September 22, 2006

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

Re: Risk-Based Assessments

Dear Sir or Madam:

The Independent Community Bankers of America (ICBA)[1] appreciates the opportunity to offer comments in connection with the FDIC's proposal for a new risk-based assessment system as authorized by the Federal Deposit Insurance Reform Act of 2005 (the Reform Act). The FDIC proposal would (1) create different risk differentiation frameworks for smaller and larger institutions that are well capitalized and well managed; (2) establish a common risk differentiation framework for all other institutions; and (3) establish a base assessment rate schedule that can be adjusted up or down by five basis points without further notice and comment rulemaking.

Summary of ICBA's Position

Overall, ICBA commends the FDIC for its proposal and believes the new risk-based premium system will improve risk differentiation and pricing and will limit the subsidization of riskier institutions by safer ones. We endorse the idea of consolidating the existing nine risk categories under the present system into four.

With respect to risk assessments of smaller institutions in Risk Category I, ICBA recommends:

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[1]*The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to representing the interests of the community banking industry. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.*

With nearly 5,000 members, representing more than 18,000 locations nationwide and employing over 265,000 Americans, ICBA members hold more than $876 billion in assets $692 billion in deposits, and more than $589 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

- Using a combination of financial ratios and supervisory ratios;
- With respect to the financial ratios, weighting the tier 1 leverage ratio the highest and the volatile liabilities ratio the lowest;
- Excluding deposits greater than $100,000 from the definition of volatile liabilities;
- With respect to the supervisory ratings, increasing the proposed weight for the capital component of the CAMELS component ratings to 30% and the earnings component to 15% and reducing the management component weighting to 15%; and
- Prohibiting the supervisory ratios from ever being weighted more than half of the total weight of both the supervisory ratings and financial ratios.

ICBA strongly opposes including Federal Home Loan Bank advances as part of "volatile liabilities" since that would inappropriately discourage banks from borrowing from the Federal Home Loan Banks and would be counterproductive to reducing risks for the FDIC.

ICBA would revise the base schedule of rates for Risk Category I institutions so that the floor or base rate would be 1 basis point and the ceiling would be 3 basis points. The proposed 2-4 basis point range for Risk Category I institutions is too high and would penalize those banks that could qualify for an assessment of less than 2 basis points. Furthermore, most small institutions in Risk Category I should be at or near the minimum rate since their capital is well above the tier I leverage ratio and pose little risk to the Deposit Insurance Fund.

New institutions should be defined as those that have been in existence for no more than three years, not seven years as proposed by the FDIC. After three years, a new institution's loan portfolio and its operations should be seasoned enough so that the FDIC can assess risks based on the bank's financial ratios and CAMELS ratings, in the same manner as other institutions.

With respect to the FDIC's proposal to differentiate large institutions in Risk Category I, ICBA recommends:

- Avoiding too much reliance on long-term debt issuer ratings and instead, using a combination of financial ratios, supervisory ratings, long-term debt issuer ratings, and other information to assess all large institutions; and
- Allowing institutions with between $5 billion and $10 billion the option of using the large institution approach.

ICBA urges the FDIC to establish actual assessment rates for 2007 close to the proposed base schedule of rates. To ensure a smooth transition to the revised assessment system and to avoid any impairment to bank capital and earnings, the FDIC should use the maximum authority it has under the Reform Act to build up reserves to meet the designated reserve ratio steadily and gradually over a three-to-five year period and avoid a surge in assessment rates.

Background and Proposal

Under the current risk-based system, there are three different capital categories (e.g., well-capitalized, adequately capitalized, and undercapitalized) and three different supervisory subgroups, resulting in potentially nine different risk categories in which a bank can be included. Approximately 95% of the banking industry is currently included in the top category (1A). As a result of the Deposit Insurance Funds Act of 1996, the FDIC was prohibited from assessing institutions in the 1A risk category unless assessments were needed to maintain the Designated Reserve Ratio or DRR at 1.25%. Since the DRR has remained at 1.25% or higher for the past ten years, most of the industry has not paid any assessments during that period.

The FDIC is proposing that the current nine risk categories be consolidated into four Risk Categories (I, II, III and IV) and that there be two methods to further differentiate risk for institutions in Risk Category I—one for small institutions and another for large institutions.

Small Bank Method: For institutions with less than $10 billion in assets, the FDIC is proposing that assessment rates be based on a combination of certain financial ratios and supervisory ratings and a statistical analysis relating these measures to the probability that an institution will be downgraded to a CAMELS 3, 4, or 5 within one year. The financial ratios and supervisory ratings are: Tier 1 leverage ratio; loans past due 30-89 days/gross assets; non-performing loans/gross assets; net loan charge-offs/gross assets; net income before taxes/risk-weighted assets; volatile liabilities/gross assets; and a weighted average of the components of the CAMELS rating (weighted 25% for Capital, 20% for Asset quality, 25% for Management, and 10% (each) for Earnings, Liquidity and Sensitivity to risks).

Institutions will be able to use automated calculators available on the FDIC's website to multiply each of the above measures by a pricing multiplier reflecting the probability that an institution would be downgraded to a CAMELS 3, 4, or 5. The calculator would also allow institutions to add the sum of these products to a uniform amount to determine their assessment rates. Pricing multipliers and uniform rates would be updated annually.

Large Bank Method: The FDIC proposes to use CAMELS component ratings, long-term debt issuer ratings, and, for some institutions, the financial ratios used for small banks, to develop an insurance score. This insurance score would be a weighted average of: (1) a weighted average CAMELS component rating; (2) long-term debt issuer ratings issued by companies like S&P, Moody's and Fitch; and (3) for institutions with between $10 billion and $30 billion in assets, financial ratios. While the weights applied to the supervisory rating element of the proposed approach would be constant across all size categories, the weights applied to long-term debt ratings would be gradually phased in, and financial ratios would be gradually phased out, as an institution's assets increased from $10 billion to $30 billion. For institutions with $30 billion or more in assets, the insurance score would be determined solely from CAMELS component ratings and long-term debt issuer ratings.

Large banks will be assigned to one of six assessment rate subcategories and the FDIC will set the cutoff scores for each subcategory based on the overall distribution of insurance scores and assessments for each quarter.

New Institutions: The FDIC proposes to exclude an institution in Risk Category I that is less than seven years old from any risk evaluation under either the small or large bank method. Instead, all new institutions in Risk Category I would be charged the same rate, which would be the highest rate charged any other institution in this Risk Category. The FDIC justifies this on the basis that new institutions have a higher failure rate than established institutions and their financial information tends to be harder to interpret.

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***Proposed Base Schedule of Assessment Rates*:**

The FDIC's proposed base schedule of rates is as follows:

	Risk Category*				
	I		II	III	IV
	Base	Ceiling			
Annual Rate in Basis Points	2	4	7	25	40

* I: CAMELS 1 or 2 and well capitalized.
II: CAMELS 1 or 2 and only adequately capitalized or CAMELS 3 and at least adequately capitalized
III: CAMELS 1, 2 or 3 and undercapitalized or CAMELS 4 or 5 and at least adequately capitalized
IV: CAMELS 4 or 5 and undercapitalized

The FDIC expects that about 90% of all banks (large and small) will be in Risk Category I and that about 45% of all banks will be subject to the base level in that category and 5% will be subject to the ceiling rate. All other banks in that category will have rates in between the base and ceiling rates.

As under the present system, the FDIC has proposed that the FDIC Board be allowed to adjust rates up to a maximum of five basis points higher or lower than the base rate schedule without the necessity of further rulemaking. Under that authority, the FDIC Board could increase the ceiling rate for Risk Category I banks as high as 9 basis points or as low as 0 for 2007.

ICBA's Position

ICBA commends the FDIC for its proposed new risk-based premium system. If adopted, the new system will improve risk differentiation and pricing and will limit the subsidization of riskier institutions by safer ones. The Federal Deposit Insurance Act, as amended by the Reform Act, requires the assessment system be risk-based and allows the FDIC to broadly define risk. Subject to our specific recommendations below, we believe that the new system will appropriately and fairly differentiate risk between institutions and will be an improvement over the present risk-based assessment system.

I. Existing Risk Categories Should Be Consolidated and Different Methods Should Be Used for Small and Large Institutions

ICBA commends the FDIC for its proposal to consolidate the existing nine risk categories under the present risk-based system into four. We agree with the FDIC that the existing nine categories are not all necessary since some of the categories contain few, if any, institutions at any given time. For instance, as of December 31, 2005, five of the existing nine categories contain a total of only 10 institutions. Furthermore, the five-year historical failure rates of some of the existing categories are nearly identical. Based on what historical failure rates would have been if the new categories had been in place since 1985, the proposed new categories more accurately align insurance risk with each category.

The FDIC proposes that all institutions within any one of the three other risk categories, other than Risk Category I, be charged the same assessment rate. **With respect to proposed new Risk Category I, ICBA supports using different methods of differentiating risks for small institutions and large institutions by using additional available information to differentiate large institutions.** Subject to our comments below about the proposed rating system, we believe that an appropriate cutoff point between large and small institutions should be $10 billion. Institutions with over $10 billion in assets tend to have more information available relating to risk and many of them have developed and adopted sophisticated risk measurement models and systems. Furthermore, some of the types of complex activities engaged in by the largest institutions (e.g., securitization, derivatives, and trading) should be evaluated using other measurements other than only current financial ratios and CAMELS component ratings. As we discuss further below, we also believe that assessment rates for large institutions should be adjusted more frequently than small institutions based on considerations of additional market, financial performance and condition, and stress considerations.

II. Assessment Rates for Smaller Institutions in Risk Category I Should Be Linked to <u>Both</u> Financial and Supervisory Ratios But With Different Weights

ICBA agrees that assessment rates for smaller institutions should be linked to a combination of <u>both</u> financial ratios and supervisory ratios. Setting the appropriate relative weights of the financial ratios is important, as more fully discussed below. Furthermore, we believe that the weight of the supervisory ratings should never exceed one-half of the total weight of both the supervisory ratings and the financial ratios.

We agree that the six financial ratios proposed by the FDIC (e.g., tier 1 leverage ratio, loans past due 30-89 days/gross assets; non-performing loans/gross assets; net loan charge-offs/gross assets; net income before taxes/risk-weight assets; and volatile liabilities/gross assets) should be used to differentiate risks among smaller institutions. The FDIC has used the financial ratios in its offsite monitoring system or SCOR and has found these ratios to be reliable guides for assessing the risk of an institution being downgraded to a CAMELS 3, 4 or 5. Using both financial ratios and supervisory ratings provides a balanced test for determining assessments since the objective nature of the financial ratios offset the subjectivity of the supervisory ratings. However, we believe that financial ratios should carry different weights.

For instance, we believe that the most important financial ratio for assessing the risk of an institution is the tier 1 leverage capital ratio and that ratio should be weighted the highest of all the financial ratios. Capital remains the most important indicator of the solvency of an institution. Community banks that have high tier 1 leverage ratios should be assessed the lowest assessment rate because these institutions are unlikely in the near term to be downgraded to a CAMELS 3, 4 or 5. If their capital should fall unexpectedly, the FDIC can quickly detect the change and adjust the bank's assessment rate since it will be reviewing the financial ratios on a quarterly basis.

However, loans past due, especially those less than 60 or 90 days past due, is not always a good indicator of risk for smaller institutions. Many community banks, for instance, have a tolerant approach to minimally past-due loans but have an excellent record of low charge-offs and are very well capitalized. In that respect, charge-offs may be more accurate indicator of risk. We would therefore weight past due loans less than some of the other ratios.

ICBA believes that the volatile liabilities/gross assets ratio should be weighted the lowest of six ratios or excluded altogether because it generally is an unreliable indicator of the solvency of an institution. Furthermore, ICBA urges the FDIC to exclude time deposits greater than $100,000 from the definition of volatile liabilities because for many community banks these deposits are stable funding from long-term customers and have the same characteristics as core deposits. Community banks also depend on these large deposits from local taxing entities or other municipal depositors for funding.

While we agree with the FDIC that time deposits greater than $100,000 are more likely than smaller deposits to be withdrawn as the financial condition of the institution deteriorates, we do not believe that this makes the volatile liabilities/gross assets ratio an accurate indicator of the risks associated with a *healthy* institution. Many well-capitalized and well-managed community banks, particularly in smaller markets, have a high proportion of their total deposits in time deposits greater than $100,000. Because these deposits are stable and come from local community customers, they should be considered core deposits. Community banks should not be penalized for holding these long-term, stable deposits. If the FDIC believes that excluding time deposits greater than $100,000 from the definition of volatile liabilities would make the volatile liabilities/gross assets ratio insignificant in explaining potential downgrades, the FDIC could consider eliminating volatile liabilities as one of the six financial ratios.

Many community banks are concerned about the FDIC relying too heavily on the supervisory ratings for determining their risk-based assessments because supervisory ratings tend to be more subjective than other kinds of indicators. **ICBA believes that the supervisory ratings should never be weighted more than half of the total weight of both the supervisory ratings and financial ratios.** This will prevent an institution's assessment being unfairly influenced by the inappropriate exercise of judgment of an examiner who might unexpectedly and suddenly downgrade one or more of the institution's CAMELS component ratings. While we agree that the supervisory ratios should be a weighted average CAMELS component rating (as opposed to a CAMELS composite rating), we believe that the proposed weights for some of the components (e.g., C-25%, A-20%, M-25%, E-10%, L-10%, and S-10%) should be revised.

Specifically the weight of the capital component should be raised from 25% to 30% and the earnings component from 10% to 15%. The weight for the management component should be reduced from 25% to 15%.

These revisions would better recognize the critical importance of capital and earnings in determining the relative health/risk of an institution. They would also reduce the weight of the management component—the most subjective component of the CAMELS rating system. Because of their relative fewer staff and financial resources, community banks frequently don't score as high on the management component of the CAMELS rating system as they do on other components. With less sophisticated management information systems and risk management tools that are nonetheless appropriate for their bank's circumstances, community banks can sometimes find that they are at a disadvantage with respect to supervisory evaluations of management. Community banks are also concerned about the possibility that an institution's assessment could be unfairly influenced by a Bank Secrecy Act issue or some other management issue. ICBA believes that changing the weights of the components as indicated above will reduce the overall subjectivity of the CAMELS component ratings and reduce the chance that an institution's assessment is unfairly affected by the subjective judgments inherent in the examination process.

It is important that the complexity of the new risk-based assessment system not undermine the transparency of risk-scoring. ICBA commends the FDIC for publishing on its website an assessment calculator so that community banks can readily calculate what their assessments would be under the proposal and perform calculations and analyze "what if" scenarios based on pro forma changes to their financial ratios or CAMEL ratings. The FDIC's publication of the assessment calculator alleviated the fears of some community bankers that the proposal was too complicated and that small changes in the financial ratios could mean large changes in their assessments. Once the FDIC proposals on risk-based assessments are adopted, the assessment calculator will continue to be an important tool to help community banks quickly understand the new and more complicated risk-based system and the impact that a change, for example to earnings or charge-offs, could have on their assessments.

III. Federal Home Loan Bank Advances Should Never be Included as Part of Volatile Liabilities

ICBA strongly opposes including Federal Home Loan Bank (FHLBank) advances in the definition of volatile liabilities. FHLB advances are one of the few sources of wholesale funding for community banks. Advances are not volatile liabilities for FHLBank members since they have predefined, understood, and predictable terms. Unlike other kinds of liabilities that could potentially be classified as "volatile," advances do not diminish when market forces or consumer habits change. An FHLBank member that obtains advances to meet liquidity requirements of its business plan has control over their existence and duration.

ICBA believes that discouraging banks from borrowing from FHLBanks would be counterproductive to reducing risks for the FDIC. FHLBank advances ensure available, cost-effective liquidity for community banks and are critical tools in managing interest-rate risk, as well as funding loan demand. Penalizing advance use will force institutions to look for alternative sources that are not as stable and dependable and are far more volatile than FHLBank advances. This would result in fewer loans, reduced profits, and higher liquidity and interest-rate risk.

ICBA also believes that penalizing the use of advances by charging higher premiums under the new risk-based assessment system would conflict with the intent of Congress in establishing the FHLBanks, in opening membership in FHLBanks to commercial banks under FIRREA, and in adopting the Gramm-Leach-Bliley Act which expanded small banks' access to advances. Congress wanted commercial banks to have unfettered access to the low-cost funding of the FHLBanks. Charging higher assessments for banks that have FHLBank advances would be inconsistent with that goal.

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When Congress considered the FDIC reform legislation, Congressional committees and principal sponsors of FDIC reform expressed specific concerns that the FDIC, in developing a risk-based insurance assessment proposal, not adversely affect advances. The Congressional intent has been expressed in both the House and Senate on a bi-partisan basis. For instance, the House Financial Services Committee stated:

> The Committee is concerned that the FDIC's development and implementation of a new risk-based assessment system not negatively impact the cost of homeownership or community credit by charging higher premiums to prudently-managed and sufficiently-capitalized institutions simply because they fund mortgages and other types of lending through advances from Federal Home Loan Banks. The Gramm-Leach-Bliley Act took great care in trying to provide adequate funding resources for community financial institutions and insured housing lenders through expanding community institutions' access to Federal Home Loan Bank advances. The Committee expects the FDIC to take into consideration the goals of the Gramm-Leach-Bliley Act with respect to Federal Home Loan Bank advances and the objectives of this Act when developing a risk-based premium system.[2]

Senator Tim Johnson (D-SD), in a Senate Floor statement on November 3, 2005, stated that FDIC reform legislation was not intended to result in increased insurance premiums simply because an institution holds advances. Rep. Richard Baker (R-La) also made statements on the House Floor on April 7, 2003 and June 5, 2002, expressing strong concern that the FDIC might classify institutions with certain amounts or percentages of advances as more risky and, therefore, charge them higher premiums. Rep. Baker said that such actions would contradict Congress' clear intent to broaden access to advances under the Gramm-Leach-Bliley Act.

Finally, ICBA believes that if an FDIC-insured institution experiences problems, there is a regulatory process in place to ensure that the FDIC and the FHLBanks communicate with each other so that the institution will have adequate liquidity. For instance, FHLBanks have the legal authority for access to regulatory exam reports to assist with this analysis. ICBA believes that this regulatory process should minimize the likelihood of bank failures resulting from the possibility of excessive borrowings from the FHLBanks.

IV. Risk Category I Institutions Should be Assessed Between 1-3 Basis Points and Most Small Institutions Should Be Assessed the Minimum Rate

While ICBA agrees with the FDIC's proposed base schedule of rates for Risk Categories II, III, and IV, ICBA urges the FDIC to revise the base schedule for Risk Category I institutions so that the floor or base rate is 1 basis point and the ceiling rate is 3 basis points. The 2-4 basis point range proposed by the FDIC for Risk Category I institutions is too high for several reasons. First, ICBA believes that the FDIC should use the authority and flexibility it has under the Reform Act to build up DIF reserves to meet the DRR steadily and gradually over the next three to five years. There should be a period of transition to allow banks

[2] House Financial Services Committee Report on H.R. 1185, House Report No. 109-67, p. 33.

to gradually use up their one-time assessment credits and adjust to paying premiums again under the new risk-based assessment system. Second, establishing the base rate for Risk Category I institutions at 2 basis points would unfairly penalize banks those banks that could qualify for an assessment of less than 2 basis points under the proposed small institution method. For instance, it would be unfair for a bank that qualifies for an assessment rate of 1.5 basis points because it has excellent CAMELS ratings and financial ratios to have to round up to 2 basis points. Third, we are skeptical that the FDIC will ever shift the base schedule of rates downward even during a time when the reserve ratio is high and the DIF is in excellent shape. A base schedule of 1-3 basis points for Risk Category I institutions would be fairer to many well-capitalized and well managed banks and would help ensure a smooth transition to the new risk-based assessment system.

The FDIC is proposing that when the final rule is issued, 45% of smaller institutions (other than new institutions) in Risk Category I will be charged the minimum assessment rate and 5% of smaller institutions will be charged the maximum assessment rate. We believe that this is an appropriate distribution of assessment rates for Risk Category I particularly when the condition of the banking industry is so favorable. **Most small institutions in Risk Category I should be at or near the minimum rate since their capital is well above the tier I leverage ratio threshold to be considered "well-capitalized" and pose little risk to the Deposit Insurance Fund.** Absent a radical change in the economy or in the condition of the banking industry, we believe that future assessment rates for Category I small institutions should reflect the same distribution.

The FDIC is also proposing that it have the flexibility to update the pricing multipliers and the uniform amount annually, without notice-and-comment rulemaking. ICBA agrees with this FDIC's proposal as long as the updates are to add new data to the analysis or to subtract old data. On the other hand, if as a result of an annual review and analysis, the FDIC concludes that additional or alternative financial measures, ratios or other risk factors should be used to determine risk-based assessments or that a new method of differentiating risk should be used, then such change should be made through notice-and-comment rulemaking. Institutions should have advance notice of any significant change to the assessment system that could impact their earnings or capital so that they have an opportunity to comment and to prepare for the change.

V. After Three Years, New Institutions in Category I Should Be Treated Like Other Institutions

The FDIC proposes to exclude an institution in Risk Category I that is less than seven years old from evaluation under either the small or large institution methods of risk differentiation. The FDIC claims that new institutions have a higher failure rate than established institutions and that financial information for new institution tends to be hard to interpret and is less meaningful. The FDIC proposes charging all new institutions in Risk Category I the ceiling rate, the highest rate charged any other institution in this Risk Category.

ICBA believes that defining an institution as "new" for seven years is excessive and unfairly discriminates against de novo institutions without regard to their individual risk. Institutions in Risk Category I should be considered new and automatically charged the

ceiling rate for no more than three years. After three years, these institutions should be treated like other institutions in Risk Category I and have their assessments based on financial ratios and CAMELS ratings.

We agree that a new institution undergoes rapid changes in the scale and scope of operations during its first three years, making it difficult to interpret current financial ratios particularly concerning income and charge-offs. However, we believe that after three years the institution's loan portfolio and its operations should be seasoned enough so that the FDIC can assess the risks of these institutions based on financial ratios and CAMELS ratings as it does for other institutions. The FDIC has not adequately shown why financial ratios such as tier 1 leverage ratio and loans past due 30-89 days/gross assets ratio along with the CAMELS component ratings are insufficient to accurately assess risk in a new institution that is more than three years old.

VI. Financial Ratios Should be Used to Differentiate Risks Among All Larger Institutions

The FDIC proposes to differentiate risk among large institutions using a combination of supervisory ratings, long-term debt issuer ratings, financial ratios for some institutions, and additional risk information. The debt rating information element would be gradually phased in, and the financial ratio element would be gradually phased out, as an institution's assets increased from $10 billion to $30 billion.

The debt rating information would be based upon the long-term debt issuer ratings of insured institutions assigned by major rating agencies such as Moody's, Standard & Poor's, and Fitch. A long-term debt issuer rating generally represents an opinion of the ability of an institution to meet its long-term financial obligations. The FDIC believes there are several advantages to using these long-term debt issuer ratings: (1) they differentiate risk among large insured institutions by assigning an institution to one of a number of risk classifications, (2) they are available for all but a small number of larger insured institutions; and (3) they supplement supervisory ratings. Moreover, because long-term debt issuer ratings can be viewed as an opinion of the likelihood of default, they serve as a proxy for an institution's relative funding costs.

ICBA is concerned about the FDIC relying too much on the long-term debt issuer ratings of the major rating agencies to assess large institutions. The failure of the nationally recognized debt agencies to lower their credit ratings in a timely matter in the cases of Enron, WorldCom, and Orange County, California debt crisis makes us concerned that the rating agencies might not catch a financial problem at one of large institutions. ICBA believes that using <u>only</u> long-term debt issuer ratings and CAMELS component ratings to evaluate institutions with assets over $30 billion is not a broad enough or reliable enough test to evaluate the likelihood that one of these institutions will fail.

ICBA recommends that the FDIC use a combination of financial ratios, supervisory ratings and long-term debt ratings to evaluate all large institutions. Financial ratios should not be phased out for institutions with assets from $10 billion to $30 billion. If necessary, additional financial ratios other than the ones used for the smaller institutions should be added to the financial ratio test to assess off-balance sheet assets, securitization and trading activities of large institutions. Alternative ratios may be included for those institutions that primarily engage in securities processing activities. A financial ratio test will help provide a constant quality control or check on the reliability of long-term debt issuer ratings and will help the FDIC to further refine the assessment process for large institutions.

VII. The FDIC Must Use Additional Information to Assess and Check Large Institutions

The FDIC proposes to assign each large Risk Category I institution to one of six assessment rate subcategories based on supervisory ratings, long-term debt issuer ratings, and for institutions with less than $30 billion in assets, financial ratios. However, once an institution is assigned to a subcategory, the FDIC will consider additional information and analysis to determine whether to adjust an institution's assessment rate subcategory assignment. This additional information would include (1) other market information, such as subordinated debt prices, equity price volatility, and spreads observed on credit default swaps, (2) other regulatory reports, such as reports filed with the SEC, together with performance trends and details and disclosures about operations, and (3) information from internal stress-test models, information pertaining to the internal risk and performance characteristics of an institution's credit portfolios and other business lines, and general balance sheet and financial performance measures.

ICBA believes that it is important that the FDIC constantly analyze this additional information for large institutions not only to adjust the subcategory assignments but to check and update evaluations of large institutions. Supervisory and long-term debt issuer ratings can quickly become dated and inaccurate which is why the FDIC needs to have as complete and timely a picture of each large institution as possible. Regulatory information as well as other market information should constantly be monitored. Financial reports issued by investment banking firms should also be analyzed and internal stress testing should be performed. Having the ability to make adjustments to subcategory assignments, combined with quality controls to ensure the adjustments are justified and well supported, will also promote greater consistency in FDIC evaluations and subcategory assignments.

VIII. Institutions Between $5 Billion and $10 Billion Should Have the Option to Be Treated Under The Large Institution Risk Differentiation Approach

ICBA supports the FDIC proposal to allow Risk Category I institutions with assets between $5 billion and $10 billion to be treated under the large institution risk differentiation approach. We believe the FDIC should grant this request when it determines that it has sufficient information to evaluate the institution's risk adequately using the large Risk Category I risk differentiation method. Once the request has been granted, the institution should be allowed to request a different approach after three years. This will allow flexibility for those small institutions that are transitioning rapidly to large institutions and want to be evaluated using long-term debt ratings.

IX. Actual Rates for 2007 Should Be Close to the Proposed Base Schedule

ICBA urges the FDIC to set actual assessment rates for 2007 close to the proposed base schedule of rates. ICBA believes that the FDIC should use the maximum authority it has under the Reform Act to build up DIF reserves to meet the DRR steadily and gradually over a three-to-five year period to avoid an unnecessary surge in assessment rates. While is it understandable that, other things being equal, the FDIC Board would want to reach its targeted reserve ratio as soon as possible, any sudden significant increase in assessment rates would be an unnecessary shock to the banking system and an impairment to bank's earnings and capital**. There should be a period of transition to allow banks to gradually use up their one-time assessment credits and to adjust to paying premiums again under the new risk-based assessment system.**

ICBA believes that there are many reasons for the FDIC to slowly build up DIF reserves and establish assessment rates close to the proposed base schedule of rates. First, economic growth is beginning to slow as higher interest rates continue to weigh on economic activity, particularly in the housing sector. A slower pace of home price appreciation is also expected to impede growth in consumer spending next year. Slower economic activity will mean that insured deposit growth will slow, reversing the trend responsible for the recent decline in the reserve ratio.

Second, the past performance and health of the banking industry has been exceptionally robust with strong asset quality, low charge-offs, and high capital and profitability. No insured institutions have failed in two years, extending the longest period without a failure since the creation of the FDIC in 1933. **With five consecutive annual records of bank earnings and with DIF balances now reaching $50 billion, the risk exposure of the DIF is at an all-time low.** In fact, the FDIC has recently estimated potential losses for future failures to be within a range of from $1 million to $241 million. These estimates suggest that near-term losses to the DIF would not alter the reserve ratio.

Furthermore, there have been great improvements in risk management and supervisory practices since 1991 when the 1.25% target level was established. The enhanced regulatory powers that the FDIC has enjoyed since the Federal Deposit Insurance Corporation Improvement Act was implemented in 1991—including prompt corrective action, depositor preference and cross guarantee measures—not only has minimized bank failures but makes it less costly to resolve a bank failure. In response to risk-based examinations and recent proposals to revise the Basel capital accord to make it more risk-sensitive, bankers have made great strides towards improving their risk management tools and implementing them into their operations.

In adopting the Reform Act, Congress expected that the FDIC would pursue a steady, low premium policy to avoid premium volatility and that it would abandon the previous policy of pursuing a designated reserve ratio without any consideration of factors such as the impact of high assessments on the banking industry. Under the Reform Act, even if the reserve ratio falls below 1.15%, the FDIC has up to five years to restore the reserve ratio to above that amount. **We urge, therefore, that the FDIC determine that three-to-five years is an appropriate time frame for DIF to achieve its proposed DRR.**

Conclusion

ICBA appreciates the opportunity to comment on the FDIC's proposal to revise its risk-based premium system. Subject to the recommendations above, we believe the new risk-based premium system will fairly differentiate risk between institutions and will be an improvement over the present system.

If you have any questions about our comments, please do not hesitate to contact the undersigned at Karen.Thomas@icba.org or Chris Cole, ICBA regulatory counsel, at Chris.Cole@icba.org. Their phone number is 202-659-8111.

Sincerely,

Karen M. Thomas

Karen M. Thomas
Executive Vice President
Director, Government Relations Group