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OFFICE OF
EXECUTIVE SECRETARY

September 20, 2006

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

RE: Comment on RIN 3064-AD09

Dear Mr. Feldman:

In principal, assessing FDIC deposit insurance premiums across banks on the basis of risk is an appropriate and equitable way to manage the Depository Insurance Fund ("DIF"). The recent FDIC proposals contain many sound elements, including the following:

- for large banks, the use of both the bank's CAMEL rating and its long term debt rating represents a simple, straightforward and analytically sound approach;
- for small banks (those under $10B), using pre-determined financial ratios in the risk assessment process also makes sense since public debt ratings may be less relevant for these banks and since the quantity/quality of information about risk is less transparent to the public debt market for these banks than it would be for larger, more frequent issuers of debt;
- eliminating/consolidating some of the risk categories in the current approach is correct since some of these categories are simply unnecessary (e.g. it is highly unlikely that any under-capitalized banks would also have the highest possible CAMEL rating, so the lowest capital/highest CAMEL category is clearly unnecessary)
- aligning risk categories by historical failure rate makes sense since that approach is fact based and statistically relevant.

We offer the following comments to help ensure that any risk-based deposit insurance system is most reflective of actual risk to the DIF, most equitable across depository institutions and least costly to the industry without increasing system risk.

1. *CAMEL Weightings:* For large banks, the banks public long term debt rating should be given greater weight in the insurance pricing calculation, instead of equal weighting with the bank's CAMEL rating. This would be consistent with

market based disciplines for pricing risk. Within the CAMEL rating itself, if the FDIC is intent on ascribing unequal weights to each component of the CAMEL rating, more weight rather than less weight should be ascribed to the liquidity component than to any of the other CAMEL components. While deterioration in some of the other CAMEL components can be predictors of emerging problems, banks ultimately fail because they run out of cash.

2. *Risk Differentiation:* While sound in principle and better differentiated than the current approach, the proposed system does not fully differentiate the risk posed to the DIF across the large number of banks in the U.S. Under the proposed approach, only about half of the nation's large banks would be assessed at rates in excess of the 2 bp minimum base rate i.e. the proposal doesn't differentiate well enough across those banks in the "lowest risk" category.

   We would encourage the FDIC to consider a more granular method that provides better market-based differentiation. This might be accomplished by lowering – or even eliminating – the premium rates for those banks with the highest debt and CAMEL ratings, or for those banks that are in the lowest proposed risk category but whose combined long term debt rating/CAMEL rating have been consistently high over time.

3. *Small vs. Large Banks:* the application of the same premium rates to both large and small banks has a bias to discriminate against large banks. Larger banks tend to have well diversified sources of income and less concentration of risks whereas small banks tend to be less diversified in their business mix – a differentiating factor that is widely recognized in the capital markets. Beyond that, larger banks are subject to a higher level of scrutiny by the regulatory agencies, accounting firms, rating agencies, and the financial markets, all of which makes their risks more transparent and which usually allows prompt action to be taken before issues become large enough to impact the DIF. Among all bank failures in the last 35 years, only one bank (Continental, Illinois) was among the largest 15 banks in the U.S. at the time. At a minimum, business diversification should be more explicitly taken into account in determining premium levels. Consideration should also be given to lower or even eliminate premium rates for those banks that adopt the advanced approach under BASEL II or whose actual capital sufficiently exceeds their BASEL II required capital since these banks by definition will have demonstrated capital levels/risk management practices that virtually eliminate any risk to the DIF.

4. *Affiliates:* Under the FDIC's proposal, premium rates would be applied to affiliates of large banks as if the affiliates were stand-alone small banks. In theory, a bank could wind up paying a higher insurance premium to the DIF for its small bank affiliate than the premium rate applied to the consolidated bank. Presumably a better answer would be to strengthen the cross guarantees within multi bank entities or to at least allow the most highly rated banks to pay the same premium rates across all of their affiliates.

5. *Target Fund Ratio:* The proposed fund target of 1.25% of insured deposits seems high in light of the fact that the FDIC's exposure today is significantly less than it was fifteen years ago when the 1.25% target was established. First, risk levels, management practices, and transparency are much better today than fifteen years ago. Second, the FDIC's exposure has declined significantly. The portion of bank funding with priority over the FDIC in bank failures fell from 67% in 1992 to 49% in early 2006 and the portion of funding backing FDIC claims (i.e. equity and subordinated debt) has risen from 8% to 12%.

   Third, the FDIC has had enhanced regulatory powers – including prompt corrective action, depositor preference, and cross guarantees – since 1991 that make it less likely a bank will fail and less costly to resolve those that do. Supervisory practices have also improved during this time period.

6. *Rebuilding Assessment Rates:* The idea that the FDIC should charge high premiums beginning next year when the new risk-based system is being implemented seems inappropriate and unnecessary. The banking industry is healthy by nearly any measure – earnings, credit quality, and capital adequacy. The recent decline in the DIF ratio does not represent a decline in DIF resources – it came about because of very strong deposit growth, which is already slowing significantly, rather than because of problems in the banking industry. With a fund balance likely to exceed $50B by the end of this year and increasing at nearly $0.5B each quarter any extra revenue raised at high assessment rates would seem to be highly unnecessary for the DIF to meet its obligations. A smooth, low premium approach to building the DIF would be much preferable to a spike and such an approach would also seem to be more consistent with Congressional intent. Under existing statute, Congress specifically allowed up to five years to rebuild the DIF if it fell below the lowest boundary in order to avoid an unnecessary spike in premium costs. It seems reasonable therefore to have at least that time frame for achieving any specific target ratio given the absence of any large industry problems.

Sincerely,

Howard Atkins

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