THE FINANCIAL SERVICES ROUNDTABLE

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September 22, 2006

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corp.
550 17th Street, N.W.
Washington, DC 20429
Attn: Comments

Re: RIN # 3064-AD09, Proposed Risk-Based Assessment Regulation

Dear Mr. Feldman:

The Financial Services Roundtable ("Roundtable")[1] appreciates this opportunity to comment on the FDIC's proposed regulation on risk-based deposit insurance assessments. The proposal evidences significant work and analytic thought, and contains many innovative concepts that would make insurance assessments more risk sensitive and thus fairer to insured depository institutions. However, there are a number of aspects of the proposal that are of serious concern to the Roundtable and its membership that we strongly urge you to address.

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[1] The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, investment products and services to the American consumer. Roundtable member companies provide fuel for America's economic engine accounting directly for $18.3 trillion in managed assets, $678 billion in revenue, and 2.1 million jobs.

As a fundamental matter, any new framework for assessing depository institutions *must* be consistent with the principles of “slow growth” and “no cliffs.” Only this approach is consistent with Congressional intent to avoid the economic consequences of a sudden change in the deposit insurance assessment rate, or the automatic imposition of a significant assessment without consideration of other relevant factors.[2] The “slow growth” and “no cliffs” principle is also required to protect our economy from the unintended consequences that could be caused by sudden changes in the assessment rates.

This letter addresses our specific concerns with the proposed regulation on risk-based deposit insurance assessments. They are:

- The potential for regulatory overlap between the FDIC and the primary regulator;
- The complexity of the proposal;
- The possible inclusion of secondary factors to change assessments;
- The size of the Category I assessment band in relation to the actual risk of loss to the FDIC;
- The potential of penalizing the use of Federal Home Loan Bank advances and acceptance of large deposits;
- Discrimination against new depository institutions;
- Flexibility to use parent company long-term debt ratings;
- The need to use averaging in determining financial ratios; and
- The need to provide advance warnings of assessment changes.

We will now discuss each of these issues in turn.

Eliminate Regulatory Overlap

[2] One of the primary goals of the Federal Deposit Insurance Reform Act was to prevent the automatic imposition of a 23 basis point deposit insurance assessment due to the reserve ratio dropping below the arbitrarily set 1.25 percent ratio.

A very serious concern raised by the proposal is the potential for the FDIC to second guess an institution's primary regulator. While the proposed regulation states that CAMELS ratings will be based on the ratings given by the primary regulator, the proposal also makes clear that the FDIC will be free to accept or not accept the primary supervisor's determination to change a CAMELS rating.[3] The primary regulator is in the best position to determine the condition of the regulated bank or thrift, and makes an informed decision based on both quantitative and subjective factors. The correlation between the primary regulators' CAMELS rating and the failure rate of depository institutions is clear and consistent. There is no reason for the FDIC to second guess the ratings proposed by the primary regulator.

Reduce Complexity

The proposal relies on complex formulas that relate selected financial ratios and CAMELS component ratings, and for larger banks, long-term debt ratings, to risk. The proposal establishes a wide array of standards depending on the asset size and age of the bank. This high degree of complexity makes it more difficult for depository institutions to understand the basis for the different assessment rates, and could result in equivalent institutions being subject to different assessments. For example, a bank holding company may have several subsidiary depository institutions, some of less than seven years of age, others older, and with many different sizes. Although all of the institutions benefit from the managerial and financial support of the parent holding company, and may in fact have the same CAMELS rating, under the proposal their assessment rates may differ. The result could lead to organizational changes designed to reduce assessments rather than to fulfill the business plans of the organization. We therefore urge the FDIC to reduce the

[3] The proposal explains that if an examination results in a change in an institution's CAMELS rating, the assessment category would also change, assuming the FDIC agrees with the primary Federal regulator's CAMELS rating. 71 Fed. Reg. at 41916.

complexity of the proposal and, at the very least, subject all depository institutions within the same holding company to the same unified standard.

Do Not Adopt "Secondary" Factors

The FDIC proposes to consider factors in addition to the CAMELS to set the assessment rate. These would include an evaluation of how an institution would perform under certain "stress" conditions, as well as other factors set out in Appendix D to the proposal. These factors would be used by the FDIC to adjust an institution's subcategory assignment within Risk Category I to the next higher or lower subcategory. We believe that this concept should not be adopted for a number of reasons.

First, many of the criteria listed in Appendix D involved subjective determinations that are not necessarily aligned with risk. For example, stock volatility, debt spreads and the composition of deposit and non-deposit funding sources may reflect more on market conditions or an individual analyst's views than on the actual risk of the bank. Second, some of these factors would again require the FDIC to duplicate the role of the bank's primary regulator, which creates potential conflicts between the agencies and adds an additional burden on essentially safe and sound Risk Category I institutions. For example, the primary regulator may determine that a bank's business activities and responses to various forms of stress are appropriate, while the FDIC could consider them sub-optimal and increase the insurance assessment. The bank is then is faced with the choice of following the advice of its primary regulator and paying a higher assessment, or altering its business plan in order to conform to the views of the FDIC and pay a lower assessment.

Modify Assessment Rate Band

The proposal currently sets the assessment rate band for Risk Category I institutions at between 2 and 4 basis points. The risk of failure of Risk Category I institutions is extremely low and the risk of *loss* to the FDIC (even in the event of a failure) is even less.[4] The FDIC's concern in setting assessment rates should focus on the potential of a loss to the fund and not merely the potential for failure.

Currently, there is no assessment at all for the 8,358 institutions in the current I-A category. The new system will differentiate among these 8,358 institutions and will undoubtedly identify institutions that pose *virtually no risk of loss* to the deposit insurance funds. Therefore, we believe that the FDIC should lower the proposed assessment rates for Risk Category I banks and also eliminate any assessment for the very safest institutions, *e.g.*, institutions with the highest debt rating and CAMELS rating or banks with consistently high debt ratings and CAMELS ratings over time.

Similarly, we note that the proposal seeks to adopt an arbitrary distribution of institutions within the Risk Category I band. This arbitrary distribution would limit to 45 percent the number of banks subject to the lowest assessment. There is no basis for this arbitrary limit, and in light of the condition of the banking industry today and the FDIC's own statistics for the Risk Category I institutions, that number is too limiting.

<u>Do Not Penalize the Use of FHLBank Advances or Large Deposits</u>

Another proposed financial factor to be used in the new system is the ratio of volatile liabilities to gross assets. The proposal asks for comment on whether time deposits in excess of $100,000 should be considered "volatile." The Roundtable believes that these deposits represent a stable source of funding for many institutions and that it would be a mistake to penalize banks that use this relatively low-cost source of funding. Therefore, we do not believe that these deposits should be included within the definition of "volatile" liabilities.

The preamble asks if secured funding, such as Federal Home Loan Bank advances, should be considered a risk factor. Federal Home Loan Bank advances are an extremely

[4] For example, subordinated debt holders would be entitled to be paid only after the claims of the FDIC are satisfied in full. A bank that has outstanding subordinated debt poses less of a risk of loss to the FDIC than other banks.

useful and inexpensive source of funding for many institutions, especially smaller institutions that do not have access to alternatives, such as direct access to the capital markets. Penalizing the use of such advances would be harmful to our housing finance system, and would be especially unfair to our nation's smaller housing lenders. Further, there is no evidence that these advances create safety or soundness risks to depository institutions, but rather enhance their safety by providing a reliable source of low cost funding. Finally, we note that the Federal Home Loan Bank System was established by Congress to provide such funding, and it would be against public policy to penalize depository institutions that utilize the Bank System. For these reasons, we do not believe that Federal Home Loan Bank advances should be considered "volatile" liabilities.

Do Not Discriminate Against New Institutions

The proposal would assess a "new" institution at the highest rate within Risk Category I, regardless of its actual risk weighting or potential risk to the FDIC fund. A "new" institution is defined as one that has been in existence for less than seven years. Imposing an additional charge on "new" institutions as a category is inconsistent with the FDIC's intent to improve risk differentiation and make the assessment system more sensitive to risk. It assumes that all "new" institutions are risky regardless of their actual risk profile or access to financial support from a regulated holding company. The articles offered by the FDIC in support of assessing all "new" institutions at a higher rate did not take into account holding company support or enhancements in supervision. As a regulatory tool, the proposal actively discourages "new" institutions from improving their risk positions as any reduction in risk would not result in a lower assessment.

One alternative is to develop an early warning system as suggested by one of the articles cited. At a minimum, the FDIC should not impose such a charge on institutions that are subsidiaries of regulated bank or thrift holding companies or foreign banks, provided the holding company or foreign bank parent is well-capitalized under applicable regulatory standards. Bank holding companies and foreign bank parents of US depository institutions are required to be a source of strength to their subsidiary banks. These established parent organizations provide both managerial and financial strength to the new bank, and the FDIC should recognize that this support significantly reduces the risk that might be present in new institutions. As noted previously, the Roundtable strongly believes that all depository institutions within the same holding company should be subject to a uniform standard for determining assessment rates.

Increase Flexibility of Ratings Requirement

For large institutions, the proposal relies on the long-term debt issuer rating of the depository institution, but excludes consideration of the long-term debt issuer rating of its holding company. For at least some organizations, debt is issued at the parent level, and not at the depository institution level. The limitation proposed by the FDIC would therefore require these institutions to obtain a long-term debt issuer rating, despite the fact that the parent company and not the bank will be the actual issuer. We suggest that the rule provide that parent ratings *may* be used in this situation and in addition, permit the use of a debt rating given to bank issued jumbo certificates of deposit as an alternative option.

Incorporate Averaging

We support averaging the financial ratios over a period of time, and suggest that that period be at least four quarters. Many financial institutions provide support to areas of the economy that experience seasonal variations in income and funding needs. A one-quarter snap shot of a financial institution serving a particular business sector could be misleading. Averaging financial ratios over a one-year period would present a better indication of the condition and management of the institution.

Provide Notice to Warn Institution of Assessment Increases

The proposal asks if institutions should be given advance notice that changes in their assessment rate are likely. The Roundtable supports this concept and urges that the notice specify the reasons for the possible change and that the institution should be afforded an opportunity to take remedial action before an increase is implemented.

Conclusion

The FDIC has proposed a new risk-based system for assessing insurance premiums that contains many innovative concepts. It is a thought-provoking proposal that will be very useful in developing a new assessment system. In developing the new assessment system, it is critical that the FDIC take a "go slow" and "no cliffs" approach as intended by the Congress. We also believe that the FDIC should take the following specific steps:

- Avoid regulatory overlap with the primary regulatory agency that is in the best position to determine CAMELS ratings and to monitor and change those ratings;
- Reduce the complexity of the proposal and apply uniform standards to all depository institutions within the same holding company;
- Eliminate the inclusion of secondary factors, that are either subjective or untested, to change assessments;
- Adjust the size of the Category I assessment band to more accurately reflect the actual risk of loss to the FDIC;
- Eliminate the assessment for the highest rated and safest institutions that pose virtually no risk of loss to the insurance fund;
- Do not penalize the use of Federal Home Loan Bank advances and acceptance of large deposits;

- Do not discriminate against new depository institutions;
- Permit the use of parent company long-term debt ratings when the depository institution does not issue long-term debt at the bank level;
- Use averaging in determining financial ratios; and
- Provide advance warnings of assessment changes.

If you have any questions concerning these comments or would like to discuss these issues further, please contact me at rich@fsround.org or 202-589-2413 or Mitzi Moore at mitzi@fsround.org or 202-589-2424.

Sincerely,

Richard M. Whiting

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Executive Director and General Counsel