AMERICAN BANKERS ASSOCIATION ®

America's Community Bankers

THE FINANCIAL SERVICES ROUNDTABLE
Impacting Policy. Impacting People.

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March 23, 2007

Mr. Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
Attn: Comments/Legal ESS
550 17th Street, NW
Washington, DC 20426

Re: Federal Deposit Insurance Corporation; Proposed Assessment Rate Adjustment Guidelines for Large Institutions and Insured Foreign Branches in Risk Category I; 72 Federal Register 7878, No. 34, Wednesday, February 21, 2007

Dear Mr. Feldman:

The American Bankers Association ("ABA"),[1] America's Community Bankers ("ACB")[2] and the Financial Services Roundtable ("Roundtable")[3] appreciate the opportunity to comment on the proposed assessment rate adjustment guidelines for large institutions (hereafter referred to as the premium-adjustment authority).

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[1] The American Bankers Association, on behalf of the more than two million men and women who work in the nation's banks, represents all types of financial institutions in this rapidly changing industry. The ABA's membership includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks, making it the largest banking trade association in the country.

[2]America's Community Bankers is the national trade association committed to shaping the future of banking by being the innovative industry leader strengthening the competitive position of community banks. To learn more about ACB, visit *www.AmericasCommunityBankers.com*

[3] The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. The Roundtable's Housing Policy Council is made up of nineteen companies that are among the nation's leaders in mortgage finance. Member companies originate sixty-twp percent of the mortgages for American home buyers.

Roundtable member companies provide fuel for America's economic engine, accounting directly for $65.8 trillion in managed assets. $1 trillion in revenue, and 2.4 millions jobs.

As background, in November 2006, the Federal Deposit Insurance Corporation (FDIC) adopted a rule implementing a new risk-based premium system (hereafter referred to as the base system). For large banks, the premium would be determined by a combination of examiner ratings (CAMELS) and debt-issuer ratings (or financial ratios when no debt issuer rating is available for the bank). In addition, as part of that rule, the FDIC adopted authority to adjust the premiums of large banks up or down by as much as one-half basis point annually. In the Notice of Proposed Rulemaking on the base system, how this authority would be used and what factors would be considered was not fully articulated. Our three associations commented that this authority was too vague and ill-defined and we recommended that it not be used. While the premium-adjustment authority was adopted in the final rule, we commend the FDIC for asking the staff to articulate more fully how this authority would be implemented and to seek public comment on it before implementation.

In the vast majority of cases, the combination of examiner ratings and debt issuer ratings will serve as reasonable measure of a bank's risk for deposit insurance purposes. However, our associations agree that it is critical to identify inconsistencies and anomalies in the base system that could lead to premiums at some institutions that are at odds with the relative risk these institutions pose to the FDIC. As the base system is untested, we agree that having a mechanism to review premiums is appropriate. We urge the FDIC to monitor the entire base system applied to all banks carefully to assure that it is generating an appropriate separation of premiums according to risk. A large number of changes under the premium-adjustment authority would suggest that the base system needs some further adjustments. If this occurs, changes should be considered to correct the base system drawing upon the experience from the use of the premium-adjustment authority. An evaluation should also be conducted to determine if there are any common characteristics associated with the rate adjustments, such as by asset size, bank specialty or charter type that might indicate a need to change the base system.

To allow the industry to evaluate the use of this premium-adjustment authority better, the FDIC should disclose the number (but not the names) of institutions that have had an adjustment of rates. The FDIC should also distinguish between the number of upward and downward adjustments and their magnitude.

Our associations also would reiterate concern that the current premium schedule established in November 2006 by the FDIC is excessively high. The reserve ratio remains well above the lower bound of the normal range (1.15 percent) and there is no timeframe required to reach the Designated Reserve Ratio. Thus, the costs already imposed on the industry are considerable and using this additional premium-adjustment authority to increase rates would add an additional burden. The average premium rate for Category 1 institutions should be considerably lower, around one or 1.5 basis points. Moreover, at those more normal levels, a half-basis point increase would represent a significant percentage increase over what the base system suggests.

Subjective Factors Should Be Used Only to Reduce the Premium Rate
The proposed guidance for changing premiums under the premium-adjustment authority consists of both objective and subjective factors. The use of more specific risk measurements does provide important information that can be overlooked with the use of only broad measures of risk. Thus, it is reasonable to use more specific measurements to evaluate whether a particular premium that has been set is accurate.

However, of particular concern is that application of the premium-adjustment authority relies upon significant elements of subjectivity. Subjectivity enters both through the weights assigned to objective factors and through factors such as stress testing and other, less well-defined, variables. Because of the subjectivity that permeates this rule, any upward adjustments could be viewed as arbitrary and misguided and will likely be disputed vigorously by the affected institutions.

The variables related to stress testing and loss severity measures are of particular concern. How these would be applied is still unclear and is likely to vary considerably – and potentially inconsistently – across institutions. ***These variables should not be used to raise rates under any circumstances***. We would note that for 45 percent of institutions – those at the minimum assessment rate – this proposal suggests a one-way street to higher premiums assessments.

Other factors that are seemingly objective, in that they can be ranked, nonetheless have a subjective component that can be troubling. For example, it is possible to rank institutions by the use of secured borrowings, such as Federal Home Loan Bank (FHLB) advances. However, such a ranking in no way indicates greater risk of loss to the FDIC. As is noted in more detail below with regard to FHLB advances, the use of secured borrowings provides considerable liquidity, diverse sources of funding and the ability to better match funding of assets, and therefore reduces the likelihood that the institution would fail in the first place. Thus, it would be inappropriate to penalize institutions that make greater use of secured borrowings. This factor should not be included at all as a variable influencing premium rates.

Another example would be the level of foreign deposits at a given institution. The proposal presents the concern that in a failure, foreign countries could ring-fence assets and thereby increase the cost to the FDIC. While this risk exists, it would be impossible to know for certain the extent of the potential problem and the implications for the FDIC. A mere ranking of institutions by foreign deposits does not provide any guide to these issues. The level of foreign deposits – ***which are not insured by FDIC*** – should not be a consideration for adjusting premium rates.

Due to the level of subjectivity involved, any decision to raise rates will likely be challenged. This will take resources away from both the FDIC and the institution without any benefit to either. ***Importantly, the full protection to appeal an increase in rates must be available so that the bank can fully defend its position.*** The FDIC would be expected to provide the detailed basis for the decision in writing and provide the institution the opportunity to present evidence in opposition.

Any Change Must be Well Supported

We agree with the proposal that any change must be well supported. If the premium-adjustment authority is used to raise rates, this is particularly important. Moreover, raising the rate must be justified by a preponderance of factors that suggest a change is required.

Our associations are pleased that the FDIC would notify an institution of an upward adjustment and provide it with an opportunity to respond and to address the concern. This is an appropriate way to address issues of concern and potentially avoid a large monetary penalty.

As noted above, we recommend that the FDIC disclose the number of upward and downward adjustments and their magnitude (but not identify the institutions).

The Analysis and Supportive Information Should be Provided to Every Bank Each Time it is Conducted

As the FDIC will be conducting a complete analysis of banks with over $10 billion in assets, it is appropriate to provide, on a confidential basis, the results of that analysis to each bank. This will enhance the dialogue between the FDIC and the bank and provide feedback on areas where differences exist and a concern may arise.

Institutions Should be Able to Petition the FDIC for a Reduction

The proposed guidance is a one-way street, allowing only the FDIC to initiate a change in the premium rate. This is not appropriate as the bank may have evidence to suggest that it is less likely to fail and less likely to cause losses to the FDIC than the base system suggests. ***The institution should have the opportunity to present its case for a downward adjustment to the FDIC.*** Having the results of the FDIC's analysis provided to each institution would help the institution to assess for itself whether there is evidence supporting a reduced rate, even if the FDIC has decided that no reduction is appropriate for that period. More importantly, there may be information not included in the base system or under the premium-adjustment authority that is relevant and argues for a decrease in the rate. Having such information would also help the FDIC to refine over time the variables included in its analysis.

This Premium-Adjustment Authority Should Not Be Linked to Whether the Institution has a System for Determining Insured Account Status

Under a separate Advanced Notice of Proposed Rulemaking, the FDIC is seeking comment on the need for and method of tracking the status of insured accounts. That proposal is highly controversial for affected institutions and a reasonable approach for tracking insured accounts has yet to be found. We commend the FDIC for working closely with the industry in the development of that proposal and we believe that the process already underway is the appropriate approach to finding a reasonable solution. The premium-adjustment authority should not consider the existing capabilities of deposit account systems. Such authority would be superfluous to what may be adopted under a separate rule. Moreover, if such a factor were to be included in the premium-adjustment authority, there would be nothing to stop the FDIC from penalizing institutions that do not have the most comprehensive – and very costly – system that might involve unique identifiers and aggregation of accounts. It is also uncertain how such a factor could be used as a risk-measurement and how the FDIC would rank institutions based on such a factor without using highly subjective criteria that are not universally accepted. All of our associations have commented separately on the account-tracking proposal. Simply put, whether and how the insured accounts are tracked should be considered separately through the normal notice and comment process and not be a factor for adjusting premiums.

FHLB Advances Should Not Be Considered for Any Upward Adjustment of Premium Rates

In the appendix, under "Risk Measures Pertaining to Stress Conditions," the FDIC proposes to consider the ratio of the sum of secured liabilities that would have priority claim in the event of failure divided by total liabilities to determine assessment rate adjustments. As noted above, secured liabilities should not be used as a factor in premium-adjustment authority. FHLB advances are a prime example of these important secured liabilities for banking organizations.

As proposed, FHLB advances would cast a negative light on an institution during the assessment adjustment process because they would raise the ratio of secured liabilities to total liabilities. This is of great concern to us as these advances are an especially stable and reliable form of liability that reduces funding risk for many banking organizations. FHLB advances have pre-defined, disclosed terms which are under the control of the institution rather than outside market forces. Banks use FHLB advances for liquidity purposes and to manage interest-rate risk, as well as to fund loan growth.

Given the reliable availability of these advances as a source of wholesale funding in all market conditions and the predictable effect of such funding on an institution's business plans, penalizing banks for using advances by increasing premium rates under the premium-adjustment authority is not an acceptable outcome. It would curtail the use of FHLB advances and force institutions to look to alternative, often more costly wholesale funding sources that are considerably more volatile. Penalizing FHLB members for using advances would not only limit their use of a valuable liquidity source, but also make them less competitive, reduce profitability, and limit the availability of credit in the communities they serve.

While it is true that FHLB advances reduce the overall collection for the FDIC should the depository institution fail, the use of advances actually decreases the likelihood of failure in the first place. If the FDIC were to include FHLB advances as a negative factor in the determination of an institution's premium assessments, it would discourage borrowing from FHLBs, be counterproductive to reducing the risk of failure of insured depository institutions and actually increase risk of loss to the FDIC. Therefore, we suggest that FHLB advances not be included in the sum of secured liabilities for purposes of this proposal. It is inappropriate to negatively affect a banking organization that holds this type of secured funding on their balance sheet.

Inclusion of Other Factors Beyond This Guidance Should Be Subject to Notice and Comment

It is likely, and appropriate, that the FDIC will review the variables included in this adjustment authority and add or delete those that do not shed light on the relative risk of failure and loss to the FDIC if a failure should occur. Which new factors might be added and how they would be used should be explained in detail and submitted to the public for comment. This is consistent with the open approach followed so far by the FDIC. For example, whether the Basel II capital disclosures should be linked to the premium system and how that would be implemented will be of particular interest to the industry.

The Willingness or Ability of the Parent Company to Provide Financial Support for the Bank Should be Included as a Factor for Reducing the Premium Rate

A bank owned by a strong financial services parent lowers the relative risk to the FDIC of losses. The FDIC should include this as a factor for reducing premium rates.

Factors Included Should Only Be Risk Based

Technical violations not related to the institution's safety and soundness and not related to the risk of failure of the institution (such as a memorandum of understanding or consent and decree order relating to compliance regulations or the Bank Secrecy Act) should not preclude a downward adjustment in premium rates. In fact, as these may have lowered the CAMELS ratings and inappropriately increased the base premium rate, such information should be taken into account to reduce the premium through this proposed process.

Moreover, care should be taken to assure that variables related only to risk of loss to the FDIC be considered for any adjustment. This premium-adjustment authority should not be used in any way as an incentive for banks to provide particular banking products or to allocate credit.

Our organizations would be happy to provide additional information or answer any questions.

Sincerely,

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