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Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Company
550 17th Street, N.W.
Washington, DC 20429

Attention: Comments/ Legal ESS

Re: Large-Bank Deposit Insurance
Determination Modernization Proposal

Ladies and Gentlemen:

The member banks of The Clearing House Association L.L.C. ("The Clearing House")[1] appreciate the opportunity to comment on the Advance Notice of Proposed Rulemaking ("ANPR") of the Federal Deposit Insurance Corporation ("FDIC") regarding a proposal to modernize the deposit insurance determination program for large banks.[2]

Our principal concern with the ANPR is the very substantial cost in terms of both financial resources and people, particularly at a time when both are being strained by other regulatory initiatives such as Basel II. We agree with the FDIC's goals of minimizing disruption to depositors and loss to the deposit insurance fund. Nonetheless, it is essential that these goals be achieved in the context of the "cost/benefit tradeoff"

[1] The members of The Clearing House are Bank of America, National Association; The Bank of New York; Citibank, N.A.; Deutsche Bank Trust Company Americas; HSBC Bank USA, National Association; JPMorgan Chase Bank, National Association; LaSalle Bank National Association; UBS AG; U.S. Bank, National Association; Wachovia Bank, National Association; and Wells Fargo Bank, National Association. Ten of our eleven members would be "Covered institutions" as defined in the ANPR.

[2] 70 Fed. Reg. 73652 (December 13, 2005).

which the FDIC has recognized and we offer certain recommendations in Part (C) below.[3]

In the ANPR, the FDIC presents three options for comment. For the reasons set forth below, we believe that Option 3 is so extraordinarily burdensome as to be unfeasible and that the burden of Option 1 is clearly excessive. Although Option 2 is less onerous and a possible solution to the FDIC's concerns, we believe that further study and dialogue between the Covered institutions and the FDIC are necessary to refine this option.

A. <u>*General*</u>

Before specifically addressing each of the three Options, we first address our general concerns about the ANPR.

1. <u>Mounting Regulatory Burden; Limited Resources.</u>

In recent years, financial institutions have become subject to an ever-increasing level of regulation related to both the war on terrorism and safety and soundness concerns. The requirements of the USA PATRIOT Act and related anti-money laundering regulations, and the major systems changes necessary for compliance with Basel II, have placed substantial strain on the people and financial resources of larger financial institutions. Any of the options proposed by the ANPR will divert resources away from these other projects, including those that have a direct and immediate impact on the safety and soundness of the Covered institutions.

We emphasize that the burdens in this case relate at least as much to availability of personnel as to financial cost. Even small changes to information systems require hundreds of man-hours, both in programming and testing. There is a limited pool of programming talent available in many areas, further exacerbating this problem.

We appreciate the FDIC's candor in recognizing that all three options involve "some regulatory and financial burden" and that the FDIC is seeking to "minimize these costs."

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[3] *Id*. at 73654.

As set forth below, however, we are concerned that even Option 2 does not create a reasonable balance.[4]

2. Benefits

We believe that the analysis of the benefits must take into account the likelihood of failure of a Covered institution, particularly one that is well-capitalized. Not only is this remote, but the FDIC's concerns would appear to be at issue only if there were a liquidation (or a "limited" bridge bank) rather than a full bridge bank or open bank assistance. Finally, the deposit preference provisions of the Federal Deposit Insurance Act serve to minimize these concerns.

We recognize that in the past, large institutions experienced liquidity pressures that forced a closing before the institution is capital insolvent.[5] We believe, however, that in each of the relevant cases, there were multiple "trip wires," such as examination downgrades, deterioration of credit or increased credit quality issues, that alerted the FDIC to an enhanced risk of failure months ahead of the bank's closure.

3. Long Development Time.

Any material information system changes take significant time. Our member banks have discussed the ANPR with their technical staffs and have determined that any of the requested changes *could* be made, but only over a significant period of time. Without more specific direction, they cannot put a specific timeframe on the project, but to make any substantial changes over multiple systems, and then fully test them, is likely to take more than one year. As recognized in the ANPR, large financial institutions function on several platforms, often in different locations, and across time zones and borders. These systems often do not "communicate" with each other, the result of which requires each system to be programmed and tested individually as well as connected by some means so that the required data can be gathered in the requested form. Just the planning for the changes could take months before a Covered institution could proceed to the implementation and testing stages.

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[4] *Id.*

[5] *Id.* at 73655. Such a scenario can, of course, also occur at a small institution.

4. Elements of Cost

Although the lack of specificity about the three Options makes it difficult to identify even all the elements of cost, much less to engage in meaningful quantification, certain elements can be identified. First, our member banks operate their deposit accounting platforms on multiple systems, and all would need to be revised and coordinated. These include both basic platforms and specialized deposit areas. Second, much of the data needed for insurance calculations are not used in day-to-day bank operations or are not readily capturable in computer-accessible format. Accordingly, there would need to be comprehensive reprogramming over multiple systems, and tremendous computing power would be necessary. Third, there would need to be ongoing maintenance and testing.[6] Fourth, there may need to be purchased and installed additional, dedicated communication links between each of the banks and the FDIC.

5. Unknown Costs.

As mentioned, the lack of specificity prevents our member banks from estimating the costs of implementing any changes. At this point, our member banks do not know what system changes are necessary or the time period for implementation. Although, as discussed below, we agree that Option 2 would be the least costly, we are concerned that its costs will be more than "fairly modest." As mentioned, these costs include planning, actual implementation of computer code changes, thorough testing and ongoing maintenance.

6. Scope of the Proposal

We agree that a principal focus of any revised program is minimization of disruption for depositors. Such disruption can, of course, occur irrespective of the size of the institution. If the program is not extended to all depository institutions, it should at least use a deposit cut-off of $500 million. There is also a question of equity when the Covered institutions pay the same insurance premiums and receive the same insurance coverage as the non-Covered institutions. Because of the extraordinary costs and burdens associated with all of the Options, we suggest that the FDIC consider a system of credits whereby a Covered institution's deposit

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6 The ANPR indicates that the systems will be regularly tested to ensure that they function should failure become imminent. *Id.* at 73658.

insurance assessment would be reduced by all or a portion of the costs such Covered institution incurred to comply with the new system.

B. *The Options*

1. Option 3

We address Option 3 first, not only because it is the most costly, but because it would be the most unfair and result in a paradigm change.

The paradigm change is to shift the insurance determination decision from the FDIC to a small number of Covered institutions. Under the current system, as well as the changes proposed under Options 1 and 2, the FDIC is responsible for making insurance determinations at the time of failure.

This change is inappropriate because it is the FDIC that has not only the statutory obligation, but the expertise, to make the necessary determinations. The insurance coverage provisions are very complex and a depository institution is not in a position to apply them. As the ANPR recognizes, "[a] precise deposit insurance determination requires a specialty system to analyze deposit data and apply the insurance rules."[7] Similarly, the "deposit insurance determination process has several steps [and] . . . [e]ach step varies in time and complexity."[8]

As recognized in the ANPR, the costs of the systems required to implement Option 3 would be very substantial. The sunk costs of implementing a real time system that is fully operational and regularly tested before there is even a hint of failure far outweigh the potential benefits to depositors of potentially receiving access to their funds more quickly. At best, a real time system would expedite insurance determinations by a day or two. Because the ANPR sets out very few details of Option 3, our member banks are unable to determine even a "ballpark" dollar cost. We are certain, however, that these costs would be significantly higher than the costs associated with the other two Options.

Finally, the ANPR calls for Option 3 to apply only to the 10 or 20 largest of the Covered institutions. We believe that because the costs of Option 3 would be significantly

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[7] *Id.* at 73653.

[8] *Id.* at 73655.

higher than the other Options, Covered institutions subject to Option 3 would be put at a competitive disadvantage. We are certainly not suggesting that Option 3 would be acceptable if its coverage were extended to a greater number of institutions; rather, we note this to further underscore the weaknesses of Option 3.

2. Option 1.

As indicated in the ANPR, Option 1 differs from Option 2 because Option 1 includes two additional and substantial data requirements. Here, we will address the two additional components of Option 1. The overlapping items will be discussed in the context of Option 2.

Option 1 would require Covered institutions to assign a unique client identifier for each depositor. We submit that generally depositors already have a unique client identifier in the form of a social security number or a taxpayer identification number. As discussed above, each additional change that Covered institutions are required to make will cost time and money. Therefore, every mandated change should have a clear benefit that justifies the cost. We do not believe this change meets that test. The only explanation for this addition is that if it is not supplied by the Covered institution, the FDIC would have to rely on a tax identification number and the name and address on the account. Again, it is unclear how a unique client identifier would be superior to a tax identification number and why the FDIC would need to refer to a name and address to differentiate between two accounts registered under the same tax identification number.

Option 1 would also require Covered institutions to identify the deposit insurance ownership category of each deposit account. Our objection to this requirement is similar to our objection to the determination of insurance status under Option 3. Identification of the deposit insurance category of each account has traditionally been the responsibility of the FDIC. Although the ANPR states that if Option 1 is adopted, the FDIC will rely on the Covered institution's determination, this involves a complex regulatory analysis which is best performed by the regulator. Moreover, the Covered institution must rely on the depositor to supply the correct information and should not be responsible for a mistake made by the depositor.

3. Option 2.

Option 2 is the least costly and the least objectionable because our member banks already maintain this information on their systems (although generally not on a single system that would be capable of producing the requested data set in a standard form).[9] Nonetheless, the details of this Option are not fully developed, and a number of issues need to be addressed. These include:

- Frequency of testing. How often would the Covered institution be expected to test its systems and how often would the FDIC itself conduct tests?

- Data security. The ANPR indicates that the FDIC itself has in place strict data security safeguards, but the remaining issues involve security during the transmission and at the Covered institution.

- Information transmission. Timing is an important factor with data transmission because of the vast amount of data that a Covered institution would transmit to the FDIC. For example, one of our member banks believes that it would take 400 hours with a dedicated T-1 line for it to transmit the requested data (after such data is gathered) to the FDIC. This is clearly not fast enough to accomplish the FDIC's goal of reopening a failed institution on the next business day after failure.

- Development time. How long would Covered institutions be given to develop and test the requisite systems?

- Application to affiliate banks. Would the new requirements be applicable only to the large bank, or would small affiliated banks also be covered? If the latter is true, the new requirements should be imposed on all institutions.

- Format of data. As noted above, the requested information is currently maintained by the Covered institutions, although not on a single system. It may be possible to limit the development time and costs if the data can be transmitted in a manner that would not require a Covered institution to compile it all into one data set.

- Timing of settlement. The business of almost all the large banks that would be affected is global in nature and often in operation around-the-clock. The cut-off time for wire and other transactions needs to be specifically addressed.

- Sweep accounts. Would sweep accounts be permitted to continue after suspension of the bank's business? These accounts move significant sums of

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[9] We note from the ANPR that potential vendors also prefer Option 2.

money in a highly automated way, the suspension of which could cause liquidity issues throughout the markets.

In short, many factors must be evaluated before our member banks can offer definitive views.

C. *Preferable Approach.*

In order to "most effectively meet [the] cost/benefit tradeoff," we recommend the following four-step approach.

First, the FDIC should determine precisely what information it will require from Covered institutions.

Second, the FDIC, in consultation with the Covered institutions, should develop uniform systems to gather this information. This would encourage best practices and would create an increased potential for achieving the correct result.

Third, rather than requiring all Covered institutions to maintain this information on their systems at all times, it would be more efficient for the FDIC to require the gathering of the required information at the time when a Covered institution falls below well-capitalized status or meets certain other "triggers". It simply does not make sense for a well-capitalized, well-managed depository institution to be required to maintain this vast store of data in a particular form at a time when failure, including as a result of a liquidity insolvency, is, at most, remote. Balanced against the enormous costs of implementing a real time system capable of continuous testing, it is clear that the benefits of preparation for a highly improbable occurrence are outweighed by the costs.

Fourth, the FDIC should develop the system, a "black box," to interface with the deposit systems of the Covered institutions. This reduces the costs to each Covered institution by including only the testing of the system. It also produces the benefit of uniformity and consistency. Each Covered institution would, of course, be responsible for ensuring that the FDIC's system is compatible with its systems.

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The Clearing House appreciates the opportunity to comment on the ANPR. If the FDIC would like additional information regarding these comments, please contact Norman R. Nelson, General Counsel of The Clearing House, at (212) 612-9205.

Sincerely yours,

cc: Christopher Hencke
(FDIC, Legal Division)