questionable practices. So the "long-term" data set contains possibly contaminated data leading up to the crisis, then data from the largest failure in the history of capitalism. When trying to validate a model or scorecard, we would welcome a test of a much larger data set. It is hard to imagine a goal of safety and normalcy being based on a dataset tainted by crisis and chaos.

Insurance should take into account loss history as part of the analysis and actuarial science. In the case of the large banks the history is zero. The failure to consider loss history for both large and small banks leads to pricing that has no relation to historic loss. This along with a limited data set leads us to question again whether or not this is truly insurance.

Our second thought on this proposal is the re-capitalization of the Insurance Fund. This is a goal we fully support.

This Proposal may be viewed as a source of needed revenue for the Fund. But this Proposal is a massive drain on liquidity and offers little in return to banks. In the last quarter of 2009 Regulators created an assessment that was to raise about $45 billion for the Fund. We have heard that with the current proposal, anticipated proceeds might reach as high as another $40 billion. In about a year banking could lose $80-90 billion in hard currency. This is a tremendous loss to liquidity. The insurance is rapidly pricing the coverage out of affordability. There will be more here later.

What if, as an alternative, there was an action banks desired but could not do? What if the desire to act was so compelling that banks would pay to act. Is it possible that similar levels of revenue could be generated as compared to the Proposal? If something could be developed and banks could receive a return, all parties would benefit.

Suppose that banks could be granted, for a fee, the ability to move some assets out of the regulatory capital computations. Before dismissing the idea, follow the example. Banking rules such as the Basel II Accord will allow for the limited use of Special Interest Vehicles (SIVs) or Special Purpose Entities (SPEs) even though these are no longer in vogue. Changes in accounting rules and Generally Accepted Accounting Principles (GAAP) are rather clear. In many proposals, including the Basel II Accord, the use of SIVs must be in line with GAAP. Here is a contradiction as GAAP does not opine on Regulatory Capital.

Consider a simple example of a bank holding a non performing asset of $100. GAAP will require the asset to be mostly or fully written off. Regulatory Capital Requirement will require again, significant reserves to capital. But what happens to the Regulatory Capital if the asset is suddenly gone?

Suppose the asset is non performing and GAAP requires a two thirds write off. Assume the same $66 is the Regulatory charge to capital. Would a bank consider paying a fee, say 15% or $15 to recover the $66? In this case the net return would be an increase of Regulatory Capital by $51.

By having a side mounted bucket or SIV, one of the chief and ongoing complaints of congress is addressed. By placing the assets in the vehicles, reporting is transparent and simplified. This would be a welcome relief to congress. The SIV can be set so that trading is not allowed. The SIV can also be set as part of the ownership and consolidated or with separate ownership. In the case of separate ownership the biggest question is how to value. We are in favor of using a Stated Par Value. However this is a topic for another paper and we limit the discussion to common ownership and consolidation.

Commercial Real Estate and Commercial Loans are generally two to five years in length, so the live of these SIVs is very limited. In the case of residential mortgages the life of the SIV may be less than the average mortgage. This would give banks time to rebuild and plan, which is needed. Regulators could offer this for a fee in the first year of say 15%, followed by a nominal maintenance fee of say 5% per following year. This gives ongoing revenue to the fund.

As an example, suppose the five largest banks in the nation have about $8.5 trillion in assets. For discussion, set the poor assets as 2% or just over $170 billion. If transferred it could be monitored, examined, and reported with great ease. In the first year assuming a 15% fee, this would generate about $25 billion alone. The revenue will increase as greater numbers of banks are added. The top twenty banks would add about $40 billion to the fund, in this example.

Again, since GAAP does not speak to Regulatory Capital, there is no need to worry over GAAP implications. While this is non-conventional, the reader has not seen a single Accord, Proposal, or Rule that would disallow such an action.

As already stated, we question this Proposal as Insurance when there is no consideration given to the historic losses and, when there is such egregious pricing discrimination between large and small banks. If the goal is to create revenue for the Fund, we propose an alternative.

Banking cannot continue endlessly with these massive drains on liquidity. If this Proposal goes through as planned we see only one of a few options to banks.

- Do nothing-unlikely as the cost of insurance is too high.
- Create a legal challenge-possible but not probable. There is no winner here as this will take years. The first step would be to seek an injunction against the assessment. The stronger the legal challenge to the Proposal the less likely there would be a complete or even a partial funding.
- Large vs. small banks-one loophole is the unequal treatment of large and small banks so break the large banks down. Unlikely as this would cost a significant loss of economies of scale and efficiencies in the use of capital.
- Become self-insured-one could argue this is happening now.
- Move the bank off shore as foreign banks have some exceptions.

This proposal is very expensive and one could argue that for the cost, banks could self-insure. For a closing statement we offer this. Recently there was a massive healthcare bill passed. We offer no opinion on the bill but simply say the following. Before the ink was dry on the bill, several of the nation's largest employers discussed dropping all healthcare for all employees. The reason was that paying penalty would be cheaper offering benefits. Congress was shocked at the reply to all of the hard work. The reader should be assured that similar meetings are going on now.

We would welcome any questions or comments on our copyrighted work.

Sincerely,

Timothy Alexander
Managing Director
Triune
tim@triunegfs.com
805/402-4943