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May 31, 2011

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Re: Proposed Assessment Rate Adjustment Guidelines for Large and Highly Complex Institutions; 12 CFR Part 327; 76 Federal Register 21256, April 15, 2011

Dear Mr. Feldman:

The American Bankers Association (ABA) welcomes the opportunity to comment on the proposed assessment rate adjustment guidelines to be used in determination of Federal Deposit Insurance Corporation (FDIC) premium assessments for banks with over $10 billion of assets (large banks). ABA represents banks of all sizes and charters and is the voice for the nation's $13.4 trillion banking industry and its two million employees. Our extensive resources enhance the success of the nation's banks and strengthen America's economy and communities. While the majority of ABA members have less than $165 million in assets, banks directly affected by the proposal are strongly represented in our membership and were consulted in developing these comments.

ABA supports and appreciates the deliberative process the FDIC staff used in developing the adjustment guidelines under the Large Bank Pricing (LBP) model. We commend the FDIC for suspending any adjustments under the new system until the guidelines have gone through a public notice and comment process.

Despite the further consideration of the proposed guidelines, subjectivity under LBP rate setting continues to be of significant concern to large banks. On the positive side, the proposal would enable banks to petition on their own part for subjective review and rate adjustment. We think this is appropriate in the context of the subjectivity otherwise included in the proposal, particularly since factors that mitigate risk are not incorporated into the LBP model. It is critical to have a workable system so that the process is easy to understand and operates efficiently. We also support the provision in the current system and proposed guidelines to allow a bank to implement modifications before an adjustment is applied in order to avoid the financial penalty associated with a subjective adjustment. Given that these subjective factors and adjustments cannot easily be anticipated, having an ability to address the concerns is appropriate.

ABA remains concerned that the proposed guidelines do not provide sufficient detail about the factors that may trigger a subjective adjustment or the magnitude of any adjustment. Furthermore, we remain troubled that the maximum amount of adjustment – while narrowed somewhat from the original proposal – is still too large and gives the FDIC too much power to

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impose significantly higher assessments on some banks. The proposal aspires to a fine level of adjustment detail that it does not achieve, certainly not enough to justify wide variations in subjective premium adjustments.

Therefore, as we have argued in the past, ABA believes that subjective adjustments that raise the assessment rate should be eliminated.[1] In fairness, ***subjective changes should only be made to lower the assessment rate and never should be used to punish banks.*** As the only provider of federal deposit insurance coverage, there must be strict limitations on discretionary changes that impose costly penalties. To do otherwise opens the door to the appearance of arbitrary and capricious regulatory action. Rather than expand the authority to use discretion, the subjective guidelines should be strictly limited to lowering assessment rates. Factors that increase risk should be objectively identified and incorporated into the LBP formula.

Finally, while we realize that the LBP rule has been finalized and is not the subject of the proposal, we believe that several aspects of the rule need to be revisited in light of the proposed guidelines. For example, many banks continue to raise concerns that pricing does not fairly differentiate risk among banks and does not give sufficient weight to the exposure of the deposit insurance fund in case of a bank failure. The model under-weights and omits critical factors that need to be considered in this regard, allowing that such factors could be handled through subjective adjustments to the model scores. We believe that instead of allowing the possibility of subjective adjustments, the LBP model should consider these factors directly in the scorecard calculation.

Further details of these recommendations are discussed below.

Subjective Changes Should Only be Made to Lower the Assessment Rate of a Bank

ABA appreciates that the potential magnitude of adjustments was reduced in the November 2010 proposal,[2] as compared to the March 2010 proposal.[3] However, the proposed guidelines still allow much larger adjustments than under current authority. We believe that it is inappropriate to expand the FDIC's authority to make arbitrary adjustments in the assessment rate. ***The scale of potential adjustments should be further limited and should be no more than under the current standard.*** We continue to feel that ***uncertainties in the conditions for and magnitude of adjustments warrant only downward rate adjustments.***

The proposed guidelines would provide FDIC with discretion to adjust the Scorecard score up or down by as much 15 points (but constrained such that the final score must be between 30 and 90). How a subjective change in the score affects the assessment rate depends on the initial score, as the rate increases by formula exponentially as the score rises. The chart – which was included in our letter of January 3, 2011 – shows quite dramatically that, even for the lowest-risk banks – those with

[1] See the letter from ABA chief economist James Chessen regarding the proposal, January 3, 2011, page 6.
[2] FDIC, "Notice of Proposed Rulemaking Regarding the Pricing of Large Bank Assessments, 75 Federal Register 72612, November 24, 2010.
[3] FDIC, "Assessments, Proposed Rule," 75 Federal Register 23516, May 3, 2010.

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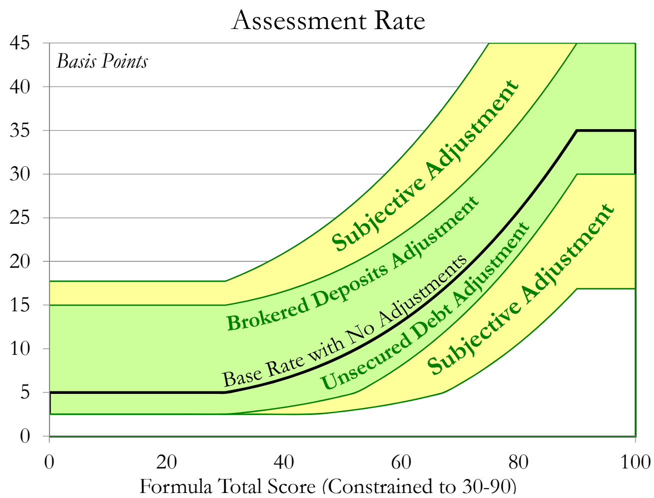

the lowest initial scores – the formula would allow a subjective increase in the assessment rate of up to 2¾ basis points. The subjective adjustment could even exceed 13 basis points for higher initial scores.

Such adjustments are many multiples greater than the FDIC's current authority to adjust an assessment rate up or down by up to one basis point on a smaller assessment base. Raising the scale of potential adjustments is completely at odds with the notion that the new system improves the accuracy of risk based assessments; indeed, it raises concerns over the ability of the model to successfully measure risk. ***If the new system is an improvement, then the subjective component should be smaller, not larger.*** If there is little confidence that the LBP formula accurately reflects relative risk, then the answer is not to provide greater subjective authority, but rather to improve the formula to reflect the true risk more accurately. Some critical improvements are discussed below.

The concerns over subjective adjustments are not just theoretical. As we have mentioned before, banks report being hit with unreasonable adjustments under the current system for which they were not provided sufficient justification. Further, the bankers report that they were not allowed to challenge effectively their adjustments through the FDIC's appeals process. ABA appreciates that the proposed guidelines provide that aggregate statistics on the number and amount of adjustments will be made public quarterly. This will help to assure that the subjective factors are not used primarily to increase assessment rates. ***ABA further requests quarterly publication of statistics on the number of challenges to assessment adjustments and rulings for and against.***

The proposed guidelines list some of the factors that may be considered in deciding whether to alter a bank's assessment rate from that determined by the LBP formula. The guidelines would allow indeterminate adjustments for outliers on ***any*** of the elements in the LBP formula. In contrast, in the May 2010 proposal the impact of being an outlier on the "criticized and classified items/tier 1 capital and reserves" or "underperforming assets/tier 1 capital and reserves" elements would have been determined exactly within the model. The proposal further provides that ***any*** "institution-specific or idiosyncratic risk factors" could lead to an adjustment, including "stress test results, capital adequacy assessments, or information detailing the risk characteristics of the institution's lending portfolios and other businesses" and "the ease with which the FDIC could make quick deposit insurance determinations and depositor payments, on the availability of sufficient information on qualified financial contracts to allow the FDIC to make timely and correct determinations on these contracts in the event of failure."[4,5] This open-ended approach does not

[4] Proposed Assessment Rate Adjustment Guidelines, page 21263.

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allow banks to know in advance what the FDIC considers to be risky activities. This means that an investment in a new activity could be subject to an after-the-fact premium penalty (if the FDIC determines that such a business raises the risk profile of the bank and should be subject to a higher assessment). Thus, banks are concerned that this open-ended approach could lead to surprises and expensive adjustments. This uncertainty undermines an important purpose of a risk-based formula: to encourage banks to manage risks more effectively. ***ABA believes that the list of factors that may be considered in making an adjustment should be specified, and that the list should include only those factors where there is a demonstrable tie to risk exposure to the deposit insurance fund such that the magnitude of the exposure can be quantified. Further, any additions or deletions from the list should go through the public comment process.***

As proposed, the FDIC would have full authority to set the level of any adjustment that is applied – *i.e.*, whether it would be the maximum 15 points in the scoring system or something less. We believe that there would be irresolvable differences of opinion as to the "amount necessary to bring an institution's total score into better alignment with those of other institutions that pose similar levels of risk."[6] Since "specific risk measures would vary in importance for different types of institutions"[7] and "institution-specific or idiosyncratic risk factors" would be considered,[8] both the FDIC and banks would not be able to establish bases for adjustments. For example, it is unclear on what basis a bank could request reconsideration that an adjustment should be more or less than what the FDIC has applied. These concerns again lead us to the conclusion that only downward adjustments in assessment rates should be permitted.

The LBP Model Should be Improved Rather than Allowing for Arbitrary Rate Adjustments

While the LBP model attempts to reflect asset risk and funding, it does not consider fully differences in loss expectations in a failure from different liability mixes; nor does it consider the effect of risk mitigation (including hedging, collateralization, insurance, and conservative underwriting practices). Thus, as complicated as the proposed system is, it does not truly reflect differences in relative risk among large banks or relative risk among banks with less than $10 billion in assets.

Acknowledging these deficiencies, the proposed guidelines would provide authority for the FDIC "to consider idiosyncratic or other relevant risk factors that are not adequately captured in the Scorecard and make appropriate adjustments to an institution's total score."[9] A preferred approach to subjective adjustments is to build known factors into the LBP model. There are specific, identified changes in the model that would clearly improve its sensitivity to risk to the insurance fund, so that *ad hoc* adjustments should not be needed.

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[5] The FDIC should consider that using results from multi-institution supervisory exercises, such as the Supervisory Capital Assessment Program of 2009 and the Comprehensive Capital Analysis and Review of 2011, to adjust assessments could discourage participation by institutions not required to participate.

[6] Proposed Assessment Rate Adjustment Guidelines, page 21259.

[7] Proposed Assessment Rate Adjustment Guidelines, page 21258.

[8] Proposed Assessment Rate Adjustment Guidelines, page 21263.

[9] Proposed Assessment Rate Adjustment Guidelines, page 21257.

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Loss Mitigants

A glaring omission from the "ability to withstand asset-related stress" measure in the LBP model is that there is no recognition of risk mitigants, including collateralization, insurance, hedging, underwriting standards, and other risk mitigants aside from capital. We believe it appropriate to allow for risk mitigants to net out against construction and development loans, subprime and leveraged loans and securities, and non-traditional mortgages, as well as the seven loan portfolios in the "growth-adjusted portfolio concentration measure." Appropriate haircuts could apply to the risk mitigants, where needed.

Assessment pricing that does not consider risk mitigation cannot truly correlate with risk and does not encourage better risk management. ***Risk mitigants should be quantified within the LBP model directly, so as to avoid arbitrary adjustments to the scoring and assessment rate.***

Loss Severity Score

Some large banks have calculated that the effective assessment rate relative to their insured deposits would be very high. Since the FDIC's only exposure is to the banks' insured deposits, this cannot correlate with risk to the insurance fund.

The Loss Severity Score is a critical element of the LBP scorecard. A major failure of the Scorecard, which undermines its objective to quantify risk to the insurance fund, is its focus on asset and liquidity risks, while it under-weights and mis-measures the potential loss to the fund should a large bank fail. The effect of the Loss Severity Score is limited to 20 percent of the Performance Score, whereas no analytical support is provided for this arbitrary weighting. This weighting appears unreasonable for some large banks funded with relatively small amounts of insured deposits, which therefore pose minimal risk exposure to the insurance fund.

In the final LBP model, the Loss Severity Score is based solely upon a measure of potential loss (calculated with specified haircuts and recovery rates by asset class, and run-off rates for deposits and other liabilities) as a ratio to total deposits in U.S. bank offices. (As ABA suggested, a measure of "noncore funds-to-total liabilities" was removed from this calculation, and we appreciate the FDIC's recognition of the value of this suggestion.) In that the haircut, recovery, and run-off parameters are the same for every bank, whereas there are significant differences among banks in the treatment of depositors, borrowers and securities, this variable is at best a crude measure.

As ABA and several banks suggested in comments on the November 2010 LBP proposal, ***a critical factor that should be included with significant weighting in the calculation is a variable for the portion of an institution's assessment base that is subordinate to the FDIC's claim in a receivership.*** Clearly, if a bank is heavily funded with capital and liabilities that stand behind the FDIC (as surrogate for the insured deposits) then the FDIC should expect to recoup more from liquidation of the institution – and suffer lower losses – if the bank fails. Goodwill and other intangible assets should also be counted as claims subordinate to the FDIC; although they are included in the new assessment base, they do not result in losses for the FDIC in a bank failure.

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Conclusion

ABA appreciates this opportunity to comment on the proposed guidelines. We are prepared to work with the FDIC in resolving remaining issues to arrive at a premium program that is more accurately sensitive to genuine risk and, thereby, a useful tool in encouraging better risk management by banks and by the FDIC.

Sincerely,

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