From: Bert Ely [mailto:Bert@ely-co.com]
Sent: Wednesday, May 18, 2016 6:30 PM
To: Comments
Subject: February 26, 2016 - RIN 3064—AE33

Dear Mr. Feldman:

I am pleased to submit as a comment on the FDIC's proposed rule on Recordkeeping for Timely Deposit Insurance Determination the following commentary of mine on the proposed rule that the American Banker posted on-line today. The commentary is below the horizontal line.

FDIC staff should feel free to contact me should they have any questions about my commentary. I can be reached by email at bert@ely-co.com or by phone at 703-836-4101.

Bert Ely

Bert Ely
Ely & Company, Inc.
Alexandria, Virginia

American Banker BANKTHINK

FDIC's Sudden Concern with Insurance Limit Makes No Sense

By Bert Ely

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In an era when the federal deposit insurance limit seems nearly irrelevant, the basis for a proposed rule to require banks to keep better tabs on insured deposits makes no sense.

The Federal Deposit Insurance Corp. is proposing that banks upgrade their systems so it can be more quickly determined in a failure whether a depositor's money is fully insured. All banks should oppose this proposal as it would impose unnecessary costs without delivering any benefit. Although the proposal is presently limited to banks with more than two million deposit accounts – likely affecting only 36 institutions – one could imagine a scenario when this regulation could easily be extended to all banks. Comments on the proposal are due by May 26.

In the highly unlikely event that one of the banks subject to the proposal failed, the new rules are meant to make the FDIC's process for liquidating the bank overnight and resolving the insured deposits more seamless. In order to differentiate the insured portion of each depositor's account balance from the uninsured portion, the bank must link all deposit accounts with the same owner

so that it can, at any time, determine if the combined balance of those accounts exceeds the $250,000 insurance limit.

The FDIC has estimated that it will cost the banks subject to this regulation approximately $328 million to upgrade their systems to implement overnight account aggregation; that cost could easily be much higher. The FDIC did not estimate the annual cost of compliance with this aggregation requirement nor did it estimate its own cost of ensuring compliance.

Given the many ways in which account ownership can be legally specified, accurately linking all accounts to which a single deposit insurance limit would apply is not simple. Such linking will be especially difficult for brokered deposits where key ownership information is held by the broker, not the bank. Brokers will not readily part with that information.

But more fundamentally, the underlying rationale for this proposed rule bears no relationship to reality. In 1991, Congress authorized the FDIC to protect a failed bank's uninsured deposits against any loss if the FDIC determined that doing so would be less costly than imposing some of the bank's insolvency loss on uninsured deposits. This is known as a least-cost resolution and is accomplished through a purchase-and-assumption transaction.

Since the IndyMac failure in July 2008, which featured widely televised scenes of panicked depositors lined up outside IndyMac branches, the FDIC has bent over backward to protect uninsured deposits by determining whenever possible that it would cost less to have another bank acquire all of the deposits of the failed bank.

Of the 512 failures since IndyMac, uninsured depositors were protected against any loss in all but 30 situations. The largest failure where uninsured deposits bore some of the bank's insolvency loss was Nevada's Silver State Bank, which was closed in September 2008; it had $1.7 billion in deposits when it was closed.

Protecting uninsured depositors in failed banks definitely has not been limited to larger banks. Since July 2008, uninsured depositors have been protected against any loss in all but five of the 122 failed banks with less than $100 million of assets.

There are sound public policy reasons why uninsured deposits should be protected against any loss when a bank fails. First, as the FDIC usually determines, it is cheaper to do so than to enforce the deposit insurance limit.

This is the case because the bank acquiring the deposits and customer relationships of the failed bank can smoothly integrate those relationships into its operations without having to deal with irate depositors. This maximizes the value of the failed bank's franchise.

Second, liquidating a failed bank in order to impose losses on the uninsured portion of depositor accounts can be very disruptive to the failed bank's lending and other nondeposit relationships, impairing its franchise value.

This is especially true for business customers, who often have both deposit accounts and loans outstanding with the failed bank. Liquidating that bank not only destroys banking relationships, but can be very harmful to the affected businesses as it takes time for them to establish new banking arrangements.

The liquidation of New Frontier Bank in Greeley, Colo., in April 2009 illustrates so well the negative consequences of liquidating a bank instead of transferring its deposits and related customer relationships to another bank.

According to news reports, numerous customers of that bank, which had deposits of $1.5 billion, experienced great difficulty establishing new banking relationships and suffered financial harm while doing so. That would not have happened had the bank been resolved through a purchase-and-assumption transaction that protected all deposit balances.

Third, regulators are increasingly concerned about ensuring that all large banks have sufficient liquidity, especially in a crisis situation, rather than whether insured versus uninsured depositors are protected in an individual failure. Guarding broader market liquidity would be much more challenging if the FDIC liquidated a large bank or transferred just its insured deposits to a new bank. Such an action would trigger runs on other banks as customers worried about the safety of their money, possibly creating enormous liquidity strains throughout the financial system.

There simply is no cost or broader economic justification for the FDIC's proposed deposit-aggregation regulation. The FDIC should simply kill it.

Bert Ely is a financial institutions and monetary policy consultant in Alexandria, Va.