Citizens Financial Group, Inc.™

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August 15, 2006

Mr. Robert Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW.
Washington, DC 20429
RIN 3064-AD07

RE: Notice of Proposed Rulemaking, One-Time Assessment Credit

On behalf of Citizens Financial Group ("CFG")[1], I am writing to strongly oppose the FDIC's definition of "Successor" set forth in Notice of Proposed Rulemaking ("NPRM") implementing the one-time assessment credit, as required by the Federal Deposit Insurance Reform Act of 2005 ("the Act").

The NPRM adopts a "follow-the-charter" approach in a manner that automatically prevents institutions which acquired deposits through asset purchases from receiving credits associated with those deposits. This approach is inconsistent with the original purpose of the one-time assessment credit which is to offset so-called "free-riders" on the Deposit Insurance Fund. Rather, the NPRM establishes a system where institutions with diminished deposit bases can go for years without paying premiums--ironically, creating new free riders on the Fund. Further, this rigid approach disregards Congressional intent by arbitrarily discriminating against institutions based on how they acquired deposits. Lastly, the NPRM raises operational concerns without fully considering the various means by which those concerns could be resolved. We therefore request that the FDIC issue a final rule which will provide an opportunity for banks that acquired

[1] Headquartered in Providence, Rhode Island, CFG is the parent company of Citizens Bank and Charter One Bank which operate retail banking centers in 13 states including Rhode Island, Massachusetts, Vermont, New Hampshire, New Jersey, New York, Connecticut, Pennsylvania, Delaware, Ohio, Illinois, Michigan, and Indiana. CFG is a wholly owned subsidiary of the Royal Bank of Scotland. Since 2000, CFG has grown significantly through both mergers and deposit acquisitions.

deposits through asset purchases to receive assessment credits for those deposits.

I. Background

One of the original goals of the FDIC Reform Act was to establish risk-based premiums, replacing uniform assessments collected only when the Designated Reserve Ratio ("DRR") fell below 1.25 percent. To accomplish this, the new law allows the FDIC to collect risk-based assessments within a flexible DRR, when and as appropriate. The result of adopting this approach will be that insured institutions will pay assessments much more frequently.

However, the FDIC has not collected premiums since 1996, the year the fund became fully capitalized. As a result, by 2003, close to 1000 newly chartered institutions held over $80 billion worth of deposits for which premiums had never been paid.[2] Billions more were held by institutions which had grown significantly since 1996. As Congress prepared to require all insured institutions to begin paying premiums on a much more frequent basis, it realized that it needed to address this inequity.

Congress initially considered imposing "special assessments" on new and rapidly growing institutions, recognizing that they held deposits for which premiums had never been paid. In fact, legislation was introduced that would have imposed such fees. (See H.R. 1293, *The Deposit Stabilization Act,* 107th Congress.) Proponents of the legislation argued that new and fast growing institutions had enjoyed a special advantage by holding deposits on which they had never paid premiums, and that those deposits posed additional risk to the fund. Essentially, proponents argued, new and rapidly growing institutions were "free riders" on the insurance fund.

The FDIC also recognized the need to address this "free-rider" issue. In testimony before the House Financial Services Committee, then-FDIC Chairman Don Powell noted that "new institutions and fast growing institutions are benefiting at the expense of their older and slower-growing competitors." Further, he noted that rapid deposit growth could damage the fund by lowering "a fund's reserve

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[2] Testimony of Chairman Don Powell before the House Financial Services Committee, March 4, 2003.

ratio and increas[ing] the probability that additional failures will push a fund's reserve ratio below the DRR [triggering additional assessments.]"[3]

Not surprisingly, the special assessment approach was vociferously opposed by a number of institutions that would have been subject to the new fees. As a compromise, the FDIC recommended that Congress address the "free-rider" issue by instituting "assessment credits based upon past contributions"-- the advantage of which would be to "avoid the moral hazard problems created by tying credits to the current assessment base."[4]

Therefore, Section 7(e)(3) of the Act requires the FDIC to allocate credits to insured depository institutions, or their successors, to be applied against future premiums "based on the assessment base of the institution on December 31, 1996, as compared to the combined aggregate assessment base of all eligible insured depository institutions." [5] The Congress chose December 31, 1996 as the date on which the assessment base would be calculated because that date corresponds to the time period in which the deposit insurance funds became fully capitalized and assessments were no longer collected.

As Congress focused on finally enacting FDIC reform legislation (after almost four Congresses), Congress became concerned that the language providing credits to "successors" of insured depository institutions might not adequately consider the numerous ways in which depository institutions acquired deposits. It was generally understood that where institutions acquired deposits as part of a merger or consolidation, the resulting institution would be the "successor" and therefore eligible to receive the credits.

However, Congress recognized that limiting the definition of "successor" to the traditional meaning could lead to an inequitable result by automatically precluding depository institutions which acquired deposits through asset purchases from receiving credits for those deposits. Therefore, the Senate in its version of the legislation

[3] Id.
[4] Id.
[5] The FDIC states in the NPRM that the total credits to be allocated amount to over $4.7 billion.

included language mandating that the FDIC define "successor" and in doing so take into account any factors the FDIC deems appropriate, including whether an "insured depository institution that purchases deposits from another insured depository institution may be deemed a successor."[6] This provision was simplified in the final enacted version to state that "The Corporation shall define the term 'successor' for purposes of this paragraph, by regulation, and may consider any factors as the Board may deem appropriate"—thereby allowing the board to consider even more broadly any manner in which an institution might obtain deposits.

Despite this legislative history, the NPRM nonetheless adopts the traditional corporate law definition of successor which holds that a "successor" is the "resulting institution in a merger or consolidation" where the charter and all of the accompanying assets of the institution are merged into the acquiring institution. The NPRM deems this the "follow-the-charter" approach.

Under the "follow-the-charter" approach, credits must be awarded to the holder of the charter, even if that institution has sold "substantially all of the assets and liabilities." In adopting the "follow-the-charter" approach, the FDIC rejected a "follow-the-deposits" approach which would have allowed credits to follow deposits from one institution to the next without regard to the method by which those deposits were transferred—whether through merger, consolidation, asset sale, or another method.

II. Argument

A. The "follow-the-charter" approach is contrary to the original purpose of the one-time credit which was to recognize that since 1996 the FDIC has been insuring billions in deposits for which assessments <u>have never been paid.</u>

Ironically, the "follow-the-charter" approach treats banks which purchased deposits the same as the "free riders" the assessment credits sought to address. As set forth above, the assessment credits provisions were included in the Act in recognition of the existence of

[6]Sec. 204(a)(2)(c), S. 1562, *The Safe and Fair Deposit Insurance Act,* as reported by the Senate Banking Committee on October 18, 2005

hundreds of billions of dollars of insured deposits on which premiums had never been assessed. Clearly, banks which hold deposits on which assessments have not been paid should not receive credits for those deposits. However, under the "follow-the-charter" approach, institutions which purchased deposits (on which insurance premiums have been paid) are treated as if they were one of the “free -rider” institutions that necessitated the credits in the first place. This turns on its head the original intent of the credits because banks that purchased deposits have not added “new” deposits to the fund and are therefore not holding the type of deposits that would “lower the fund’s reserve ratio and increases the probability of additional failures” referred to in Chairman Powell’s aforementioned testimony.

Automatically awarding credits to charter holders could create a new type of free-rider or more properly “reverse free-rider.” This will occur because institutions which sold deposits will automatically be getting credits for deposits they no longer hold. Where an institution has sold a significant amount of its deposits, it could go for years without paying any premiums—getting a free ride on the backs of other premium payers. For example, the *American Banker* has estimated that Mellon Bank, which sold virtually all of its retail banking deposits to Citizens, will go for years without ever paying a premium, while Citizens will pay premiums on those same deposits immediately. That article noted:

> “The big winners in the FDIC's credit giveaway include those that have sold large amounts of deposits since 1996. . . . The decision leaves Mellon Bank, which sold $13 billion of deposits to Citizens in 2001, with a $35.3 million credit, but a considerably reduced assessment base. The FDIC estimated its credit would withstand 42 basis points of premiums, suggesting that Mellon will not be paying premiums again for several years.”[7]

B. The “follow-the-charter” approach arbitrarily places institutions which acquired deposits through asset

[7] *American Banker,* FDIC Credit Data Shows Many Banks Wouldn't Pay, Rob Blackwell, May 19, 2006

acquisition at a competitive disadvantage based merely on the method by which they acquired deposits.

As noted by the reference in the *American Banker* to selling institutions being "big winners" under the "follow-the-charter" approach, institutions which sold deposits are provided with additional compensation while institutions which purchased deposits are saddled with extra assessments. As former Comptroller Eugene Ludwig notes in his filing on behalf of Pormentory Financial Corporation, acquiring institutions that have purchased deposits have "paid the embedded cost of deposit insurance." Now, under "follow-the-charter" approach, purchasing institutions are forced to pay again by being denied any opportunity to benefit from the one time assessment credits. At the same time, institutions which sold deposits will receive additional compensation by receiving credits for deposits they no longer hold and against which they will no longer pay premiums.

It is important to note that purchasing institutions could not have foreseen that they would be putting themselves at such a disadvantage as they considered whether to acquire deposits through asset acquisition or merger. This is acknowledged in the NPRM, which notes that "it is unlikely the parties to most of these deposit transfers took into account the potential for assessment credits at the time of the transactions." Indeed, it would be inequitable to favor one form of transaction over the other where the substantive result is the same.

The NPRM justifies its approach by making the blanket-statement that the traditional corporate law definition of successor "is more consistent with the general expectations of the industry" and noting that institutions that acquired another through a merger or consolidation "rightly believe that they are receiving all of the rights and privileges of the acquired institution, known or unknown." While true, this explanation nonetheless ignores the fact that parties who purchase deposits also believe that they are receiving, often at a substantial price, all of "rights and privileges" associated with those deposits. In other words, the FDIC recognizes that companies that acquire deposits through a merger expect all of the rights and privileges associated with those deposits but at the same time concludes that companies that acquire deposits through an asset acquisition have different expectations. Such an assumption is grounded neither in fact nor logic.

C. Reverting to the Corporate Law definition of "Successor" takes a rigid approach that disregards Congressional intent by automatically awarding credits to selling banks.

Congress required the FDIC to conduct a rulemaking to define "successor" as a recognition that the traditional corporate law definition of the word may yield inequitable results in some circumstances. Had Congress merely intended for the FDIC to automatically revert to the traditional corporate definition, the rulemaking would not have been necessary. In fact, Congress could have just as easily included such a definition in the legislation. Instead Congress intended to provide the FDIC the opportunity to make equitable determinations as to which institutions should receive credits. The "follow-the-charter" approach prematurely cuts off any such consideration by automatically awarding credits to a bank that sells deposits, preventing any opportunity for a purchasing institution to demonstrate that it is entitled, for equitable purposes, to the assessment credits.

D. The FDIC's operational concerns can be addressed and do not provide a sufficient reason to ignore the inequities resulting from a "follow-the-charter" approach.

The NPRM in part rejects the "follow-the-deposits" approach due to concerns about its operational viability. Most notably, the NPRM states that there is an absence of reliable existing data that could be used to track deposits from one bank to another because the FDIC does not routinely maintain detailed data on all deposit transfer transactions. As a result, most if not all information would have to be collected from industry--leading to disputes between institutions and potential inequities where parties fail to retain records. However, the NPRM recognizes that there may be other viable operational approaches and invites commentors to discuss those possible approaches.

We believe that the FDIC's operational and equitable concerns could be easily addressed if the FDIC used its discretion to require institutions seeking to receive credits for purchased deposits to demonstrate that there is an ability to reasonably identify and track deposits associated with a particular transaction. In doing so, the FDIC could place a high standard for the types of data and information that must be provided, assuring that it provides for defensible and consistent determinations.

Nonetheless, there are numerous methods to track previous sales of deposits which we believe the NPRM fails to consider. In many transactions, including most of the larger deposit acquisitions, deposits have only been sold once, which belies the NPRM's concerns about numerous "interrelated" transactions. The FDIC could further address this issue by requiring purchasing institutions seeking deposits to demonstrate that those deposits are traceable.

Limiting credit transfers to transactions that meet a de minimis test would also eliminate the need for the FDIC to unwind numerous interrelated transactions. Ironically, the FDIC opposes such an approach arguing it may result in disparate treatment of some similarly situated institutions which acquired deposits through asset purchases. However, this logic fails in light of the fact that the "follow-the-charter" approach itself would be inequitable to virtually <u>all</u> institutions that acquired deposits.

One approach, as mentioned in the NPRM, is that credits could be transferred on a pro-rata basis. We agree that would be viable approach. An even more precise method to track deposits is to simply match branches sold with the FDIC's publicly available Summary of Deposits database. While both pro-rata and branch sales would be operationally viable and equitable, other institutions may propose additional appropriate methods.

Lastly, the FDIC noted concerns about relying on data supplied by the parties, stating that some parties may fail to retain vital records surrounding a particular transaction. In any transaction, numerous records are generated and, in our experience, preserved for years by institutions and legal counsel. It is unlikely that any significant necessary documentation would be unavailable.

Because the "follow-the-deposits" approach could in fact be implemented fairly and efficiently, it makes no sense to disregard the equitable considerations attendant with providing credits to purchasing institutions by automatically foreclosing any opportunity for those institutions to receive credits for their purchased deposits.

III. Conclusion

The NPRM discriminates against one class of institutions based simply on the method by which those institutions acquired deposits. By automatically defaulting to a traditional definition of "Successor," the NPRM disregards any legitimate claim institutions which purchased deposits would have to assessment credits. In doing so, the NPRM establishes a system for allocating credits which ignores the original intent behind those credits. Further, the NPRM raises operational considerations without adequately considering the means by which assessment credits could be fairly and efficiently provided to purchasing institutions. Therefore, we respectfully request that in the final rule the FDIC provide for a method by which institutions that purchased deposits could receive credits against those deposits.

Sincerely,

Robert T. Gormley

Robert T. Gormley
Vice Chairman
Citizens Financial Group