MICHAEL WHITE ASSOCIATES
BANK INSURANCE CONSULTANTS
BANKINSURANCE.com

MICHAEL D. WHITE, PH.D., CLU, CHFC
PRESIDENT

MWA@BANKINSURANCE.COM
RADNOR, PENNSYLVANIA

November 18, 2008

Filed in PDF via email and by post

Herbert J. Messite
Counsel
Attn: Comments, Room F-1052
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
Attention: Consolidated Reports of Condition and Income, 3064-0052

Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
Attention: Consolidated Reports of Condition and Income, 7100-0036

Communications Division
Office of the Comptroller of the Currency
Public Information Room
Mailstop 1-5
Attention: 1557-0081
250 E Street, SW
Washington, DC 20219

RE: Consolidated Reports of Condition and Income

Dear Sir or Madam:

This letter is submitted in response to the request for public comment issued by the Federal Deposit Insurance Corporation, Board of Governors of the Federal Reserve System, and Office of the Comptroller of the Currency (collectively, the “Agencies”) regarding proposed changes in agency information collection activities, published in the *Federal Register*, Vol. 73, No. 185, Tuesday, September 23, 2008, pages 54807-54822.

The federal banking regulatory agencies propose “Exemptions from Reporting for Certain Existing Call Report Items” on page 54812. Regarding these exemptions, the agencies say they “have identified certain Call Report items for which the reported data are of lesser usefulness for banks with less than $1 billion in total assets. Accordingly, the agencies are proposing to exempt such banks from completing [a number of] Call Report items effective March 31, 2009.”

Preserve the reporting of Schedule RI, Memorandum item 2.

I am concerned about the first Call Report item the agencies propose to exempt for banks with less than $1 billion in total assets: Schedule RI, Memorandum item 2, "Income from the sale and servicing of mutual funds and annuities (in domestic offices)."

I believe strongly that this data field should be preserved in all bank Call Reports. Banks with assets less than $1 billion that earn income from mutual fund and annuity activities should continue to report that income.

If the agencies eliminate reporting of mutual fund and annuity income among banks with assets less than $1 billion, we will lose our sole window into community banks' mutual fund and annuity activities. At a time when regulators are being criticized for not regulating or not having the information needed and statutory tools to regulate, exempting community banks with assets less than $1 billion from reporting mutual fund and annuity income would seem highly contradictory.

The agencies' rationale for exempting smaller banks is unstated and, therefore, unknown.

The agencies do not provide any rationale as to how they arrived at their determination that "income from the sale and servicing of mutual funds and annuities" ("mutual fund and annuity income" or "MF&A income") earned by community banks is now "of lesser usefulness for banks with less than $1 billion in total assets" (page 54812). No explanation or reason is offered to justify the agencies' conclusion about this item.

Using the same Call Report data currently in question, I will show empirically that the amount of mutual fund and annuity income generated by banks with assets less than $1 billion is not only significant and useful in monitoring the fiscal well-being of these small banks, but is growing at a faster pace than it is at larger institutions and constitutes an even more significant portion of small banks' nonlending activities than that of large banks.

I hope that the agencies' minds are not already made up and that, in fact, this invitation to comment truly means the agencies will subject this proposed change to empirical analyses, internal reflection, and a considered reversal.

Reporting on mutual fund and annuity sales and servicing provides valuable insight for monitoring the fiscal well-being of all banks, especially in light of recent industry turmoil and weakening economic conditions.

In the agencies' assertion that this data field is no longer particularly useful, there is an implication that mutual fund and annuity data are less useful in monitoring the condition, performance and risk profile of institutions with less than $1 billion in assets both individually and as contributors to the banking industry as a whole. However, bank activities involving mutual funds and annuities, regardless of bank size, are one of the "areas in which the banking industry is facing heightened turmoil and illiquidity and weakening economic and credit conditions" (page 54808).

Mutual funds and annuities are critical, fundamental investment product offerings that, in recent weeks, have been substantially affected by the same economic crisis that has struck investment and commercial banks and investment companies. In fact, one of the original and largest money market mutual funds was heavily hit by the collapse of Lehman Brothers Holdings and further helped precipitate the current financial crisis. Within days of the agencies' publication of this proposed exemption in mid-September, The Reserve Primary Fund imposed a seven-day freeze on investor redemptions after the net asset value of its shares fell below $1 in a rare instance of what is called "breaking the buck" by the fund industry. The freeze reflected a surge in redemption requests by investors after The Reserve said its $785 million holding of Lehman debt had been valued at zero. In a matter of hours, Primary Fund's assets fell $40 billion from nearly $63 billion to $23 billion. At this same time, Wachovia

Corp. declared it would pump money into three proprietary money market funds run by its subsidiary Evergreen Investments.

Five weeks later on October 23, 2008, Fidelity Investments announced that all of Fidelity's retail and institutional money market mutual funds were participating in the U.S. Treasury Department Temporary Guarantee Program for Money Market Funds. Fidelity said, "… We expect the [insurance] program to reassure our investors that their money market funds will continue to provide safety and liquidity for their cash investments."

And, on November 11, 2008, the New York Federal Reserve Bank announced that, on November 24, it will begin funding special-purpose vehicles to finance the purchase of certain assets from money market mutual funds through its Money Market Investor Funding Facility program. The goal is to provide liquidity in short-term funding markets. This program, authorized on October 21, is to provide loans for the purchase of "U.S. dollar-denominated certificates of deposit, bank notes and commercial paper [of relatively short maturities] issued by highly rated financial institutions."

Finally, just yesterday, Monday, November 17, 2008, one weekend after Hartford Financial Services disclosed its plan to buy a thrift, become a thrift holding company, and apply to participate in the U.S. Treasury's Capital Purchase Program, Dow Jones Newswires reported, "Hartford Financial Services shares fell 20%…as another recent stock market decline renewed concern about the insurer's variable annuity business…. Hartford has been hit hard in recent months on concern about equity-market guarantees embedded in its large variable annuity business. Goldman Sachs analysts estimated last week that the insurance industry could face a $50 billion liability from guaranteed minimum income benefits that are included in some variable annuities…. 'We remain concerned about additional credit deterioration and the capital pressure from equity market guarantees,' [Deutsche Bank analyst Darin] Arita wrote in a note to clients. 'Insurers that have little excess capital and large exposures to variable annuity equity-market guarantees might still need to raise additional capital.'"

These events, and others that have occurred since the agencies' drafting of the proposed exemption, are striking examples of an area, i.e., mutual fund investing, distribution and management, "in which the banking industry is facing heightened turmoil and illiquidity and weakening economic and credit conditions" (page 54808). This, then, would hardly seem to be a favorable time to exempt small banks from reporting mutual fund and annuity income, the only measure left by which the agencies and expert industry observers might measure the extent of bank involvement in MF&A income-generating activities.

These mutual fund and annuity data can tell us the extent of participation in these investment product activities; the impact the falling markets may have on these sales; and the relative success of all banks, but small community banks in particular, in employing this source of noninterest income to replace lost lending income and loan and investment losses.

Relevance: More small banks report mutual fund and annuity income than report eight of the twelve noninterest fee income line items in the Call Report.

To suppose these mutual fund and annuity income data are "relevant to only a small percentage of banks" (page 54808) is a mistake. One-fifth (20%) of small banks – roughly the same proportion (22%) as all banks – are engaged in mutual fund and annuity sales and servicing activities. In fact, mutual fund and annuity income is more frequently reported by small banks than most other forms of noninterest fee income.

At June 30, 2008, more banks with less than $1 billion in assets reported mutual fund and annuity income (19.6%) than reported eight other noninterest fee income items in Schedule RI of the Call Report (items 5.a.-5.g. and 5.l.). Among the noninterest fee income items that small banks reported less frequently were income from fiduciary activities (15.5%), investment banking, advisory and underwriting fees and commissions (7.4%), net securitization income (0.3%), trading revenue (1.3%), and venture capital (0.4%). Nearly as many of these community banks reported mutual fund and annuity income as net servicing fees (22.8%). To summarize these findings, mutual fund and annuity income was more frequently reported by small banks with assets less than $1 billion than most other forms of noninterest fee income.

<u>Significance: Mutual fund and annuity income among smaller banks is substantial and growing.</u>

While it is true that the largest institutions account for the majority of mutual fund and annuity income, just as they account for the majority of virtually every datum point the industry reports to the agencies, the facts show that mutual fund and annuity income is highly significant to those banks with less than $1 billion in assets that are earning it.

Let's contrast the smallest banks under $1 billion in assets that generate this revenue with those in the next largest asset-grouping the agencies traditionally use, i.e., those banks with assets between $1 billion and $10 billion:

- In 2007, banks with less than $1 billion in assets produced $241 million in income from mutual fund and annuity activities. That was an amount equal to two-thirds (66.2%) of the $364 million in mutual fund and annuity income produced by banks with assets between $1 billion and $10 billion. That is a strong showing by smaller banks. (See Attachment A, Table 1.)

- In 2007, community banks had a growth rate of 8% in MF&A income that was 70% greater than the 4.7% growth rate in mutual fund and annuity income experienced by banks with assets between $1 billion and $10 billion. (See Attachment A, Table 1.)

- In 2007, mutual fund and annuity income constituted a mean 6.7% of community banks' noninterest income, whereas large banks with assets between $1 billion and $10 billion generated a mean 5.0% of their noninterest income from MF&A activities.

- In the first half of 2008, mutual fund and annuity income among the large banks with assets between $1 billion and $10 billion dropped 5.5%. During the same period, mutual fund and annuity income declined by less than one percentage point (0.76%) among community banks with assets less than $1 billion. This performance may be indicative of a number of important factors, such as the quality of the products or investment advice being offered, different risk allocations in portfolios, a higher degree of salesmanship, or stronger customer relationships among community banks. Regardless, it is certainly a finding worth noting that, during a tough time, the community banks' mutual fund and annuity income largely managed to stay level when the big banks were experiencing a noticeable decline. (See Attachment A, Table 1.)

Small banks with assets under $1 billion are as significant as another grouping of large banks with assets between $1 billion and $6 billion, which constitute 92% of all banks with assets between $1 billion and $10 billion:

- In 2007, banks with assets under $1 billion earned virtually the same amount ($241 million versus $244 million) of MF&A income as banks with assets between $1 billion and $6 billion. (See Attachment A, Table 1.)

- Also, in 2007, MF&A income among banks with assets between $1 billion and $6 billion actually declined 2.6%, while that income was growing over 8% among banks with assets under $1 billion. (See Attachment A, Table 1.)

- In the first half of 2008, MF&A income among large banks with assets between $1 billion and $6 billion dropped 14.6%. While MF&A income was flat among community banks with assets less than $1 billion, their $121.0 million exceeded the $110.4 million earned by banks with assets between $1 billion and $6 billion. (See Attachment A, Table 1.)

So, we see that banks with assets less than $1 billion produce greater or comparable amounts of mutual fund and annuity income relative to those of different groupings of larger banks. And, their growth in MF&A income has been outpacing that of larger banks. Therefore, these findings argue strongly that MF&A income of banks with less than $1 billion in assets remains meaningful, significant and useful to measure.

Proprietary mutual fund and annuity assets under management similarly argue against the proposed exemption.

If the agencies exempt small banks from reporting "Income from the sale or servicing of mutual funds and annuities," of what use will be the question about proprietary mutual fund and/or annuity assets under management (AUM)? That Call Report question is asked in Schedule RC-M – Memoranda item 7.

If the former datum field of mutual fund and annuity income were of little value to small banks, then of what value would be the latter item of proprietary mutual fund and annuity assets under management? Who would care about the proprietary AUM, if there is no linkage to the income that proprietary AUM, in part, generate? Of what interest are the proprietary mutual fund and annuity AUM to the agencies, if they are willing to exempt from reporting mutual fund and annuity income 92.7% of banks (i.e., 7,063 banks with assets less than $1 billion out of a total of 7,622 banks as of June 30, 2008)?

These are, of course, entirely rhetorical questions on my part, since I believe both the MF&A income and proprietary MF&A AUM questions are worth asking all banks. In truth, facts about the proprietary MF&A AUM of smaller banks with assets less than $1 billion similarly argue in favor of, and justify, not exempting their reporting of mutual fund and annuity income. Here is how banks with assets less than $1 billion stack up in proprietary MF&A AUM against larger brethren:

- In 2007, community banks with assets under $1 billion held $8.5 billion in proprietary MF&A AUM. Larger banks with assets between $1 billion and $10 billion held $13.1 billion in proprietary MF&A AUM. So, the smaller banks held an amount of proprietary MF&A AUM equal to a very respectable two-thirds (65%) of what the larger banks held. (See Attachment B, Table 1.)

- In 2007, the smaller banks' proprietary MF&A AUM grew 34.4%, while MF&A AUM at banks with assets between $1 billion and $10 billion dropped 13.8%. (See Attachment B, Table 1.)

- In 2007, the smaller banks' adjusted mean proprietary mutual fund and annuity AUM to bank deposits was 37% of bank deposits. In other words, proprietary assets generally constituted an amount equal to almost two-fifths of bank deposits. In 2007, banks with assets between $1 billion and $10 billion attained a lower mean ratio of proprietary MF&A AUM of deposits of 28%. Thus, the smaller banks are gathering and managing a greater proportion of their depositors' assets in proprietary mutual funds and annuities than their larger competitors. (See Attachment B, Table 1.)

- In first half 2008 among banks with assets less than $1 billion, proprietary MF&A AUM grew 46.2% year-over-year to $10.5 billion. Meanwhile, at banks with assets between $1 billion and $10 billion, proprietary AUM declined 14.3% year-over-year to $13.9 billion in first half 2008. In just the passage of six months, the smaller banks held an amount of proprietary MF&A AUM equal to 76% of what the larger banks held at June 30, 2008, better than 10 percentage points higher than the 65% held at the end of 2007. (See Attachment B, Table 1.)

If we again compare them, we discover that the smaller banks have far more proprietary MF&A AUM than banks with assets between $1 billion and $6 billion:

- At the end of 2007, banks with assets under $1 billion held $8.5 billion in proprietary MF&A AUM. That was $2.8 billion or 49% more than the $5.7 billion held by banks with assets between $1 billion and $6 billion. (See Attachment B, Table 1.)

- Again, in 2007, the 34.4% growth rate of proprietary MF&A AUM among banks with assets under $1 billion was 71% greater than the 20.1% growth rate of banks with assets between $1 billion and $6 billion. (See Attachment B, Table 1.)

- In first half 2008, the gap widened between the amounts of proprietary MF&A AUM held by community banks and the somewhat larger banks. Banks with assets under $1 billion held $10.5 billion in proprietary MF&A AUM. That was $4.8 billion or 84% more than the unchanged $5.7 billion held by banks with assets between $1 billion and $6 billion. (See Attachment B, Table 1.)

- The 46.2% growth rate of proprietary MF&A AUM in first half 2008 compared to first half 2007 of proprietary AUM among banks with assets under $1 billion was four-and-a-half times greater than the 10.2% growth rate of proprietary MF&A AUM at banks with assets between $1 billion and $6 billion during the same period. (See Attachment B, Table 1.)

- Finally, the growth rate of proprietary MF&A AUM from December 31, 2007 to June 30, 2008 was spectacular among banks with assets under $1 billion. Their assets grew 24% in those six months from $8.5 billion to $10.5 billion. Meantime, the proprietary MF&A AUM of banks with assets between $1 billion and $6 billion barely budged from $5.725 billion at year-end 2007 to $5.733 billion at mid-year 2008. (See Attachment B, Table 1.)

These findings clearly indicate that small-bank mutual fund and annuity-related Call Report data are of great usefulness. Smaller banks with assets less than $1 billion are producing as much mutual fund and annuity income as those with assets between $1 billion and $6 billion. The community banks are growing their MF&A business in the worst of times, while slightly larger banks with $1 billion to $6 billion in assets have seen their MF&A income shrink in the last year. The smaller banks compete well with the larger banks in terms of the amount of their proprietary mutual fund and annuity assets under management; and, their growth in proprietary MF&A AUM has strongly outpaced that of larger banks. Indeed, the smaller asset class completely outperforms banks with assets of $1 billion to $6 billion in MF&A income and MF&A AUM. And, it rivals and frequently surpasses the performance of banks with assets between $1 billion to $10 billion. (See Tables 1 and 2 in the attachment.)

What more can be said to demonstrate that mutual fund and annuity sales and servicing activities that produce income and capture assets are meaningful to banks with assets less than $1 billion… that community banks' efforts in that arena are comparable to those of the next largest asset-groupings of banks… and, therefore, that community banks' income from the sale and servicing of mutual funds and annuities is worthy of measuring and valuable in its "usefulness"?

There is great usefulness in all banks – including small banks – reporting their mutual fund and annuity income.

Reporting income from the sale and servicing of mutual funds and annuities has been required of all commercial banks, FDIC-supervised savings banks, OTS-supervised thrifts, and large bank holding companies since 1994. Indeed, it is the longest standing, nationally standardized, and universal measure of nondeposit investment product sales programs that the banking industry currently possesses and on which it has historically relied. Exempting its reporting by banks with less than $1 billion in assets will strip community banks of the one piece of reliable data about nondeposit investment product programs they have depended on for the last fifteen years.

Schedule RI, Memorandum item 2 in the Call Report continues to be critical and useful to warrant its continued collection from all banks. Its continued inclusion in the Call Report enables regulators and the public to understand and measure the proportions of income from packaged-product sales (i.e., mutual funds and annuities) versus commission and fee income from the sales of individual securities. These data aid in determining whether a bank has just an annuity-mutual fund sales program or a full-service securities brokerage operation, whether it is likely a Series 6 or Series-7 licensed or a hybrid program. And, the reporting of MF&A income helps in evaluating the relative types and degrees of risk involved in those different sales programs. In fact, this data item is the only one available by which the industry and its observers can estimate the amount of income earned solely from the sale and servicing of mutual funds.

Additionally, this data item is important to these smaller banks under $1 billion in assets and to the third-party marketers and vendors that provide mutual fund and annuity products and services to them for ultimate distribution to the banks' customers. Its usefulness is more widespread than the agencies might imagine. This data item provides critical benchmarks of the performance of nondeposit investment product sales programs. This data item also aids smaller banks in evaluating their performance and assessing their standing relative to large banks that have greater resources.

If the agencies stop asking these smaller banks to report mutual fund and annuity income, these community banks will be deprived of comparable performance measurements available to large banks, peer-performance benchmarking tools, and data for strategic decision-making whereby they (and other banks considering selling mutual fund and annuity products) can judge the worthiness and contributions of distributing mutual funds and annuities to both their customers and their banks. It is simply inaccurate and incorrect for the agencies to say that mutual fund and annuity income is a "Call Report item for which the reported data are of lesser usefulness for banks with less than $1 billion in total assets." To the contrary, these banks find that this item is of much greater usefulness than the agencies have apparently imagined. They are used to reporting it and used to relying on it.

Office of Thrift Supervision continues to require this same data item the banking agencies propose to exempt.

Please also note that the Office of Thrift Supervision continues to require all thrifts to report income from the sale and servicing of mutual funds and annuities. The bank regulatory agencies' proposed exemption would result in further inconsistencies between the reporting of banks and thrifts at a time when people want consistent information and a standardized system for viewing their depository institutions and determining what they are doing.

Consolidated Financial Statements for bank holding companies (Form FR Y-9C)

Presumably, the proposed exemption from reporting mutual fund and annuity income earned by banks under $1 billion in assets is not intended to be similarly applied to the reporting by bank holding companies in the Consolidated Financial Statements for Bank Holding Companies (Form FR Y-9C).

I certainly hope that is the case now and in the future, especially since mutual fund and annuity activities occur not just in banks or direct subsidiaries of banks, but also in non-bank affiliates owned by a BHC. The proposed reporting exemption ought not to be made to the Form FR Y-9C, where the activities accounting for these forms of commissions and fee income are large and widespread. Sadly, in 2006, BHCs with $150 million to $500 million in consolidated assets ("small" BHCs) were exempted from reporting mutual fund and annuity income. In 2005 when those BHCs were still required to report this item, more than 40% of them reported

MF&A income. In first half 2008, more than 55% of all top-tier bank holding companies (BHCs) with consolidated assets between $500 million and $1 billion engaged in selling and servicing mutual funds and annuities.

If the agencies eliminate reporting of mutual fund and annuity income among all banks with assets less than $1 billion, we will have no idea at all what community banking institutions are doing in terms of selling and servicing mutual funds and annuities.

That would be a truly strange thing to begin ignoring, given the high level of scrutiny now being placed on the enactment of the Gramm-Leach-Bliley Act, which made these activities all the more common within banks. At a time when regulators are being criticized for not regulating or not having the information needed and statutory tools to regulate, exempting community banks with assets less than $1 billion from reporting mutual fund and annuity income would seem highly contradictory.

Thank you for the opportunity to comment on this very important subject. If you have any questions concerning these comments or need additional information, please do not hesitate to contact me at (610) 254-0440 or mwa@bankinsurance.com.

Sincerely yours,

Michael D. White

Michael D. White

Attachments A and B

ATTACHMENT A

Table 1. Income from the Sale and Servicing of Mutual Funds & Annuities: Comparison of Small Banks (assets < $1 billion) to Next Larger Classes of Banks (assets from $1 billion to $6 billion and from $1 billion to $10 billion)					
	A. Banks with assets less than $1 billion	**B. Banks with Assets between $1 billion and $6 billion (constitute 92% of Column D)**	**C. Column A as a Percentage of Column B**	**D. Banks with Assets between $1 billion and $10 billion**	**E. Column A as a Percentage of Column D**
2007 Mutual Fund & Annuity (MF&A) Income	$241 million	$244 million	Nearly Equal: 98.8%	$364 million	Two-thirds: 66.2%
2007 Growth Rate of MF&A Income	8.0%	-2.6%	Positive Variance: 407.7%	4.7%	Positive Variance: 170.2%
1st Half 2008 MF&A Income	$121 million	$110.4 million	Positive Variance: 109.6%	$188.7 million	Two-thirds: 64.4%
1st Half 2008 Growth of MF&A Income	-0.76%	-14.6%	Positive Variance	-5.5%	Positive Variance
Source: Michael White Analyses of FDIC Call Report Data					

ATTACHMENT B

Table 2. Proprietary Mutual Fund & Annuity Assets Under Management: Comparison of Small Banks (assets < $1 billion) to Next Larger Classes of Banks (assets from $1 billion to $6 billion and from $1 billion to $10 billion)					
	A. Banks with assets less than $1 billion	**B. Banks with Assets between $1 billion and $6 billion (constitute 92% of Column D)**	**C. Column A as a Percentage of Column B**	**D. Banks with Assets between $1 billion and $10 billion**	**E. Column A as a Percentage of Column D**
2007 Proprietary Mutual Fund & Annuity (MF&A) Assets Under Management (AUM)	$8.5 billion	$5.7 billion	Positive Variance: 149.1%	$13.1 billion	Two-thirds: 64.9%
2007 Growth in Proprietary MF&A AUM	34.4%	20.1%	Positive Variance: 171.1%	-13.8%	Positive Variance: 349.3%
2007 Adjusted Mean Proprietary MF&A AUM to Retail Deposits	37.1%	17.9%	Meaningful Variance: 207.3%	28%	Meaningful Variance: 132.5%
1st Half 2008 Proprietary MF&A AUM	$10.5 billion	$5.7 billion	Positive Variance: 184.2%	$13.9 billion	Positive Variance: 75.5%
1st Half 2008 Growth in Proprietary MF&A AUM	46.2%	10.2%	Positive Variance: 452.9%	-14.3%	Positive Variance: 423.1%
Growth in Proprietary MF&A AUM from Dec. 31, 2007 to June 30, 2008	23.5%	0.14%	Positive Variance: 168 times greater	6.1%	Positive Variance: 385.2%
Source: Michael White Analyses of FDIC Call Report Data					