Massachusetts Bankers Association

September 22, 2006

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

RE: RIN 3064–AD09, Assessments

Dear Mr. Feldman:

On behalf of our 210 commercial, savings, cooperative, and savings and loan members throughout Massachusetts and New England, the Massachusetts Bankers Association (MBA) appreciates the opportunity to comment on the Federal Deposit Insurance Corporation's (FDIC) proposed rule regarding deposit insurance assessments. This proposal, one of several issued by the FDIC to implement the Federal Deposit Insurance Reform Act (FDIRA) of 2005, is designed to make the assessment system more sensitive to risk and eliminate the subsidies in the current system.

MBA appreciates the FDIC's efforts over the last year to implement FDIRA. We are concerned, however, that some provisions in the assessment proposal could have a negative impact on depository institutions in Massachusetts and throughout the nation. While we generally support the use of a risk-based system, we believe the FDIC's current proposal could penalize some well-managed and well-capitalized institutions. In addition, we do not believe that the proposal sufficiently mitigates the impact of institutions with rapid deposit growth on the deposit insurance fund.

Risk Differentiation

The FDIC proposes using a bifurcated system of risk differentiation, with separate systems for banks with more than $10 billion in assets and those institutions with less than $10 billion in assets. Our comments focus on the risk differentiation system for smaller institutions. The proposal indicates that assessment rates for these institutions will be linked to a formula that relies on financial ratios and supervisory ratings. While we believe that the use of this data is appropriate, we are concerned with the weighting placed on some of this data and certain redundancies in the FDIC's proposal.

Specifically, the 25 percent risk weighting is applied to both the capital (C) and management (M) management ratios in a bank's CAMELS rating. However, while capital is a quantifiable measurement, the management rating is subjective. Well-capitalized institutions that do not pose a threat to the deposit insurance fund could be forced to pay higher premiums due largely to a subjective rating. We encourage the FDIC to reallocate the risk weightings, placing more emphasis on capital and other objective measurements of an institution's risk. We propose increasing the C weighting to 30 percent, while lowering the M weighting to 20 percent.

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We are also concerned that small community banks might receive an "M" component rating of 3, and yet not pose a high degree of insurance loss risk due to the conservative nature of their asset mix, operating profile and capital. Particularly with the FDIC's focus on compliance issues, minor technical mistakes could result in a higher M rating even though an institution has strong capital and is generally well-managed. According to the proposed formula, this could result in a significantly higher assessment. We believe that only "M" component ratings of 4 or higher should trigger the maximum assessment rate.

In addition, we encourage the FDIC to carefully study the impact of using earnings as a risk weighting factor, particularly with regard to mutual institutions. Earnings at many mutual banks tend to be somewhat lower than at commercial banks, however because of the nature of the mutual charter, this does not indicate a greater risk to the fund. In addition, some mutual banks have created charitable foundations by selling securities and other assets. These types of transactions can have an impact on earnings, and we believe the FDIC should consider these factors in the final assessment formula.

We would also point out that the risk weighting formula is needlessly biased against residential mortgage lenders. Many of our member banks have strong portfolios of 1-4 family, owner-occupied residential mortgage loans. Since these assets are secured, we would assert that they have a lower risk of deposit insurance loss when compared to many other types of loans. Therefore, we believe that these residential mortgage loans that have a loan-to-value ratio of less than 80 percent be excluded from these risk weighting factors.

Finally, we believe that some of the risk measures proposed by the FDIC are duplicative or do not accurately reflect the risk of an institution. In fact, most of the financial ratios the FDIC is proposing to use are also considered in the CAMELS rating. In particular, the FDIC proposes to use Loans Past Due 30-89 Days with a pricing multiplier of 0.37. Because loan delinquencies are a significant factor in decreased asset quality (A) and management (M) ratios in an institution's CAMELS rating, including 30-89 day delinquencies could actually be weighting this factor twice. We urge the FDIC to exclude 30-89 day delinquencies from the risk measures and encourage an analysis of whether the risk factors are duplicative.

New Institutions

Under the FDIC's proposal, institutions in Risk Category I that are less than seven years old will be assessed the highest premium available for any other institution in this category. If an established institution (older than 7 years) merges into or consolidates with a new institution, the resulting institution would be considered a new institution but would have the ability to request FDIC review to determine whether it should be treated as an established institution.

MBA is concerned that the proposed definition of a new institution as being less than seven years old is significantly longer than most current estimates that are widely used by the industry and the banking agencies. In fact, many times de novo institutions can't deploy all of their capital immediately and therefore present a balance sheet that is even more conservative than its seasoned competitors. We also do not support the concept of requiring established institutions that acquire or merge with institutions less than seven years old to automatically be considered "new" under the FDIC rule, regardless of the circumstances of the two institutions. In addition, forcing these institutions to pay the maximum premium could artificially decrease shareholder value in de novo institutions.

We believe that new banks should be assessed in a manner similar to all other depository institutions and not the "one-size-fits-all" approach contained in the proposal. At the very least, the seven-year timeline should be shortened to a maximum of three years and acquiring institutions should not be considered "guilty until proven innocent" and forced to pay higher premiums due to a merger.

Base Rate Schedule

The FDIC is proposing a base-rate schedule where all institutions in any one risk category (except Risk Category I) would be charged the same assessment rate. In Risk Category I, the FDIC proposes to establish a continuous scale with a 2 basis point spread between a set floor and ceiling. Under the proposal, institutions in Risk Category I will pay annual assessment rates between two and four basis points. Risk Category II institutions will be charged seven basis points, while Risk Category III and IV will be charged 25 and 40 basis points, respectively.

MBA opposes the current proposal to set the base rate floor at two basis points for Risk Category I institutions. Using the FDIC data, a preliminary analysis of our member banks indicates that most institutions should be charged a premium between one and two basis points. However, under the current proposal, these banks' assessments are "rounded-up" to two basis points. In effect, these institutions will subsidize other banks in the fund with higher risk indicators. We strongly urge the FDIC to lower the floor assessment rate to one basis point for the base rate schedule in Risk Category I and retain the proposed ceiling of four basis points. This widens the spread to three basis points and allows for greater differentiation among institutions within this Risk Category.

The FDIC also proposes to retain the authority to adjust rates uniformly up to a maximum of five basis points higher or lower than the base rates without a notice and comment period, provided that any single adjustment from one quarter to the next cannot move rates more than five basis points. While we believe the FDIC should have flexibility to adjust premiums, the industry should have an opportunity to comment on any proposed change. An expedited comment period could be used in cases where the FDIC indicated that a change was needed quickly.

Excess Deposit Insurance

In Massachusetts, deposits in excess of the FDIC limits at state-chartered co-operative and savings are fully insured by the Share Insurance Fund (for co-operative banks) or the Depositors Insurance Fund (for savings banks). Similarly, a number of banks have insured excess deposits through the CDARS program. This excess deposit insurance adds an additional layer of oversight of the financial condition of these institutions. Because deposits in excess of the FDIC limits are fully insured at these institutions, we believe that these excess deposits should be excluded from the volatile liabilities category for all banks that have excess deposit insurance.

Federal Home Loan Bank Advances

In the proposed rule, the FDIC asks for comments on whether Federal Home Loan Bank (FHLB) advances should be included in the definition of volatile liabilities. We strongly oppose this inference. There is no reason that the use of advances as a funding source should cause a bank to pay higher deposit insurance assessments.

FHLB advances are a stable and reliable source of funds for all of our member banks. Advances are readily available for FHLB member banks with available collateral and have pre-defined and predictable terms – the maturity dates of home loans and other term credits. In addition, in cases where a bank may be experiencing financial difficulty, the FHLB is required to ensure that the bank has adequate liquidity while minimizing other risks, including losses to the FDIC.

There is also no evidence that the use of FHLB advances has any correlation to an increased risk of bank failure. Without the availability of FHLB advances, some institutions might be forced to turn to alternative, more costly wholesale funding sources that are demonstrably more volatile. Therefore, the use of FHLB advances results in lower risk to the FDIC fund. We urge the FDIC not to adopt this proposal.

“Free Riders”

MBA continues to be concerned about “free riders”: those institutions that added significant amounts of deposits to the BIF and the SAIF after the FDIC stopped collecting insurance premiums in 1996. As you know, these institutions have never paid into the deposit insurance fund and their excessive deposit growth has contributed to substantially lowering the reserve ratio.

While these institutions will finally be assessed premiums after the new assessment formula is implemented, we are concerned that they still have the capability to dilute the deposit insurance reserves going forward. We believe the “free riders” should be assessed for this risk through the use of an assessment premium charged to institutions with rapid deposit growth. This additional premium would help to avoid further dilution of the fund and ensure that other institutions would not be forced to pay increased premiums due to the rapid growth of a few large institutions.

Conclusion

MBA supports the FDIC’s efforts to implement FDIRA. However, we believe that the deposit insurance assessment proposal needs some modifications before it is finalized. We encourage the FDIC to reassess the risk factors, lower the base assessment rate floor for Risk Category I institutions, and address the “free rider” issue. In addition, we believe that the assessment schedule for new institutions should be changed and that the FDIC should not consider FHLB advances as volatile liabilities. Finally, we encourage the FDIC to recognize the unique nature of the excess deposit insurance system in Massachusetts by excluding insured deposits in excess of the FDIC limits from the volatile liabilities calculation.

Thank you for the opportunity to comment on the proposed rule. If you have any questions or need additional information regarding our comments, please contact me at (617) 523-7595 or via email at jskarin@massbankers.org.

Sincerely,

Jon K. Skarin
Director, Federal Regulatory & Legislative Policy

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