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November 17, 2008 Via electronic delivery

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

Re: RIN 3064-AD35; Assessments; 12 CFR 327; 73 Federal Register 61560; October 16, 2008

Dear Mr. Feldman:

The American Bankers Association (ABA) appreciates the opportunity to comment on the proposal of the Federal Deposit Insurance Corporation (FDIC) to raise premium assessment rates in 2009. The ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.3 trillion in assets and employ over 2.2 million men and women.

First and foremost, our members understand the importance of having a financially sound FDIC insurance fund. Bank premiums have provided the entire financial support since the FDIC was created 75 years ago. Banks have been and continue to be prepared to meet their obligation to keep the fund strong. The industry expects that the assessment schedule will rise in the short run in order to pay for current bank failures, provide reserves for the future, and rebuild the fund's reserve ratio. Since banks are responsible for the fund's financial health, the ultimate cost to the industry will be virtually the same no matter what recapitalization plan is implemented.

At issue is the timing of payments to rebuild the fund. In setting premium rates, it is critical that the FDIC strike the right balance so that the fund can remain strong without pulling resources unnecessarily from banks that need them to support loans in local communities. The current Treasury Department Capital Purchase Program highlights the importance of maximizing bank resources available for lending and economic growth in our communities. ABA believes that the proposed premium rates are too high under the current circumstances and we recommend that the rate hike should be moderated. A phased-in increase in the assessment schedule over the next few years may be appropriate, considering that the present economic recession and financial turmoil will likely ebb in the future. We accept and support our obligation to strengthen FDIC resources, but we propose doing so in a way that is less pro-cyclical, that keeps more resources available in the communities for loans and other key financial services.

Our main thoughts on the proposal, which are discussed in more detail below, are as follows:

- **The proposed rate hikes are too high – particularly in the early stages of the plan – and do not take full advantage of the authority provided by Congress to assure adequate resources are available for lending.**
- **Unnecessarily high premiums will restrain credit.**
- **A longer recapitalization period and slower expected deposit growth rates support a more moderate rate increase.**
- **A phase-in approach to higher premium rates should be considered.**

The proposed rate hikes are too high – particularly in the early stages of the plan – and do not take full advantage of the authority provided by Congress to assure adequate resources are available for lending.

Congress explicitly gave the FDIC authority to rebuild the reserve ratio to 1.15 percent within five years in order to avoid having large premium increases reinforce an economic downturn. Moreover, Congress provided the FDIC with additional flexibility under this authority to extend the period of time ***beyond*** five years under extraordinary circumstances.[1] There is no question that we are in extraordinary times, so much so that the FDIC has, under a separate and unprecedented ruling, invoked its systemic risk authority to provide further guarantees on transactions deposits and senior unsecured debt.[2]

Moreover, Congress directed the FDIC when setting rates to take "into account economic conditions generally affecting insured depository institutions so as to allow the designated reserve ratio to increase during more favorable economic conditions and to decrease during less favorable economic conditions, notwithstanding the increased risks of loss that may exist during such less favorable conditions."[3] It would be hard to imagine an economic situation more in line with congressional intent than the conditions that prevail today.

Given this explicit direction, it is particularly troubling that the assessment rates contemplated in the proposal (for first quarter 2009 and beyond) are expected to rebuild the reserve ratio to 1.15 percent in ***four*** years, not five. In fact, the FDIC expects the assessment income to be so large that the reserve ratio ***surpasses 1.25 percent*** in five years. This is a very aggressive and costly plan that does not strike the appropriate balance envisioned by Congress between rebuilding the fund and assuring credit is available in banks' communities. Charging high premiums is also counter to other efforts by Congress and the Treasury to support bank liquidity and stimulate lending. Premium rates should be substantially less than what is proposed.

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[1] Federal Deposit Insurance Reform Act of 2005 §2108, P.L. 109-171, as reflected in Section 1817(b)(3)(E)(ii) of the Federal Deposit Insurance Act (12 U.S.C. 1817(b)(3)(E)(ii)).
[2] Federal Deposit Insurance Act §13(c)(4)(G), 12 U.S.C. 1823(c)(4)(G).
[3] Federal Deposit Insurance Reform Act of 2005 §2108, P.L. 109-171, as reflected in Section 1817(b)(3)(C)(ii) of the Federal Deposit Insurance Act (12 U.S.C. 1817(b)(3)(C)(ii)).

Unnecessarily high premiums will restrain credit.

The FDIC proposes to raise the existing assessment schedule by seven basis points. This means that healthy banks (Category I) that are well-capitalized and have CAMELS ratings of 1 or 2 will pay between 12 and 14 basis points for the first quarter of 2009. The FDIC expects the average premium assessment rate across the industry to be 13½ basis points, which would raise over $2½ billion in the first quarter alone and over $10 billion for all of 2009. Interest income on the fund balance is expected to add another $1½ billion or so.

This represents a huge increase, more than doubling current premiums.[4] This will have a significant impact on bank earnings and, more importantly, the ability of ***healthy*** banks to make loans. The FDIC estimates that the premium cost alone will mean a hit to industry earnings of 5.6 percent. Given current market conditions, with declining bank earnings, this number will clearly be greater in the third quarter and most economic forecasts see no improvements until the second half of 2009.

Paying excess premiums takes resources out of banks and their communities at the very time in the economic cycle when credit availability is so critical to recovery. The impact on credit availability in communities will be significant. Each basis point in the premium rate will cost the industry about $760 million. Since each dollar in capital supports roughly seven dollars in bank lending and 10 dollars in bank assets, each basis point increase has the potential to reduce lending by over $5 billion and asset growth by over $7½ billion. Paying excess premiums is certainly counter to the goal of the Treasury's Capital Purchase Program that provides extra capital for healthy banks to encourage greater lending.

A longer recapitalization period and slower expected deposit growth rates support a more moderate rate increase.

If the FDIC were to make full use of the five-year timeframe to build the fund to 1.15 percent, the premium rate for healthy banks would be more than a full basis point lower than proposed (assuming deposits grow at five percent).[5] Moreover, if the FDIC were to use its authority to extend the period to six years, the Category I premium range would be only 8½ to 10½ basis points; using a full seven years, the range would be 7 to 9 basis points (see table).

Category I Premiums to Rebuild the Fund to 1.15 Percent

(Basis Points)	Annual Deposit Growth Rate		
Recapitalization in:	3%	4%	5%
Five Years	9¾–11¾	10¼–12¼	10¾–12¾
Six Years	7½–9½	8–10	8½–10½
Seven Years	6–8	6½–8½	7–9

[4] The increase in premiums will be even greater for some banks, as higher losses have lowered their risk rating which has resulted in higher risk-based premiums.
[5] These projections are based on FDIC's assumptions, particularly with respect to expected losses in bank failures and growth of insured deposits, as stated in the proposal. Some assumptions were made regarding the level of reserving for possible failures and the timing of the costs. The FDIC's proposal also notes that the expected average assessments after 2009 would fall by 0.9 basis points. Our modeling assumes the same reduction in rates.

The FDIC is assuming that deposits will grow at a five percent rate over the next five years, which is the same as the average over the last five years. Certainly, deposit flows are difficult to estimate and the third quarter may well show stronger growth due to shifts out of the stock market into insured deposits. However, it is difficult to imagine that insured deposits over time will grow substantially faster than the economy, and the Congressional Budget Office predicts nominal GDP growth of 3.8 percent next year.[6] The experience of the early 1990s is instructive: insured deposits actually ***declined*** for four straight years following the 1990-91 recession. This was likely due to both the slow economy (with slow income growth and, therefore, slow deposit growth) and the high premiums the FDIC charged then (discouraging banks from taking on deposits).

The assumption about insured deposit growth has important implications for setting premium rates, primarily because the level of insured deposits is the denominator of the reserve ratio. As the table above shows, with three or four percent, rather than five percent, deposits growth, the assessment schedule for 2009 should be even less and still meet the goal for rebuilding the FDIC reserve ratio.

Thus, rather than more than doubling premiums as proposed, it would be more reasonable to raise the assessment schedule by two or three basis points, i.e., a 7 – 9 basis points or 8 – 10 basis points range for the strong, Category I, banks. Raising rates by two or three basis points, instead of the proposed seven basis points, will keep $6½ billion in banks which could support up to $45 billion in lending.

A phase-in approach to higher premium rates should be considered.

At the very least, the FDIC should consider phasing in increases in the assessment schedule, given the current economic recession and forecast for next year. Such a phase-in would also be consistent with proposals for rates under a revised risk-based assessment formula for the second quarter of 2009 and beyond. As is currently contemplated, the rates for the second quarter would be 10 – 14 basis points (which we believe is also too high a level for the same reasons stated above). Moreover, some of these banks would likely qualify for a further reduction under the proposed risk-based formula, which could reduce rates by as much as two basis points, or a minimum eight basis point charge. This means that the best rated banks would pay a 12 basis points premium in the first quarter and 10 basis points – or even as low as eight basis points – in the second quarter. This clearly is counter-intuitive and would end up imposing a much bigger cost on the healthiest banks in this country at the very time when resources are needed most to stimulate the economy.

We recommend further that the recapitalization plan should explicitly require that premiums be adjusted downward should the reserve ratio rise faster than expected under the plan. In a similar vein, the recapitalization plan can flexibly raise rates should there be greater losses than expected and the rebuilding pace slower than expected. Indeed, this flexibility supports a more limited increase in rates since the FDIC can make adjustments later as needed. The FDIC has the ability to adjust premiums up or down each quarter and, while it is reasonable to avoid frequent adjustments, the

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[6] Congressional Budget Office, "CBO's Year-by-Year Forecast and Projections for Calendar Years 2008 to 2018," September 9, 2008 (www.cbo.gov/budget/econproj.shtml).

FDIC should not wait more than two quarters if it becomes clear that the actual pace strays materially from what is expected.

The ABA appreciates the opportunity to comment on the premium assessment schedule for the first quarter of 2009. We stand ready to work with the FDIC to improve the rule. We also plan to file comments at a later date on the expanded proposal on changes in the risk classification system for determining premium assessments. Should you have questions or seek further explanation of these recommendations, please do not hesitate to call me at 202-663-5130 or Rob Strand at 202-663-5350.

Sincerely,

James Chessen