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Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Subject: RIN: 3064-AD08 -- FDIC Notice of Proposed Rulemaking to implement the one-time assessment credit under the Federal Deposit Insurance Reform Act of 2005.

Dear Mr. Feldman:

Background & Summary Conclusion

On May 18, 2006, the FDIC published in the *Federal Register* a notice of proposed rulemaking, including a request for comment on its plan to grant a one-time assessment credit to institutions in existence on December 31, 1996, or their successors. Under the proposed rule, the FDIC would grant successor institutions – that is, institutions that acquired the deposits of eligible institutions that have gone out of business since year-end 1996 – an assessment credit if they acquired the deposits through a merger or consolidation. The FDIC asked for comments on whether deposits acquired through other means should be considered as well.

We are pleased to respond to the FDIC's request for comment on whether other deposit acquisition methods should be eligible for assessment credit. We have been asked to review this matter by PNC Corporation; and our views, after having carefully considered the matter, are as follows:

The FDIC, in its final rule, should grant the one-time assessment credit to insured depository institutions that can demonstrate that they are successors to institutions that paid assessments on deposits prior to December 31, 1996, through purchase and assumption transaction acquisitions where substantially all the assets and liabilities of the acquiree have been purchased. This means that presently operating institutions would receive a credit whether the deposits were acquired through merger and consolidation or through the functionally equivalent method of purchase and assumption transactions.

We come to this conclusion because we believe that a broader definition of "successor" is consistent with the public policy objectives of the Congress and the FDIC in fairly and equitably providing credit against sums that long-established financial institutions paid in the 1990's to rebuild the insurance funds. This more inclusive approach also ensures that the FDIC avoids discriminating against purchase and assumption transactions, a method that bank acquirers, as well as the FDIC itself, sometimes prefer in arranging the disposition of liabilities and assets of failed institutions.

Discussion

Issue

The FDIC and the Congress have concurred that the current federal deposit insurance assessment methodology is flawed. Long-established institutions that paid significant deposit insurance premiums to fully fund the FDIC funds in essence subsidized new and sometimes fast-growing institutions that have not had to pay premiums because the funds are already at their target reserve ratios. More particularly, all the administrative costs and insurance payouts since 1995-1996 have been paid entirely by institutions in existence before year-end 1996 (and from the interest earned on the funds). Former FDIC Chairman Powell testified before Congress last year that since 1996, "almost 1,100 new banks and thrifts, which hold $262 billion in assessable deposits, have joined the system and never paid for insurance."[1]

The Federal Deposit Insurance Reform Act of 2005 addresses this issue by providing a "credit" against future premiums to institutions that paid assessments on deposits before 1997, or to their successor institutions. The Act gives the FDIC substantial flexibility in determining the factors it weighs to determine whether an existing bank or thrift is a successor institution for the purposes of calculating the assessment credit.

In its proposed rule, the FDIC defines a successor institution as the "resulting institution in a merger or consolidation."[2] When one institution buys another in its entirety or merges fully with another, identifying the successor institution is a straightforward matter.

However, the FDIC also specifically recognizes in the preamble to the proposed rule that there are other legitimate methods that institutions use to acquire some or all of the assets

[1] Donald E. Powell, Chairman of the FDIC, in testimony before the Subcommittee on Financial Services, U.S. House of Representatives, March 17, 2005, page 4.
[2] Federal Deposit Insurance Corporation, "One-Time Assessment Credit," *Federal Register*, Volume 71, Number 96, May 18, 2996, page 28812.

of an institution, including its deposits. The FDIC calls transactions that are functionally no different from ordinary merger transactions, *de facto* mergers and consolidations. This makes considerable good sense, and we commend the FDIC for taking this point of view. In our free market economy, it is fundamentally important that one form of corporate transaction not be preferred over another when the substantive result is the same. The flexibility that this principle allows for institutions to conclude business restructurings in the way that best suits them creates important efficiencies that help to advance the national economy generally and the financial services industry in particular.

One important type of corporate transaction that fits this "*de facto*" merger and consolidation category is a purchase and assumption transaction where substantially all of the assets of one institution are acquired by another. In such a transaction it is accurate to say that the acquirer is in substance the successor institution to the institution that sold essentially all of its assets and liabilities.

Analysis

As noted above, we believe that any institution that legally acquires substantially all of the assets and liabilities of an acquiree through a purchase and assumption transaction -- including pre-1997 deposits that originated in a pre-1997 federally insured institution -- should be considered a "successor" institution and fully eligible for the original institution's assessment credit. We believe that this approach is entirely consistent with the public policy goals and intent of the FDIC and the Congress in granting the assessment credit.

In the Section-by-Section Analysis in the report on the legislation from the House Committee on Financial Services, the Congress directs:

> "For purposes of allocating dividends and credits, the FDIC is *required* [emphasis added] to determine each insured depository's relative contribution to the DIF (or any predecessor deposit insurance fund), taking into account the institution's relative share of the assessment base as of December 31, 1996...."[3]

In addition, in his testimony to the Congress last year, Chairman Powell said:

> "Allocating the initial assessment credit according to the institutions' relative assessment bases at the end of 1996, the year that both funds were fully capitalized, reasonably approximates relative contributions to the funds' capitalization, while avoiding the considerable complications that can be

[3] Committee Report on the Federal Deposit Insurance Reform Act of 2005, Committee on Financial Services, U.S. House of Representatives, April 29, 2005, page 35.

> introduced by attempting to reconstruct the individual payment histories of all institutions." [4]

Importantly, both the Congress and Chairman Powell focus on the need to allocate credits to institutions (and their successors) that paid premiums before the end of 1996, and neither makes any distinction among the methods institutions used to acquire those deposits. This is precisely our position.

The inequities caused by the fact that institutions have deposits for which no bank ever paid assessments can only be erased by granting credit to all institutions that can demonstrate that they hold deposits on which assessments were paid to recapitalize the insurance funds. Erasing this inequity is a public policy goal of the FDIC and the Congress. Hence, the method by which an institution purchased the deposits should not be a consideration; no matter what method an institution used to acquire the deposits, its predecessor paid the insurance assessments on those deposits.

Indeed, drawing technical distinctions among deposit acquisition methods that are functionally equivalent would only increase inequities. It would place some legitimate successor institutions at a further competitive disadvantage. Unlike their younger competitors, these successors have paid the embedded cost of deposit insurance; and unlike their long-established competitors, they would not benefit from the one-time credit. The only way to avoid this problematic situation is to provide all legitimate successor institutions with these credits.

In addition, and importantly, it would be unfair to differentiate among deposit purchase methods after the fact. No institution could have anticipated that the FDIC would grant a credit for deposits that an institution acquired though a merger or consolidation transaction, but not through a purchase and assumption transaction. So a bank would not have had any chance to take this into consideration when it was selecting among various acquisition alternatives. If institutions had this knowledge, they may well have taken a different approach.

We believe that the FDIC should not discriminate against privately negotiated purchase and assumption transactions; quite the contrary. The interests of the FDIC are best served if purchase and assumption transactions are treated no differently from mergers and consolidations.

Purchase and assumption transactions have important virtues in the banking context. These include:

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[4] Donald E. Powell, Chairman of the FDIC, testimony before the Subcommittee on Financial Services, U.S. House of Representatives, March 17, 2005, page 5.

- They allow an acquirer to move quickly and efficiently to complete an acquisition where the acquiree may be financially troubled or in essence failed.

- Beyond speed, which can be of critical importance in such cases, a purchase and assumption approach in what in essence is a merger or consolidation has the virtue of protecting the acquirer from unanticipated liabilities arising from the transaction, enhancing the safety and soundness of the acquirer.

- Furthermore, because of the efficiency and higher degree of certainty involved in a purchase and assumption transaction, acquirers are inclined to pay more for deposits and liabilities than would otherwise be the case. This injects more private funds to resolve a troubled bank case and lowers the financial responsibilities of the FDIC as the receiver of failed banks.

- Indeed, as has already been noted, the FDIC itself uses this technique to resolve failed banks.

Providing institutions with credit, when purchase and assumption transactions were used to acquire pre-1997 deposits, would not place undue administrative burden on the FDIC. The FDIC understandably expresses concern about the possibility that it could become an excessively burdensome process to identify the deposits on which institutions have paid assessments. The change we recommend, however, is easily accommodated within the administrative framework that the FDIC is proposing. A bank that claims to be the successor to an institution that was in business in 1996, where substantially all of the assets and liabilities have been acquired by this bank, must submit appropriate documentation. Hence, by far the greatest burden of deposit tracing is on the bank acquirer, not the FDIC.

Also, the potential number of additional cases that the FDIC might need to review is limited. We do not have precise statistics, but it appears that there may not have been more than ten (10) purchase and assumption transactions involving in essence all the assets and liabilities of the acquiree since the end of 1996.

Verifying the legitimacy of the claims by banks that they are the successor institutions in purchase and assumption transactions should not be any more difficult for the FDIC than verifying it for mergers or consolidations. Further, the review that the FDIC must perform is in many ways similar to the tracing and verification of deposit balances that it does under the Bank Merger Act. In these situations, acquirers must submit analyses of deposit concentrations in local markets that would result from proposed mergers, which the FDIC must review and verify.

Summary

In sum, we believe that the FDIC should grant assessment credits for deposits acquired by an insured depository, where the deposits have been acquired as the result of a purchase and assumption transaction involving the acquisition of substantially all of the assets and liabilities of an institution that was in business prior to the end of 1996 and for which the predecessor paid insurance.

Sincerely yours,

Eugene A. Ludwig