The Clearing House

February 2, 2011

Roberta K. McInerney, Esq.
Deputy General Counsel
Federal Deposit Insurance Corporation
550 Seventeenth Street, N.W.
Washington, D.C. 20429

Re: RIN 3064 – AD 66: Notice of Proposed Rulemaking – Assessment, Large Bank Pricing

Dear Roberta:

As a follow-up to our meeting with you on January 13, 2011, I am enclosing a copy of the presentation we used at that meeting setting out the effects of the proposed rulemaking on large bank pricing. After reflection, we have decided not to request confidential treatment for this document. We believe that it is important that the FDIC have the benefit of the information that we have been able to develop relating to the proposal as it considers the final rule, which is now scheduled for February 7, 2011.

Thanks for your attention to these matters. If you need to talk to me, I can be reached at 212-612-9234.

Sincerely yours,

Joseph R. Alexander
Senior Vice President, Deputy General Counsel,
and Secretary

cc: Michael H. Krimminger, Esq.
Acting General Counsel
Federal Deposit Insurance Corporation

Mr. Arthur Murton
Director of Division of Insurance and Research
Federal Deposit Insurance Corporation

Ms. Diane Ellis
Deputy Director of Financial Risk Management and Research
Federal Deposit Insurance Corporation

Comment on Notices of Proposed Rulemaking

Discussion with the Federal Deposit Insurance Corporation

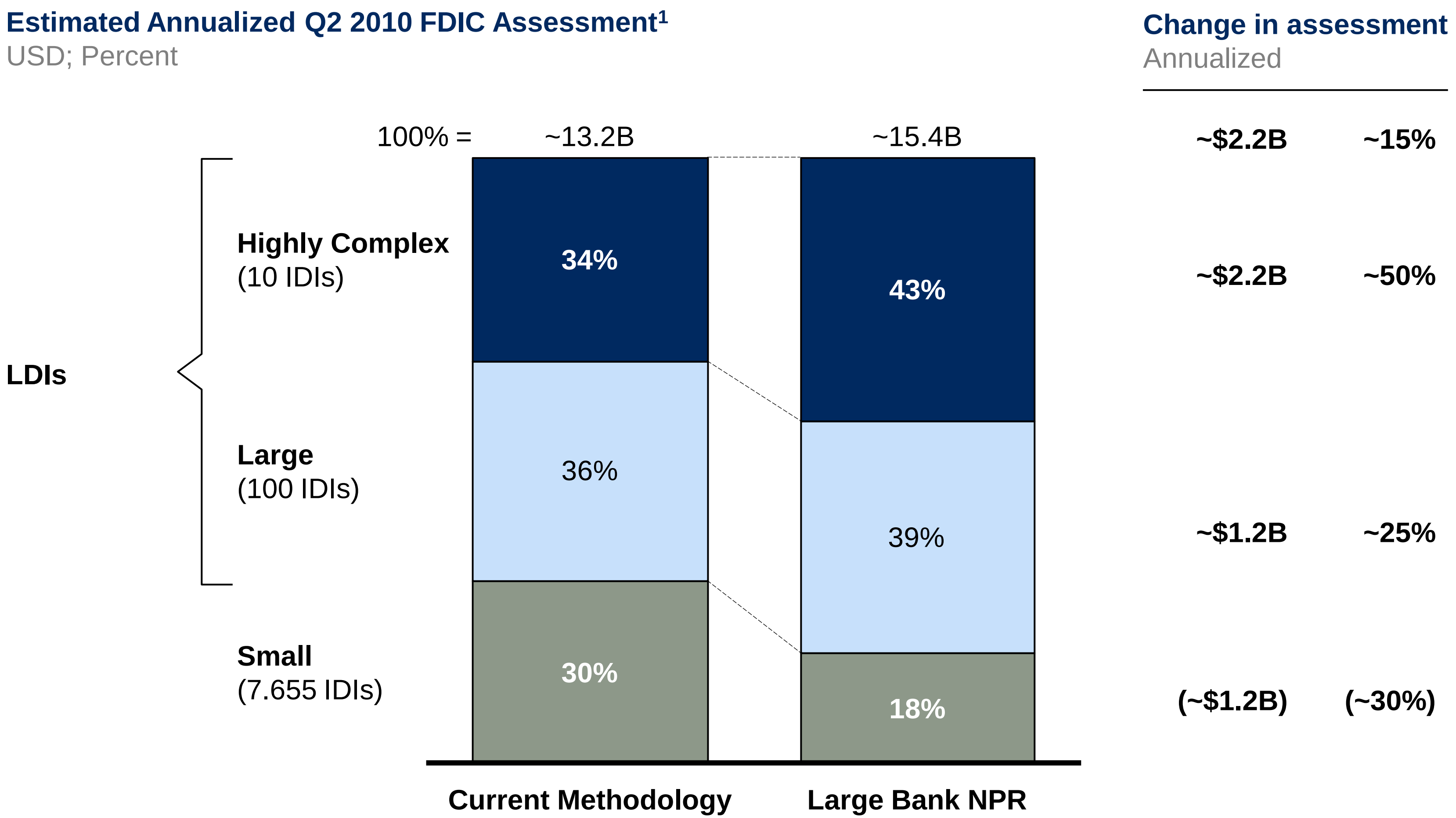
January 13, 2011

Executive summary

We appreciate the opportunity to meet with you to discuss the preliminary results of our effort to understand the potential impacts of changes proposed to the large bank pricing methodology and the deposit insurance assessment base (collectively, the *"NPRs"*) – **we hope to continue this dialogue as we refine our perspectives** through additional analysis and discussions with our members

- **In assessing the potential impact of the NPRs, we estimated current and proposed assessment fees** across all 7,765 FDIC insured institutions **as of second quarter 2010**
  - **Obtained actual data for 18 IDIs representing ~45% of US banking assets** at June 30, 2010
  - **Estimated assessment fees for non-participating IDIs using the FDIC assessment calculators**; leveraging publically available data, Veribanc CAMELS estimates, and peer comparison/expert opinions for other non-public assessment calculator inputs
- **Collectively, the NPRs represent a departure from past practice** for deposit insurance assessment
  - Overall, we estimate that **industry wide assessment fees in Q2'10 would be ~15% higher under the changes proposed in the NPRs** compared to the current assessment methodology
  - On average, **we expect assessment costs for Highly Complex IDIs and Large IDIs (collectively*, "LDIs"*) to increase by approximately 50% and 25%, respectively** – increasing LDI's share of deposit insurance costs to ~80% of the total, up from ~70% under the current methodology
  - T**he NPRs would result in an additional annual assessment cost of ~$3.4 billion for LDIs**
- **Aspects of the NPR's proposed assessment methodology should be reviewed;** e.g.,
  - **Assessment fees** resulting from the proposed methodology **do not appear aligned with observed risk to the Deposit Insurance Fund** (DIF)
  - **The proposed methodology does not fully account for Loss Given Default (LGD)** and results in an high level of assumed losses for LDIs on average

The NPRs result in a dramatic shift in deposit insurance costs, with annualized LDI assessments expected to increase by $3.4 billion



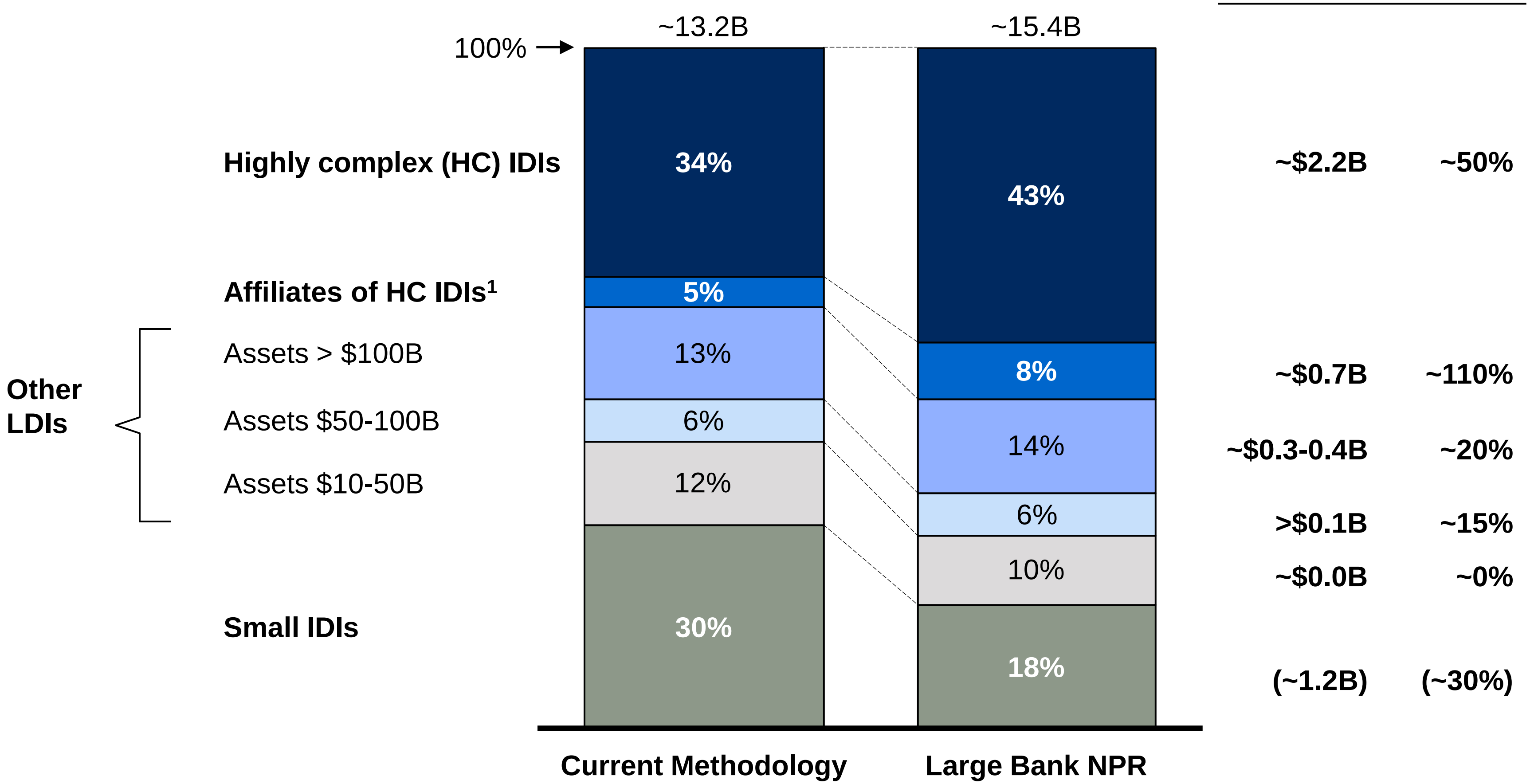
1 Actual data obtained for 18 IDIs representing ~45% of assets; rates for non-participating IDIs estimated using the FDIC assessment calculators, leveraging public data, Veribanc CAMELS estimates, and peer comparison/expert opinions for other non-public assessment calculator inputs

SOURCE: SNL FDIC Financial Reports and Assessment Calculators; The Clearing House

On average, IDIs with over $50 billion in assets bear all of the increase in deposit insurance assessment cost

Estimated Annualized Q2 2010 FDIC Assessment
USD Billions; Percent

Change in assessment
Annualized



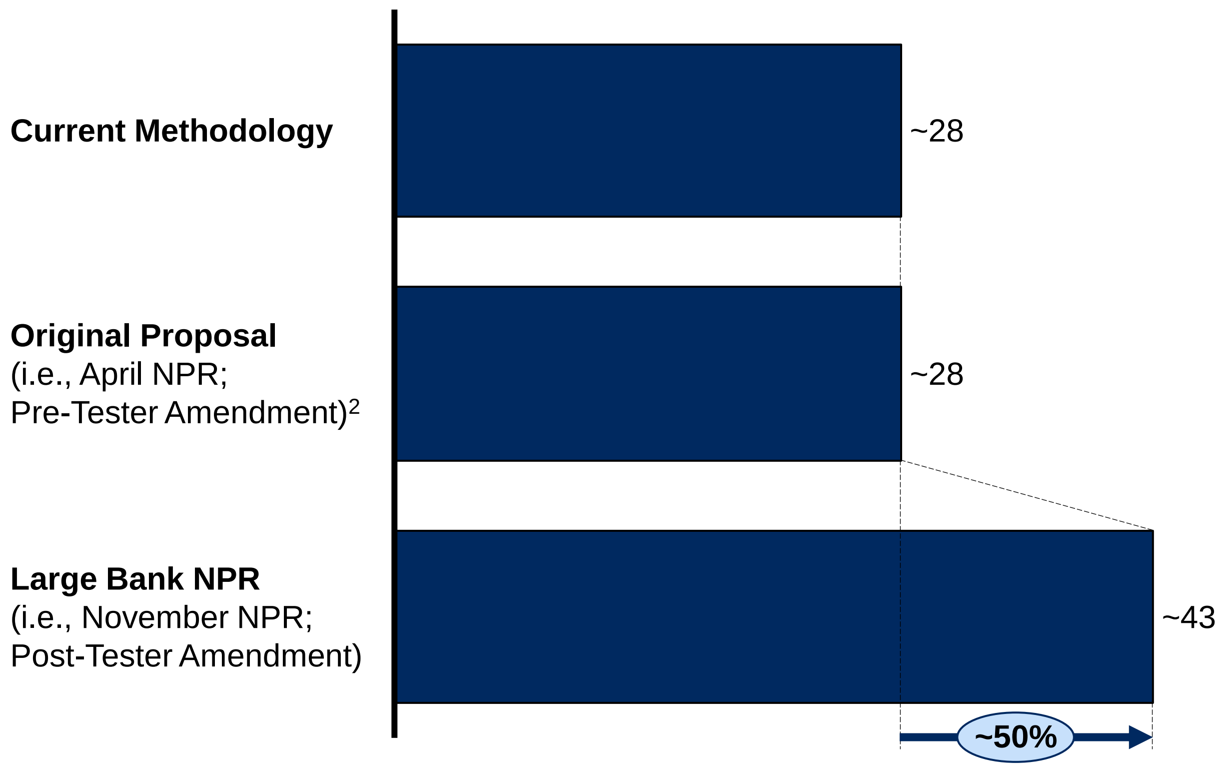
1 Includes both credit card and non-credit card IDIs which are subsidiaries of Bank Holding Companies (BHCs) that also control a highly complex IDI; does not include several affiliates of highly complex IDIs classified as small IDIs

SOURCE: SNL FDIC Financial Reports and Assessment Calculators; The Clearing House

Comparison of the current Large Bank NPR vs. the Original Proposal suggests the view of LDIs as higher risk is a recent development

Highly Complex IDI Average Annual Premium on Insured Deposit Balances[1]

bps



The Large Bank NPR increases the assessment costs for Highly Complex IDIs by 50% vs. the Original proposal issued in April 2010

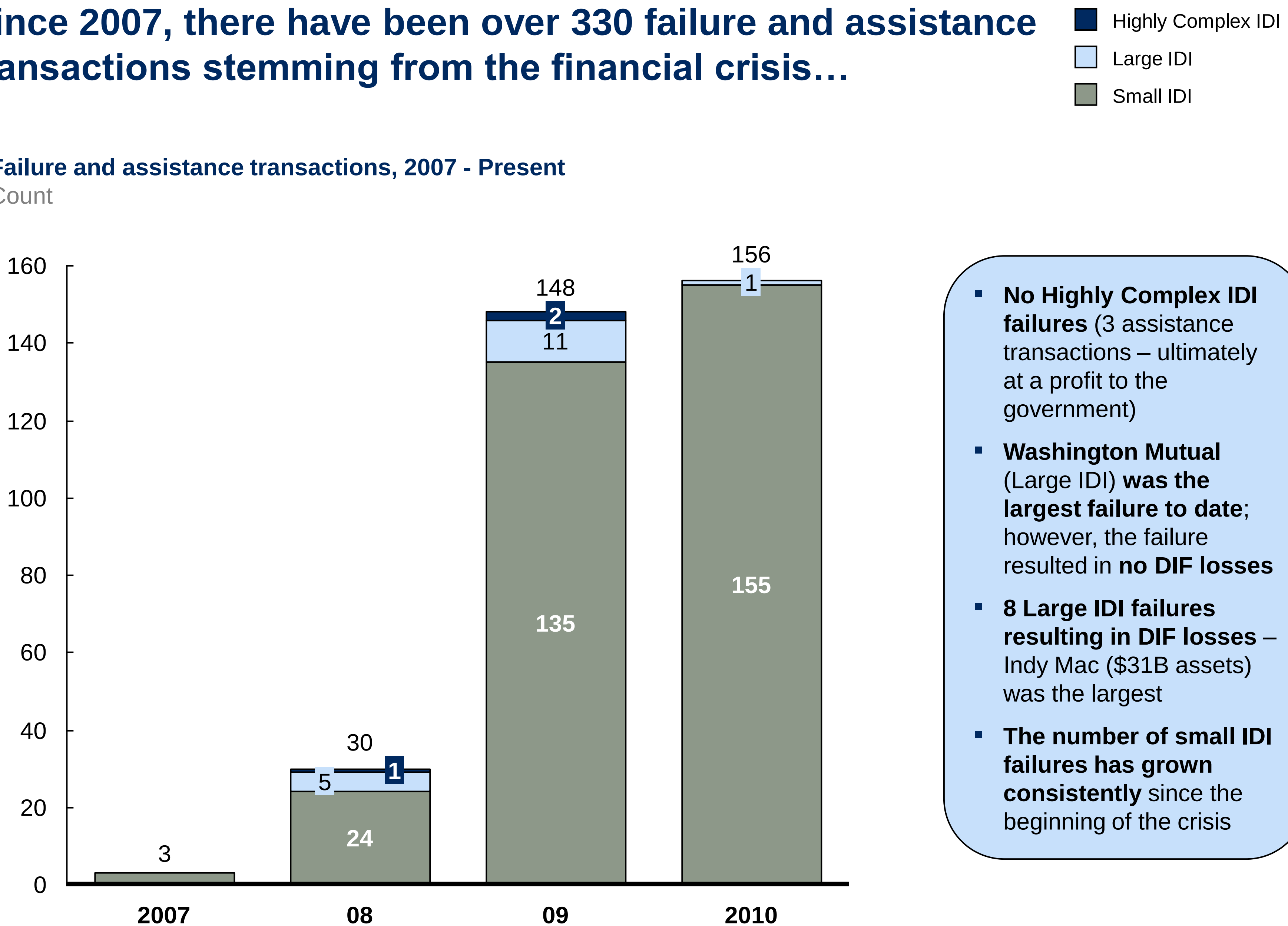
1 Annual premium estimated for current methodology and Large Bank NPR as of 6/30/10 and for Original Proposal as of 12/31/09

2 Includes 3 bps pricing adjustment included in the Original Proposal

SOURCE: SNL FDIC Financial Reports and Assessment Calculators; The Clearing House

Since 2007, there have been over 330 failure and assistance transactions stemming from the financial crisis…

Failure and assistance transactions, 2007 - Present
Count



- **No Highly Complex IDI failures** (3 assistance transactions – ultimately at a profit to the government)
- **Washington Mutual** (Large IDI) **was the largest failure to date**; however, the failure resulted in **no DIF losses**
- **8 Large IDI failures resulting in DIF losses** – Indy Mac ($31B assets) was the largest
- **The number of small IDI failures has grown consistently** since the beginning of the crisis

SOURCE: FDIC, Press Search

. . . With Large IDIs with assets of $10-50 billion and Small IDI failures responsible for 100% of DIF losses to date

	Failure and Assistance transactions, 2007 – Present[1] (Count): Failure	Failure and Assistance transactions, 2007 – Present[1] (Count): Assistance	Cumulative DIF Losses (USD billions)	Cumulative DIF Losses/ Q2'10 Insured Deposits[2]
Highly Complex IDIs	0	3	0.0	0.0 %
Affiliates of HC IDIs	0	9	0.0	0.0 %
Other LDIs: Assets > $100B	1	1	0.0	0.0 %
Other LDIs: Assets $50-100B	0	0	0.0	0.0 %
Other LDIs: Assets $10-50B	8	0	33.5	5.0 %
Small IDIs	317	0	45.2	2.5 %

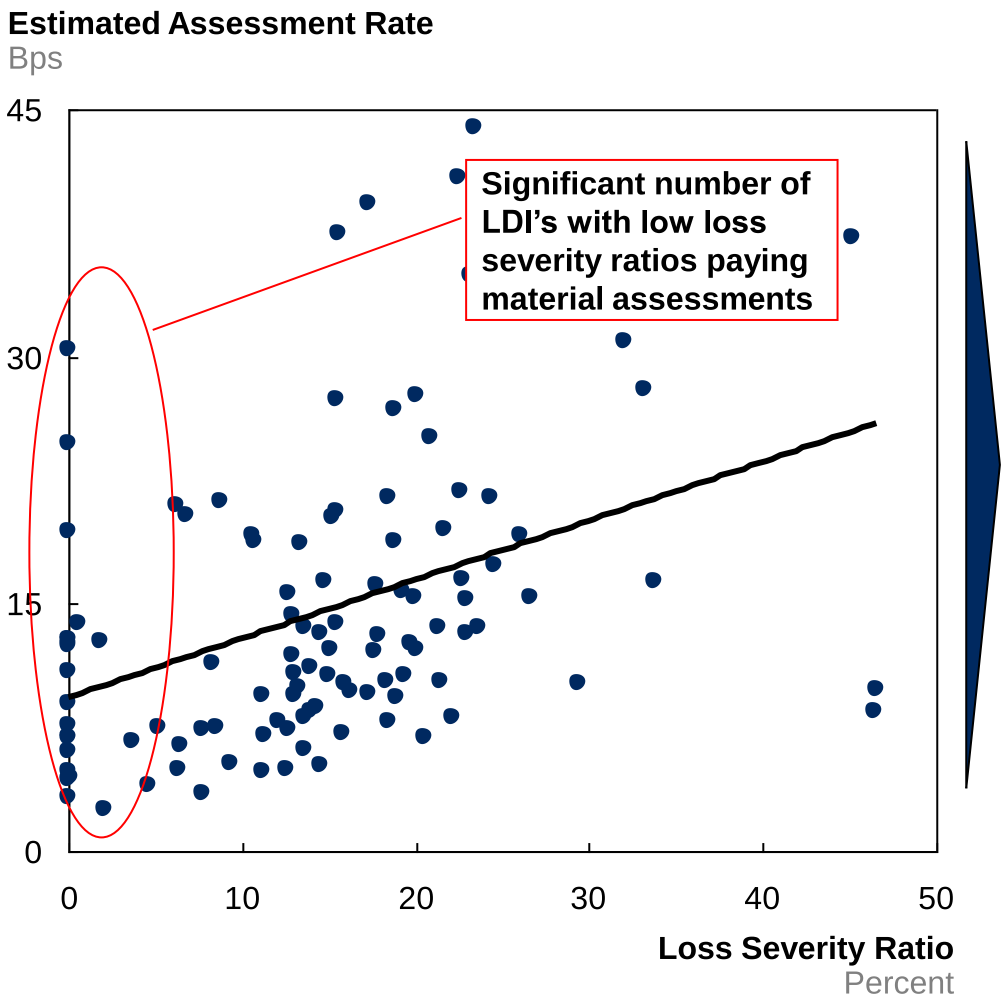
1 Present as of 1/10/2011

2 Represents cumulative DIF losses by segment vs. 6/30/10 insured deposits by segment– a proxy for expected loss

SOURCE: FDIC, Press Search

The impact of the loss severity ratio on assessment rates is muted by two factors

LDI Calculated Loss Severity Ratio vs. Assessment Rate
Percent, as of 6/30/10

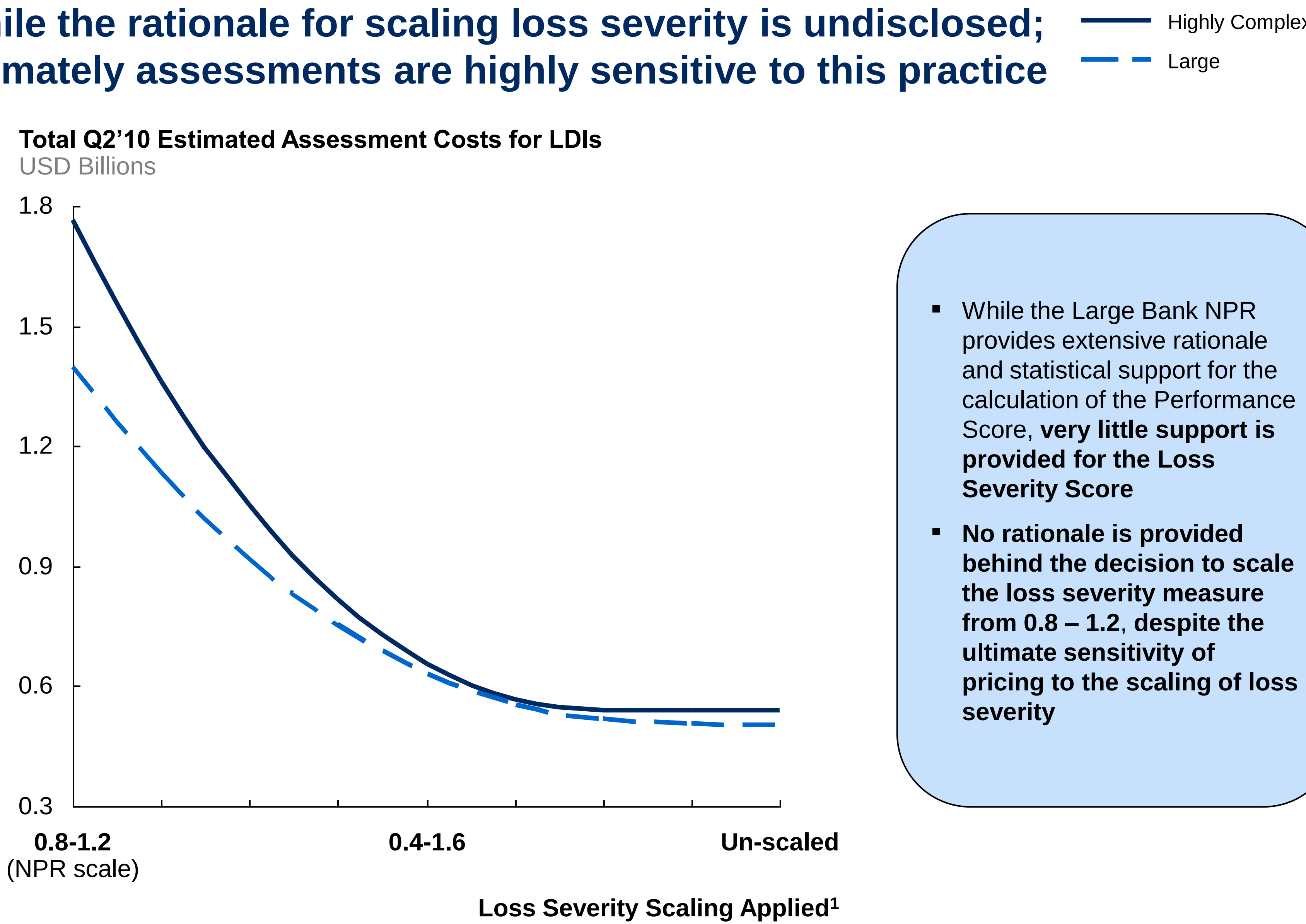


- **The loss severity ratio's influence on assessment rates is muted by two factors:**
  - **Scaling the loss severity measure from 0.8-1.2**
  - **Inclusion of a non-core funding ratio**, in addition to the loss severity ratio, **when determining the loss severity measure**
- **The impact is significant; for example:**
  - **22 LDIs have a calculated loss severity ratio below 5 percent** (16 LDIs have a ratio of zero – making the average less than 0.5%)
  - **These LDIs are assessed at an average rate of ~10 bps -** meaning they fully fund expected losses in less than 5 years even under an unrealistic assumption of a 100% failure rate for all 22 LDIs

SOURCE: FDIC Large and Highly Complex Assessment Rate Calculator

While the rationale for scaling loss severity is undisclosed; ultimately assessments are highly sensitive to this practice

Total Q2'10 Estimated Assessment Costs for LDIs
USD Billions



- While the Large Bank NPR provides extensive rationale and statistical support for the calculation of the Performance Score, **very little support is provided for the Loss Severity Score**
- **No rationale is provided behind the decision to scale the loss severity measure from 0.8 – 1.2**, **despite the ultimate sensitivity of pricing to the scaling of loss severity**

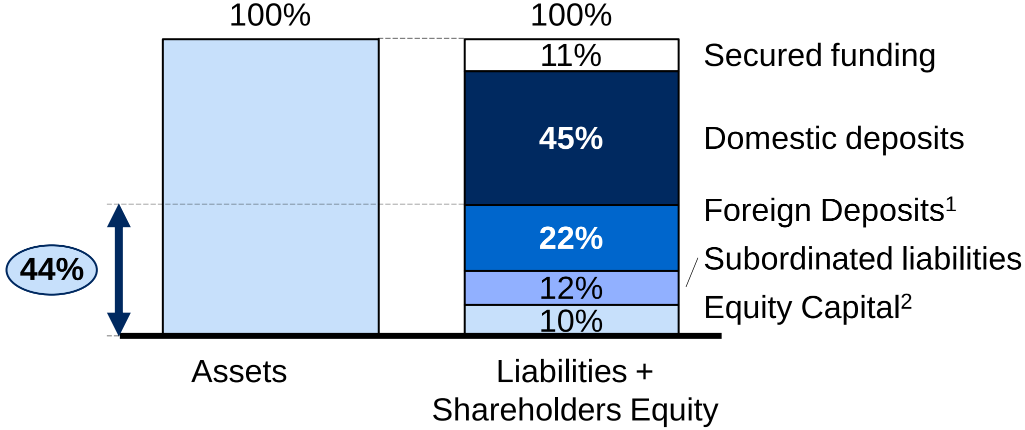
1 Sensitivity of total assessment to the scaling of loss severity model by adjusting the scaling function within the Assessment Rate Calculators

SOURCE: FDIC Large and Highly Complex Assessment Rate Calculator

In addition, the Large Bank NPR does not provide a full consideration for the loss absorption function of statutorily subordinated liabilities

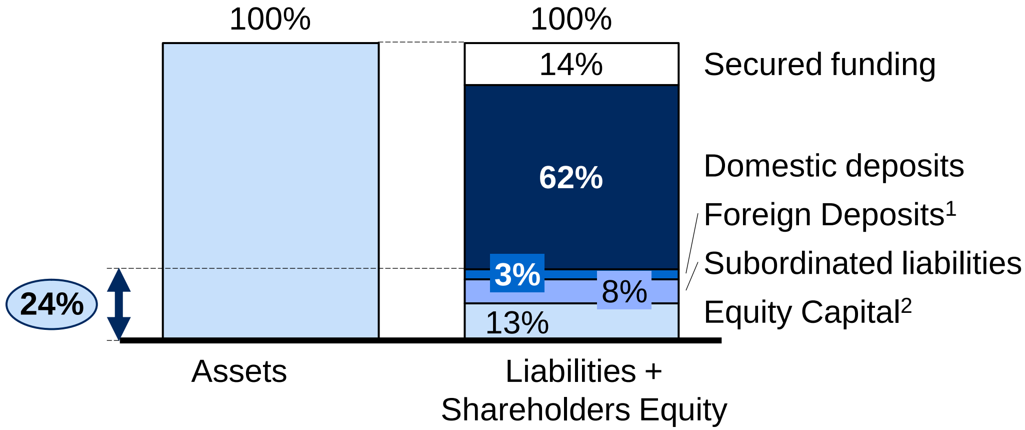
Highly Complex IDIs average balance sheet

Percent; as of 6/30/10



Large IDIs average balance sheet

Percent; as of 6/30/10



- **Foreign deposits are a significant component of Highly Complex IDI balance sheets** which are not given credit as subordinated liabilities under the Large Bank NPR
- **For the FDIC to suffer a loss from failure of IDIs, losses on assets must exceed:**
  - **44%** for a Highly Complex IDI
  - **24%** for a Large IDI

1 Calculation of statutorily subordinated liabilities does not treat unsecured foreign deposits as secured liabilities – contrary to the FDIC's treatment of these liabilities as secured at the time of failure in its calculation of the loss severity ratio

2 Includes Secured Federal Funds Purchased, Repurchase Agreements, and Secured Other Borrowed Money

SOURCE: http://www2.fdic.gov/sdi/main.asp