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Sent: Tuesday, February 16, 2010 9:45 PM
To: Comments
Subject: RIN 3064-AD56

From the context of my viewpoint as a business lawyer that advises clients that are heavily debt capitalized due to their structure and from the standpoint of an investor and bank customer, several reforms are necessary for the FDIC, in light of the near-destruction of the finance industry and near depression of the world economy:

1. FDIC insurance premiums need to make cost follow risk; that is, if an entity with deposits insured by the FDIC, and wanting the customer trust that the FDIC insurance provides, takes merchant risks in order to reap short-term merchant gains, they must expect to pay the premium associated with that risk. After all, the fundamental premise of capital markets, in particular the finance markets, is that risk and reward has corresponding costs. The FDIC deposit insurance puts the rest of the system and the taxpayers at risk, and we have incurred real costs from the many bank failures caused by the finance markets collapse. The entities causing that risk must be willing to shoulder the associated costs through higher premiums. That is a fundamental premise of the insurance business.

2. The merchant banks (with first the mortgage lending and securitized junk debt, and now as we discover, with the derivatives issued to hide the sovereign debt crisis) have taken enormous risks in large part because the individual bankers in the deals could become rich overnight from a successful deal. The amounts of personal wealth reaped are truly staggering to anywhere else but Wall Street and a few other areas in the world where individual incomes of multiple millions may be commonplace. That level of compensation taken without personal risks (the individual bankers did not have their own wealth on the line, but used their companies' wealth and the implicit backing of the federal banking system) often made them blind from the risks they were taking for their companies. And it made those risks irrelevant, because after one or two years, the individual bankers no longer needed their jobs or their companies to be wealthy for the rest of their lives. The only way to break that cycle of irresponsible decision making is to limit the individual compensation on merchant banking deals (so that it will still matter to the individual whether or not their company survives for the next year or two) and/or limit the payment of the compensation to payments over a significant period of time, thereby making the long-term health of the bank critical to the banker ever receiving their compensation. Those reforms will have two salutary results: individual deals are less likely to make individual bankers immune to the financial risks taken, and if their receipt of large compensation is delayed for 10 years of periodic payments, they will be more likely to be concerned about the risks taken by OTHER bankers that might be swinging for the fences with their deals. If they want the FDIC deposit insurance and the aura of trust that gives, they need to show at least a glimmer of restraint on their compensation practices.

3. A fundamental cause of the near meltdown was the near absence of any real risk management inside the merchant banks. Credit default swaps were traded like candy, on

the apparent belief that offsetting CDS had no real risk, when in fact they multiplied the risk when an individual counterparty faltered and triggered margin calls that could never be met. In the insurance business, insurers commonly rein in risk taking that causes significant losses and insurance is experience rated. In the business insurance business, insurers do not hesitate to impose risk management and prudent business practices as a condition of continued coverage. The Fed (and the FDIC) should do the same. Fundamentally, the banks are woefully undercapitalized to sustain the risks that would earn anywhere near the yields of $145 billion reported for 2009. Make them plow that capital back into the business rather than skim it off as personal compensation. Insist on adequate capitalization to cover the kinds of merchant banking risks that generate those levels of profits. That might just convince some banks to make more traditional, longer-term loans that carry less risk, but that would support the economic recovery so sorely needed.

4. What clearly is needed is beyond FDIC reach, re-imposition of the barrier between traditional banks (with insured deposits) and the merchant banks wanting to hit home runs in the securities and merchant banking business. Fundamentally that is what is needed, so that if merchant banks want to take big risks with the risk of failure, they will take it all by themselves, without taxpayer risk.