AMERICAN BANKERS ASSOCIATION

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August 15, 2006 Via E-mail

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

Re: RIN 3064–AD08; Proposal for Distribution of Assessment Credits, as provided in the Federal Deposit Insurance Reform Act of 2005; 71 Federal Register 28809; May 18, 2006 (as revised in 71 Federal Register 36717; June 28, 2006)

Dear Mr. Feldman:

The Federal Deposit Insurance Corporation (FDIC) has issued a Notice of Proposed Rulemaking (NPR) to put into effect a system of assessment credits, as provided for in the Federal Deposit Insurance Reform Act of 2005 (Reform Act)[1] and the Federal Deposit Insurance Reform Conforming Amendments Act of 2005 (Amendments Act).[2] The Amendments Act requires the FDIC to establish regulations by November 5, 2006, governing the aggregate amount, eligibility, allocation and application of credits and procedures for banks to challenge the credit allocation.

The American Bankers Association (ABA) appreciates the opportunity to comment on this proposal. ABA, on behalf of the 2.2 million men and women who work in the nation's banks, brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest banking trade association in the country.

The key points discussed in this letter are as follows:

- The assessment credit system is temporary, and FDIC's funding expectations – both in the short run and long run – should reflect this. The existence of the credits should not distract the FDIC from achieving the key goals of the legislation: the creation of a flexible premium program that ensures adequate

[1] Sections 2107(a) and 2109(a)(3) of the Federal Deposit Insurance Reform Act of 2005 (Title II of the Deficit Reduction Act of 2005, P.L. 109-171) amend Section 7(e)(2) of the Federal Deposit Insurance Act, 12 U.S.C. 1817(e).
[2] Federal Deposit Insurance Reform Conforming Amendments Act of 2005 (P.L. 109–173) §5.

FDIC resources while minimizing costs and disruptions to the banking industry. A spike in FDIC premium rates, when fund resources would still grow appreciably under a smoother premium program, would create an unnecessary burden on banks that have little or no credits.

- The definition of "successor" in a business combination should recognize *de facto* mergers, where a bank acquires substantially all the assets and liabilities of another bank.

- Credits are reductions in future premiums.

- The time limit for banker responses in appeals of the credit allocation should be extended to 60 days.

I. The credit system is transitory and should not distract from achieving adequate FDIC resources under a program of smooth, low premium rates.

The FDIC has stated that the clear purpose of the one-time assessment credit is "to recognize the contributions that some insured depository institutions made to capitalize the deposit insurance funds and conversely to recognize that many newer institutions have never paid assessments because they were chartered after the reserve ratios of BIF and SAIF reached 1.25 percent and most institutions were charged nothing." That statement seems to be consistent with the intent of Congress.

While the system will perform in some ways differently during the transition period from how it will once the new assessment system is fully-implemented, the difference is not enough to justify a spike in premium rates. We appreciate the desire by the FDIC to acquire adequate resources when the industry is healthy, as it is today, to be available when the industry may be under some financial stress. We would note that an increase in Deposit Insurance Fund (DIF) resources can be achieved within the context of a program of low premium rates, even during the period when credits are available to offset premiums. The use of credits, while limiting DIF receipts does not eliminate receipts. The more notable effect of the credits, as reflected in the FDIC statement, is in the short-term apportionment of payments into the DIF; such apportionment differences should not and need not be exaggerated, though, by a structure of short-term high premium rates. During the transition period where credits are used such an approach would impose a significant financial burden on some institutions. Achievement of the goal of increasing DIF resources in good times to be available in hard times will, of course, be moderated during the transition period, but not enough to abandon the other goals of stable and low premium rates.

There are no significant disruptions in the banking industry today. It is important to manage the transition in a way that avoids creating disruptions. There is no need for aggressive augmentation of the insurance fund during this transition period when DIF resources will grow under a non-disruptive program. Raising the bulk of revenues from the small minority of banks without credits in order to boost the insurance fund quickly would impose major cost imbalances at a time when the needs of the DIF do not require it.

Rather, the ***short***- and ***long***-term goals should be low and stable premiums. The FDIC has supported this approach throughout the debate in Congress. There is no reason to deviate from this approach during the transition period where credits are being used to offset premium assessments for some banks. Setting high premiums would, in fact, frustrate the achievement of this goal and would disrupt a smooth and steady transition to the system where all banks would be paying cash premiums. Under a sustainable, low-premium rate program, most credits would be used within three or four years – a short time period for any transition.

There are several reasons supporting this approach:

First, the banking industry is healthy, with strong earnings, rising capital, and problem loans near historic lows. With the development of new risk management techniques, it is no surprise that the banking industry performed exceedingly well over the last decade (which included the 2000-2001 recession).

The decline in the insurance fund reserve ratio does not represent a decline in DIF resources. Instead, the reduction in the ratio is due to strong insured deposit growth rather than problems in the banking industry. The number of banks on the FDIC's problem bank list has steadily declined, and no bank has failed in over two years. We would note that the DIF reserve ratio is well within the normal operating range set by Congress and is not inconsistent with the current and expected low financial demands on the fund. Simply put, this is an excellent time for a transition.

Second, the insurance fund balance will *exceed $50 billion* by the end of 2006, having grown by more than *$400 million each quarter* on average for the last three years – even with most banks paying no premiums at all. The fund is so large that the earnings off the securities portfolio have exceeded operating expenses and the cost of bank failures by over $12 billion over the last decade. Thus, extra revenue raised at high assessment rates would have little practical benefit to the FDIC's ability to meet its obligations.

What higher premiums would do, however, is reduce the resources available for banks to serve their customers. In fact, every dollar that goes to Washington rather than to bank capital means at least eight fewer dollars lent in local communities. In view of the big impact that high premium rates can have on the capital and earnings – and services – of banks, Congress specifically required the FDIC to consider such factors in setting rates.[3]

De novo banks are particularly affected. These banks will be paying premiums without any offsetting credits and, under the terms of a separate NPR on risk-based premiums, may be paying the highest rate in the healthy bank category.[4] A high premium rate program would be a heavy burden on these banks at the very time that they are drawing upon every resource to establish their new business. Moreover, it could present a significant barrier to entry for banks in formation, which would be counter to an open and competitive market.

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[3] Federal Deposit Insurance Reform Conforming Amendments Act of 2005 (P.L. 109–173) §2104(a)(1).

[4] Proposal for Assessments, as provided in the Federal Deposit Insurance Reform Act of 2005; 71 Federal Register 41910; July 24, 2006.

Third, Congress anticipated that there would be times when the reserve ratio would fluctuate and abandoned a statutory reserve ratio for the flexibility of a range. Clearly, this was intended to allow the FDIC to pursue a smooth, low premium policy that avoids spikes in premium levels. Indeed, even if the reserve ratio were to fall below the lower bound of the normal range of 1.15 percent, the FDIC would have under the statute up to ***five years*** to regain that level, thereby avoiding an unwarranted spike in premium costs. If Congress allowed such a sensible time frame for returning to the normal range, it seems more than reasonable to have an appropriate transition time frame for achieving any specific designated reserve ratio. Given that the system will be in transition as the credit pool is exhausted, a deliberate, smooth and steady approach is justified.

Fourth, the FDIC's exposure today – measured by the ratio of insured deposits to assets – is far less than it was fifteen years ago when the 1.25 percent target level was established. The enhanced regulatory powers the FDIC has enjoyed since 1991 – including the prompt corrective action, depositor preference and cross guarantee measures – make it less likely that a bank would fail and less costly to resolve those that do. Thus, the proposed Designated Reserve Ratio of 1.25 percent level is high relative to FDIC's risk and, therefore, there is little need for an expedited movement to it.

The ABA believes that it is appropriate and advisable to keep the impact of premiums relatively modest on banks with few or no credits while still conforming to the letter and spirit of the law that recognizes the significant contributions made by banks in the early 1990s. This would require the FDIC to take the long view and set low and stable premiums.

II. The definition of "successor" in a business combination should recognize *de facto* mergers where a bank acquires substantially all the assets and liabilities of another bank.

The ABA has heard from members that are on opposite sides of deposit sales transactions and believe that both sides have strong and legitimate arguments for why they would be the successor. As there is no industry consensus on the proper approach, the ABA takes no position on the definition of "successor," except as noted below.

The ABA recommends that the term "successor" include a business combination that results in a *de facto* merger. The FDIC has proposed to treat a transaction as a *de facto* merger where one insured institution purchases all or substantially all of a conveying institution's assets and assumes its deposit liabilities, and the conveying institution terminates its deposit insurance and is liquidated or merged out of existence. The ABA agrees that this type of transaction ought to qualify as a *de facto* merger and that the acquiring institution should be treated as a successor to the conveying institution's assessment credit.

These transactions follow the same procedural and substantive rules that apply to *de jure* mergers and consolidations, including regulatory approval under section 18(c) of the Federal Deposit Insurance Act. The final result is essentially the same as if the target bank had been merged with and into the acquiring bank. Thus, the ABA believes that such a definition is consistent with Congressional intent and is wise policy.

Allowing for *de facto* mergers is also in the best interests of the FDIC. For example, a purchase and assumption transaction of this sort often is done where the target bank is troubled. Transferring credits to the acquirer will facilitate this type of transaction, encouraging the more rapid acquisition of a troubled bank and decreasing the likelihood that the insurance fund will have to engage in a liquidation and/or make payments to claimants.

III. Credits are reductions in future premiums.

We have evaluated the accounting for the assessment credits and believe it is critical that the accounting treatment be resolved before finalizing the rule. We believe that the credits, as intended and enacted by Congress, represent a potential future reduction in premiums, requiring no balance sheet or income statement recognition (other than footnote disclosure if material). Some may believe that the mere existence of transferability of credits would result in recording the credits as assets and income. We disagree, such transferability being little different from and analogous to a discount coupon in a retail sales transaction that can be transferred among potential customers.

In today's environment, many accounting issues – even those that have been in place for many years – are being re-evaluated by accounting technicians. It is important to ensure that the technicians agree – including those within accounting firms and banks – so that any necessary structural changes to the credits can be made prior to issuing the final regulations. We would value the opportunity to discuss these issues with the FDIC.

IV. The procedure to appeal the credit allocation should parallel the procedure for appealing quarterly premium assessments.

The ABA appreciates the effort made by the FDIC to post the credit information on its website in order for banks to review the information. Nonetheless, the proposed procedure to allow a bank an opportunity to challenge the amount of its credits should be lengthened to parallel the procedure for challenging a quarterly premium assessment. The ABA sees no reason to create a different timetable from that used for challenging premium assessments, and believes that a separate schedule is likely to create confusion on the part of affected banks.

ABA appreciates this opportunity to comment on the NPR. We would be happy to answer any questions you may have on these issues.

Sincerely,

Wayne A. Abernathy
Executive Director
Financial Institutions Policy
And Regulatory Affairs