

November 17, 2008

MEMORANDUM TO: The Board of Directors

FROM: Arthur J. Murton
Director
Division of Insurance and Research

Bret D. Edwards
Director
Division of Finance

SUBJECT: Final Rule on Assessment Dividends

RECOMMENDATION

Staff recommends that the Board authorize publication of the attached final rule on assessment dividends to replace the temporary final rule that expires December 31, 2008. The final rule, if adopted, would take effect on January 1, 2009.

BACKGROUND

Reform Act Requirements

By statute, the FDIC must, under most circumstances, declare dividends from the Deposit Insurance Fund (the DIF or the fund) when the DIF reserve ratio at the end of a calendar year equals or exceeds 1.35 percent.¹ When the reserve ratio equals or exceeds 1.35 percent, and is not higher than 1.50 percent, the FDIC generally must declare one-half of the amount in the DIF in excess of the amount required to maintain the reserve ratio at 1.35 percent as dividends to be paid to insured depository institutions. The FDIC Board of Directors may suspend or limit dividends to be paid under certain conditions.

When the reserve ratio exceeds 1.50 percent at the end of a calendar quarter, the FDI Act requires the FDIC, except in certain limited circumstances, to declare a dividend equal to the excess of the amount required to maintain the reserve ratio at 1.50 percent as dividends to be paid to insured depository institutions. The FDI Act further directs the FDIC to consider each insured depository institution's relative contribution to the DIF when calculating such institution's share of any dividend. More specifically, the Board must consider:

¹ Section 7(e)(2) of the Federal Deposit Insurance Act (the FDI Act), 12 U.S.C. § 1817(e)(2), as amended by the Federal Deposit Insurance Reform Act of 2005 (the Reform Act).

Concur: _____
John V. Thomas
Acting General Counsel

1. the ratio of the assessment base of an insured depository institution (including any predecessor) on December 31, 1996, to the assessment base of all eligible insured depository institutions on that date;
2. the total amount of assessments paid on or after January 1, 1997, by an insured depository institution (including any predecessor) to the DIF (and any predecessor fund);
3. that portion of assessments paid by an insured depository institution (including any predecessor) that reflects higher levels of risk; and
4. such other factors as the Board deems appropriate.

The Reform Act requires the FDIC to prescribe by regulation the method for calculating, declaring and paying dividends. The dividend regulation must allow a depository institution a reasonable opportunity to challenge administratively the amount of dividends awarded. Any review by the FDIC is final and not subject to judicial review.²

The temporary final rule on assessment dividends

In October 2006, the FDIC issued a temporary final rule to implement the dividend requirements of the Reform Act (the Temporary Final Rule).³

The Temporary Final Rule, which expires on December 31, 2008, provides definitions and details on how an institution may request FDIC review of a determination of the institution's dividend and how an institution may appeal the FDIC's response to that request. In the Temporary Final Rule, the FDIC adopted a simple system for allocating any dividends that might be declared during the two-year duration of the regulation. Any dividends awarded before January 1, 2009, will be distributed simply in proportion to an institution's 1996 assessment base ratio, as determined pursuant to the one-time assessment credit rule.⁴

The advance notice of proposed rulemaking and notice of proposed rulemaking

At the time it adopted the Temporary Final Rule, the FDIC stated its intention to initiate a second, more comprehensive notice-and-comment rulemaking on dividends beginning with an advanced notice of proposed rulemaking to explore alternative methods for distributing future dividends after the temporary dividend rules expires on December 31, 2008. The publication of the assessment dividend advance notice of rulemaking in September 2007 (the ANPR) commenced that process.⁵ Subsequently in

² Sections 7(e)(2)(C) and (D), and (e)(4) of the Federal Deposit Insurance Act (the FDI Act), 12 U.S.C. 1817(e)(2)(C) and (D), and (e)(4).

³ 71 FR 61385 (October 18, 2006).

⁴ 12 CFR 327.53. No dividend has or will be issued under the Temporary Final Rule.

⁵ 72 Fed. Reg. 53181 (September 18, 2007).

March 2008, based upon comments received on the ANPR, the FDIC issued a proposed rule on the distribution of future dividends (the NPR).⁶

THE FINAL RULE

FDIC staff is proposing adoption of a final rule identical to the proposed rule, with a few exceptions described below.

The FDIC received three comment letters on the proposed rule: two from banking trade associations and one from a savings association. The savings association generally supported the proposed rule. One trade association stated that the proposal generally met the specifications that the association had suggested in its comments on the ANPR, although the association would not endorse the NPR. The other trade association supported many specific provisions of the proposed rule. Each of the comments had some specific suggestions that are discussed further below.

Annual determination of whether dividends are required/declaration of dividends

The process under the final rule for the annual determination of dividends and declaration of dividends is identical with the process under the proposed rule. The FDIC would determine annually whether the reserve ratio at the end of the prior year equaled or exceeded 1.35 percent of estimated insured deposits or 1.50 percent, thereby triggering a dividend requirement. If a dividend were triggered, the FDIC would determine, based on statutory factors, whether payment of dividends should be limited or suspended. If the FDIC did not limit or suspend payment, or did not renew such a determination, the aggregate amount of the dividend under the final rule would be determined as provided by the Reform Act. The FDIC would declare any dividend on or before May 10th of the year following the year in which the reserve ratio exceeded 1.35 percent or 1.50 percent.⁷

The FDIC received one specific comment on this part of the proposal. One of the trade associations endorsed an accelerated annual process for determination and distribution of dividends.

Allocation of dividends

The final rule would adopt the proposed rule's methodology for allocation of dividends. The total dividend in any year would be divided into two parts. One of the two parts would be allocated based on the ratio of each institution's (including any predecessors') 1996 assessment base compared to the total of all existing eligible

⁶ 73 Fed. Reg. 15459 (Mar. 24, 2008).

⁷ The two banking trade associations generally promoted conservative fund management as the optimal strategy for solving the dividend allocation issue. They both stated that FDIC fund management should ensure that the fund be kept beneath the 1.35 percent statutory level so that dividends were not triggered. Low, smooth, steady premiums that prevent a dividend trigger would obviate the issue of how to equitably distribute dividends between the older and newer segments of the banking industry. One of the associations stated that such a policy would benefit the insurance fund, the industry in general, and consumers.

institutions' 1996 assessment bases (an institution's 1996 assessment base share). The other part of the total dividend would be allocated based on each institution's (including any predecessors') ratio of cumulative eligible premiums over the previous five years to the total of cumulative eligible premiums paid by all existing institutions (or their predecessors) over the previous five years (an institution's eligible premium share). The part of any potential dividend that would be allocated based upon 1996 assessment base shares would decline steadily from 100 percent to zero over 15 years; the part of any potential dividend that would be allocated based upon eligible premium shares would increase steadily over the same 15-year period from zero to 100 percent. After the 15-year period, any dividend would be allocated solely based on eligible premium shares.

The 15-year period would run from the end of 2006 to the end of 2021 and would govern dividends based upon the reserve ratio at the end of the years 2008 through 2021. Actual dividends, if any, would be allocated and paid the following year. Table A shows the change in the allocation of potential dividends over time.

Table A		
Total DIF Dividend Distribution Table		
Based upon the DIF Reserve Ratio at Year-End	Part of Total DIF Dividend	
	Determined by:	
	1996 Assessment Base Shares	Eligible Premium Shares
2006	1 (100.0%)	0 (0%)
2007	14/15 (93.3%)	1/15 (6.7%)
2008	13/15 (86.7%)	2/15 (13.3%)
2009	4/5 (80.0%)	1/5 (20.0%)
2010	11/15 (73.3%)	4/15 (26.7%)
2011	2/3 (66.7%)	1/3 (33.3%)
2012	3/5 (60.0%)	2/5 (40.0%)
2013	8/15 (53.3%)	7/15 (46.7%)
2014	7/15 (46.7%)	8/15 (53.3%)
2015	2/5 (40.0%)	3/5 (60.0%)
2016	1/3 (33.3%)	2/3 (66.7%)
2017	4/15 (26.7%)	11/15 (73.3%)
2018	1/5 (20.0%)	4/5 (80.0%)
2019	2/15 (13.3%)	13/15 (86.7%)
2020	1/15 (6.7%)	14/15 (93.3%)
2021	0 (0%)	1 (100.0%)
Thereafter	0%	100.0%

The FDIC received three comments on the proposed method of allocating dividends. One banking trade association supported the balanced consideration of alternative dividend allocation schemes, taking into account the significant premiums paid in the early 1990s to recapitalize the FDIC. The second banking trade association stated that the FDIC proposal was a reasonable compromise between the fund balance method and the payments method described in the ANPR and that the proposed rule generally responded to their wishes that the method be simple but detailed enough so that community banks understood it, and that it not be subject to sudden or unexpected

changes.⁸ It suggested one additional change: that the 15-year phase-out period begin in 2009 rather than 2006 as banks were operating under the existing rule on dividends for the years 2006 through 2008.

The commenting savings association generally supported the provisions of the proposed rule but recommended that the FDIC use a 10-year rather than a 15-year transition period. The bank stated that parity dictated a 10-year phase-in period since a 10-year period elapsed with no general collection of premiums, and it would be punitive to other organizations to continue to count an institution's assessment credits after they have been used to offset premiums.

Staff continues to believe that the 15-year phase-out transition period, beginning in 2006, is a reasonable compromise between the legitimate points of view of older and newer banking institutions and thus recommends adopting the allocation method proposed in the NPR.

Eligible premiums

As under the proposed rule, an eligible premium would be defined as that part of an assessment that was charged at no more than the maximum rate then applicable to a Risk Category I institution. Whether an institution paid its assessment in cash or offset it with assessment credits would not affect its eligible premium. An institution's eligible premium would include eligible premiums paid by a predecessor.

The final rule clarifies that eligible premiums would not include any assessments or fees paid by insured depository institutions for the Temporary Liquidity Guarantee Program or any emergency special assessments paid by insured depository institutions pursuant to the systemic risk provisions of the Federal Deposit Insurance Act, whether related to the Temporary Liquidity Guarantee Program or not.⁹

The FDIC received three comments on this part of the proposal. The banking trade associations supported the proposal. The commenting savings association suggested that the FDIC only count payments made with "real dollars" rather than assessment credits in calculating eligible premiums.

Staff continues to believe that allowing an eligible premium to include premiums offset with assessment credits is also part of the reasonable compromise between the

⁸ The ANPR sought comment on two general approaches to allocating dividends—the fund balance method and the payments method. The two allocation methods potentially differed most significantly in the way they balanced two of the statutory factors that the Board must consider—an institutions' relative 1996 assessment bases and assessments paid after 1996—and, thus, in the way each method would treat older versus newer institutions. The terms "older" and "newer," however, do not simply refer to age. An institution that had a large 1996 assessment base compared to its current assessment base is considered an older institution, and an institution that had no assessment base in 1996 or only a small assessment base compared to its present assessment base is considered a newer institution.

⁹ The systemic risk emergency special assessment provision is Section 13(c)(4)(G) of the FDI Act, 12 U.S.C. 1823(c)(4)(G).

legitimate points of view of older and newer banking institutions and thus recommends adopting the definition of an eligible premium proposed in the NPR. In any event, most assessment credits have already been used. Staff estimates that at the end of 2008 only four percent of the original assessment credits will remain. Given the small likelihood of a dividend within the next several years, including premiums offset with assessment credits within the definition of an eligible premium will have little practical effect for most institutions.

Definition of a “predecessor” insured depository institution

Under the final rule, consistent with the requirements of the Reform Act, the allocation of dividends to an insured depository institution would in part be based on the 1996 assessment base ratio of, and the post-1996 assessments paid by, insured depository institutions of which the insured depository institution is the successor. As in the Temporary Final Rule, the final rule would define a predecessor insured depository institution by cross referencing the definition of successor insured depository institution in the one-time assessment credit rule. (See 12 CFR 327, subpart B.) In effect, a predecessor institution is the mirror image of a successor institution. Notably, the definition of successor in the one-time credit regulation includes a de facto rule, applicable in transactions in which an insured depository institution assumes substantially all of the deposit liabilities and acquires substantially all of the assets of another insured depository institution.

The FDIC received one specific comment on this part of the proposal. The banking trade association that submitted the comment supported the proposal.

Notification and payment of dividends

The process for notifying institutions of their dividend amounts and paying dividends would be as proposed in the NPR, with one minor change. The FDIC would advise each institution of its dividend as soon as practicable after the Board's declaration of a dividend on or before May 10th. However, individual dividend amounts would be paid to institutions on June 30 (in connection with the deposit insurance assessment process), rather than within 45 days after the issuance of the special notice (or as soon as practicable thereafter) as proposed in the NPR.

This change is intended to simplify the distribution process. Dividends would be paid through the Automated Clearing House (ACH) and offset against assessment payments. If an institution owed additional assessments, there would be a net debit (resulting in payment to the FDIC). Conversely, if the FDIC owed additional dividend amounts, there would be a net credit (resulting in payment from the FDIC).

Under the final rule, the FDIC would freeze the payment of any disputed portion of dividends. Any adjustment to an individual institution's dividend resulting from its request for review would be handled through ACH in the same manner as existing procedures for underpayment or overpayment of assessments.

The proposed final rule states that the FDIC intends, beginning no later than 2010, to include with its quarterly assessment invoices the institution's 1996 assessment base share and its rolling five-year eligible premium share.

The FDIC received only one specific comment on this part of the proposal. The banking trade association that submitted the comment supported the "acceleration of the annual process for determination and distribution of dividends, so that any dividends would be distributed in the first quarter following the year-end declaration." Staff notes that dividends cannot be declared at year-end, since the year-end fund reserve ratio will not be known until some time in the following February. However, under the final rule, dividends would be distributed in the same quarter as the declaration (when the Board declares a dividend in the second quarter, since payment would be made on June 30th), and would be always be distributed as least as soon as the quarter after the declaration.

Requests for review

The final rule's provisions for challenging dividend shares and amounts are as proposed in the NPR and are similar to those in the Temporary Final Rule, except that they reflect the FDIC's intention to provide, beginning in 2010, quarterly dividend-related information with each assessment invoice. Under the final rule, if a dividend is declared before 2010, an institution will have 30 days from the date of the notice of its dividend to request review.

Once the quarterly invoice updates become available, an institution generally would have 90 days from the date of the invoice to request review of that dividend-related information, except in a year in which a dividend is declared. If the FDIC declared a dividend, the institution would have 30 days from the date of its notice of dividend amount to request review either of that amount or of any dividend-related information in its March invoice for that year; the institution would not have the full 90-day period following the March invoice to request review.

The rule would require that, when quarterly dividend-related information becomes available in 2010, an institution would have to request review of its dividend-related information within 90 days of the first invoice that failed to reflect accurate information. If it did not submit a timely request for review, it would be barred from subsequently requesting review of that information.

The requirement that insured depository institutions monitor their dividend-related information quarterly and promptly request review is necessitated by the proposed timing for the payment of dividends. In the absence of such a strict quarterly requirement, staff would have needed to reconsider both the timing of dividend payment and possibly the look-back period for calculating institutions' dividend shares, which at 5 years is longer than the 3-year recordkeeping requirement in the FDI Act and longer than the 3-year statute of limitations for bringing an action on assessment underpayments and overpayments.

The rule would require that at the time of the request for review the requesting institution would need to notify all institutions that would be directly and materially affected, and that it provide those institutions with copies of the request for review, supporting documentation, and FDIC procedures for requests for review. The FDIC would make reasonable efforts to determine that these institutions had been identified and notified.

Institutions would then have 30 days to submit a response and any supporting documentation to the FDIC's Division of Finance, copying the institution making the original request for review. If an institution notified through this process did not submit a timely response, that institution would be foreclosed from subsequently disputing the information submitted by any other institution on the transaction(s) at issue in the review process. The FDIC may request additional information as part of its review, and the institution from which such information was requested would be required to supply that information within 21 days of the date of the FDIC's request.

The rule would require a written response from the FDIC's Director of the Division of Finance (the Director), or his or her designee, notifying the requesting institution and any materially affected institutions of the determination of the Director as to whether the requested change was warranted, whenever feasible: (1) within 60 days of receipt by the FDIC of the request for review; (2) within 60 days of the date of the last response to the notification if additional institutions were notified by the requesting institution or the FDIC; or (3) within 60 days of its receipt of the additional information, whichever date was latest.

If a requesting institution disagreed with the determination of the Director, that institution could appeal to the FDIC's Assessment Appeals Committee (the AAC). Notice of the procedures applicable to appeals to the AAC would be included with the Director's written determination. Under the final rule, an appeal to the AAC would need to be filed within 30 calendar days of the date of the Director's written determination. The AAC's determination would be final and not subject to judicial review.

The FDIC would freeze temporarily the distribution of any dividend amount in dispute for the institutions involved in the challenge until the challenge was resolved.

The FDIC received specific comments on this part of the proposal from only one source. The banking trade association that submitted the comment supported "quarterly notification of each bank's share of future dividends" and "clarification of the dispute resolution process to be consistent with that for risk-based premium classification."

The association also requested that the quarterly notification provide enough information for banks to understand how their dividend shares were computed. Given that a bank would be provided with a relatively short time period of 90 days to challenge its share, the notification needed to provide sufficient data so that a bank could readily check its allocation, and the notification should provide the deadline for filing a challenge. The FDIC concurs with this request. It is the FDIC's intention that the quarterly notification will provide the necessary data.

Additional comments on the proposed rule

One of the banking trade associations also recommended that the FDIC establish a rule regarding the transferability of claims on future dividends; specifically, it recommended that the FDIC permit sales of dividend shares and promulgate rules clarifying the regulatory implications. Staff agrees that these claims should be transferable and has so provided in the final rule. Staff recommends that the transfer of these claims remain a matter of contract solely between the interested parties. Staff recommends that the FDIC pay dividends to institutions according to the FDIC's records without regard to whether claims on dividends have been transferred. Thus, the FDIC would not track sales or recognize assignments for payment purposes, since doing so would be labor-intensive and require a substantial amount of resources. As staff expects that only a very limited number of institutions will be interested in transferring claims to future dividends, it would be inequitable to make the entire banking industry subsidize the costs of tracking sales and recognizing assignments.

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