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September 22, 2006

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

RE: RIN#3064-AD09, Proposed Risk-based Assessment Regulation

Dear Mr. Feldman:

Charles Schwab Bank, N.A. ("Schwab Bank") appreciates the opportunity to comment on the FDIC's proposed risk-based assessment regulations. As proposed, the revisions to the risk-based assessment system would have a significant impact on Schwab Bank which opened for business in April 2003. For the reasons discussed below, we strongly urge the FDIC to reconsider its proposal regarding new institutions.

Schwab Bank is a wholly owned subsidiary national bank of the Charles Schwab Corporation ("Schwab"), a Federal Reserve supervised financial holding company. Schwab was the first non-bank centric holding company to become a financial holding company after the enactment of the Gramm-Leach-Bliley Act of 1999[1] when in June 2000 it completed its acquisition of the U.S. Trust Corporation and the U.S. Trust family of insured depository institutions.

The FDIC's proposed risk-based assessment regulations reflect a significant effort to make the system more risk sensitive. We support that effort but are concerned that the application of a premium surcharge on new institutions would result in unnecessary additional financial burden on such institutions for seven years regardless of the 'probable' risk posed by a particular institution to the Deposit Insurance Fund ("Fund").

For the reasons discussed below, we do not believe that this proposal is consistent with the Federal Deposit Insurance Act ("FDIA")[2], the FDIC's goal to make the system more risk-sensitive, or the probable risk to the Fund posed by many of these institutions. We are also concerned that the proposal is anti-competitive favoring established institutions and potentially creating a barrier to entry into the banking system. We strongly urge the FDIC to adopt a system that assesses the probable risk each new institution presents to the deposit insurance system rather than assessing these institutions

[1] Public Law 106-102
[2] 12 USC 1811 et seq.

as a group. In the alternative, the FDIC should except from application of the surcharge new institutions established by regulated holding companies.

The proposed regulations would exclude an institution in Risk Category I that is less than seven years old from evaluation under either the smaller or larger institution method of risk differentiation. The rationale for this proposal is that "[O]n average, new institutions have higher failure rates than established institutions. Financial information for newer institutions also tends to be harder to interpret and less meaningful. A new institution undergoes rapid changes in the scale and scope of operations, often causing its financial ratios to be volatile. In addition, a new institution's loan portfolio is often unseasoned, and therefore, it is difficult to assess credit based solely on current financial ratios." [3]

In support of its position that new institutions are as a category more risky, the FDIC cites two studies that "show that new institutions exhibit a "life cycle" pattern and it takes close to a decade after its establishment for a new institution to mature".[4] While we agree with the conclusion in these studies that new institutions are subject to a "life cycle" pattern, we respectfully suggest that these studies do not support imposing a surcharge on new charters. Rather, the conclusion reached in these studies regarding new institutions suggest that a risk-based assessment system that is applied on an individual bank basis could be created which would identify early warning signals permitting risk to be appropriately identified and premiums to be assessed as warranted. In his study, Robert De Young specifically suggests that "early warning signals may be easier to identify for de novo banks than for established banks, perhaps because banks in the early stages of their life cycle are less heterogeneous and hence simpler to model than mature banks. " [5]

Adopting such an approach would be more consistent with the FDIA's definition of a risk –based system as a "system for calculating a[n] . . . assessment based on – (i) the probability that the deposit insurance fund will incur a loss with respect to an institution . . ." [6] rather than the proposed one-size fits all approach which would impose unnecessary burden on those new institutions which do not present undue risk to the Fund. Moreover, it would be consistent with the FDIC's goal of making "the assessment system more sensitive to risk . . . [and] . . . fairer, by limiting the subsidization of riskier institutions by

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[3] 71 Federal Register 41927 (July 24, 2006)
[4] Id., The studies are Robert De Young, "For How Long Are Newly Chartered Banks Financially Fragile?", Federal Reserve Bank of Chicago Working Paper Series 2000-09 and Chiwon Yom, "Recently Chartered Banks Vulnerability to Real Estate Crisis," FDIC Banking Review 17 (2005).
[5] De Young, p. 27
[6] 12 USC 1817 (b)(1)(C)

safer ones." [7] Differentiating between institutions on the basis of risk would also provide an incentive for new institutions to engage in effective risk management. Imposing a surcharge on an institution under a risk-based system that will not be removed for a set period of time regardless of the risk profile of the institution eliminates some of the incentive for an institution to effectively manage its risk.

We also note that neither study considered banks chartered in the late 1990s or more precisely after 1999 which is the group of banks to which the surcharge would initially apply. Both authors noted that the enhanced regulatory oversight of new institutions chartered in the 1990s and thereafter may result in these institutions performing differently. It would be anomalous to impose a surcharge on a group of banks based on studies which acknowledge that the environment under which these banks operate may be different than the environment which they studied.

In assessing the risk on new institutions to the Fund, the proposal did not take into consideration access to financial resources that would limit an institution's risk to the Fund. In particular, the proposal does not consider holding company ownership. The Federal Reserve mandates that financial and bank holding companies serve as a source of strength to their subsidiary institutions. Moreover, the 1999 Gramm-Leach-Bliley Act requires financial holding companies to keep their subsidiary institutions well capitalized and well managed. [8] In assessing whether new institutions pose a risk to the Fund, the FDIC should consider whether the institution is owned by a holding company. The De Young study found that multi-bank holding company ownership is a positive determinant in terms of a de novo's survival time.

Finally, we are concerned about the potential anti-competitive effect of proposed surcharge on new institutions and the effect it may have on potential new entrants into the banking industry. The imposition of a surcharge for seven years will significantly add to the cost of operating the bank limiting its ability to compete effectively. The proposed surcharge on new charters may also affect whether banking organizations or potential new entrants acquire an existing bank or seek to charter a new institution. This new surcharge is on top of the 8% leverage ratio imposed by the FDIC on new institutions during their initial three years of operation. The difference, however, is that the capital requirement can be used to support the bank whereas the surcharge will represent funds that are no longer available to the bank. We urge the FDIC to consider these issues in evaluating the new institution surcharge.

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[7] 71 Federal Register 41911 (July 24, 2006)

[8] See, Section 4(l) (1)(A) and (B) of the Bank Holding Company Act, as amended, 12 USC 1843.

We strongly recommend that the FDIC eliminate the surcharge on new institutions and use a risk-based assessment system which considers the risk posed by each institution. Doing so would more fairly assess the risk of each institution and avoid unnecessarily imposing a financial burden on all new institutions. At a minimum, the FDIC should not impose the surcharge on new institutions formed or controlled by regulated financial or thrift holding companies.

We would be happy to provide any additional information. Please do not hesitate to contact me at (775) 689-6870.

Sincerely,

Richard F. Kenny
Chief Executive Officer
Charles Schwab Bank, N.A.