ING DIRECT

September 22, 2006

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

RE: RIN 3064-AD09:
Proposed Rule Modifying the FDIC's Risk-Based Assessment System

Dear Mr. Feldman:

ING Bank, fsb ("ING DIRECT")[1] appreciates this opportunity to comment on the proposed rule modifying the Federal Deposit Insurance Corporation's ("FDIC's") risk-based assessment system. As you know, ING DIRECT is vitally interested in and will be significantly impacted by the manner in which the FDIC implements the recently enacted Federal Deposit Insurance Reform Act of 2005 ("FDIRA"). We have previously submitted extensive comments regarding administration of the one-time assessment credits; designation of the Designated Reserve Ratio ("DRR"); and establishment of the dividend requirements as authorized by FDIRA.

Summary of Recommendations Regarding the "Risk-Based" Rule

At the outset, let me state clearly that ING DIRECT fully supports the FDIC's efforts to implement well-crafted modifications to the current risk-based assessment system. The goal of such a system should be to ensure that those institutions that pose the greatest risk of loss to the Deposit Insurance Fund ("DIF") should pay proportionally greater premiums than those institutions that pose the least risk of loss to the DIF. In implementing modifications to the current "risk-based" system and in making a smooth transition from the old system, ING DIRECT recommends that the proposed rule be modified in order to:

- Avoid the temptation to adopt a "one size fits all" approach to "new" institutions by eliminating the provision in the proposed rule that would treat all institutions in Risk Category I established within the last seven years the

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[1] ING DIRECT provides retail banking services and financial products to individuals and businesses across the United States. Chartered in August 2000, in six years ING DIRECT has grown from nothing to a savings bank with assets of $61 billion and deposits of $46 billion, while consistently remaining well-capitalized. ING DIRECT has done so through innovation and a strict focus on its brand vision: leading Americans back to saving.

same and assess them at the maximum rate applicable to Risk Category I institutions without considering the risk of loss they pose to the DIF; and,

- Clarify that the proposed authority permitting the FDIC to adjust rates by five basis points (“bp”) without notice and comment is an aggregate figure and specify the circumstances under which the exercise of such discretionary authority would be considered appropriate.

We elaborate on these proposed changes to the rule in the discussion that follows. In addition, we also urge the FDIC to adopt the following provisions of the current proposal and support their adoption in the final rule as written:

- Use of the weighted average CAMELS component rating and financial ratio factors (each weighted to account for 50% of the final rating) in calculating the risk classification for large institutions that do not have long-term debt issuer ratings;

- relying on an institution’s primary regulator's CAMELS determination[2];

We also recommend that the FDIC adopt the following provisions which, we understand, will likely be the subject of detailed comment by other commentators:

- relying on an institution’s primary regulator's evaluation of the adequacy of an institution's internal models[3];

- consideration of early warning signs of fraud in evaluating risk; and,

- allowing the use of secured funding (such as Federal Home Loan Bank advances) by insured institutions without incurring “risk” penalties.

Background of the Problem and General Principles for Solutions

With the enactment of Federal Deposit Insurance Corporation Improvement Act of 1991 (“FDICIA”) and the implementation of Prompt Corrective Action ("PCA"), Section 38 of the FDI Act, bank regulators were given new enforcement tools that, to a large extent, have enabled them to prevent bank failures. The utilization of cross-

[2] The FDIC currently has back up examination authority that was given to it by Congress specifically in order to allow the FDIC as insurer to investigate situations if it has concerns about the accuracy of the examination ratings of an institution. However, the existence of that authority reinforces the concept that Congress expected the FDIC to defer to the examination ratings of the primary regulator in all instances where the FDIC has not undertaken to do its own examination. If the FDIC does not feel comfortable deferring to the primary regulator, it cannot merely second guess from afar; it must actually conduct its own examination.

[3] Ibid.

guarantees provides a margin of safety that would otherwise be lacking and PCA standards have enabled regulators to identify potential problems and implement remedial steps much earlier.

On the other hand, despite the strength of the banking industry, it is well-known that the rate of savings in the United States is distressingly low. According to the U.S. Commerce Department's Bureau of Economic Analysis, Americans spent more than they earned in 2005, resulting in a negative savings rate of 0.5 percent for the year. This is the first time since the Great Depression that our country has experienced a negative savings rate.

Since its inception six years ago, ING DIRECT has had a commitment to rewarding savers by paying rates designed to both attract and retain deposits, with no minimum deposit requirement and all transactions conducted exclusively online, by phone, or by mail. Our business model has proven to be highly successful precisely because ING DIRECT is responding to consumers' desire to use technology efficiently and to be rewarded for their saving. After just five years in operation ING DIRECT closed its books last year with $39.98 billion in consumer savings.

While we recognize that FDIRA requires all institutions (once any available assessment credits are exhausted) to pay their fair share of insurance assessments, we urge the FDIC to structure its transition rules so that well-capitalized and well-managed institutions like ING DIRECT are not forced to significantly reduce the rates of interest with which we reward savers in order to meet our premium assessment obligations. One effect of a well-structured deposit insurance fund should be the encouragement of individual savings and an increase in the national savings rate.

Similarly, in a period of rising interest rates such as we are currently experiencing, it makes sense to moderate insurance assessments so that banks will have these funds available to make loans to America's homebuyers and business community. Dollars do a much more efficient job driving the engine of our economy when in the hands of America's consumers and businesses rather than held in reserve in the government's coffers.

We also believe it is essential that the FDIC's rules implementing FDIRA do not establish unnecessary or overly burdensome barriers to entry for those who otherwise would charter new banks and thrifts. This is a particular concern in this time of rapid industry consolidation.

Foundational Principles for a "Risk-Based" Approach to Deposit Insurance

ING DIRECT fully supports a risk-based approach to deposit insurance. It is eminently fair and economically prudent that those institutions whose business model, portfolio or balance sheet present a greater risk of loss to the DIF should be assessed higher insurance premiums and, conversely, that those whose business model, portfolio or balance sheet present less of a risk of loss to the DIF should be assessed smaller insurance premiums. Taking away the incentives for institutions to structure their portfolios in conservative manners could possibly lead those institutions to behave in a manner that would actually increase the risk in the system.

This principle has been supported by the FDIC. In fact, just last year when then-FDIC Chairman Donald E. Powell testified in support of reform of the deposit insurance system he emphasized that absent such reform, “flaws in the system could actually prolong an economic downturn, rather than promote the conditions necessary for recovery.”[4] In his testimony Chairman Powell singled out what he considered the three “most critical” elements that he believed Congress should include in any reform legislation. Those three elements were: merging the funds, improving the FDIC’s ability to manage a merged fund and pricing premiums properly to reflect risk.[5]

It is the final element that Chairman Powell identified as being “most critical” (“pricing premiums properly to reflect risk”) that is the focus of this rulemaking proceeding. In regard to that final element Chairman Powell went on to emphasize that one of the goals of a properly constructed risk-based deposit insurance system would be to end the practice whereby “safer banks unnecessarily subsidize riskier banks” and that the resulting premium system should be “fair and understandable”; “simple and straightforward”; “transparent and open”; and, should “temper statistical analysis with common sense.”[6] ING DIRECT fully agrees that the elements singled out by then-Chairman Powell are truly foundational principles upon which a fair and equitable risk-based system can and should be built. It is with those principles in mind that we offer the recommendations that follow.

"New" Institution Brightline Test:
Contrary to the Statutory Purpose and Incompatible in a Risk-Based System

As currently drafted the proposed rule would assess "new" institutions (defined as those that have been in existence for less then seven years) at the highest rate within Risk Category I. ING DIRECT feels compelled to ask why, in a true risk-based system, any class of institution (including “new” banks) should be subject to increased assessments merely because they fall into a particular “class” or “category”. Such an approach seems contrary to the foundational principles enunciated by Chairman Powell in his testimony just last year before the House Financial Services Committee and upon which a fair and equitable risk-based system of deposit insurance should be based. Such an approach is also contrary to the statutory purpose of the new law.

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[4] U.S. House of Representatives. Committee on Financial Services, Subcommittee on Financial Institutions and Consumer Credit. *Financial Deposit Insurance Reform Act of 2005* (H.R. 1185). 109th Congress, 1st Session, 2005. Serial No. 109-10 at page 40.

[5] Ibid.

[6] Ibid at 42-43.

Statutory Authorization for a Risk-Based System: The statutory definition of the term "risk-based assessment system" is found in Section 7(b)(1)(C) of the Federal Deposit Insurance Act (12 USC 1817(b)(1)(C)) and reads as follows:

> 12 USC 1817(b)(1)(C) RISK-BASED ASSESSMENT SYSTEM DEFINED. – *For purposes of this paragraph, the term "risk-based assessment system" means a system for calculating a depository institution's assessment based on –*
>
> *(i) the probability that the Deposit Insurance Fund will incur a loss* <u>*with respect to the institution*</u>*, taking into consideration the risks attributable to—*
>
> *(I) different categories and concentrations of assets;*
>
> *(II) different categories and concentrations of liabilities, both insured and uninsured, contingent and noncontingent; and*
>
> *(III) any other factors the Corporation determines are relevant to assessing such probability;*
>
> *(ii) the likely amount of any such loss; and*
>
> *(iii) the revenue needs of the Deposit Insurance Fund.*
>
> [Emphasis Added]

While the statute speaks in the aggregate of "categories and concentrations" of assets and liabilities, it speaks in the singular when making reference to "<u>***a***</u> depository institution's assessment" and "<u>***the***</u> institution" insured by the FDIC. We believe that Congress' use of the singular form when discussing how assessments are to be calculated under a risk-based assessment system was deliberate and intended to convey the message that under a risk-based insurance system each and every institution is entitled to be viewed as unique and as presenting a greater or lesser risk of loss to the DIF than all other institutions. Therefore, it is contrary to the statutory purpose to aggregate all institutions that are not yet seven years old and treat them as a class of "new" institutions, rather than afford them the opportunity to have the risk of loss that they pose to the DIF assessed on a case-by-case basis.

A "7-year rule" is both unnecessary and inappropriate: An approach that discriminates against "new" institutions as has been proposed is diametrically opposed to the principles upon which a true risk-based system should be built and needlessly perpetuates the specific types of inequities that the risk-based system was intended to eliminate. An arbitrary "7-year rule" is both unnecessary and inappropriate given the ready availability of true indicators of risk-exposure such as CAMELS ratings and financial ratios. In addition, there is no consensus even among the experts within the

FDIC who have studied the failure rate of newly-chartered institutions as to what the appropriate dividing-line should be between “new” and “established” institutions.[7]

To the extent that the FDIRA reforms were intended to give the FDIC the necessary tools to properly construct a risk-based deposit insurance system in which “safer banks” would no longer subsidize “riskier banks”, there should be no appetite for or tolerance of a “7-year rule” that turns that foundational principle on its head.

We note that the FDIC placed great reliance on two academic studies[8] in justifying a regulatory approach that would conveniently lump all “new” institutions into a single category and assess them at the highest rate within Risk Category I. However, we urge the members of the FDIC Board to thoroughly review both of those studies and ask themselves if they do, in fact, support the regulatory approach contemplated in this proposed rule. A thorough review of both studies would seem to tip the scale against the FDIC's plan to use 7 years as a "brightline" test for "new" institutions. As Chiwon Yom, the author of one of the studies, writes:

> For a number of reasons, this new batch of de novo institutions may differ in performance and viability from the de novo banks of the 1980s. First, economic conditions are more favorable now than they were in the 1980s, when many banking institutions operated under severe regional recessions. Second, regulation and supervision are more stringent now. … Third, once chartered, a new bank is now supervised more closely by its regulatory agency. … Fourth, new banks are required to maintain a higher capital ratio than their established counterparts. … Finally, bank supervisors typically place restrictions on dividend payouts by new banks, limit the amount of debt that new bank holding companies can issue, and require new banks to maintain minimum levels of loan-loss reserves.[9]

Ms. Yom concludes with a very clear word of caution that no one should place undue reliance upon her research into the behavior of financial institutions a quarter of a century ago in an effort to forecast the behavior of financial institutions today. She writes:

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[7] See by Eric P. Bloecher, Gary A. Seale and Robert D. Vilim, "Options for Pricing Federal Deposit Insurance," FDIC Banking Review 15 (2003): “No consensus exists as to when a new bank takes on the characteristics of a seasoned institution. For purposes of deposit insurance pricing, we define new banks as those existing for five years or less. ... at the end of this five-year period, failure rates of new institutions approach failure rates of seasoned institutions. Moreover, five years should allow new institutions enough time to confirm the viability of their business plans. Conversely, using a period longer than five years could discourage bank formation because of the relatively higher premiums to be paid by new institutions.

[8] See Chiwon Yom, ``Recently Chartered Banks" Vulnerability to Real Estate Crisis," FDIC Banking Review 17 (2005): 115 and Robert DeYoung, ``For How Long Are Newly Chartered Banks Financially Fragile?" Federal Reserve Bank of Chicago Working Paper Series 2000-09.

[9] Yom at page 3 - 4.

> … one must be cautious when extrapolating from a banking experience in the 1980s to banking experience today, for even if economic conditions were to become comparable to those in the 1980s, the regulatory environment, as noted above, differs greatly from what it was in the 1980s.[10]

ING DIRECT also notes that our loan portfolio (and we believe that of many other "new" banks) differs dramatically in composition from that of the institutions of a quarter century ago that were the subject of Yom's study. In her study Yom notes that "the kinds of real estate lending done by young banks are riskier than the kinds done by established banks…. Young banks tended to have more commercial and industrial (C&I), construction and development (C&D), and nonresidential real estate loans – the three types generally considered risky … the relatively safer 1 – 4 family loans make up a smaller share of assets for young banks than for established banks."[11]

As of June 30 of this year over 99% of ING DIRECT's real estate loan portfolio consisted of loans on 1 – 4 family dwellings, and 97% of those loans were first liens. Significantly, all of ING DIRECT's mortgages are adjustable rate mortgages ("ARMs"), which means that ING DIRECT faces much less interest rate risk than an institution that holds 15-year and 30-year fixed rate mortgages. In addition, approximately 96%-97% of all ING DIRECT's securities are either AAA rated or government-backed securities; these investments constitute approximately 70% of ING DIRECT's assets. Therefore, you cannot compare the "new" banks that failed in the 80's to "new" banks (like ING DIRECT) in the year 2006 that have much safer asset portfolios.

Adding further weight against the establishment of what would appear to many to be an arbitrary "7-year rule" is the study by Robert DeYoung referenced by the FDIC in promulgating the proposed rule. After a thorough review of the financial performance of 1,664 "new" banks and a benchmark sample of 2,047 "small established banks" DeYoung concluded that "… our results suggest it should be relatively easy to develop a useful early warning model for de novo bank distress …"[12]; not only that, but that "… it would appear to be *easier to identify early warning indicators for de novo banks than for established banks*…". (emphasis added)[13] Based upon the combined research of Yom and DeYoung it seems both rational and reasonable to conclude that in modifying its risk-based assessment system the FDIC should be able to design a system based upon the risk-exposure the FDIC incurs by insuring each institution individually, and not as a class or category.

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[10] Yom at page 12.

[11] Yom at page 7-8.

[12] DeYoung at page 3.

[13] DeYoung at page 27.

In keeping with the spirit of FDIRA that those institutions that pose a greater risk of loss to the DIF should be assessed higher insurance premiums and that those who present less of a risk of loss to the DIF should be assessed smaller insurance premiums, and heeding Chairman Powell's pledge that the FDIC would "temper statistical analysis with common sense,"[14] ING DIRECT urges the FDIC to apply risk-based principles on an institution-by-institution basis to all institutions including de novo institutions. Any other course will not only be inconsistent with the underlying principles of a risk-based system, but would place "new banks" in what would amount to "double jeopardy" and impose on them a "double whammy" in that they would have little (if any) access to assessment credits AND they would be subject to the maximum 4 bp base rate for no other reason than the mere fact that they are "new."

ING DIRECT agrees with others who believe that the proposed assessment rate for Risk Category I institutions of 2 to 4 basis points is unnecessarily high, and that the low end of the range should be set at some figure less than a full basis point. The fact of the matter is that not only is the risk of failure of a Risk Category I institution is extremely low, but the risk of loss to the DIF even if a Risk Category I institution should fail is even more remote. In a risk-based system where safer banks no longer are intended to unnecessarily subsidize riskier banks but in which all insured institutions pay something, an assessment of less than 1 basis point would seem appropriate for such institutions.

Throughout the debate on deposit insurance reform both Congress and the FDIC were emphatic in expressing their commitment to eliminating the potential "cliff effect" that existed under the old deposit insurance program. Ironically, if the modifications to the risk-based assessment system treat "new" institutions uniformly as a "class" rather than requiring a case-by-case analysis of the risk they pose to the DIF, the modifications would actually create a perverse "new" cliff that will have to be dealt with by some but not all FDIC-insured institutions. It will also serve as a significant barrier to entry for those who are contemplating chartering a new bank or thrift.

Should the FDIC, despite our recommendation to the contrary, adopt a "one-size-fits-all" 7-year brightline test for "new" institutions, ING DIRECT strongly recommends that 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, especially for the banks whose parent companies are subject to the Basel II

[14] U.S. House of Representatives. Committee on Financial Services, Subcommittee on Financial Institutions and Consumer Credit. *Financial Deposit Insurance Reform Act of 2005* (H.R. 1185). 109th Congress, 1st Session, 2005. Serial No. 109-10 at page 43.

requirements. As one such bank, ING DIRECT has developed the Advanced Internal Ratings-Based credit risk system, adopted the Advanced Measurement Approach for operational risk and established rigorous risk control processes that are in compliance with Basel II standards and further ensure its safety and soundness. Therefore, the FDIC should recognize that all these efforts significantly reduce the risk that might be present in new institutions.

In a true risk-based system we believe that Congress intended the FDIC to abide by Chairman Powell's pledge to "temper statistical analysis with common sense"[15] and look beyond convenient definitions. In our case ING DIRECT would, admittedly, be defined as a "new" institution under the proposed rule; yet the fact of the matter is that we are a "new" institution that traces its lineage to a banking firm that entered the business of banking more than 160 years ago.[16] We believe that long history of stability coupled with the strength of our parent significantly reduces the risks that might otherwise be present in a start-up institution, and in such cases institutions should be excluded from the FDIC's definition of "new" institution.

Rate Adjustment Without Notice and Comment

As part of this rulemaking proceeding the FDIC has proposed that it be allowed to adjust rates uniformly up to a maximum of five basis points higher or lower than the base rates without the necessity of further notice-and-comment, provided that "any single adjustment from one quarter to the next could not move rates more than five basis points."

The actual text of the proposed regulation reads as follows:

> "Rate adjustments and procedures--(1) Adjustments. The Board may increase or decrease the assessment schedules of this section up to a maximum increase of 5 basis points or a fraction thereof or a maximum decrease of 5 basis points or a fraction thereof (after aggregating increases and decreases), as the Board deems necessary. Any such adjustment shall apply uniformly to each rate in the base assessment schedule. In no case may such adjustments result in an assessment rate that is mathematically less than zero or in a rate schedule that, at any time, is more than 5 basis

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[15] Ibid.

[16] The roots of ING can be traced to the insurers *De Nationale Levensverzekering Bank* and *De Nederlanden van 1845* and to the public bank services such as *De Rijkspostspaarbank* and *De Postcheque- and Girodienst*, as well as to the *Nederlandsche Middenstands Bank*. These are the legal predecessors of the 'founding fathers' of ING; *Nationale-Nederlanden* and *NMB Postbank Group.* (Source: http://www.ing.com/group/showdoc.jsp?docid=074177_EN&menopt=abo|his). Furthermore, ING Group is a global financial services company, providing a wide array of banking, insurance and asset management services in over 50 countries. Based on market capitalization, ING is one of the 20 largest financial institutions worldwide and ranked in the top-10 in Europe. In the United States, ING is a top-5 provider of retirement services and life insurance.

> points above or below the base assessment schedule for the Deposit Insurance Fund, nor may any one such adjustment constitute an increase or decrease of more than 5 basis points. "

Given the significant impact such adjustments would have on insured institutions, we recommend that in promulgating a final rule the FDIC: (1) clarify that the proposed authority permitting the FDIC to adjust rates up or down by five basis points without notice and comment is an aggregate figure over time; and, (2) specify in the body of the rule the specific circumstances under which the exercise of such discretionary authority would be considered appropriate. For example, the rule could be amended to specify that the FDIC could only invoke this authority to raise rates without notice and comment if the reserve ratio dropped below a certain level; or, if the actual reserve ratio was "x" basis points below the DRR. Absent the establishment of some objective criteria, we recommend that the authority of the FDIC to raise assessment rates without notice to and comment by those who will be obligated to pay the assessment be limited to no more than 2.5 basis points.

CONCLUSION

In conclusion, in order to effect a smooth transition to the new deposit insurance program ING DIRECT recommends that in implementing modifications to the current "risk-based" system the FDIC Board:

- Abandon the "one size fits all" approach to "new" institutions and assess premiums on all institutions based on the actual risk of loss that they themselves pose to the DIF; and,

- Clarify that the proposed authority permitting the FDIC to adjust rates by five basis points without notice and comment is an aggregate figure over time and specify the circumstances under which the exercise of such discretionary authority could be used.

Thank you for the opportunity to share the views of ING DIRECT. If you have any questions or if I can be of further assistance please do not hesitate to contact me at 302-255-3008.

Sincerely,

Deneen D. Stewart
General Counsel
ING DIRECT