National Association of Industrial Bankers

NAIB

60 South 600 East Suite #150 | Salt Lake City, UT 84102 | (801) 355-2821 | info@industrialbankers.org

January 30, 2014

Mr. Robert Feldman
Executive Secretary
FDIC
550 17th Street, N.W.
Washington, DC 20552

ATTN: Comments/Legal ESS

Re: Liquidity Coverage Ratio, Liquidity Risk Measurement, Standards and Monitoring
RIN 3064-AE04
Submitted via the Federal e-Rulemaking Portal at www.regulations.gov

Dear Mr. Feldman:

The National Association of Industrial Bankers ("NAIB")[1] appreciates the opportunity to comment on the Advance Notice of Proposed Rulemaking ("ANPR") on the proposed rule for liquidity coverage ratios drafted in response to standards established by the Basel Committee on Banking Supervision, often referred to as Basel III.

I. Statement of Interest

NAIB is the national association representing industrial banks and our comments focus on those banks, their parent companies and customers. Our member banks share many of the concerns of all banks and have other concerns specific to this type of bank. Unlike other types of bank charters, industrial banks may be owned by non-financial companies. Additionally, industrial banks typically serve unique customer groups and markets nationwide instead of specific geographic areas. Industrial banks rarely have branches and typically do not offer checking and other kinds of transaction accounts.

The liquidity needs of most industrial banks differ significantly from banks that offer transaction accounts and maintain branch networks. Because industrial banks do not offer checking accounts and rarely offer any other kind of transaction account, they experience substantially less liquidity volatility. Many industrial banks match loans with time deposits of a

[1] First chartered in 1910, industrial banks operate under a number of titles; industrial loan banks, industrial loan corporations, or thrift and loan companies. These banks engage in consumer and commercial lending on both a secured and unsecured basis. They do not offer demand checking accounts but do accept time deposits, savings deposit money market accounts and NOW accounts. Industrial banks provide a broad array of products and services to customers and small businesses nationwide, including some of the most underserved segments of the US economy. Our members are chartered in California, Nevada and Utah.

similar term so inflows and outflows of cash are predictable and outflows are readily funded with loan payments. Cash inflows and outflows at banks holding checking and other transaction accounts are not linked to loan payments and are more volatile necessitating larger liquidity reserves. Additionally, most brokered time deposits do not permit early withdrawal except if the depositor dies or is adjudicated incompetent so the term of the deposit is immune from unexpected withdrawals even in conditions where market rates have significantly increased or the depositor has grown concerned about a run on the bank. In most cases, the depositor in a brokered time deposit doesn't even know which bank holds the deposit and often lives in another community where he is unaware of adverse news or gossip about the bank.

Another unique characteristic of most NAIB member banks is that they have ready access to capital through diversified parent companies. As a result, they are the best capitalized, most profitable class of banks in the nation and have been so for many years. As of September 30, 2013, industrial banks had combined assets of $157.0 billion and capital of $25.5 billion.

At the outset we acknowledge that the proposed rule will not apply to all industrial banks. Most industrial banks are below the threshold where the rule would apply in its current form but some would be affected. Additionally, our members are concerned about the likelihood that the standards for the large banks will be extended to smaller banks to some degree in practice.

II. General Concerns

The proposed Basel III liquidity formula will cause major adverse changes in long standing liquidity practices and standards when there is no empirical evidence that such changes are needed or justified. These changes, claimed to make banks safer, will tend more to make them less safe and less viable as businesses by further compressing already narrow net interest margins. The proposed Liquidity Coverage Ratio may actually increase a bank's liquidity risk. The penalty for holding brokered deposits with a term above 30 days may cause banks to source deposits from more volatile sources such as the Internet.

The proposed requirements are not prompted by any record of liquidity problems among industrial banks or most other banks during the last recession or in other times of unusual stress. The banks that did have liquidity problems in the last recession had runs that would not have been manageable with the added liquidity mandated by the proposed rule. It is simply not feasible for a bank to hold sufficient liquidity to withstand a major run.

The proposed rule will require many banks to substantially increase assets held for liquidity purposes but only permit liquidity investments with the lowest yield. There is no indication that the regulators considered the impact of the additional costs and reduced asset yields on the already pressured income of many banks. This will be added to other recent changes such as increased loan loss reserves, higher capital standards, and substantially increased compliance costs, which will significantly constrict net interest margins and profitability. The combined effects have brought many banks close to the point where their business is no longer viable.

Given the marginal benefits of the proposed rule, we recommend staying the adoption of the rule at least until a thorough study can be completed on the effect of all these changes and how much added expense and reduced income banks can absorb and remain viable.

III. Specific Concerns

Cash outflow analysis

The proposed rule adopts a different standard for projecting cash outflows at U.S. banks than the standards applicable to banks in other nations. The international standard looks at median cash outflows during the applicable period. The proposed U.S. rule will base projections on the highest single day multiplied by the applicable period (30 days or 21 days) rather than the median. This formula is not supported by any empirical rationale and substantially increases the amount of liquidity a bank must hold with virtually no income. We believe this standard is unreasonably high and should be reconsidered.

Liquidity reserves for specific deposits.

Unlike other kinds of banks, most industrial banks market their products and serve their customers without branches and only rarely offer transaction accounts of any kind. This limits the opportunities to raise retail deposits directly from depositors except through the Internet and other electronic means. (It also eliminates the expense of building and maintaining a branch system). For that reason, industrial banks have traditionally been more reliant on brokered deposits for funding. Today, industrial banks are looking at ways to diversify funding sources, but regardless of the success of those programs, many industrial banks will always use brokered deposits to a significant degree because of their ready availability, competitive rates, stability and all-in cost savings over deposits raised through retail offices.

It should be noted that industrial banks have compiled a strong record of safety and soundness over the past 20 years and have not experienced any significant problems relying on brokered deposits. No industrial bank has experienced a run or other volatility in connection with brokered deposits, even in the most disrupted and volatile economic conditions. During the last recession, supplies of brokered deposits actually increased as people moved money out of other investments and into FDIC insured deposit accounts. Many industrial banks were able to grow during the recession because they remained liquid, well capitalized and profitable during the recession while many competitors contracted or exited markets altogether. The big difference is that industrial banks were not involved in the bubbles surrounding real estate development and they used brokered deposits to match fund loans. Banks that had liquidity problems during the recession were either heavily involved in the real estate bubbles and used brokered deposits to grow with the bubble, or were very large banks whose liquidity problems had nothing to do with brokered deposits.

Brokered deposits have proven time and again to be very stable even in dire economic conditions. Brokered deposits are almost always time deposits. Views held by some that brokered deposits are more expensive and "hot money" likely to be withdrawn as soon as another bank offers a higher rate are grossly inaccurate. These deposits are the least "hot" of any available to a bank, as the record over the past several years amply demonstrates. A good example is a more than 100 year old community bank that failed in Utah after stories in a local paper about problems at the bank sparked a run in which deposits equaling about 15% of its total assets were withdrawn in a two week period. All of the deposits withdrawn were "core" deposits originally deposited directly into the bank by local residents. None of the deposits withdrawn were brokered even though that bank held a significant amount of brokered deposits.

With this in mind, NAIB strongly objects to the provision in the proposed rule requiring a bank to always hold liquidity equal to 10% of brokered deposits maturing more than 30 days later. There is no substantive risk of unanticipated early withdrawals justifying this requirement. Industrial banks are among the most experienced users of brokered deposits and have never encountered a situation where any significant amount of early withdrawals occurred. The narrative in the request for comments on the proposed rule does not describe any rationale for this provision or circumstances where there is a credible risk of early withdrawals.

Coupled with an expected loss of income due to new limits on what qualifies as a liquid asset, this requirement for liquidity equal to 10% of all brokered deposits maturing more than 30 days later will significantly impact the income and profitability of some industrial banks. This should not happen absent a compelling reason based on a credible liquidity risk that has not yet been identified.

A similar issue relates to the proposed rule's requirement to hold 100% coverage for wholesale deposits (defined broadly as deposits placed by other insured depository institutions). That effectively eliminates any incentive or business reason for a bank to take such deposits and they will cease to be offered. This complete disruption of wholesale deposits will severely disrupt the availability of correspondent deposit options for all depository institutions and is not justified by any experience of a run on such deposits by any bank in any economic conditions of which we are aware.

Reporting requirements.

The growing regulatory burden is an increasingly common problem in the banking industry today. It arises in two ways.

First, apart from the merits of any particular rule, the mass of rules impedes efficient and sustainable operations and is approaching the point where the business can become unsustainable. Each new rule and reporting requirement adds to the growing list of other rules and requirements. Compliance is a cost for any business. If the cost rises too high to compete and earn a profit, the business will eventually close. It is increasingly clear that many smaller banks are at the tipping point where they are required to do more than they can feasibly do, as evidenced by the ongoing and unfortunate reduction in the number of banks operating in the nation today. This trend has to end or community banks will soon become extinct.

The second issue is whether the specific requirement at issue is necessary and justified. Ideally, rules are developed to accomplish a very well defined goal.

The proposed rule will require all covered banks to report liquidity positions daily. Industrial banks feel this is unnecessary and objectionable both as overkill and another costly burden helping to drive profitability down to the point of unsustainability for many banks.

High Quality Liquid Assets

The proposed rule would restrict the kinds of assets that will qualify as liquid investments. Industrial banks believe the list of qualified liquid investments is too restrictive and fails to adequately consider the impact on income. The narrative fails to cite any evidence that investing in assets other than government securities or deposits at the Federal Reserve caused any liquidity problems for banks during the recent recession. This is particularly true for investments in money market funds. One fund had to "break the buck" but only by a small amount and that risk is more than offset by the difference in yield between government securities and money markets.

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We appreciate the opportunity to share our views and would be pleased to discuss any of them further at your convenience.

Sincerely,

Frank Pignanelli
Executive Director