FEDERAL REGISTER

Part II

Federal Deposit Insurance Corporation

12 CFR Part 327
Assessments, Large Bank Pricing; Final Rule

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 327

RIN 3064–AD66

Assessments, Large Bank Pricing

AGENCY: Federal Deposit Insurance Corporation (FDIC).

ACTION: Final rule.

SUMMARY: The FDIC is amending its regulations to implement revisions to the Federal Deposit Insurance Act made by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") by modifying the definition of an institution's deposit insurance assessment base; to change the assessment rate adjustments; to revise the deposit insurance assessment rate schedules in light of the new assessment base and altered adjustments; to implement Dodd-Frank's dividend provisions; to revise the large insured depository institution assessment system to better differentiate for risk and

better take into account losses from large institution failures that the FDIC may incur; and to make technical and other changes to the FDIC's assessment rules.

DATES: *Effective Date:* April 1, 2011.

FOR FURTHER INFORMATION CONTACT: Munsell St. Clair, Chief, Banking and Regulatory Policy Section, Division of Insurance and Research, (202) 898–8967, Rose Kushmeider, Senior Economist, Division of Insurance and Research, (202) 898–3861; Heather Etner, Financial Analyst, Division of Insurance and Research, (202) 898–6796; Lisa Ryu, Chief, Large Bank Pricing Section, Division of Insurance and Research, (202) 898–3538; Christine Bradley, Senior Policy Analyst, Banking and Regulatory Policy Section, Division of Insurance and Research, (202) 898–8951; Brenda Bruno, Senior Financial Analyst, Division of Insurance and Research, (630) 241–0359 x 8312; Robert L. Burns, Chief, Exam Support and Analysis, Division of Supervision and Consumer Protection (704) 333–3132

x 4215; Christopher Bellotto, Counsel, Legal Division, (202) 898–3801; and Sheikha Kapoor, Counsel, Legal Division, (202) 898–3960, 550 17th Street, NW., Washington, DC 20429.

SUPPLEMENTARY INFORMATION:

I. Dates

Except as specifically provided, the final rule will take effect for the quarter beginning April 1, 2011, and will be reflected in the June 30, 2011, fund balance and the invoices for assessments due September 30, 2011.

II. Background

A. Current Deposit Insurance Assessments

At present, for deposit insurance assessment purposes, an insured depository institution is placed into one of four risk categories each quarter, determined primarily by the institution's capital levels and supervisory evaluation. Current annual initial base assessment rates are set forth in Table 1 below.

TABLE 1—CURRENT INITIAL BASE ASSESSMENT RATES [1] RISK CATEGORY

	I*		II	III	IV
	Minimum	Maximum			
Annual Rates (in basis points)	12	16	22	32	45

*Rates for institutions that do not pay the minimum or maximum rate will vary between these rates.

Within Risk Category I, initial base assessment rates vary between 12 and 16 basis points. For all institutions in Risk Category I, rates depend upon weighted average CAMELS component ratings and certain financial ratios. For a large institution (generally, one with at least $10 billion in assets) that has debt issuer ratings, rates also depend upon these ratings.

Initial base assessment rates are subject to adjustment. An insured depository institution's total base assessment rate can vary from its initial

base assessment rate as the result of an unsecured debt adjustment and a secured liability adjustment. The unsecured debt adjustment lowers an insured depository institution's initial base assessment rate using its ratio of long-term unsecured debt (and, for small insured depository institutions, certain amounts of Tier 1 capital) to domestic deposits.[2] The secured liability adjustment increases an insured depository institution's initial base assessment rate if the insured

depository institution's ratio of secured liabilities to domestic deposits is greater than 25 percent.[3] In addition, insured depository institutions in Risk Categories II, III and IV are subject to an adjustment for large levels of brokered deposits (the brokered deposit adjustment).[4]

After applying all possible adjustments, the current minimum and maximum total annual base assessment rates for each risk category are set out in Table 2 below.

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[1] Within Risk Category I, there are different assessment systems for large and small insured depository institutions, but the possible range of rates is the same for all insured depository institutions in Risk Category I.

[2] Unsecured debt excludes debt guaranteed by the FDIC under its Temporary Liquidity Guarantee Program.

[3] The initial base assessment rate cannot increase more than 50 percent as a result of the secured liability adjustment.

[4] 12 CFR 327.9(d)(7).

Table 2

Initial and Total Base Assessment Rates

	Risk Category I	Risk Category II	Risk Category III	Risk Category IV
Initial base assessment rate.................	12–16	22	32	45
Unsecured debt adjustment...........	(5)–0	(5)–0	(5)–0	(5)–0
Secured liability adjustment..........	0–8	0–11	0–16	0–22.5
Brokered deposit adjustment.........	....	0–10	0–10	0–10
TOTAL BASE ASSESSMENT RATE	7–24	17–43	27–58	40–77.5

All amounts for all risk categories are in basis points annually. Total base rates that are not the minimum or maximum rate will vary between these rates.

The FDIC may uniformly adjust the total base rate assessment schedule up or down by up to 3 basis points without further rulemaking.[5]

An institution's assessment is determined by multiplying its assessment rate by its assessment base. Its assessment base is, and has historically been, domestic deposits, with some adjustments. (These adjustments have changed over the years.)

B. The Dodd-Frank Wall Street Reform and Consumer Protection Act

The Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), enacted in July 2010, revised the statutory authorities governing the FDIC's management of the Deposit Insurance Fund (the DIF or the fund). Dodd-Frank granted the FDIC the ability to achieve goals for fund management that it has sought to achieve for decades but lacked the tools to accomplish: maintaining a positive fund balance even during a banking crisis and maintaining moderate, steady assessment rates throughout economic and credit cycles.

Among other things, Dodd-Frank: (1) Raised the minimum designated reserve ratio (DRR), which the FDIC must set each year, to 1.35 percent (from the former minimum of 1.15 percent) and removed the upper limit on the DRR (which was formerly capped at 1.5 percent) and therefore on the size of the fund;[6] (2) required that the fund reserve ratio reach 1.35 percent by September 30, 2020 (rather than 1.15 percent by the end of 2016, as formerly required);[7] (3) required that, in setting assessments, the FDIC "offset the effect of [requiring that the reserve ratio reach 1.35 percent by September 30, 2020 rather than 1.15 percent by the end of 2016] on insured depository institutions with total consolidated assets of less than $10,000,000,000";[8] (4) eliminated the requirement that the FDIC provide dividends from the fund when the reserve ratio is between 1.35 percent and 1.5 percent;[9] and (5) continued the FDIC's authority to declare dividends when the reserve ratio at the end of a calendar year is at least 1.5 percent, but granted the FDIC sole discretion in determining whether to suspend or limit

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[5] Specifically:

The Board may increase or decrease the total base assessment rate schedule up to a maximum increase of 3 basis points or a fraction thereof or a maximum decrease of 3 basis points or a fraction thereof (after aggregating increases and decreases), as the Board deems necessary. Any such adjustment shall apply uniformly to each rate in the total base assessment rate schedule. In no case may such Board rate adjustments result in a total base assessment rate that is mathematically less than zero or in a total base assessment rate schedule that, at any time, is more than 3 basis points above or below the total base assessment schedule for the Deposit Insurance Fund, nor may any one such Board adjustment constitute an increase or decrease of more than 3 basis points.

12 CFR 327.10(c). On October 19, 2010, the FDIC adopted a new Restoration Plan that foregoes a uniform 3 basis point increase in assessment rates scheduled to go into effect on January 1, 2011. Thus, the assessment rates in this final rule reflect that change.

[6] Public Law 111–203, § 334(a), 124 Stat. 1376, 1539 (to be codified at 12 U.S.C. 1817(b)(3)(B)).

[7] Public Law 111–203, § 334(d), 124 Stat. 1376, 1539 (to be codified at 12 U.S.C. 1817(nt)).

[8] Public Law 111–203, § 334(e), 124 Stat. 1376, 1539 (to be codified at 12 U.S.C. 1817(nt)).

[9] Public Law 111–203, § 332(d), 124 Stat. 1376, 1539 (to be codified at 12 U.S.C. 1817(e)).

the declaration or payment of dividends.[10]

Dodd-Frank also required that the FDIC amend its regulations to redefine the assessment base used for calculating deposit insurance assessments. Under Dodd-Frank, the assessment base must, with some possible exceptions, equal average consolidated total assets minus average tangible equity.[11]

C. Notice of Proposed Rulemaking on Assessment Dividends, Assessment Rates and the Designated Reserve Ratio

Given the greater discretion to manage the DIF granted by Dodd-Frank, the FDIC developed a comprehensive, long-range management plan for the DIF. In October 2010, the FDIC adopted a Notice of Proposed Rulemaking on Assessment Dividends, Assessment Rates and the Designated Reserve Ratio (the October NPR) setting out the plan, which is designed to: (1) Reduce the pro-cyclicality in the existing risk-based assessment system by allowing moderate, steady assessment rates throughout economic and credit cycles; and (2) maintain a positive fund balance even during a banking crisis by setting an appropriate target fund size and a strategy for assessment rates and dividends.[12]

In developing the comprehensive plan, the FDIC analyzed historical fund losses and used simulated income data from 1950 to the present to determine how high the reserve ratio would have to have been before the onset of the two banking crises that occurred during this period to maintain a positive fund balance and stable assessment rates. Based on this analysis and the statutory factors that the FDIC must consider when setting the DRR, the FDIC proposed setting the DRR at 2 percent. The FDIC also proposed that a moderate assessment rate schedule, based on the long-term average rate needed to maintain a positive fund balance, take effect when the fund reserve ratio exceeds 1.15 percent.[13] This schedule

would be lower than the current schedule. Finally, the FDIC proposed suspending dividends when the fund reserve ratio exceeds 1.5 percent.[14] In lieu of dividends, the FDIC proposed to adopt progressively lower assessment rate schedules when the reserve ratio exceeds 2 percent and 2.5 percent.

D. Final Rule Setting the Designated Reserve Ratio

In December 2010, the FDIC adopted a final rule setting the DRR at 2 percent (the DRR final rule), but deferred action on the other subjects of the October NPR (dividends and assessment rates) until this final rule. The FDIC's decision to set the DRR at 2 percent was based partly on additional historical analysis, which is described below.

E. Notice of Proposed Rulemaking on the Assessment Base, Assessment Rate Adjustments and Assessment Rates

In a notice of proposed rulemaking adopted by the FDIC Board on November 9, 2010 (the Assessment Base NPR), the FDIC proposed to amend the definition of an institution's deposit insurance assessment base consistent with the requirements of Dodd-Frank, modify the unsecured debt adjustment and the brokered deposit adjustment in light of the changes to the assessment base, add an adjustment for long-term debt held by an insured depository institution where the debt is issued by another insured depository institution, and eliminate the secured liability adjustment. The Assessment Base NPR also proposed revising the current deposit insurance assessment rate schedule in light of the larger assessment base required by Dodd-Frank and the revised adjustments. The FDIC's goal was to determine a rate schedule that would have generated approximately the same revenue as that generated under the current rate schedule in the second quarter of 2010 under the current assessment base. The Assessment Base NPR also proposed revisions to the rate schedules proposed in the October NPR, in light of the changes to the assessment base and the adjustments. These revised rate schedules were also intended to generate the same revenue as the corresponding rates in the October NPR.

F. Notices of Proposed Rulemaking on the Assessment System Applicable to Large Insured Depository Institutions

In April 2010, the FDIC adopted a notice of proposed rulemaking with request for comment to revise the risk-based assessment system for all large insured depository institutions to better capture risk at the time large institutions assume the risk, to better differentiate among institutions for risk and take a more forward-looking view of risk, to better take into account the losses that the FDIC may incur if such an insured depository institution fails, and to make technical and other changes to the rules governing the risk-based assessment system (the April NPR).[15]

Largely as a result of changes made by Dodd-Frank and the Assessment Base NPR, the FDIC reissued its proposal applicable to large insured depository institutions for comment on November 9, 2010 (the Large Bank NPR), taking into account comments received on the April NPR.

In the Large Bank NPR, the FDIC proposed eliminating risk categories and the use of long-term debt issuer ratings for large institutions, using a scorecard method to calculate assessment rates for large and highly complex institutions, and retaining the ability to make a limited adjustment after considering information not included in the scorecard. In the Large Bank NPR, the FDIC stated that it would not make adjustments until the guidelines for making such adjustments are published for comment and subsequently adopted by the FDIC Board.

G. Update of Historical Analysis of Loss, Income and Reserve Ratios

The analysis set out in the October NPR to determine how high the reserve ratio would have had to have been to have maintained both a positive fund

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[10] Public Law 111–203, § 332, 124 Stat. 1376, 1539 (to be codified at 12 U.S.C. 1817(e)(2)(B)).

[11] Public Law 111–203, § 331(b), 124 Stat. 1376, 1538 (to be codified at 12 U.S.C. 1817(nt)).

[12] 75 FR 66262 (Oct. 27, 2010). Pursuant to the comprehensive plan, the FDIC also adopted a new Restoration Plan to ensure that the DIF reserve ratio reaches 1.35 percent by September 30, 2020, as required by the Dodd-Frank Wall Street Reform and Consumer Protection Act. 75 FR 66293 (Oct. 27, 2010).

[13] Under section 7 of the Federal Deposit Insurance Act, the FDIC has authority to set assessments in such amounts as it determines to be necessary or appropriate. In setting assessments, the FDIC must consider certain enumerated factors, including the operating expenses of the DIF, the estimated case resolution expenses and income of the DIF, and the projected effects of assessments on

the capital and earnings of insured depository institutions.

[14] 12 U.S.C. 1817(e)(2), as amended by § 332 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

[15] The preamble to the Large Bank NPR incorrectly summarized the definition of a "large institution"; however, the definition was correct in the proposed regulation. The final rule, like the proposed regulation, defines a large institution as an insured depository institution: (1) That had assets of $10 billion or more as of December 31, 2006 (unless, by reporting assets of less than $10 billion for four consecutive quarters since then, it has become a small institution); or (2) that had assets of less than $10 billion as of December 31, 2006, but has since had $10 billion or more in total assets for at least four consecutive quarters, whether or not the institution is new. In almost all cases, an insured depository institution that has had $10 billion or more in total assets for four consecutive quarters will have a CAMELS rating; however, in the rare event that such an institution has not yet received a CAMELS rating, it will be given a weighted average CAMELS rating of 2 for assessment purposes until actual CAMELS ratings are assigned. An insured branch of a foreign bank is excluded from the definition of a large institution.

balance and stable assessment rates from 1950 through 2010 assumed assessment rates based upon an assessment base related to domestic deposits rather than the assessment base required by Dodd-Frank (average consolidated total assets minus average tangible equity).[16] The FDIC undertook additional analysis (described in the DRR final rule and repeated here) to determine how the results of the original analysis would change had the new assessment base been in place from 1950 to 2010. Due to the larger assessment base resulting from Dodd-Frank, the constant nominal assessment rate required to maintain a positive fund balance from 1950 to 2010 would have been 5.29 basis points (compared with 8.47 basis points using a domestic-

deposit-related assessment base). (See Chart 1.)

The assessment base resulting from Dodd-Frank, had it been applied to prior years, would have been larger than the domestic-deposit-related assessment base, and the rates of growth of the two assessment bases would have differed both over time and from each other. At any given time, therefore, applying a constant nominal rate of 8.47 basis points to the domestic-deposit-related assessment base would not necessarily have yielded exactly the same revenue as applying 5.29 basis points to the Dodd-Frank assessment base.

Despite these differences, the new analysis applying a 5.29 basis point assessment rate to the Dodd-Frank assessment base resulted in peak reserve

ratios prior to the two crises similar to those seen when applying an 8.47 basis point assessment rate to a domestic-deposit-related assessment base.[17] (See Chart 2.) Both analyses show that the fund reserve ratio would have needed to be approximately 2 percent or more before the onset of the 1980s and 2008 crises to maintain both a positive fund balance and stable assessment rates, assuming, in lieu of dividends, that the long-term industry average nominal assessment rate would have been reduced by 25 percent when the reserve ratio reached 2 percent, and by 50 percent when the reserve ratio reached 2.5 percent.[18] Eliminating dividends and reducing rates would have successfully limited rate volatility, whichever assessment base was used.

Chart 1
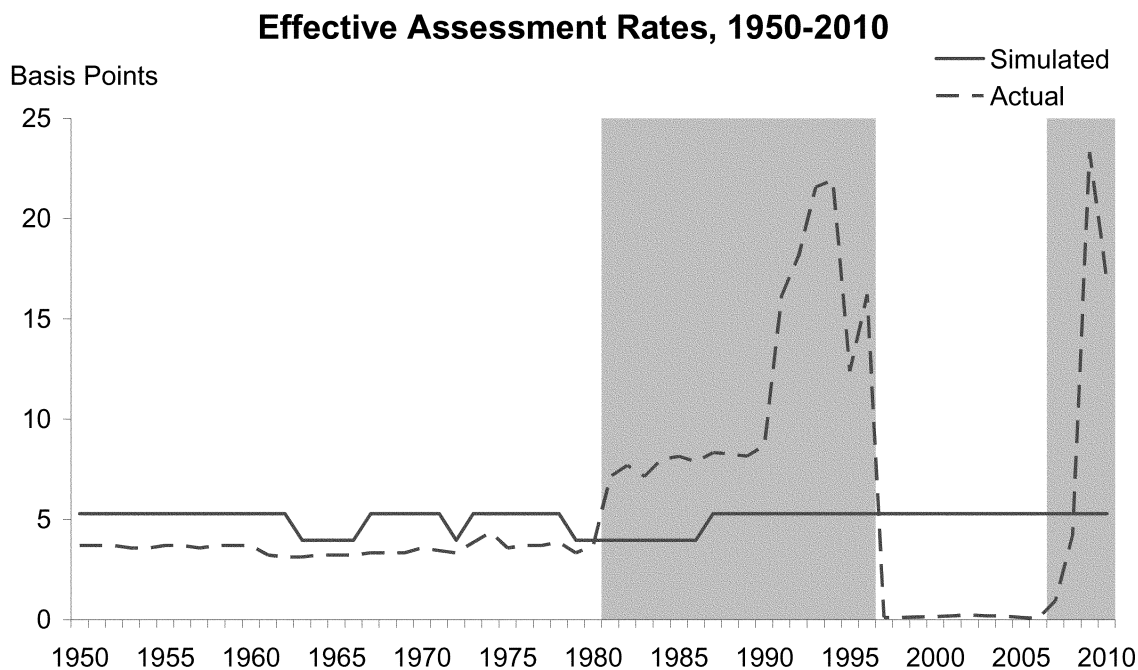
Effective Assessment Rates, 1950-2010

Source: FDIC, data through June 30, 2010.
Note: Effective assessment rate reduced by 25 percent when reserve ratio reaches 2 percent and 50 percent when reserve ratio reaches 2.5 percent, with 5.29 basis point average nominal assessment rate using new assessment base. Shaded areas denote periods of crisis and associated high assessment rates.

[16] The historical analysis contained in the October NPR is incorporated herein by reference.

[17] Using the domestic-deposit-related assessment base, reserve ratios would have peaked at 2.31 percent and 2.01 percent before the two crises. (*See* Chart G in the October NPR.) Using the Dodd-Frank assessment base, reserve ratios would have peaked

at 2.27 percent and 1.95 percent before the two crises.

[18] Dodd-Frank provides that the assessment base be changed to average consolidated total assets minus average tangible equity. *See* Public Law 111–203, § 331(b). For this simulation, from 1990 to 2010, the assessment base equals year-end total

industry assets minus Tier 1 capital. For earlier years (before the Tier 1 capital measure existed) it equals year-end total industry assets minus total equity. Other than as noted, the methodology used in the additional analysis was the same as that used in the October NPR.

Chart 2

Reserve Ratios, 1950-2010
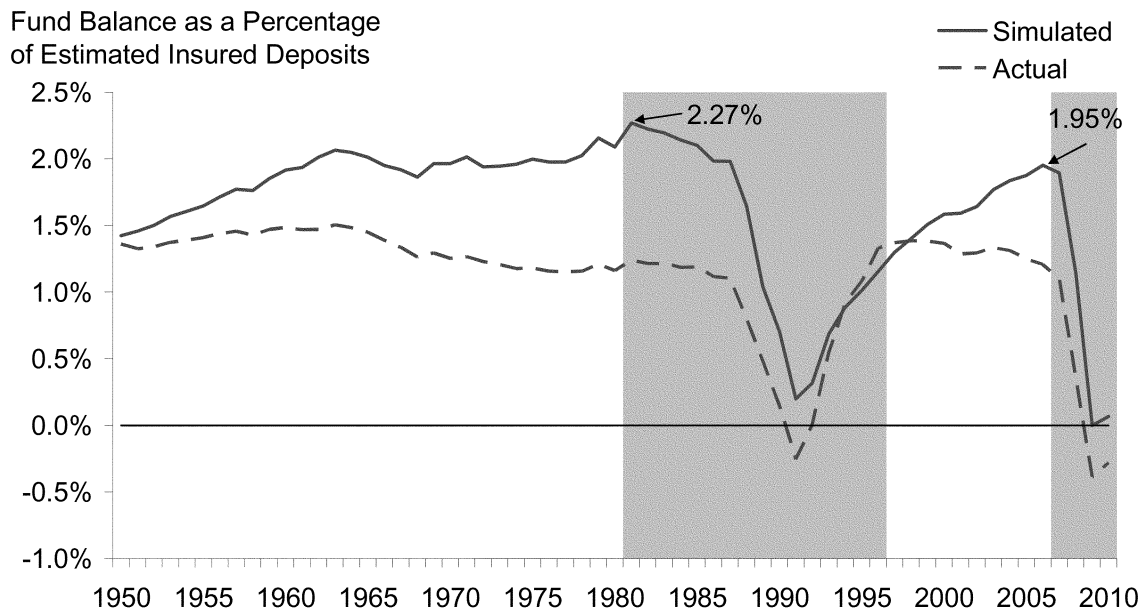
Fund Balance as a Percentage
of Estimated Insured Deposits

—— Simulated
-- - Actual

Source: FDIC, data through June 30, 2010.
Note: Effective assessment rate reduced by 25 percent when reserve ratio reaches 2 percent and 50 percent when reserve ratio reaches 2.5 percent, with 5.29 basis point average nominal assessment rate using new assessment base. Shaded areas denote periods of crisis and associated high assessment rates.

H. Scope of the Final Rule

This final rule encompasses all of the proposals contained in the October NPR, the Assessment Base NPR and the Large Bank NPR, except the proposal setting the DRR, which was covered in the DRR final rule.

I. Structure of the Next Sections of the Preamble

The next sections of this preamble are structured as follows:
• Section II briefly discusses the number of comments received;
• Section III discusses the portion of the final rule related to changes to the assessment base and adjustments to assessment rates proposed in the Assessment Base NPR;
• Subsection IV discusses the portion of the final rule related to dividends and assessment rates proposed in the Assessment Base NPR and the October NPR; and
• Subsection V discusses the portion of the final rule related to the assessment system applicable to large insured depository institutions proposed in the Large Bank NPR.

III. Comments Received

The FDIC sought comments on every aspect of the proposed rules. The FDIC received a total of 55 written comments

on the October NPR, the Assessment Base NPR and the Large Bank NPR, although some were duplicative. Comments are discussed in the relevant sections below.

IV. The Final Rule: The Assessment Base and Adjustments to Assessment Rates

A. Assessment Base

As stated above, Dodd-Frank requires that the FDIC amend its regulations to redefine the assessment base used for calculating deposit insurance assessments. Specifically, Dodd-Frank directs the FDIC:

To define the term "assessment base" with respect to an insured depository institution * * * as an amount equal to—
(1) the average consolidated total assets of the insured depository institution during the assessment period; minus
(2) the sum of—
(A) the average tangible equity of the insured depository institution during the assessment period, and
(B) in the case of an insured depository institution that is a custodial bank (as defined by the Corporation, based on factors including the percentage of total revenues generated by custodial businesses and the level of assets under custody) or a banker's bank (as that term is used in * * * (12 U.S.C. 24)), an amount that the Corporation determines is necessary to establish

assessments consistent with the definition under section 7(b)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1817(b)(1)) for a custodial bank or a banker's bank.[19]

To implement this requirement, the FDIC, in this final rule, defines "average consolidated total assets," "average tangible equity," and "tangible equity," and sets forth the basis for reporting consolidated total assets and tangible equity.

To establish assessments consistent with the definition of the "risk-based assessment system" under the Federal Deposit Insurance Act (the FDI Act), Dodd-Frank also requires the FDIC to determine whether and to what extent adjustments to the assessment base are appropriate for banker's banks and custodial banks. The final rule outlines these adjustments and provides a definition of "custodial bank."

1. Average Consolidated Total Assets

The final rule, like the proposed rule, requires that all insured depository institutions report their average consolidated total assets using the accounting methodology established for reporting total assets as applied to Line 9 of Schedule RC–K of the Consolidated

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[19] Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, § 331(b), 124 Stat. 1376, 1538 (codified at 12 U.S.C. 1817(nt)).

Reports of Condition and Income (Call Report) (that is, the methodology established by Schedule RC–K regarding when to use amortized cost, historical cost, or fair value, and how to treat deferred tax effects). The final rule differs from the proposed rule, however, by allowing certain institutions to report average consolidated total assets on a weekly, rather than daily, basis. The final rule requires institutions with total assets greater than or equal to $1 billion and all institutions that are newly insured after March 31, 2011, to average their balances as of the close of business for each day during the calendar quarter. Institutions with less than $1 billion in quarter-end consolidated total assets on their March 31, 2011 Call Report or Thrift Financial Report (TFR) may report an average of the balances as of the close of business on each Wednesday during the calendar quarter or may, at any time, permanently opt to calculate average consolidated total assets on a daily basis. Once an institution that reports average consolidated total assets using a weekly average reports average consolidated total assets of $1 billion or more for two consecutive quarters, it shall permanently report average consolidated total assets using daily averaging starting in the next quarter.

While some commenters supported the requirement that all institutions average their assets using daily balances, one trade group requested that all institutions be allowed to choose between daily and weekly averages. In the FDIC's view, institutions with at least $1 billion in assets should be able to compute averages using daily balances. (Many already do so.) However, to avoid imposing transition costs on smaller institutions (those with less than $1 billion in assets), the final rule allows these institutions to calculate an average of Wednesday asset balances, unless they opt permanently to report daily averages.[20] Newly insured institutions incur no transition costs (since they have no existing systems) and, thus, must average using daily balances.

Under the final rule, an institution's daily average consolidated total assets equal the sum of the gross amount of consolidated total assets for each calendar day during the quarter divided by the number of calendar days in the quarter. An institution's weekly average consolidated total assets equal the sum of the gross amount of consolidated total assets for each Wednesday during the

quarter divided by the number of Wednesdays in the quarter. For days that an office of the reporting institution (or any of its subsidiaries or branches) is closed (e.g., Saturdays, Sundays, or holidays), the amounts outstanding from the previous business day will be used. An office is considered closed if there are no transactions posted to the general ledger as of that date.

In the case of a merger or consolidation, the calculation of the average assets of the surviving or resulting institution must include the assets of all the merged or consolidated institutions for the days in the quarter prior to the merger or consolidation, regardless of the method used to account for the merger or consolidation.

In the case of an insured depository institution that is the parent company of other insured depository institutions, the final rule, like the proposed rule, requires that the parent insured depository institution report its daily or weekly, average consolidated total assets without consolidating its insured depository institution subsidiaries into the calculations.[21] Because of intercompany transactions, a simple subtraction of the subsidiary insured depository institutions' assets and equity from the parent insured depository institution's assets and equity will not usually result in an accurate statement of the parent insured depository institution's assets and equity. This treatment is consistent with current assessment base practice and ensures that all parent insured depository institutions are assessed only for their own assessment base and not that of their subsidiary insured depository institutions, which will be assessed separately.

For all other subsidiaries, assets, including those eliminated in consolidation, will also be calculated using a daily or weekly averaging method, corresponding to the daily or weekly averaging requirement of the parent institution. The final rule clarifies that Call Report instructions in effect for the quarter being reported will govern calculation of the average amount of subsidiaries' assets, including those eliminated in consolidation. Current Call Report instructions state that the calculation should be for the same quarter as the assets reported by the parent institution to the extent practicable, but in no case differ by more than one quarter. However, under the final rule, once an institution reports

the average amount of subsidiaries' assets, including those eliminated in consolidation, using concurrent data, the institution must do so for all subsequent quarters.

Finally, for insured branches of foreign banks, as in the proposed rule, average consolidated total assets are defined as total assets of the branch (including net due from related depository institutions) in accordance with the schedule of assets and liabilities in the Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks, but using the accounting methodology for reporting total assets established in Schedule RC–K of the Call Report, and calculated using the appropriate daily or weekly averaging method as described above.

In choosing to require all but smaller insured institutions to report "average consolidated total assets" using daily averaging, the FDIC sought to develop a measure that would be a truer reflection of the assessment base during the entire quarter.[22] By using a methodology already established in the Call Report, the FDIC believes the reporting requirements for the new assessment base will be minimized. Finally, by using the Call Report methodology for reporting average consolidated total assets, all institutions will report average consolidated total assets consistently.

2. Comments

Commenters favored the use of an existing measure for average consolidated total assets because it will minimize the burden of the rulemaking on institutions.

A few commenters suggested that the FDIC deduct goodwill and intangibles from average consolidated total assets. According to one commenter, a loss in value or write-off of goodwill (unlike other assets) poses no additional risk of loss to the FDIC in the event of a failure of an insured institution; goodwill is not an asset for which the FDIC as receiver could have any expectation of recovery. Moreover, failing to deduct goodwill could lead to anomalous results—two institutions that merge and create goodwill would have a combined assessment base greater than the sum of the two assessment bases separately. The FDIC is not persuaded by these

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[20] Institutions currently may report a daily average or an average of Wednesday assets on Call Report Schedule RC–K.

[21] The amount of the institution's average consolidated total assets without consolidating its insured depository institution subsidiaries determines whether the institution may report a weekly average.

[22] In this way, the daily averaging requirement is consistent with the actions taken by the FDIC in 2006 when it determined that using quarter-end deposit data as a proxy for balances over an entire quarter did not accurately reflect an insured depository institution's typical deposit level. As a result, the FDIC required certain institutions to report a daily average deposit assessment base.

arguments. Dodd-Frank specifically states that the assessment base should be "average consolidated total assets minus average tangible equity." Subtracting intangibles from assets as well as equity negates the purposeful use of the word "tangible" in the definition of the new assessment base and, in the FDIC's view, is counter to the intent of Congress.

A number of commenters stated that the FDIC should exclude transactions between affiliated banks from the assessment base to avoid double counting the assets associated with these transactions in the assessment base. Commenters acknowledge that the FDIC currently assesses deposits received from affiliated banks, but believe that, with the requirement to change the assessment base, the FDIC should now exclude transactions between affiliated banks. The FDIC has generally assessed risk at the insured institution level and is not persuaded to change this practice.

3. Tangible Equity

The final rule, like the proposed rule, uses Tier 1 capital as the definition of tangible equity. Although this measure does not eliminate all intangibles, it eliminates many of them, and it requires no additional reporting by insured depository institutions. The FDIC may reconsider the definition of tangible equity once new Basel capital definitions have been implemented.

The final rule, like the proposed rule, defines the averaging period for tangible equity to be monthly; however, institutions that report less than $1 billion in quarter-end consolidated total assets on their March 31, 2011 Call Report or TFR may report average tangible equity using an end-of-quarter balance or may, at any time, opt to report average tangible equity using a monthly average balance permanently. Once an institution that reports average tangible equity using an end-of-quarter balance reports average consolidated total assets of $1 billion or more for two consecutive quarters, it shall permanently report average tangible equity using monthly averaging starting in the next quarter. Newly insured institutions must report monthly averages. Monthly averaging means the average of the three month-end balances within the quarter. For the surviving institution in a merger or consolidation, Tier 1 capital must be calculated as if the merger occurred on the first day of the quarter in which the merger or consolidation actually occurred.

Under the final rule, as in the proposed rule, an insured depository institution with one or more

consolidated insured depository institution subsidiaries must report average tangible equity (or end-of-quarter tangible equity, as appropriate) without consolidating its insured depository institution subsidiaries into the calculations. This requirement conforms to the method for reporting consolidated total assets above and ensures that all parent insured depository institutions will be assessed only on their own assessment base and not that of their subsidiary insured depository institutions.

As in the proposed rule, an insured depository institution that reports average tangible equity using a monthly averaging method and that has subsidiaries that are not insured depository institutions must use monthly average data for the subsidiaries. The monthly average data for these subsidiaries, however, may be calculated for the current quarter or for the prior quarter consistent with the method used to report average consolidated total assets.

As in the proposed rule, for insured branches of foreign banks, tangible equity is defined as eligible assets (determined in accordance with Section 347.210 of the FDIC's regulations) less the book value of liabilities (exclusive of liabilities due to the foreign bank's head office, other branches, agencies, offices, or wholly owned subsidiaries). This value is to be calculated on a monthly average or end-of-quarter basis, according to the branch's size.

The FDIC does not foresee a need for any institution to report daily average balances for tangible equity, since the components of tangible equity appear to be subject to less fluctuation than are consolidated total assets. Thus, the definition of average tangible equity in the final rule achieves a true reflection of tangible equity over the entire quarter by requiring monthly averaging of capital for institutions that account for the majority of industry assets and end-of-quarter balances for all other institutions.

Defining tangible equity as Tier 1 capital provides a clearly understood capital buffer for the DIF in the event of the institution's failure, while avoiding an increase in regulatory burden that a new definition of capital could cause.[23] This methodology should not increase regulatory burden, since institutions

with assets of $1 billion or more generally compute their regulatory capital ratios no less frequently than monthly. To minimize regulatory burden for small institutions, the proposal allows these institutions to report an end-of-quarter balance.

4. Comments

A number of commenters explicitly supported the use of Tier 1 capital for average tangible equity because this would minimize the burden of the rulemaking on institutions. One trade group asked that institutions with less than $10 billion in assets (as opposed to less than $1 billion) be allowed to report end-of-quarter balances rather than an average of month-end balances on the grounds that these institutions experience few fluctuations in capital and allowing them to report end-of-quarter balances would reduce burden. The FDIC believes that many institutions of this size already determine their capital more frequently than once a quarter, so that the requested change is not needed.

5. Banker's Bank Adjustment

Like the proposed rule, the final rule will require a banker's bank to certify on its Call Report or TFR that it meets the definition of "banker's bank" as that term is used in 12 U.S.C. 24. The self-certification will be subject to verification by the FDIC. The final rule, however, clarifies that banker's banks that have funds from government capital infusion programs (such as TARP and the Small Business Lending Fund), stock owned by the FDIC resulting from bank failures or stock that is issued as part of an equity compensation program will not be excluded from the definition of banker's bank solely for these reasons.[24] As in the proposed rule, for an institution that meets the definition (with the exception noted below), the FDIC will exclude from its assessment base the average amount of reserve balances "passed through" to the Federal Reserve, the average amount of reserve balances held at the Federal Reserve for the institution's own account, and the average amount of the institution's federal funds sold. (In each case, the average is to be calculated daily or weekly depending on how the

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[23] The changes needed to implement the new assessment base will require the FDIC to collect some information from insured depository institutions that is not currently collected on the Call Report or TFR. However, the burden of requiring new data will be partly offset by allowing some assessment data that are currently collected to be deleted from the Call Report or TFR.

[24] Some commenters had asked that the FDIC use the definition of banker's bank contained in 12 U.S.C. 461(b)(9) (which is repeated verbatim in the implementing regulation, 12 CFR 204.121) in lieu of 12 U.S.C. 24. The definition of banker's bank in the final rule adheres to the requirement in Dodd-Frank that the potential assessment base reduction apply to banker's banks "as that term is used in * * * 12 U.S.C. 24." However, in the FDIC's view, the clarification in the preamble should meet the concerns of these commenters.

institution calculates its average consolidated total assets.) The collective amount of this exclusion, however, cannot exceed the sum of the bank's average amount of total deposits of commercial banks and other depository institutions in the United States and the average amount of its federal funds purchased. (Again, in each case, the average is to be calculated daily or weekly depending on how the institution calculates its average consolidated total assets.) Thus, for example, if a banker's bank has a total average balance of $300 million of federal funds sold plus reserve balances (including pass-through reserve balances), and it has a total average balance of $200 million of deposits from commercial banks and other depository institutions and federal funds purchased, it can deduct $200 million from its assessment base. Federal funds purchased and sold on an agency basis will not be included in these calculations as they are not reported on the balance sheet of a banker's bank.

As in the proposed rule, the assessment base adjustment applicable to a banker's bank is only available to an institution that conducts less than 50 percent of its business with affiliates (as defined in section 2(k) of the Bank Holding Company Act (12 U.S.C. 1841(k)) and section 2 of the Home Owners' Loan Act (12 U.S.C. 1462)). Providing a benefit to a banker's bank that primarily serves affiliated companies would undermine the intent of the benefit by providing a way for banking companies to reduce deposit insurance assessments simply by establishing a subsidiary for that purpose.

Currently, the corresponding deposit liabilities that result in "pass-through" reserve balances are excluded from the assessment base. The final rule, like the proposal, retains this exception for banker's banks.

A typical banker's bank provides liquidity and other services to its member banks that may result in higher than average amounts of federal funds purchased and deposits from other insured depository institutions and financial institutions on a banker's bank's balance sheet. To offset its relatively high levels of these short-term liabilities, a banker's bank often holds a relatively high amount of federal funds sold and reserve balances for its own account. The final rule, therefore, like the proposed rule, adjusts the assessment base of a banker's bank to reflect its greater need to maintain liquidity to service its member banks.

6. Comments

Several commenters addressed the issue of providing an adjustment to banker's banks. The most common comment among the respondents was a concern that the adjustment for federal funds sold may have unintended consequences for the federal funds market. The commenters argued that federal funds are generally sold on thin margins and that, if non-banker's banks pay even a few basis points of FDIC assessments on federal funds sold when banker's banks do not, the non-banker's banks will not be able to compete in this market. The comments further state that banker's banks alone cannot provide sufficient funding to maintain the federal funds market at its current size and that by providing a deduction from assets solely for banker's banks, the proposal could potentially lead to a considerable contraction of the federal funds market with detrimental implications for bank liquidity. The comments suggested that the FDIC provide a deduction for federal funds sold for all insured depository institutions or, alternatively, assign a zero premium weight to federal funds sold for all institutions.

The FDIC recognizes that, by allowing banker's banks to subtract federal funds sold from their assessment base, the cost of providing those funds for banker's banks will be reduced relative to other banks that are not afforded such a deduction. However, there is no uniform assessment rate for all banks, and since assessment rates will now be applied to an assessment base of average consolidated total assets, the cost—due to the assessment rate—of providing federal funds will potentially differ for every institution. While banker's banks may gain an incentive to sell more federal funds than they currently have and may gain a larger profit from doing so than would some other banks, it is not clear, a priori, what their total cost of funding will be, given that the assessment rate is only one factor in the cost of providing federal funds. Further, it is not likely that non-banker's banks will completely withdraw from providing federal funds as long as the market finds such funding more attractive than the alternatives.

Three commenters called for all excess reserve balances maintained by banker's banks to be included in the banker's bank deduction; some also called for the FDIC to allow a deduction for balances due from other banks. The FDIC clarifies that the proposed deduction for reserve balances held at the Federal Reserve would include all balances due from the Federal Reserve as reported on Schedule RC–A, line 4 of the Call Report. Balances due from other banks include assets that are relatively less liquid, such as time deposits. The FDIC does not believe it is appropriate to include these balances in the banker's bank deduction.

One banker's bank argues that banker's banks are subject to "double taxation" because every dollar on deposit has been received from another bank that is also being assessed a deposit insurance premium on its deposits. In the FDIC's view, there is no double assessment, since each institution is receiving the benefit of deposit insurance and is paying for it. This view is consistent with the treatment of interbank deposits under the current deposit insurance assessment system, which includes these deposits in an institution's assessment base.

Another bank argues that there is no reasonable basis to deny the banker's bank assessment base deduction to banker's banks that conduct business primarily with affiliated insured depository institutions. This bank also argues that the interaffiliate transactions that such a banker's bank engages in result in counting the same assets twice, once at the banker's bank and again at its affiliate, although overall risk is not increased because of cross-guarantees. The FDIC believes that, while such a bank may meet the technical definition of a banker's bank, it does not serve the same function as a true banker's bank. Moreover, as discussed above, the FDIC has generally assessed risk at the insured depository institution level (for example, it currently assesses separately on interaffiliate deposits) and is not persuaded to change this practice. The FDIC cannot invariably collect on cross-guarantees from affiliated institutions, since the guarantor may also be insolvent or could be made insolvent by fulfilling the guarantee.

7. Custodial Bank Definition

The final rule identifies custodial banks as insured depository institutions with previous calendar year-end trust assets (that is, fiduciary and custody and safekeeping assets, as reported on Schedule RC–T of the Call Report) of at least $50 billion or those insured depository institutions that derived more than 50 percent of their revenue (interest income plus non-interest income) from trust activity over the previous calendar year. Using this definition, the FDIC estimates that 62 insured depository institutions would have qualified as custodial banks for deposit insurance purposes using data as of December 31, 2009.

This definition differs from the definition in the Assessment Base NPR, in that it expands the definition to include fiduciary assets and revenue as well as custody and safekeeping assets and revenue. Commenters have convinced the FDIC that fiduciary accounts have a custodial component, which, in many cases, is the primary reason for the account. This change will mean that more institutions will qualify under the definition.

8. Custodial Bank Adjustment

The final rule states that the assessment base adjustment for custodial banks should be the daily or weekly average—in accordance with the way the bank reports its average consolidated total assets—of a certain amount of low-risk assets—designated as assets with a Basel risk weighting of 0 percent, regardless of maturity,[25] plus 50 percent of those assets with a Basel risk weighting of 20 percent, again regardless of maturity [26]—subject to the limitation that the daily or weekly average value of these assets cannot exceed the daily or weekly average value of those deposits classified as transaction accounts (as reported on Schedule RC–E of the Call Report) and identified by the institution as being directly linked to a fiduciary or custodial and safekeeping account.

The final rule differs from the Assessment Base NPR in that it allows the deduction of all 0 percent risk-weighed assets and 50 percent of 20 percent risk-weighted assets without regard to specific maturity (although the purpose of the 50 percent reduction in the 20 percent risk weighted assets is to apply a sufficient haircut to those assets to account for the risk posed by longer-term maturities). Again based upon comments, the FDIC has concluded that transaction accounts associated with fiduciary and custody and safekeeping assets generally display the characteristics of core deposits, justifying a relaxation of the maturity length requirement in the proposal.[27]

The final rule also differs from the proposed rule in two other ways. First, it allows a deduction up to the daily or weekly average value of those deposits classified as transaction accounts that are identified by the institution as being linked to a fiduciary or custodial and safekeeping account. The final rule includes fiduciary accounts, rather than just custodial and safekeeping accounts, for the reasons stated above. Second, the final rule limits the deduction to transaction accounts, rather than all deposit accounts, because deposits generated in the course of providing custodial services (regardless of whether there is a fiduciary aspect to the account) are used for payments and clearing purposes, as opposed to deposits held in non-transaction accounts, which may be part of a wealth management strategy.

B. Assessment Rate Adjustments

In February 2009, the FDIC adopted a final rule incorporating three adjustments into the risk-based pricing system.[28] These adjustments—the unsecured debt adjustment, the secured liability adjustment, and the brokered deposit adjustment—were added to better account for risk among insured depository institutions based on their funding sources. In light of the changes to the deposit insurance assessment base required by Dodd-Frank, the final rule modifies these adjustments. In addition, the final rule adds an adjustment for long-term debt held by an insured depository institution where the debt is issued by another insured depository institution.

1. Unsecured Debt Adjustment

The final rule maintains the long-term unsecured debt adjustment, but the amount of the adjustment is now equal to the amount of long-term unsecured liabilities [29] an insured depository institution reports times the sum of 40

basis points plus the institution's initial base assessment rate divided by the amount of the institution's new assessment base; that is: [30]

UDA = (Long-term unsecured liabilities/ New assessment base) * (40 basis points + IBAR)

Thus, if an institution with a $10 billion assessment base issued $100 million in long-term unsecured liabilities and had an initial base assessment rate of 20 basis points, its unsecured debt adjustment would be 0.6 basis points, which would result in an annual reduction in the institution's assessment of $600,000.

All other things equal, greater amounts of long-term unsecured debt can reduce the FDIC's loss in the event of a failure, thus reducing the risk to the DIF. Because of this, under the current assessment system, an insured depository institution's assessment rate is reduced through the unsecured debt adjustment, which is based on the amount of long-term, unsecured liabilities the insured depository institution issues. Adding the initial base assessment rate to the adjustment formula maintains the value of the incentive to issue long-term unsecured debt, providing insured depository institutions with the same incentive to issue long-term unsecured debt that they have under the current assessment system.

Unless this revision is made, the cost of issuing long-term unsecured liabilities will rise (as will the cost of funding for all other liabilities except, in most cases, domestic deposits) as there will no longer be a distinction, in terms of the cost of deposit insurance, among the types of liabilities funding the new assessment base. The FDIC remains concerned that this will reduce the incentive for insured depository institutions to issue long-term unsecured debt. Therefore, the final rule, like the proposed rule, revises the adjustment so that the relative cost of issuing long-term unsecured debt will not rise with the implementation of the new assessment base.

The final rule, like the proposed rule, also changes the cap on the unsecured debt adjustment from the current 5 basis points to the lesser of 5 basis points or 50 percent of the institution's initial base assessment rate. This cap will apply to the new assessment base. This change allows the maximum dollar amount of the unsecured debt adjustment to increase because the assessment base is larger, but ensures that the assessment rate after the

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[25] Specifically, all asset types described in the instructions to lines 34, 35, 36, and 37 of Schedule RC–R of the Call Report as of December 31, 2010 with a Basel risk weight of 0 percent, regardless of maturity. These types of assets are also currently reported on corresponding line items in the TFR. These same asset types will be used regardless of changes to the Call Report or TFR.

[26] Specifically, 50 percent of those asset types described in the instructions to lines 34, 35, 36, and 37 of Schedule RC–R of the Call Report (or corresponding items in the TFR) with a Basel risk weighting of 20 percent. These types of assets are also currently reported on corresponding line items in the TFR. These same asset types will be used regardless of changes to the Call Report or TFR.

[27] All of the commenters on the issue disagreed with limiting the assets eligible for the deduction

to those with a stated maturity of 30 days or less. Most of the comments noted that assets with 20 percent or lower Basel risk weightings are high-quality and liquid, regardless of maturity, and one commenter stated that any breakdown of these assets by maturity would require additional reporting as such information is not currently collected. A number of the comments noted that the maturity of an asset is not the only indicator of the asset's liquidity. Comments from the banks generally argued that custodial deposits are relatively stable—akin to core deposits, rather than wholesale deposits—and, as such, it would be imprudent for them to manage their portfolios by matching these deposits strictly to assets with a maturity of 30 days or less.

[28] 74 FR 9525 (March 4, 2009).

[29] Unsecured debt remains as defined in the 2009 Final Rule on Assessments, with the exceptions (discussed below) of the exclusion of Qualified Tier 1 capital and certain redeemable debt. See 74 FR 9537 (March 4, 2009).

[30] The IBAR is the institution's initial base assessment rate.

adjustment is applied does not fall to zero.

In addition, the final rule, like the proposed rule, eliminates Qualified Tier 1 capital from the definition of unsecured debt. Under the current assessment system, the unsecured debt adjustment includes certain amounts of Tier 1 capital (Qualified Tier 1 capital) for insured depository institutions with less than $10 billion in assets. Since the new assessment base excludes Tier 1 capital, defining long-term, unsecured liabilities to include Qualified Tier 1 capital would have the effect of providing a double deduction for this capital.

Finally, the final rule, unlike the proposed rule, slightly alters the definition of long-term unsecured debt. At present, and under the proposed rule, long-term unsecured debt is defined as long-term if the unsecured debt has at least one year remaining until maturity. The final rule provides that long-term unsecured debt is long-term if the debt has at least one year remaining until maturity, unless the investor or holder of the debt has a redemption option that is exercisable within one year of the reporting date. Such a redemption option negates the benefit of long-term debt to the DIF.

2. Comments

Some commenters expressed support for increasing the adjustment to 40 basis points plus the initial base assessment rate.

A number of commenters believed that the long-term unsecured liability definition should be expanded to include short-term unsecured liabilities, uninsured deposits and foreign office deposits or all liabilities subordinate to the FDIC. A few commenters also stated that the original, rather than remaining, maturity of unsecured debt should be used to determine whether unsecured debt qualifies as long term.

The FDIC does not believe that the definition of long-term liabilities should be expanded. Short-term unsecured liabilities (including those that were long-term at issuance) provide less protection to the DIF in the event of failure. By the time an institution fails, unsecured debt remaining at an institution is primarily longer-term debt that has not yet come due. Thus, providing a benefit for short-term unsecured debt does not make sense, since this kind of debt is unlikely to provide any cushion to absorb losses in the event of failure. Similarly, the FDIC does not agree that unsecured debt should include foreign office deposits, since there is likely to be a significant reduction in these deposits by the time

of failure. In addition, while, under U.S. law, foreign deposits are subordinate to domestic deposits in the event an institution fails, they can be subject to asset ring-fencing that effectively makes them similar to secured liabilities.

One commenter stated that the long-term unsecured liability definition should include goodwill and other intangibles. The FDIC does not agree. The purpose of this adjustment is to provide an incentive for insured depository institutions to issue long-term unsecured debt to absorb losses in the event an institution fails. Goodwill and other intangibles are assets (rather than liabilities) and they provide little to no value to the FDIC in a resolution.

One commenter recommended that the unsecured debt adjustment cap should be increased or removed. The commenter argued that all long-term unsecured claims subordinate to the FDIC reduce the FDIC's risk equally and the cap artificially and arbitrarily mutes the effect. Further, the commenter noted that a bank with a lower initial base assessment rate and arguably less risk to the FDIC should not have a lower cap simply due to its lower initial base assessment rate. The FDIC disagrees. An excessive deduction could create moral hazard. While the FDIC acknowledges that an institution with a lower initial base assessment rate may have a lower cap than one with a higher initial base assessment rate, the FDIC believes that, to avoid the potential for moral hazard that would ensue from an assessment rate at or near zero, all institutions should pay some assessment. Thus, setting the cap at half of the initial base assessment rate is appropriate.

3. Depository Institution Debt Adjustment

Like the proposed rule, the final rule creates a new adjustment, the depository institution debt adjustment (DIDA), which is meant to offset the benefit received by institutions that issue long-term, unsecured liabilities when those liabilities are held by other insured depository institutions.[31] However, in response to comments, the final rule allows an institution to exclude from the unsecured debt amount used in calculating the DIDA an amount equal to no more than 3 percent of the institution's Tier 1 capital as posing de minimis risk. Therefore, the final rule will apply a 50 basis point DIDA to every dollar (above 3 percent of an institution's Tier 1 capital) of long-

term unsecured debt held by an insured depository institution when that debt is issued by another insured depository institution.[32] Specifically, the adjustment will be determined according to the following formula:

DIDA = [(Long-term unsecured debt issued by another insured depository institution—3% * Tier 1 capital) * 50 basis points]/New assessment base

An institution should use the same valuation methodology to calculate the amount of long-term unsecured debt issued by another insured depository institution that it holds as it uses to calculate the amount of such debt for reporting on the asset side of the balance sheets.

Although issuance of unsecured debt by an insured depository institution lessens the potential loss to the DIF in the event of an insured depository institution's failure, when this debt is held by other insured depository institutions, the overall risk to the DIF is not reduced as much. For this reason, the final rule increases the assessment rate of an insured depository institution that holds this debt. The FDIC considered reducing the benefit from the unsecured debt adjustment received by insured depository institutions when their long-term unsecured debt is held by other insured depository institutions, but debt issuers generally do not track which entities hold their debt. The FDIC believes that the magnitude of the DIDA will approximately offset the decrease in the assessment rate of the issuing institution, and will discourage insured depository institutions from holding excessive amounts of other insured depository institutions' debt.

4. Comments

A number of commenters noted that the proposed level of 50 basis points for the DIDA is excessive relative to the risk presented to the FDIC. The FDIC disagrees. A fixed level of 50 basis points was established to generally offset the deduction received by the issuing institution of 40 basis points plus the initial base assessment rate. While the initial base assessment rate for the issuing institution may be less or greater than 10 basis points, the FDIC believes that 50 basis points is an appropriate approximation to offset the deduction to the issuing insured depository institution and to discourage insured depository institutions from

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[31] For this reason, the long-term unsecured debt that is subject to the DIDA is defined in the same manner as the long-term unsecured debt that qualifies for the unsecured debt adjustment.

[32] Debt issued by an entity other than an insured depository institution, including such an uninsured entity that owns or controls, either directly or indirectly, an insured depository institution, is not subject to the DIDA.

holding excessive amounts of each other's debt, which leaves the risk from such debt within the banking system.

A few commenters noted that a 50 basis point increase is punitive towards insured depository institutions that wish to manage a diversified portfolio of earning assets, including unsecured debt issued by strong depository insured institutions. The FDIC recognizes that the 50 basis point charge represents a disincentive to insured depository institutions to purchase the unsecured debt of another insured institution. That is one of the goals of the adjustment. However, the FDIC concedes that a small amount of debt that would otherwise be subject to the DIDA could be held to facilitate prudent portfolio management activities and, as discussed above, has created a de minimis exception.

Another commenter noted that the implementation of the 50-basis point adjustment could cause banks that issue unsecured debt to face reduced access to liquidity and funding, resulting from an increased cost of issuing unsecured debt to insured depository institutions. The FDIC believes that an increase, if any, in the cost of funding as the result of this adjustment will be significantly less than the long-term unsecured debt reduction an issuer receives. Further, the FDIC's exclusion of a de minimis amount of debt issued by insured depository institutions should minimize or eliminate any potential effect. The FDIC's intent is only to permit a net reduction in insurance premiums in the event that the risk of default on unsecured debt issued by an insured depository institution has limited or no effect on any other insured depository institution.

A few commenters stated that a cap should be set for the DIDA. The FDIC disagrees, since a cap would undermine the purpose of the DIDA.

A few commenters stated that the DIDA will result in a reporting burden for insured depository institutions, particularly since CUSIP numbers do not identify industries. The FDIC disagrees. The FDIC believes that a bank should know and understand the attributes of its investments, including, among other things, the name of the issuer and the industry that the issuer operates in. While the FDIC acknowledges some reporting modifications may have to be made at some institutions, the FDIC believes those changes can be accomplished at minimal time and cost.

5. Secured Liability Adjustment

The final rule, like the proposed rule, discontinues the secured liability

adjustment. In arguing for the secured liability adjustment the FDIC stated that, "[t]he exclusion of secured liabilities can lead to inequity. An institution with secured liabilities in place of another's deposits pays a smaller deposit insurance assessment, even if both pose the same risk of failure and would cause the same losses to the FDIC in the event of failure." The change in the assessment base will eliminate the advantage of funding with secured liabilities associated with the current assessment base (domestic deposits), thus eliminating the rationale for continuing the adjustment.

6. Comments

A few commenters stated support for the removal of the secured liability adjustment, although one commenter opined that FHLB funding is more damaging to the FDIC than brokered deposits. On balance, the FDIC believes that including secured liabilities in the assessment base has removed the need for the secured liability adjustment.

7. Brokered Deposit Adjustment

The final rule, like the proposed rule, retains the current adjustment for brokered deposits, but scales the adjustment to the new assessment base by the insured depository institution's ratio of domestic deposits to the new assessment base. The new formula for brokered deposits is the following:

BDA = ((Brokered deposits − (Domestic deposits * 10%))/New assessment base) * 25 basis points

As discussed below, the final rule changes the assessment system for large institutions and eliminates risk categories for these institutions. Based on comments, however, the final rule provides an exemption from the brokered deposit adjustment for certain large institutions. The brokered deposit adjustment will not apply to those large institutions that are well-capitalized and have a composite CAMELS rating of 1 or 2. The FDIC believes that this exemption will result in a more equitable distribution of assessments. The brokered deposit adjustment does not apply to small institutions that are well-capitalized and have a composite CAMELS rating of 1 or 2. The brokered deposit adjustment will continue to apply to all other large institutions and to small institutions in risk categories II, III, and IV when the ratio of brokered deposits to domestic deposits exceeds 10 percent. As discussed, small Risk Category I institutions will continue to be excluded.

The final rule, like the proposed rule, maintains a cap on the adjustment of 10

basis points. The FDIC recognizes that keeping the cap constant could result in an increase in the amount an institution is assessed due to the adjustment, since the cap will apply to a larger assessment base. However, the FDIC remains concerned that significant reliance on brokered deposits tends to increase an institution's risk profile, particularly as its financial condition weakens.

8. Comments

A few commenters noted that the FDIC has not demonstrated a positive correlation between bank failures and the use of brokered deposits, which is inconsistent with a risk-based assessment system. The FDIC disagrees. A number of costly institution failures, including some recent failures, involved rapid asset growth funded through brokered deposits. Moreover, the presence of brokered deposits in a failed institution tends to reduce its franchise value, resulting in increased losses to the DIF.

Numerous comment letters argued that certain types of brokered deposits, including reciprocal deposits and sweeps, should be excluded from the brokered deposit adjustment because they are more stable than other types of brokered deposits. The FDIC considered the substance of these comments when it originally adopted the brokered deposit adjustment and remains unpersuaded. The final rule does not apply the brokered deposit adjustment to a well-capitalized, CAMELS 1- or 2- rated institution. When an institution's condition declines and it becomes less than well capitalized or is not rated CAMELS 1 or 2, statutory and market restrictions on brokered deposits become much more relevant. For this reason, the FDIC has decided to continue to include all brokered deposits above 10 percent of an institution's domestic deposits in the brokered deposit adjustment.

A few commenters noted that Dodd-Frank directs the FDIC to study the definition of brokered deposits. The commenters contend that determining the definition of brokered deposit prior to completion of the study is counter to the intent of Congress. The FDIC will continue to use its current definition for the present, but will examine the definition in light of the completed study and will consider changes then, if appropriate.

One commenter argued for a reduction of the cap from 10 basis points to 6.5 basis points given the increase in assessment base. While the FDIC acknowledges that maintaining the 10 basis point cap could increase the size of the adjustment as a result in the

change in assessment base, the FDIC believes this increase is appropriate. The FDIC remains concerned that significant reliance on brokered deposits tends to increase an institution's risk profile, particularly as it weakens.

V. The Final Rule: Dividends and Assessment Rates

A. Dividends

1. Final Rule

As proposed in the October NPR and consistent with the FDIC's long-term, comprehensive plan for fund management, the final rule suspends dividends indefinitely whenever the fund reserve ratio exceeds 1.5 percent to increase the probability that the fund reserve ratio will reach a level sufficient to withstand a future crisis.[33] In lieu of dividends, and pursuant to its authority to set risk-based assessments, the final rule adopts progressively lower assessment rate schedules when the reserve ratio exceeds 2 percent and 2.5 percent, as discussed below. These lower assessment rate schedules serve much the same function as dividends in preventing the DIF from growing unnecessarily large but, as discussed in the October NPR, provide more stable

and predictable effective assessment rates, a feature that industry representatives said was very important at the September 24, 2010 roundtable organized by the FDIC.

2. Comments

In the October NPR, the FDIC had proposed suspending dividends "permanently." One trade group, representing community banks, agreed that permanently foregoing dividends:

[I]s much more likely to ensure steady, predictable assessment rates. While we think that the FDIC should never completely rule out the possibility of paying a dividend from the DIF, we believe that at least until the DIF reserve ratio reaches 2.5 percent, it is prudent to forego a dividend in favor of steady, predictable assessment rates.

Another trade group argued that a permanent suspension of dividends is an unnecessary limitation on the FDIC's discretion under Dodd-Frank. The trade group argued that decisions on dividends should be based on facts and circumstances whenever the reserve ratio exceeds 1.5 percent. If the suspension is adopted, the trade group believes that the FDIC should provide that it could be lifted in appropriate circumstances.

The FDIC is persuaded that the word "indefinitely" should be used in place of the word "permanently," although the distinction is semantic. The rule is not intended to, and in any event, could not abrogate the authority of future FDIC Boards of Directors to adopt a different rule governing dividends.

Another trade group argued that the FDIC should establish a dividend policy to slow the growth of the insurance fund as it approaches an upper limit. In the FDIC's view, the historical analysis set out in the October NPR and updated in the DRR final rule, as described above, reveals that lower rates, like dividends, can effectively slow the growth of the reserve ratio, but can lead to less volatility in effective assessment rates.

B. Assessment Rate Schedules

1. Rate Schedule Effective April 1, 2011

Pursuant to the FDIC's authority to set assessments, the initial and total base assessment rates described in Table 3 below will become effective April 1, 2011. These rates are identical to those proposed in the Assessment Base NPR. (The rate schedule does not include the depository institution debt adjustment.)

TABLE 3—INITIAL AND TOTAL BASE ASSESSMENT RATES *

	Risk category I	Risk category II	Risk category III	Risk category IV	Large and highly complex institutions
Initial base assessment rate	5–9	14	23	35	5–35
Unsecured debt adjustment **	(4.5)–0	(5)–0	(5)–0	(5)–0	(5)–0
Brokered deposit adjustment		0–10	0–10	0–10	0–10
Total Base Assessment Rate	2.5–9	9–24	18–33	30–45	2.5–45

* Total base assessment rates do not include the depository institution debt adjustment.
** The unsecured debt adjustment cannot exceed the lesser of 5 basis points or 50 percent of an insured depository institution's initial base assessment rate; thus for example, an insured depository institution with an initial base assessment rate of 5 basis points will have a maximum unsecured debt adjustment of 2.5 basis points and cannot have a total base assessment rate lower than 2.5 basis points.

The FDIC believes that the change to a new, expanded assessment base should not change the overall amount of assessment revenue that the FDIC would otherwise have collected using the assessment rate schedule under the Restoration Plan adopted by the Board on October 19, 2010.[34] Several industry trade groups and insured institutions supported this approach. Based on the FDIC's estimations, the rate schedule in

Table 3 above will result in the collection of assessment revenue that is approximately revenue neutral.[35][36] Because the new assessment base under Dodd-Frank is larger than the current assessment base, the assessment rates in Table 3 above are lower than current rates.

The rate schedule in Table 3 includes a column for institutions with at least $10 billion in total assets. This column

represents the assessment rates that will be applied to institutions of this size pursuant to the changes to the large institution pricing system discussed below. The range of total base assessment rates (2.5 basis points to 45 basis points) is the same for institutions of all sizes; however, institutions with at least $10 billion in total assets will not be assigned to risk categories.

[33] As discussed above, Dodd-Frank continued the FDIC's authority to declare dividends when the reserve ratio at the end of a calendar year is at least 1.5 percent, but granted the FDIC sole discretion in determining whether to suspend or limit the declaration or payment of dividends. Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, § 332, 124 Stat. 1376, 1539 (codified at 12 U.S.C. 1817(e)(2)(B)).
[34] 75 FR 66293 (October 27, 2010).

[35] Specifically, the FDIC has attempted to determine a rate schedule that would have generated approximately the same revenue as that generated under the current rate schedule in the second and third quarters of 2010 using the current assessment base.
[36] As discussed earlier, under Dodd-Frank, the FDIC is required to offset the effect on small institutions (those with less than $10 billion in assets) of the statutory requirement that the fund

reserve ratio increase from 1.15 percent to 1.35 percent by September 30, 2020. Thus, assessment rates applicable to all insured depository institutions need only be set high enough to reach 1.15 percent. The Restoration Plan postpones until later this year rulemaking regarding the method that will be used to reach 1.35 percent by the statutory deadline of September 30, 2020, and the manner of offset.

The final rule retains the FDIC Board's flexibility to adopt actual rates that are higher or lower than total base assessment rates without the necessity of further notice-and-comment rulemaking, but provides that: (1) The Board cannot increase or decrease rates from one quarter to the next by more than 2 basis points (rather than the current and proposed 3 basis points); and (2) cumulative increases and decreases cannot be more than 2 basis points higher or lower than the total base assessment rates. Retention of this flexibility (with the proportionate reduction in the size of the adjustment) will continue to allow the Board to act in a timely manner to fulfill its mandate to raise the reserve ratio in accordance with the Restoration Plan, particularly in light of the increased uncertainty about expected revenue resulting from the change in the assessment base. The reduction from 3 to 2 basis points was prompted by an industry trade group, which noted that 2 basis points of the new assessment base is approximately equal to 3 basis points of the domestic deposit assessment base.

2. Analysis of Statutory Factors for the New Rate Schedule

In setting assessment rates, the FDIC's Board of Directors is authorized to set assessments for insured depository institutions in such amounts as the Board of Directors may determine to be necessary or appropriate.[37] In setting assessment rates, the FDIC's Board of Directors is required by statute to consider the following factors:

(i) The estimated operating expenses of the Deposit Insurance Fund.

(ii) The estimated case resolution expenses and income of the Deposit Insurance Fund.

(iii) The projected effects of the payment of assessments on the capital and earnings of insured depository institutions.

(iv) The risk factors and other factors taken into account pursuant to section 7(b)(1) of the Federal Deposit Insurance Act (12 U.S.C Section 1817(b)(1)) under the risk-based assessment system, including the requirement under section 7(b)(1)(A) of the Federal Deposit Insurance Act (12 U.S.C Section 1817(b)(1)(A)) to maintain a risk-based system.[38]

(v) Other factors the Board of Directors has determined to be appropriate.

Section 7(b)(2) of the Federal Deposit Insurance Act, 12 U.S.C. 1817(b)(2)(B).

When the Board adopted the most recent Restoration Plan, it left the current assessment rate schedule in effect and took these statutory factors into account. The Restoration Plan requires that the FDIC update income and loss projections semiannually. The Board's decision to leave current assessment rates in effect was based on the FDIC's most recent projections, which projected lower expected losses for the period 2010 through 2014 than the FDIC's projections in June 2010 (approximately $50 billion rather than approximately $60 billion as projected in June 2010).[39] Because of the lower expected losses and the additional time provided by Dodd-Frank to meet the minimum (albeit higher) required reserve ratio, the FDIC opted, in the new Restoration Plan, to forego the uniform 3 basis point increase in assessment rates previously scheduled to go into effect on January 1, 2011. The FDIC estimated that the fund reserve ratio will reach 1.15 percent in 2018, even without the 3 basis point uniform increase in rates. As stated above, the final rule changes the current assessment rate schedule such that the new assessment rate schedule (applied against the new assessment base) will result in the collection of about the same amount of assessment revenue as the current assessment rate schedule applied against the domestic deposit assessment base.

For this reason, as stated in the Assessment Base NPR, the new assessment rates and assessment base should, overall, have no effect on the capital and earnings of the banking industry, although the new rates and base will affect the earnings and capital of individual institutions. The great majority of institutions will pay assessments at least 5 percent lower than currently and would thus have higher earnings and capital. However, 117 insured depository institutions, comprising 71 small institutions and 46

large institutions, would pay assessments at least 5 percent higher than they currently do. Appendix 1 contains additional detail on the projected effects of increases or decreases in assessments on the capital and earnings of insured depository institutions.

3. Comments on New Rate Schedule

Comments on the new rate schedule effective April 1, 2011, focused on two areas: The appropriateness of the shift in the rate schedule due to the new assessment base and the speed at which these rates would restore the DIF to 1.15 percent. As stated above, commenters generally supported the rate schedule in light of the new assessment base, since it maintains approximate revenue neutrality.

Several trade groups believed that the FDIC's projection for how quickly the reserve ratio will recover was too pessimistic and, thus, the rate schedule to restore the DIF was too high. A trade group believed that the revenue from the Temporary Liquidity Guarantee Program will allow the reserve ratio to reach 1.35 percent by 2017. A trade group also suggested basing reserve ratio projections on loss rates from the recovery period after the crisis of the early 1990s. Some commenters urged the FDIC to monitor progress of the Restoration Plan and reduce rates if the DIF reserve ratio reaches 1.35 percent more quickly than the FDIC has projected.

The FDIC has projected that the reserve ratio will reach 1.15 percent at the end of 2018. This projection was based on approximately $50 billion in losses from bank failures in 2010 through 2014 with markedly lower losses thereafter. (In fact, losses for 2017 and each year thereafter were assumed to equal average annual losses from 1995 to 2004, a period of very low fund losses.) The FDIC did not include income from the TLGP, because it believes that it is too early to determine the amount that may be transferred to the DIF when the TLGP ends at the end of 2012.

The FDIC does not believe that its projections are too pessimistic. Given the uncertainty of the pace of recovery in the economy and banking industry, as well as the uncertainty inherent in projecting reserve ratios eight years in advance, the FDIC believes that lowering assessment rates now (in addition to foregoing the 3 basis point rate increase previously scheduled to take effect in 2011) would not be prudent. However, under the Restoration Plan, the FDIC is required to update its loss and income projections

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[37] 12 U.S.C. 1817(b)(2)(A).

[38] The risk factors referred to in factor (iv) include:

(i) The probability that the Deposit Insurance Fund will incur a loss with respect to the institution, taking into consideration the risks attributable to—

(I) Different categories and concentrations of assets;

(II) Different categories and concentrations of liabilities, both insured and uninsured, contingent and noncontingent; and

(III) Any other factors the Corporation determines are relevant to assessing such probability;

(ii) The likely amount of any such loss; and

(iii) The revenue needs of the Deposit Insurance Fund.

Section 7(b)(1)(C) of the Federal Deposit Insurance Act (12 U.S.C. 1817(b)(1)(C)).

[39] The projections also cover expenses and the reserve ratio. The FDIC anticipates that the next semiannual update of projections will occur in the first half of 2011.

for the fund at least semiannually and, if necessary—for example, if there is a change in the projected losses from bank failures—increase or decrease assessment rates to meet the statutory minimum reserve ratio by September 2020. (Such an increase or decrease would not affect the assessment rate schedules below.)

An industry trade group commented that, given the FDIC's decision in October 2010 to forego the uniform 3 basis point increase in assessment rates scheduled to go into effect on January 1, 2011, the FDIC should reassess its cash

needs and return excess prepaid assessments earlier, such as by December 2011. The FDIC will continue to monitor its cash resources to determine whether to undertake a rulemaking to return unused portions of the prepayments before the scheduled return date.

4. Rate Schedule Once the Reserve Ratio Reaches 1.15 Percent

Pursuant to the FDIC's authority to set assessments, the initial base and total base assessment rates set forth in Table 4 below will take effect beginning the

assessment period after the fund reserve ratio first meets or exceeds 1.15 percent, without the necessity of further action by the FDIC's Board. These rates are identical to those proposed in the Assessment Base NPR. The rates will remain in effect unless and until the reserve ratio meets or exceeds 2 percent. The FDIC's Board will retain its authority to uniformly adjust the total base rate assessment schedule up or down without further rulemaking, but the adjustment cannot exceed 2 basis points.

TABLE 4—INITIAL AND TOTAL BASE ASSESSMENT RATES *

[Once the reserve ratio reaches 1.15 percent and the reserve ratio for the immediately prior assessment period Is less than 2 percent [40]]

	Risk category I	Risk category II	Risk category III	Risk category IV	Large and highly complex institutions
Initial base assessment rate	3–7	12	19	30	3–30
Unsecured debt adjustment **	(3.5)–0	(5)–0	(5)–0	(5)–0	(5)–0
Brokered deposit adjustment	....	0–10	0–10	0–10	0–10
Total Base Assessment Rate	1.5–7	7–22	14–29	25–40	1.5–40

*Total base assessment rates do not include the depository institution debt adjustment.

** The unsecured debt adjustment cannot exceed the lesser of 5 basis points or 50 percent of an insured depository institution's initial base assessment rate; thus, for example, an insured depository institution with an initial base assessment rate of 3 basis points will have a maximum unsecured debt adjustment of 1.5 basis points and cannot have a total base assessment rate lower than 1.5 basis points.

When the reserve ratio reaches 1.15 percent, the FDIC believes that it is appropriate to lower assessment rates so that the average assessment rate will approximately equal the long-term, moderate, steady assessment rate—5.29 basis points, as discussed in the October NPR and the DRR final rule—that would have been needed to maintain a positive fund balance throughout past crises.[41] Doing so is consistent with the goals of the FDIC's comprehensive, long-term fund management plan, which are to: (1) Reduce the pro-cyclicality in the existing risk-based assessment system by allowing moderate, steady assessment rates throughout economic and credit cycles; and (2) maintain a positive fund balance even during a

banking crisis by setting an appropriate target fund size and a strategy for assessment rates and dividends.

The FDIC considers these goals important for several reasons. During an economic and banking downturn, insured institutions can least afford to pay high deposit insurance assessment rates. Moreover, high assessment rates during a downturn reduce the amount that banks can lend when the economy most needs new lending. Consequently, it is important to reduce pro-cyclicality in the assessment system and allow moderate, steady assessment rates throughout economic and credit cycles. As discussed above, at a September 24, 2010 roundtable organized by the FDIC, bank executives and industry trade

group representatives uniformly favored steady, predictable assessments and objected to high assessment rates during crises.

It is also important that the fund not decline to a level that could risk undermining public confidence in federal deposit insurance. Furthermore, although the FDIC has significant authority to borrow from the Treasury to cover losses when the fund balance approaches zero, the FDIC views the Treasury line of credit as available to cover unforeseen losses, not as a source of financing projected losses. A sufficiently large fund is a necessary precondition to maintaining a positive fund balance during a banking crisis

[40] The Assessment Base NPR contained a typographical error in the lower range of the total base assessment rate for Risk Category IV. It stated that the range of rates was 29 basis points to 40 basis points; it should have stated that the range was 25 basis points to 40 basis points. The final rule corrects the error.

[41] The FDIC arrived at the rate schedule in Table 4 as follows. First, the FDIC determined the rate schedule that would have been needed during a period when insured depository institutions had strong earnings to achieve approximately an 8.5 basis point average assessment rate, which is the long-term, moderate, steady assessment rate that would have been needed to maintain a positive fund balance throughout past crises using a domestic deposit assessment base. Based on the FDIC's analysis of weighted average assessment rates paid immediately prior to the current crisis (when the industry was relatively prosperous, and

had both good CAMELS ratings and substantial capital), weighted average rates during times of industry prosperity tend to be somewhat less than 1 basis point greater than the minimum initial base assessment rate applicable to Risk Category I (for rates applicable to a domestic deposit assessment base). The first year in which rates applicable to Risk Category I spanned a range (as opposed to being a single rate) was 2007, when initial assessment rates ranged between 5 and 7 basis points. During that year, weighted average annualized industry assessment rates for the first three quarters varied between 5.41 and 5.44 basis points. (By the end of 2007, deterioration in the industry became more marked and weighted average rates began increasing.) The difference between the minimum rate and the weighted average rate (approximately 0.4 basis points) is 20 percent of the 2 basis point difference between the then existing minimum and maximum rates. 20

percent of the 4 basis point difference between the current, domestic deposit minimum and maximum rates is 0.8 basis points. By analogy, in 2007 the current assessment schedule would have produced average assessment rates of about 12.8 basis points. Thus, to achieve, during prosperous times, approximately an 8.5 basis point average assessment rate, initial base rates would have to be set about 4 basis points lower than current initial base assessment rates (applied against the domestic deposit assessment base). This analysis underlay the rate schedule in the October NPR that was proposed to become effective when the reserve ratio reaches 1.15 percent. As of June 30, 2010, the rate schedule in Table 4 applied against the Dodd-Frank mandated assessment base would have produced approximately the same amount of revenue as the October NPR's proposed rate schedule applied against the domestic deposit assessment base.

and allowing for long-term, steady assessment rates.

5. Rate Schedule Once the Reserve Ratio Reaches 2.0 Percent

In lieu of dividends, and pursuant to the FDIC's authority to set assessments, the initial base and total base

assessment rates set forth in Table 5 below will come into effect without further action by the FDIC Board when the fund reserve ratio at the end of the prior assessment period meets or exceeds 2 percent, but is less than 2.5 percent.[42] These rates are identical to

those proposed in the Assessment Base NPR. The FDIC's Board will retain its authority to uniformly adjust the total base rate assessment schedule up or down without further rulemaking, but the adjustment cannot exceed 2 basis points.[43]

TABLE 5—INITIAL AND TOTAL BASE ASSESSMENT RATES *

[If the reserve ratio for prior assessment period is equal to or greater than 2 percent and less than 2.5 percent]

	Risk category I	Risk category II	Risk category III	Risk category IV	Large and highly complex institutions
Initial base assessment rate	2–6	10	17	28	2–28
Unsecured debt adjustment **	(3)–0	(5)–0	(5)–0	(5)–0	(5)–0
Brokered deposit adjustment	....	0–10	0–10	0–10	0–10
Total Base Assessment Rate	1–6	5–20	12–27	23–38	1–38

* Total base assessment rates do not include the depository institution debt adjustment.
** The unsecured debt adjustment could not exceed the lesser of 5 basis points or 50 percent of an insured depository institution's initial base assessment rate; thus, for example, an insured depository institution with an initial assessment rate of 2 basis points will have a maximum unsecured debt adjustment of 1 basis point and could not have a total base assessment rate lower than 1 basis point.

The historical analysis discussed above revealed that, in lieu of dividends, reducing the 5.29 basis point weighted average assessment rate by 25 percent when the reserve ratio reached 2 percent allowed the fund to remain positive during prior banking crises and successfully limited rate volatility. The assessment rates in Table 5 should produce a weighted average assessment rate approximately 25 percent lower

than the assessment rates in Table 4 during periods of industry prosperity.[44]

6. Rate Schedule Once the Reserve Ratio Reaches 2.5 Percent

Also in lieu of dividends, and pursuant to the FDIC's authority to set assessments, the initial base and total base assessment rates set forth in Table 6 below will come into effect without further action by the FDIC Board when

the fund reserve ratio at the end of the prior assessment period meets or exceeds 2.5 percent.[45] These rates are identical to those proposed in the Assessment Base NPR. The FDIC's Board will retain its authority to uniformly adjust the total base rate assessment schedule up or down without further rulemaking, but the adjustment cannot exceed 2 basis points.[46]

TABLE 6—INITIAL AND TOTAL BASE ASSESSMENT RATES *

[If the reserve ratio for the prior assessment period is equal to or greater than 2.5 percent]

	Risk category I	Risk category II	Risk category III	Risk category IV	Large and highly complex institutions
Initial base assessment rate	1–5	9	15	25	1–25
Unsecured debt adjustment **	(2.5)–0	(4.5)–0	(5)–0	(5)–0	(5)–0
Brokered deposit adjustment	....	0–10	0–10	0–10	0–10
Total Base Assessment Rate	0.5–5	4.5–19	10–25	20–35	0.5–35

* Total base assessment rates do not include the depository institution debt adjustment.
** The unsecured debt adjustment could not exceed the lesser of 5 basis points or 50 percent of an insured depository institution's initial base assessment rate; thus, for example, an insured depository institution with an initial assessment rate of 1 basis point will have a maximum unsecured debt adjustment of 0.5 basis points and could not have a total base assessment rate lower than 0.5 basis points.

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[42] New institutions will remain subject to the assessment schedule in Table 4 when the reserve ratio reaches 2 percent. Subject to exceptions, a new insured depository institution is a bank or savings association that has been federally insured for less than five years as of the last day of any quarter for which it is being assessed. 12 CFR 327.8(j).

[43] However, the lowest total base assessment rate cannot be negative.

[44] The FDIC arrived at the rate schedule in Table 5 as follows. As described in an earlier footnote, based on the FDIC's analysis of weighted average assessment rates paid immediately prior to the current crisis (when the industry was relatively prosperous, and had both good CAMELS ratings

and substantial capital), weighted average rates during times of industry prosperity tend to be somewhat less than 1 basis point greater than the minimum initial base assessment rate applicable to Risk Category I (for rates applicable to a domestic deposit assessment base). Given this relationship, as described in an earlier footnote, the FDIC determined that the rate schedule that would have been needed during prosperous times to achieve approximately an 8.5 basis point average assessment rate would have had a minimum initial base assessment rate of 8 basis points. Similarly, the assessment rate schedule that, when applied to the domestic deposit assessment base would reduce the weighted average assessment rate by approximately 25 percent, would have had a minimum initial base

assessment rate of 6 basis points (Table 4 in the October NPR). The FDIC then determined the relative diminution in assessment revenue that would have occurred using Table 4, rather than current assessment rates, applied against the domestic deposit assessment base as of June 30, 2010. Applying the rates in Table 5 rather than those in Table 4 against the Dodd-Frank assessment base as of June 30, 2010, would have produced a similar relative diminution in assessment revenue.

[45] New institutions will remain subject to the assessment schedule in Table 4 when the reserve ratio reaches 2.5 percent.

[46] However, the lowest initial base assessment rate cannot be negative.

The historical analysis discussed above revealed that, in lieu of dividends, further reducing the 5.29 basis point weighted average assessment rate by 25 percent when the reserve ratio reached 2 percent and by 50 percent when the reserve ratio reached 2.5 percent allowed the fund to remain positive during prior banking crises and successfully limited rate volatility. The assessment rates in Table 6 should produce a weighted average assessment rate approximately 50 percent lower than the assessment rates in Table 4 during periods of industry prosperity.[47]

7. Analysis of Statutory Factors for Future Rate Schedules

The FDIC Board took into account the required statutory factors when adopting the rate schedules that will take effect when the reserve ratio reaches 1.15 percent, 2 percent and 2.5 percent.[48] These rate schedules were based on the historical analysis in the October NPR and the updated historical analysis in the DRR final rule. These analyses took into account fund operating expenses, resolution expenses and income over many decades to determine assessment rates that would keep the fund positive and assessment rates stable even during crises like those that have occurred within the past 30 years.

As the FDIC stated in the October NPR, it anticipates that when the reserve ratio exceeds 1.15 percent, and particularly when it exceeds 2 or 2.5 percent, the industry is likely to be prosperous. Consequently, to determine the effect on earnings and capital of lowering rates (once the reserve ratio thresholds are met) after taking into account the new assessment base, the FDIC examined the effect of the lower rates on the industry at the end of 2006, when the industry was prosperous. Under that scenario, reducing assessment rates when the reserve ratio reaches 1.15 percent would have increased average after-tax income by 1.25 percent and average capital by 0.14 percent. Reducing assessment rates when the reserve ratio reaches 2 percent would have further increased average after-tax income by 0.62 percent and average capital by 0.07 percent. Similarly, reducing assessment rates when the reserve ratio reaches 2.5 percent would have further increased average after-tax income by 0.61 percent and average capital by 0.07 percent. Decreasing assessment rates as provided in the final rule would not negatively affect the capital or earnings of any insured depository institution.

8. Comments on Future Rate Schedules

Commenters generally favored the establishment of a long-term, steady, predictable rate schedule that does not fluctuate with economic and credit cycles. One trade group stated that "[t]he more consistent and steady the premiums can be, the better bankers are able to plan and continue their work in their local communities." The FDIC agrees that setting this long-term rate schedule now will bring more stability and transparency to the deposit insurance system.

However, an industry trade group argued that, by maintaining the 4 basis point difference between minimum and maximum Risk Category I initial base assessment rates and applying these rates to a larger assessment base, the proposed assessment rates would effectively widen the assessment spread within Risk Category I. The trade group recommended that the spread be reduced when the FDIC lowers the overall assessment schedule in the future. The FDIC is not convinced. In the FDIC's view, risk differentiation becomes more important during times of banking prosperity, particularly when an expansion continues for a long period. During these periods, insured depository institutions are lending more and taking on more risk and greater risk differentiation allows this risk to be captured.

One trade group argued that these assessment rates would cause the reserve ratio to increase from 1.15 percent to 2 percent within 3 years and were therefore too high. The FDIC disagrees. The FDIC projects that it will take about 9 years for the fund to grow from 1.15 percent to 2 percent, assuming very low fund losses (the average loss rate from 1995 to 2004, a period of very low fund losses) and forward interest rates as of the date the projection was made.[49]

This trade group also stated that the rate reductions at 2 and 2.5 percent do not effectively restrict the growth of the insurance fund and instead create an "effective floor" for the fund. The trade group also argued that the FDIC's analysis ignored the large amount of interest income that would be generated by a fund with a reserve ratio of 2 percent, and that this would be particularly significant during periods of stability and low losses to the fund.

As described in the section on dividends above, the FDIC believes the rate decreases do effectively limit the growth of the insurance fund while preventing the moral hazard that would occur if institutions paid no assessments at all. Furthermore, the FDIC's analysis reveals that it would require very low losses over many years for the fund to reach 2.5 percent. Given the experience of the past 30 years, the FDIC considers it unlikely that the fund would experience such a prolonged period of low losses. Moreover, in the FDIC's 75 year history, the fund reserve ratio has never reached 2 percent.[50]

Moreover, the FDIC's analysis did not ignore interest income. The analysis simulated fund growth by combining assessment income and investment income earned based on historical interest rates. The analysis covered periods of stability and low losses as well as crisis periods accompanied by high losses. It covered periods of high interest rates as well as low rates. The simulated fund also covered an extended period during which the fund reached or exceeded a reserve ratio of 2 percent. This period was not

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[47] The FDIC arrived at the rate schedule in Table 6 as follows. As described in an earlier footnote, based on the FDIC's analysis of weighted average assessment rates paid immediately prior to the current crisis (when the industry was relatively prosperous, and had both good CAMELS ratings and substantial capital), weighted average rates during times of industry prosperity tend to be somewhat less than 1 basis point greater than the minimum initial base assessment rate applicable to Risk Category I (for rates applicable to a domestic deposit assessment base). Given this relationship, as described in an earlier footnote, the FDIC determined that the rate schedule that would have been needed during prosperous times to achieve approximately an 8.5 basis point average assessment rate would have had a minimum initial base assessment rate of 8 basis points. Similarly, the assessment rate schedule that, when applied to the domestic deposit assessment base would reduce the weighted average assessment rate by approximately 50 percent, would have had a minimum initial base assessment rate of 4 basis points (Table 5 in the October NPR). The FDIC then determined the relative diminution in assessment revenue that would have occurred using Table 5, rather than current assessment rates, applied against the domestic deposit assessment base as of June 30, 2010. Applying the rates in Table 6 rather than those in Table 4 against the Dodd-Frank assessment base as of June 30, 2010, would have produced a similar relative diminution in assessment revenue.

[48] As noted earlier, in setting assessment rates, the FDIC's Board of Directors is authorized to set assessments for insured depository institutions in such amounts as the Board of Directors may determine to be necessary. 12 U.S.C. 1817(b)(2)(A). In so doing, the Board must consider certain statutorily defined factors. 12 U.S.C. 1817(b)(2)(B). As reflected in the text, the FDIC has taken into account all of these statutory factors.

[49] Using forward interest rates as of December 3, 2010, when forward rates were slightly higher than those used in the original projection, the FDIC still projects that it will take 8 years for the fund to grow from 1.15 percent to 2 percent.

[50] In addition, the rule does not create an effective floor above 2 percent. In the analysis, when the reserve ratio fell below 2 percent, rates did not need to rise above the necessary long-term assessment rate to keep the fund from becoming negative. Instead, rates could be held constant at the long-term assessment rate in keeping with the goal of reducing pro-cyclicality.

accompanied by rapid fund growth, and fund growth was limited by assessment rate reductions. Had fund growth not been interrupted by periods of high losses during the 60-year period, the fund might gradually have reached a much larger size, but, historically, unbroken periods of stability are not the norm—rather they are interrupted by periods of high losses when the fund's growth decreases significantly.

VI. The Final Rule: Risk-Based Assessment System for Large Insured Depository Institutions

A. Overview of the Large Bank Risk-Based Assessment System

The final rule amends the assessment system applicable to large insured depository institutions to better capture risk at the time the institution assumes the risk, to better differentiate risk among large insured depository institutions during periods of good economic and banking conditions based on how they would fare during periods of stress or economic downturns, and to better take into account the losses that the FDIC may incur if a large insured depository institution fails. Except where noted, the final rule adopts the proposals in the Large Bank NPR.

The final rule eliminates risk categories and the use of long-term debt issuer ratings for calculating risk-based

assessments for large institutions.[51] Instead, assessment rates will be calculated using a scorecard that combines CAMELS ratings and certain forward-looking financial measures to assess the risk a large institution poses to the DIF. One scorecard will apply to most large institutions and another to institutions that are structurally and operationally complex or that pose unique challenges and risk in the case of failure (highly complex institutions).[52]

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[51] Dodd-Frank requires all federal agencies to review and modify regulations to remove reliance upon credit ratings and substitute an alternative standard of creditworthiness. Public Law 111–203, § 939A, 124 Stat. 1376, 1886 (15 U.S.C. 78o–7 note).

[52] A "highly complex institution" is defined as: (1) An IDI (excluding a credit card bank) that has had $50 billion or more in total assets for at least four consecutive quarters that either is controlled by a U.S. parent holding company that had $500 billion or more in total assets for four consecutive quarters, or is controlled by one or more intermediate U.S. parent holding companies that are controlled by a U.S. holding company that has had $500 billion or more in assets for four consecutive quarters, and (2) a processing bank or trust company. A processing bank or trust company is an insured depository institution whose last three years' non-lending interest income, fiduciary revenues, and investment banking fees, combined, exceed 50 percent of total revenues (and its last three years fiduciary revenues are non-zero), whose total fiduciary assets total $500 billion or more and whose total assets for at least four consecutive quarters have been $10 billion or more. The final rule clarifies that only U.S. holding companies come within the definition of highly complex

The scorecards use quantitative measures that are readily available and useful in predicting a large institution's long-term performance.[53] These measures are meant to differentiate risk based on how large institutions would fare during periods of economic stress. Experience during the recent crisis shows that periods of stress reveal risks that remained hidden during periods of prosperity. As discussed in the Large Bank NPR and shown in Chart 3, over the 2005 to 2008 period, the new measures were useful in predicting performance of large institutions in 2009.

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institution. Control has the same meaning as in section 3(w)(5) of the FDI Act. See 12 USC 1813(w)(5)(2001). A credit card bank is defined as a bank for which credit card plus securitized receivables exceed 50 percent of assets plus securitized receivables. The final rule makes a technical change to the definition of a highly complex institution to avoid including certain non-complex institutions by requiring, among other things, that for an institution to be defined as a processing bank or trust company (one type of highly complex institution), it must have total fiduciary assets total $500 billion or more.

[53] Most of the data are publicly available, but data elements to compute four scorecard measures— higher-risk assets, top 20 counterparty exposures, the largest counterparty exposure, and criticized/classified items—are not. The FDIC proposes that insured depository institutions provide these data elements in the Consolidated Reports of Condition and Income (Call Report) or the Thrift Financial Report (TFR) beginning with the second quarter of 2011.

Chart 3

Various Measures' Ability to Predict Current Expert Judgment Risk Ranking[54,55]

Percentage Approximated by Factors (Adjusted R-Square)
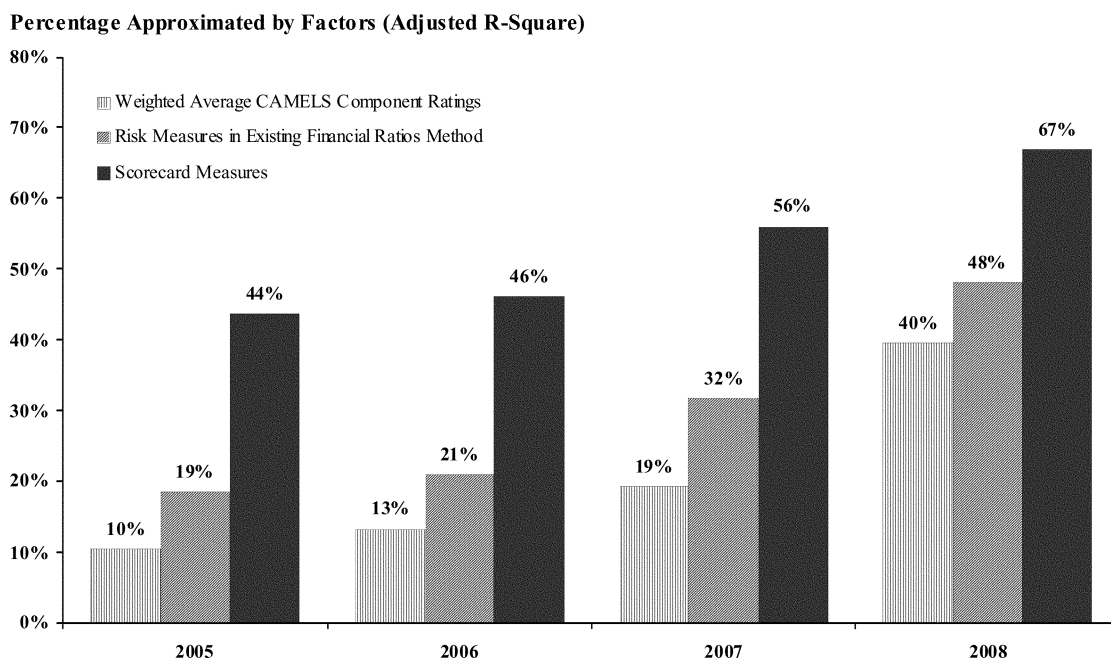
B. Scorecard for Large Insured Depository Institutions (Other Than Highly Complex Insured Depository Institutions)

The scorecard for large institutions (other than highly complex institutions) produces two scores—a performance score and a loss severity score—that are combined and converted to an initial base assessment rate.

The performance score measures a large institution's financial performance and its ability to withstand stress. To arrive at a performance score, the scorecard combines a weighted average of CAMELS component ratings and certain financial measures into a single performance score between 0 and 100.

The loss severity score measures the relative magnitude of potential losses to the FDIC in the event of a large institution's failure. The scorecard converts a loss severity measure into a loss severity score between 0 and 100. The loss severity score is converted into

a loss severity factor that ranges between 0.8 and 1.2.

Multiplying the performance score by the loss severity factor produces a combined score (total score) that can be up to 20 percent higher or lower than the performance score. Any score less than 30 will be set at 30; any score greater than 90 will be set at 90. As discussed below, the FDIC will have a limited ability to alter a large institution's total score based on quantitative or qualitative measures not captured in the scorecard. The resulting total score after adjustment cannot be less than 30 or more than 90. The total score is converted to an initial base assessment rate.

Table 7 shows scorecard measures and components, and their relative contribution to the performance score or loss severity score. Scorecard measures (other than the weighted average CAMELS rating) are converted to scores between 0 and 100 based on minimum and maximum cutoff values for each

measure. A score of 100 reflects the highest risk and a score of 0 reflects the lowest risk. A value reflecting lower risk than the cutoff value receives a score of 0. A value reflecting higher risk than the cutoff value receives a score of 100. A risk measure value between the minimum and maximum cutoff values converts linearly to a score between 0 and 100, which is rounded to 3 decimal points. The weighted average CAMELS rating is converted to a score between 25 and 100 where 100 reflects the highest risk and 25 reflects the lowest risk.

Most of the minimum and maximum cutoff values are equal to the 10th and 90th percentile values for each measure, which are derived using data on large institutions over a ten-year period beginning with the first quarter of 2000 through the fourth quarter of 2009—a period that includes both good and bad economic times.[56][57]

Appendix B describes how each scorecard measure is converted to a score.

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[54] The rank ordering of risk for large institutions as of the end of 2009 (based on a consensus view of staff analysts) is largely based on the information available through the FDIC's Large Insured Depository Institution (LIDI) program. Large institutions that failed or received significant government support over the period are assigned the worst risk ranking and are included in the statistical analysis. Appendix 1 to the NPR describes the statistical analysis.

[55] The percentage approximated by factors is based on the statistical model for that particular year. Actual weights assigned to each scorecard measure are largely based on the average coefficients for 2005 to 2008, and do not equal the weight implied by the coefficient for that particular year (See Appendix 1 to the NPR).

[56] Appendix 2 shows selected percentile values of each scorecard measure over this period. The

detailed results of the statistical analysis used to select risk measures and the weights are also provided. An online calculator is available on the FDIC's Web site to allow institutions to determine how their assessment rates will be calculated under this final rule.

[57] Some cutoff values have been updated since the Large Bank NPR to reflect data updates.

TABLE 7—SCORECARD FOR LARGE INSTITUTIONS

	Scorecard measures and components	Measure weights (percent)	Component weights (percent)
P	Performance Score	....	....
P.1	Weighted Average CAMELS Rating	100	30
P.2	Ability to Withstand Asset-Related Stress	....	50
	Tier 1 Leverage Ratio	10	....
	Concentration Measure	35	....
	Core Earnings/Average Quarter-End Total Assets *	20	....
	Credit Quality Measure	35	....
P.3	Ability to Withstand Funding-Related Stress	....	20
	Core Deposits/Total Liabilities	60	....
....	Balance Sheet Liquidity Ratio	40	....
L	Loss Severity Score	....	....
L.1	Loss Severity Measure	....	100

* Average of five quarter-end total assets (most recent and four prior quarters).

1. Performance Score

The performance score for large institutions is a weighted average of the scores for three components: (1) Weighted average CAMELS rating score; (2) ability to withstand asset-related stress score; and (3) ability to withstand funding-related stress score. Table 7 shows the weight given to the score for each of these components.

a. Weighted Average CAMELS Rating Score

To compute the weighted average CAMELS rating score, a weighted average of the large institution's CAMELS component ratings is first calculated using the weights shown in Table 8. These weights are the same as the weights used in the financial ratios method, which is currently used to determine assessment rates for all insured depository institutions in Risk Category I.[58]

TABLE 8—WEIGHTS FOR CAMELS COMPONENT RATINGS

CAMELS component	Weight (percent)
C	25
A	20
M	25
E	10
L	10
S	10

A weighted average CAMELS rating converts to a score that ranges from 25 to 100. A weighted average rating of 1 equals a score of 25 and a weighted average of 3.5 or greater equals a score of 100. Weighted average CAMELS ratings between 1 and 3.5 are assigned a score between 25 and 100. The score increases at an increasing rate as the weighted average CAMELS rating increases. Appendix B describes how the FDIC converts a weighted average CAMELS rating to a score.

b. Ability To Withstand Asset-Related Stress Score

The score for the ability to withstand asset-related stress is a weighted average of the scores for the four measures that the FDIC finds most relevant to assessing a large institution's ability to withstand such stress; they are:
• Tier 1 leverage ratio;
• Concentration measure (the greater of the higher-risk assets to the sum of Tier 1 capital and reserves score or the growth-adjusted portfolio concentrations score);
• The ratio of core earnings to average quarter-end total assets; and
• Credit quality measure (the greater of the criticized and classified items to the sum of Tier 1 capital and reserves score or the underperforming assets to the sum of Tier 1 capital and reserves score).
In general, these measures proved to be the most statistically significant

measures of a large institution's ability to withstand asset-related stress, as described in Appendix 2. Appendix A describes these measures.

The method for calculating the scores for the Tier 1 leverage ratio and the ratio of core earnings to average quarter-end total assets is described in Appendix B.

The score for the concentration measure is the greater of the higher-risk assets to Tier 1 capital and reserves score or the growth-adjusted portfolio concentrations score.[59] Appendix B describes the conversion of these ratios to scores. Appendix C describes the ratios.

The score for the credit quality measure is the greater of the criticized and classified items to Tier 1 capital and reserves score or the underperforming assets to Tier 1 capital and reserves score.[60] Appendix B describes conversion of the credit quality measure into a credit quality score.

Table 9 shows the ability to withstand asset related stress measures, gives the cutoff values for each measure and shows the weight assigned to the measure to derive a score. Appendix B describes how each of the risk measures is converted to a score between 0 and 100 based upon the minimum and maximum cutoff values.[61]

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[58] 12 CFR part 327, Subpt. A, App. A (2010).

[59] The ratio of higher-risk assets to Tier 1 capital and reserves gauges concentrations that are currently deemed to be high risk. The growth-adjusted portfolio concentration measure does not solely consider high-risk portfolios, but considers most loan portfolio concentrations, along with growth of the concentration.

[60] The criticized and classified items ratio measures commercial credit quality while the underperforming assets ratio is often a better indicator for consumer portfolios.

[61] Most of the minimum and maximum cutoff values for each risk measure equal the 10th and 90th percentile values of the measure among large institutions based upon data from the period between the first quarter of 2000 and the fourth quarter of 2009. The 10th and 90th percentiles are not used for the higher-risk assets to Tier 1 capital and reserves ratio and the criticized and classified items ratio due to data availability. Data on the higher-risk assets to Tier 1 capital and reserves ratio are available consistently since second quarter 2008, while criticized and classified items are

available consistently since first quarter 2007. The maximum cut off value for the higher-risk assets to Tier 1 capital and reserves measure is close to but does not equal the 75th percentile. The maximum cutoff value for the criticized and classified items ratio is close to but does not equal the 80th percentile value. These alternative cutoff values are based on recent experience since earlier data is unavailable. Appendix 2 includes information regarding the percentile values for each risk measure.

TABLE 9—CUTOFF VALUES AND WEIGHTS FOR MEASURES TO CALCULATE ABILITY TO WITHSTAND ASSET-RELATED STRESS SCORE

Measures of the ability to withstand asset-related stress	Cutoff values		Weights (percent)
	Minimum (percent)	Maximum (percent)	
Tier 1 Leverage Ratio	6	13	10
Concentration Measure			35
Higher-Risk Assets to Tier 1 Capital and Reserves; or	0	135	
Growth-Adjusted Portfolio Concentrations	4	56	
Core Earnings/Average Quarter-End Total Assets*	0	2	20
Credit Quality Measure			35
Criticized and Classified Items/Tier 1 Capital and Reserves; or	7	100	
Underperforming Assets/Tier 1 Capital and Reserves	2	35	

*Average of five quarter-end total assets (most recent and four prior quarters).

The score for each measure is multiplied by its respective weight and the resulting weighted score is summed to arrive at a score for an ability to withstand asset-related stress, which can range from 0 to 100.

Table 10 illustrates how the score for the ability to withstand asset-related stress is calculated for a hypothetical bank, Bank A.

TABLE 10—CALCULATION OF BANK A'S ABILITY TO WITHSTAND ASSET-RELATED STRESS SCORE

Measures of the ability to withstand asset-related stress	Value (percent)	Score*	Weight (percent)	Weighted score
Tier 1 Leverage Ratio	6.98	86.00	10	8.60
Concentration Measure		100.00	35	35.00
Higher Risk Assets/Tier 1 Capital and Reserves; or	162.00	100.00		
Growth-Adjusted Portfolio Concentrations	43.62	76.19		
Core Earnings/Average Quarter-End Total Assets	0.67	66.50	20	13.30
Credit Quality Measure		100.00	35	35.00
Criticized and Classified Items/Tier 1 Capital and Reserves; or	114.00	100.00		
Underperforming Assets/Tier 1 Capital and Reserves	34.25	97.73		
Total ability to withstand asset-related stress score				91.90

*In the example, scores are rounded to two decimal points for Bank A. In actuality, scores will be rounded to three decimal places.

Bank A's higher risk assets to Tier 1 capital and reserves score (100.00) is higher than its growth-adjusted portfolio concentration score (76.19). Thus, the higher risk assets to Tier 1 capital and reserves score is multiplied by the 35 percent weight to get a weighted score of 35.00 and the growth-adjusted portfolio concentrations score is ignored. Similarly, Bank A's criticized and classified items to Tier 1 capital and reserves score (100.00) is higher than its underperforming assets to Tier 1 capital and reserves score (97.73). Therefore, the criticized and classified items to Tier 1 capital and reserves score is multiplied by the 35 percent weight to get a weighted score of 35.00 and the underperforming assets to Tier 1 capital and reserves score is ignored. These weighted scores, along with the weighted scores for the Tier 1 leverage ratio (8.60) and core earnings to average quarter-end total assets ratio (13.30), are added together, resulting in the ability to withstand asset-related stress score of 91.90.

c. Comments on Ability To Withstand Asset-Related Stress

The FDIC received a number of comments that relate to scorecard measures used to assess an institution's ability to withstand asset-related stress.

Criticized and Classified Items Ratio

The FDIC received several comments suggesting that the FDIC discount or exclude certain items, such as purchased credit impaired (PCI) loans or performing restructured loans, from the definition of criticized and classified items, since these items do not result in the same degree of loss as other, typical, classified and criticized items.

The FDIC acknowledges that losses associated with various items included in criticized and classified items may vary, depending on collateral, the degree of previous loss recognition and other factors. However, relying on greater detail on these types of assets would increase, not decrease, the complexity of the model and would require additional data elements to be collected from institutions. The FDIC believes that the added complexity and burden of collecting more detailed data outweighs the additional benefit, but, relying upon data obtained through the examination process, will consider the idiosyncratic and qualitative factors that may influence potential losses associated with various criticized and classified items in determining whether to apply a large bank adjustment (discussed below).

One commenter cautioned against potential inconsistencies in reported criticized and classified items, particularly when examination classifications differ from an institution's internal classifications. For the purpose of the large bank scorecard, criticized and classified items are defined as those items that the institution has internally identified as Special Mention, Substandard, Doubtful, or Loss on its own management reports or items identified as Special Mention or worse by an institution's primary federal regulator.

Appendix A of the final rule describes the definition.

Growth-Adjusted Portfolio Concentrations Ratio

Several commenters stated that the growth-adjusted portfolio concentrations ratio unfairly captures growth attributed to the Statement of Financial Accounting Standards No. 166, Accounting for Transfers of Financial Assets, an Amendment of FASB Statement No. 140, and Statement of Financial Accounting Standards No. 167, Amendments to FASB Interpretation No. 46(R), which are one-time accounting adjustments (FAS 166/167).

FDIC analysis shows that asset growth associated with FAS 166/167 guidelines has a one-time effect on only a small number of institutions. Weighing the benefit of collecting additional information on the effect of FAS 166/167 against the added complexity and associated data collection burden, the FDIC has concluded that it would be better to consider the effect of FAS 166/167 as it determines whether to apply a large bank adjustment.

Higher-Risk Assets Ratio

A number of commenters stated that certain elements of the higher-risk assets ratio contain data items that are not Call Report items and could lead to inconsistent reporting among banks. As proposed in the Large Bank NPR, the FDIC will collect all data elements, other than CAMELS ratings, directly from institutions through the Call Reports and TFRs. These measures are defined in Appendix A.

The FDIC also received a number of comments suggesting changes in the definition of leveraged lending, subprime loans and nontraditional mortgages, which are used in the higher-risk assets ratio. These comments are discussed below.

Leveraged Lending

Several commenters asked for a change in the definition of leveraged lending to exclude small business loans, real estate loans or loans for buyout, acquisition, and recapitalization that do not otherwise meet the definition of leveraged lending. Commenters also cautioned against using specific "bright line" financial metrics to determine whether a loan is leveraged. In addition, commenters stated that regular updating of loan data for the purposes of identifying leveraged loans is burdensome and costly.

The FDIC agrees that several of these comments have merit. For the purpose of this rule, leveraged loans exclude all real estate loans and those small business loans with an original amount of $1 million or less.[62] The FDIC believes that some bright-line metrics are necessary to ensure consistency in reporting among institutions; however, the final rule removes the total liabilities to asset ratio test from the definition of leveraged loans.[63] Any other commercial loan or security, regardless of the stated purpose, will be considered leveraged only if it meets one of the two remaining criteria described in Appendix C.

Subprime Loans

Several commenters asked that the definition of a subprime loan be revised to comport with the 2001 Interagency Guidance and to exclude loans that have deteriorated subsequent to origination, citing the burden and cost associated with regular updating of borrower information.[64] One commenter argued against referencing the FICO score in defining subprime loans, stating that the rule should not endorse a specific brand. A couple of commenters cautioned about potential inconsistencies among institutions in identifying subprime loans.

To reduce any potential burden, the final rule defines subprime loans as those that meet the criteria for being subprime at origination or refinancing. The definition in the final rule deletes the reference to FICO and other credit bureau scores. While the FDIC is aware that originators often use credit scores in the loan underwriting process, the FDIC has decided not to use a credit score threshold as a potential characteristic of a subprime borrower. Such a definition would require reliance on credit scoring models that are controlled by credit rating bureaus; thus, the models may change materially at the discretion of the credit rating bureaus. There also may be inconsistencies among the various models that the credit rating bureaus use. Research has consistently found that borrower credit history is among the most important predictors of default.[65] The final rule focuses on credit history as a characteristic of a subprime borrower, but, to avoid underreporting of subprime loans, the definition now includes loans that an institution itself identifies as subprime based upon similar borrower characteristics. Appendix A describes the definition.

Nontraditional Mortgages

A number of commenters argued that interest-only loans should not be included in the definition of non-traditional mortgages for the higher risk concentration measure, given that the risk they pose differs from other non-traditional mortgages. The FDIC disagrees. The FDIC believes that interest-only loans generally exhibit higher risk than traditional amortizing mortgage loans, particularly in a stressful economic environment. The FDIC understands that qualitative factors such as credit underwriting or credit administration are important in determining potential losses associated with interest-only loans; however, these factors can influence potential losses for any type of loan and, in addition, are not easily measurable systematically. The FDIC will consider these qualitative factors in determining whether to apply a large bank adjustment.

One comment asked for a specific definition of a teaser rate mortgage. For the purpose of the final rule, a teaser-rate mortgage is a mortgage with a discounted initial rate and lower payments for part of the mortgage term.

Averaging the Credit Quality and Concentration Scores

A number of commenters suggested that the FDIC should average the two concentration scores and the two credit quality scores, rather than using the greater of the two scores in each case. The FDIC disagrees. The two credit quality ratios capture credit risk in different ways: the criticized and classified items ratio is more relevant for the performance of an institution's commercial portfolio; the underperforming asset ratio is more relevant for the performance of an institution's retail portfolio. Depending on an institution's asset composition, one measure may better capture the institution's credit quality than another. Therefore, averaging the two scores could understate credit quality concerns.

Similarly, the two concentration ratios are designed to capture different concentration risk. The high-risk asset concentration ratio captures the risk associated with concentrated lending in high-risk areas that directly contributed to the failure of a number of large

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[62] The original amount is defined in Appendix C.

[63] The remaining tests for determining whether a loan is leveraged are consistent with the Office of the Comptroller of the Currency's Handbook, *http://www.occ.gov/static/publications/handbook/ LeveragedLending.pdf.*

[64] FDIC Press Release PR–9–2001 01–31–2001, *http://www.fdic.gov/news/news/press/2001/ pr0901a.html.*

[65] *See, e.g.,* Board of Governors of the Federal Reserve System, *Report to the Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit,* August 2007, *http://www. federalreserve.gov/boarddocs/rptcongress/ creditscore/creditscore.pdf.*

institutions during the recent economic downturn. The FDIC recognizes, however, that other types of concentrations may lead to failure in the future, particularly if the concentrations are accompanied by rapid growth, which is what the growth-adjusted portfolio concentration ratio is designed to measure. Recent experience shows that many institutions that subsequently experienced problems eased underwriting standards and expanded beyond their traditional areas of expertise to grow rapidly. Since these two concentration ratios are designed to capture different types of concentration

risk, averaging the two scores could reduce the scorecard's ability to differentiate risk.

d. Ability To Withstand Funding-Related Stress Score

The ability to withstand funding-related stress component contains two measures that are most relevant to assessing a large institution's ability to withstand such stress—a core deposits to total liabilities ratio and a balance sheet liquidity ratio, which measures the amount of highly liquid assets needed to cover potential cash outflows in the event of stress.[66][67] These ratios

are significant in predicting a large institution's long-term performance in the statistical test described in Appendix 2. Appendix A describes these risk measures. Appendix B describes how each of these measures is converted to a score between 0 and 100.

The score for the ability to withstand funding-related stress is the weighted average of the scores for two measures. Table 11 shows the cutoff values and weights for these measures. Weights assigned to each of these two risk measures are based on a statistical analysis described in Appendix 2.

TABLE 11—CUTOFF VALUES AND WEIGHTS TO CALCULATE ABILITY TO WITHSTAND FUNDING-RELATED STRESS SCORE

Measures of the ability to withstand funding-related stress	Cutoff values		Weight (percent)
	Minimum (percent)	Maximum (percent)	
Core Deposits/Total Liabilities	5	87	60
Balance Sheet Liquidity Ratio	7	243	40

Table 12 illustrates how the score for the ability to withstand funding-related

stress for hypothetical bank, Bank A, is calculated.

TABLE 12—CALCULATION OF BANK A'S SCORE FOR ABILITY TO WITHSTAND FUNDING-RELATED STRESS

Measures of the ability to withstand funding-related stress	Value (percent)	Score*	Weight (percent)	Weighted score
Core Deposits/Total Liabilities	60.25	32.62	60	19.57
Balance Sheet Liquidity Ratio	69.58	73.48	40	29.39
Total ability to withstand funding-related stress score	....	....	....	48.96

*In the example, scores are rounded to two decimal points for Bank A. In actuality, scores will be rounded to three decimal places.

e. Comments on the Ability To Withstand Funding-Related Stress

Definition of Core Deposits and Brokered Deposits

Several commenters stated that the definitions for core deposits and brokered deposits as used in the core deposits to total liabilities ratio are outdated and should be revised. These commenters stated that reciprocal deposits, affiliated broker-dealer sweeps and long-term brokered deposits are stable deposits, and therefore, should be included in the definition of core deposits. In the final rule, for this purpose, core deposits exclude all brokered deposits. However, as mentioned in Section III, Dodd-Frank mandated that the FDIC conduct a study to evaluate the existing brokered deposit and core deposit definitions. The FDIC

will examine the definition in light of the completed study and will consider changes then, if appropriate.

Balance Sheet Liquidity Ratio

Several commenters argued that unencumbered agency mortgage-backed securities (MBSs) should be included as liquid assets in calculating the balance sheet liquidity ratio, arguing that they are a reliable source of liquidity. These commenters also pointed to the Basel liquidity measures, which include unencumbered agency MBSs as highly liquid assets, with appropriate haircuts.

The FDIC believes that an institution's ability to withstand funding-related stress can be best measured by highly liquid assets that can be readily converted to cash with little or no loss in value, relative to potential short-term funding outflows. While agency MBSs

are generally liquid, they are not as highly liquid as other assets included as liquid assets in the definition of balance sheet liquidity ratio, particularly given the greater interest rate risk inherent in these securities.

One commenter noted that deposits owned by a parent should not be subjected to the same runoff rates as other deposits for the purpose of the balance sheet liquidity ratio, given that these deposits behave similarly to long-term unsecured debt. The same comment was made in the context of loss severity. The FDIC disagrees. Parent companies, as well as other creditors, can have incentives to withdraw deposits from a troubled institution. Deposits are not equivalent to long-term unsecured debt.

[66] The final rule clarifies that all securities included in the definition of liquid assets are measured at fair value.

[67] The deposit runoff assumptions proposed in the Large Bank NPR were based on the Basel liquidity measure. The final rule modified deposit runoff rates for the balance sheet liquidity ratio to reflect changes issued by the Basel Committee on

Banking Supervision in its December 2010 document, "Basel III: International framework for liquidity risk measurement, standards and monitoring," *http://www.bis.org/publ/bcbs188.pdf.*

Calculation of Performance Score

The scores for the weighted average CAMELS rating, the ability to withstand asset-related stress component, and the ability to withstand funding-related stress component are multiplied by their respective weights and the results are summed to arrive at the performance score. The performance score cannot be less than 0 or more than 100, where a score of 0 reflects the lowest risk and a score of 100 reflects the higher risk. In the example in Table 13, Bank A's performance score would be 70.92, assuming that Bank A's score for its weighted average CAMELS score of 50.60, which results from a weighted average CAMELS rating of 2.2.

TABLE 13—PERFORMANCE SCORE FOR BANK A

Performance score components	Weight (percent)	Score*	Weighted score
Weighted Average CAMELS Rating	30	50.60	15.18
Ability to Withstand Asset-Related Stress	50	91.90	45.95
Ability to Withstand Funding-Related Stress	20	48.96	9.79
Total Performance Score	....	....	70.92

*In the example, scores are rounded to two decimal points for Bank A. In actuality, scores will be rounded to three decimal places.

2. Loss Severity Score

The loss severity score is based on a loss severity measure that estimates the relative magnitude of potential losses to the FDIC in the event of a large institution's failure. The loss severity measure applies a standardized set of assumptions—based on recent failures—regarding liability runoffs and the recovery value of asset categories to calculate possible losses to the FDIC. (Appendix D describes the calculation of this measure.) Asset loss rate assumptions are based on estimates of recovery values for insured depository institutions that either failed or came close to failure. Run-off assumptions are based on the actual experience of insured depository institutions that either failed or came close to failure during the 2007 through 2009 period.

The loss severity measure is a quantitative measure that is derived from readily available data. Appendix A defines this measure. Appendix B describes how the loss severity measure is converted to a loss severity score between 0 and 100. Table 14 shows cutoff values for the loss severity measure. The loss severity score cannot be less than 0 or more than 100.

TABLE 14—CUTOFF VALUES TO CALCULATE LOSS SEVERITY SCORE

Measure of loss severity	Cutoff values	
	Minimum (percent)	Maximum (percent)
Loss Severity	0	28

In the example in Table 15, Bank A's loss severity measure is 23.62 percent, which represents potential losses in the event of Bank A's failure relative to its domestic deposits. This measure would result in a loss severity score of 84.36.

TABLE 15—LOSS SEVERITY SCORE FOR BANK A

Measure of loss severity	Ratio (percent)	Score*
Potential Losses/Total Domestic Deposits (Loss severity measure)	23.62	84.36

*In the example, the score is rounded to two decimal points for Bank A. In actuality, scores will be rounded to three decimal places.

3. Comments on Loss Severity Score

In general, commenters did not oppose including loss severity in the initial base assessment rate calculation. However, many commenters questioned the proposed assumptions regarding the loss rates applied to various asset types and regarding liability runoff rates, arguing that they were too harsh or lacked empirical support. These comments are discussed below.

a. Loss Rate Assumptions

Some commenters disagreed with the loss rates assigned to various asset categories and argued that:
• The FDIC should not discount asset values;
• Using the same loss rates for all institutions is not reasonable and the loan-to-value ratio should be considered in determining the loss rate;
• A zero loss rate should be applied to government-guaranteed loans;
• Loss rates applied to acquired loans booked at fair value are too high; and
• Asset categories (*e.g.,* leases, first-lien home equities, all other loans, all other assets) should be further subdivided to provide the less-risky assets within those categories a lower loss rate.

The FDIC disagrees with these comments. The current value of an institution's assets is not a good indicator of the recovery value of these assets in the event of failure. To estimate potential recovery values, the loss severity measure applies a standardized set of loss rates to various asset categories, based on independent valuations obtained by the FDIC in 2009 on assets expected to be taken into receivership.

The FDIC recognizes that collateral value, the loan-to-value ratio and the existence of a government guarantee may have a bearing on recovery rates; however, data on collateral value and other risk mitigants are not systematically available for all institutions. Also, government guarantees may or may not reduce the FDIC's risk of loss, depending on the agency issuing the guaranty and the transferability of the guaranty in the event of failure. In these cases, the FDIC will consider available information on collateral and other risk mitigants, including the materiality of guarantees, in determining whether to apply a large bank adjustment.

The FDIC does not believe the loss severity measure should systematically try to adjust for loans booked at fair value. Loans booked at fair value are typically not material for most institutions, and, even when they are, their recovery values in the event of failure are often well below current fair values.

The FDIC recognizes that the loss rates applied to broad categories of assets may overstate or understate potential losses, depending on the composition of those assets. However, the FDIC believes that further subdividing asset categories introduces greater complexity and is not practical without imposing undue burden.

b. Runoff Assumptions

A number of commenters stated that the proposed insured deposit growth assumption used in the loss severity measure is too high and unrealistic given the supervisory constraint that will restrict growth as an institution nears failure. The FDIC agrees. Runoff and growth assumptions for deposits proposed in the Large Bank NPR were based on the actual experience of eleven large institutions that failed between 2007 and 2009 over a two-year period leading up to their failure. The FDIC has re-estimated deposit runoffs based on data for all insured depository institutions that failed since 2007—including small institutions, which were added to improve the robustness of the analysis—over a one-year period leading up to their failure, and reduced the growth rate for insured deposits from 32 percent to 10 percent while increasing the run-off rate for uninsured deposits from 28.6 percent to 58 percent.[68] The changes are primarily due to shorter time-to-failure, not the inclusion of small institutions in the sample. The FDIC believes that data based on shorter time-to-failure (one year) better reflect changes in deposit composition experienced by failed institutions as they approach failure.

c. Foreign Deposits

Several commenters stated that runoff and ring-fencing assumptions applied to foreign deposits are excessive and unsupported. Foreign deposits are not insured by the FDIC and would be treated as unsecured claims in a receivership. Unsecured claims in a receivership rarely receive any payment since they have a lower priority than domestic deposits. The FDIC believes that these deposits were more stable during the recent crisis primarily because of extraordinary government action, both by the U.S. and European governments. In the absence of "too big to fail" perceptions or policies, the FDIC believes that foreign deposits are more likely to run off than domestic deposits. Moreover, foreign governments may ring-fence assets to protect these deposits and reduce their own losses. As a result, the final rule retains the Large Bank NPR's assumptions regarding foreign deposit runoff.

d. Noncore Funding

In the Large Bank NPR, the FDIC proposed including a noncore funding ratio in the loss severity scorecard as a potential proxy for franchise value. Most commenters stated that the noncore funding ratio should not be included because this risk is considered elsewhere. They also questioned the weight assigned to the measure. The FDIC continues to believe that potential franchise value is an important factor to consider in the overall assessment of loss severity. However, given that liability composition is explicitly considered in the loss severity measure, the final rule eliminates the noncore funding ratio from the loss severity scorecard. Instead, qualitative factors that affect an institution's franchise value will be considered in determining whether to apply a large bank adjustment.

e. Capital

One commenter stated that assuming capital will fall to 2 percent and that assets will be reduced pro rata is unreasonable. The FDIC disagrees. Path-to-failure assumptions are a necessary feature of a potential loss severity calculation, particularly for institutions that are not close to failure. Using assumptions regarding reductions in specific categories of assets introduces significant complexity. The FDIC believes that the pro rata assumption is both reasonable and practical. This may be an area, however, that lends itself to further research and analysis as the FDIC continues to pursue improvements to the risk-based assessment system.

C. Scorecard for Highly Complex Institutions

As mentioned above, those institutions that are structurally and operationally complex or that pose unique challenges and risks in case of failure have a different scorecard with measures tailored to the risks these institutions pose.

The structure and much of the scorecard for a highly complex institution are, however, similar to the scorecard for other large institutions. Like the scorecard for other large institutions, the scorecard for highly complex institutions contains a performance score and a loss severity score. Table 16 shows the measures and components and their relative contribution to a highly complex institution's performance score and loss severity score. As with the scorecard for large institutions, most of the minimum and maximum cutoff values for each scorecard measure used in the highly complex institution's scorecard equal the 10th and 90th percentile values of the particular measure among these institutions based upon data from the period between the first quarter of 2000 and the fourth quarter of 2009.[69]

TABLE 16—SCORECARD FOR HIGHLY COMPLEX INSTITUTIONS

	Measures and components	Measure weights (percent)	Component weights (percent)
P	Performance Score	....	....
P.1	Weighted Average CAMELS Rating	100	30
P.2	Ability to Withstand Asset-Related Stress	....	50
	Tier 1 Leverage Ratio	10	....
	Concentration Measure	35	....
	Core Earnings/Average Quarter-End Total Assets	20	....
	Credit Quality Measure and Market Risk Measure	35	....
P.3	Ability to Withstand Funding-Related Stress	....	20
	Core Deposits/Total Liabilities	50	....
	Balance Sheet Liquidity Ratio	30	....
	Average Short-Term Funding/Average Total Assets	20	....
L	Loss Severity Score	....	....
L.1	Loss Severity Measure	....	100

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[68] This updated analysis also resulted in changing the runoff assumptions for Federal funds purchased and for repurchase agreements. These new assumptions are set forth in Appendix D.

[69] Three measures used in the highly complex institution's scorecard (that are not used in the scorecard for other large institutions) do not use the 10th and 90th percentile values as cutoffs due to lack of historical data. The cutoffs for these measures are based partly upon recent experience; the maximum cutoffs range from approximately the 75th through the 78th percentile of these measures among only highly complex institutions.

1. Performance Score

The performance score for highly complex institutions is the weighted average of the scores for three components: weighted average CAMELS rating score, weighted at 30 percent; ability to withstand asset-related stress score, weighted at 50 percent; and ability to withstand funding-related stress score, weighted at 20 percent.

a. Weighted Average CAMELS Rating Score

The score for the weighted average CAMELS rating for highly complex institutions is derived in the same manner as in the scorecard for other large institutions.

b. Ability To Withstand Asset-Related Stress Score

The ability to withstand asset-related stress score contains measures that the FDIC finds most relevant to assessing a highly complex institution's ability to withstand such stress:

• Tier 1 leverage ratio;
• Concentration measure (the greatest of the higher-risk assets to the sum of Tier 1 capital and reserves score, the top 20 counterparty exposure to the sum of Tier 1 capital and reserves score, or the largest counterparty exposure to the sum of Tier 1 capital and reserves score);
• The ratio of core earnings to average quarter-end total assets;
• Credit quality measure (the greater of the criticized and classified items to the sum of Tier 1 capital and reserves score or the underperforming assets to the sum of Tier 1 capital and reserves score) and market risk measure (the weighted average of the four-quarter trading revenue volatility to Tier 1 capital score, the market risk capital to Tier 1 capital score, and the level 3 trading assets to Tier 1 capital score).

Two of the four measures used to assess a highly complex institution's ability to withstand asset-related stress (the Tier 1 leverage ratio and the core earnings to average quarter-end total assets ratio) are determined in the same manner as in the scorecard for other large institutions. However, the method used to calculate the score for the other remaining measures—the concentration measure and the credit quality and market risk measure—differ and are discussed below.

Concentration Measure

As in the scorecard for large institutions, the concentration measure for highly complex institutions includes the higher-risk assets to Tier 1 capital and reserves ratio described in Appendix C. However, the concentration measure in the highly complex institution's scorecard considers the top 20 counterparty exposures to Tier 1 capital and reserves ratio and the largest counterparty exposure to Tier 1 capital and reserves ratio instead of the growth-adjusted portfolio concentrations measure used in the scorecard for large institutions. The highly complex institution's scorecard uses these measures because recent experience shows that the concentration of a highly complex institution's exposures to a small number of counterparties—either through lending or trading activities—significantly increases the institution's vulnerability to unexpected market events. The FDIC uses the top 20 counterparty exposure and the largest counterparty exposure to capture this risk.

Credit Quality Measure and Market Risk Measure Scores

As in the scorecard for large institutions, the ability to withstand asset-related stress component includes a credit quality measure. However, the highly complex institution scorecard also includes a market risk measure that considers trading revenue volatility, market risk capital, and level 3 trading assets. All three risk measures are calculated relative to a highly complex institution's Tier 1 capital and multiplied by their respective weights to calculate the score for the market risk measure. All three risk measures can be calculated using data from an insured depository institution's quarterly Call Reports or TFRs. The FDIC believes that combining these three risk measures better captures a highly complex institution's market risk than any single measure.

The trading revenue volatility ratio measures the sensitivity of a highly complex institution's trading revenue to market volatility. The market risk capital ratio uses historical experience to estimate the effect on capital of potential losses in the trading portfolio due to market volatility.[70] However, this ratio may not be a good measure of market risk when an institution holds a large volume of hard-to-value trading assets. Therefore, the level 3 trading assets ratio is included as an indicator of the volume of hard-to-value trading assets held by an institution.

The FDIC recognizes that the relevance of credit risk and market risk in assessing a highly complex institution's vulnerability to stress depends on an institution's asset composition. A highly complex institution with a significant amount of trading assets can be as risky as an institution that focuses on lending even though the primary source of risk may differ. In order to treat both types of institutions fairly, the FDIC allocates an overall weight of 35 percent between the credit risk measure and the market risk measure. The allocation will vary depending on the ratio of average trading assets to the sum of average securities, loans, and trading assets (the trading asset ratio) as follows:

• Weight for Credit Quality Measure = (1 − Trading Asset Ratio) * 0.35.
• Weight for Market Risk Measure = Trading Asset Ratio * 0.35.

Table 18 shows cutoff values and weights for the ability to withstand asset-related stress measures.

TABLE 18—CUTOFF VALUES AND WEIGHTS FOR MEASURES TO CALCULATE ABILITY TO WITHSTAND ASSET-RELATED STRESS SCORE

Measures of the ability to withstand asset-related stress	Cutoff values		Market risk measures	Weight
	Minimum (percent)	Maximum (percent)		
Tier 1 Leverage Ratio	6	13	....	10%.
Concentration Measure	....	....	....	35%.
Higher Risk Assets/Tier 1 Capital and Reserves	0	135		
Top 20 Counterparty Exposure/Tier 1 Capital and Reserves; or	0	125		

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[70] Market risk capital is defined in Appendix C of Part 325 of the FDIC Rules and Regulations,.

http://www.fdic.gov/regulations/laws/rules/2000-4800.html#fdic2000appendixctopart325.

TABLE 18—CUTOFF VALUES AND WEIGHTS FOR MEASURES TO CALCULATE ABILITY TO WITHSTAND ASSET-RELATED STRESS SCORE—Continued

Measures of the ability to withstand asset-related stress	Cutoff values		Market risk measures	Weight
	Minimum (percent)	Maximum (percent)		
Largest Counterparty Exposure/Tier 1 Capital and Reserves.	0	20		
Core Earnings/Average Quarter-end Total Assets	0	2	....	20%.
Credit Quality Measure*	....	....	....	35% * (1 − Trading Asset Ratio).
Criticized and Classified Items to Tier 1 Capital and Reserves; or	7	100		
Underperforming Assets/Tier 1 Capital and Reserves	2	35		
Market Risk Measure*	....	....	....	35% * Trading Asset Ratio.
Trading Revenue	0	2	60	
Volatility/Tier 1 Capital				
Market Risk Capital/Tier 1 Capital	0	10	20	
Level 3 Trading Assets/Tier 1 Capital	0	35	20	

* Combined, the credit quality measure and the market risk measure will be assigned a 35 percent weight. The relative weight of each of the two measures will depend on the ratio of average trading assets to sum of average securities, loans and trading assets (trading asset ratio).

c. Ability To Withstand Funding-Related Stress Score

The score for the ability to withstand funding-related stress contains three measures that are most relevant to assessing a highly complex institution's ability to withstand such stress—a core deposits to total liabilities ratio, a balance sheet liquidity ratio, and an average short-term funding to average total assets ratio.

Two of the measures (the core deposits to total liabilities ratio and the balance sheet liquidity ratio) in the ability to withstand funding-related stress score are determined in the same manner as in the scorecard for large institutions, although their weights differ. The FDIC has added the average short-term funding to average total assets ratio to the ability to withstand funding-related stress component of the

highly complex institution scorecard because experience during the recent crisis shows that heavy reliance on short-term funding significantly increases a highly complex institution's vulnerability to unexpected adverse developments in the funding market.

Table 19 shows cutoff values and weights for the ability to withstand funding-related stress measures.

TABLE 19—CUTOFF VALUES AND WEIGHTS TO CALCULATE ABILITY TO WITHSTAND FUNDING-RELATED STRESS MEASURES

Measures of the ability to withstand funding-related stress	Cutoff values		
	Minimum (percent)	Maximum (percent)	Weight (percent)
Core Deposits/Total Liabilities	5	87	50
Balance Sheet Liquidity Ratio	7	243	30
Average Short-term Funding/Average Total Assets	2	19	20

d. Calculating the Performance Score

To calculate the performance score for a highly complex institution, the scores for the weighted average CAMELS score, the ability to withstand asset-related stress score, and the ability to withstand funding-related stress score are multiplied by their respective weights and the results are summed to arrive at the performance score.

2. The Loss Severity Score

The loss severity score for highly complex institutions is calculated the same way as the loss severity score for other large institutions.

D. Total Score

1. Calculating the Total Score

The method for calculating the total score for large institutions and highly complex institutions is the same. Once the performance and loss severity scores are calculated for these institutions, their scores are converted to a total score. Each institution's total score is calculated by multiplying its performance score by a loss severity factor as follows:

First, the loss severity score is converted into a loss severity factor that ranges from 0.8 (score of 5 or lower) to 1.2 (score of 85 or higher). Scores at or below the minimum cutoff of 5 receive a loss severity factor of 0.8 and scores at or above the maximum cutoff of 85 receive a loss severity factor of 1.2.

Again, a linear interpolation is used to convert loss severity scores between the cutoffs into a loss severity factor. The conversion is made using the following formula:

Loss Severity Factor = 0.8 + [0.005 * (Loss Severity Score − 5]

For example, if Bank A's loss severity score is 68.57, its loss severity factor would be 1.12, calculated as follows:

0.8 + (0.005 * (68.57 − 5)) = 1.12

Next, the performance score is multiplied by the loss severity factor to produce a total score (total score = performance score * loss severity factor). Since the loss severity factor ranges from 0.8 to 1.2, the total score can be up to 20 percent higher or lower than the performance score but cannot be less than 30 or more than 90. For

example, if Bank A's performance score is 69.33 and its loss severity factor is 1.12, its total score would be calculated as follows:

69.33 * 1.12 = 77.65

Extreme values for certain risk measures make an institution more vulnerable to risk, which the FDIC believes should be addressed on a bank-by-bank basis. To do this, the FDIC can adjust a large institution's or highly complex institution's total score, up or down, by a maximum of 15 points, based upon significant risk factors that are not adequately captured in the scorecard. The FDIC will use a process similar to the current large bank adjustment to determine the amount of the adjustment to the total score.[71] The resulting total score cannot be less than 30 or more than 90. This adjustment is discussed in more detail below.

2. Comments on Total Score

Some commenters stated that limiting the effect of the loss severity score on the total score to 20 percent has no support and that loss severity should have a greater effect to account for institutions that pose little to no risk to the insurance fund. The FDIC believes that loss severity should be considered in determining an insured institution's deposit assessments; this rulemaking is the first time that the FDIC has explicitly incorporated loss severity in the calculation of an institution's assessment rate. While the FDIC believes that the loss severity measure provides a reasonable risk ranking of institutions' potential losses to the DIF, the FDIC believes that it is prudent at this time to incorporate this measure in a limited way and evaluate it further before increasing its effect on the

assessment rate. Furthermore, the loss severity measure does not yet incorporate off-balance sheet obligations, complex funding structures and other qualitative factors that can have a significant effect on DIF losses in the event of failure.

E. Initial Base Assessment Rate

A large institution or highly complex institution with a total score of 30 will pay the minimum initial base assessment rate and a large institution or highly complex institution with a total score of 90 will pay the maximum initial base assessment rate; for total scores between 30 and 90, initial base assessment rates will rise at an increasing rate as the total score increases.[72][73] The initial base assessment rate (in basis points) is calculated using the following formula:[74]

$$Rate = Minimum\ Rate + \left[\left(\left(1.4245 \times \left(\frac{Score}{100} \right)^3 \right) - 0.0385 \right) \times \left(Maximum\ Rate - Minimum\ Rate \right) \right]$$

where Rate is the initial base assessment rate (expressed in basis points), Maximum Rate is the maximum initial base assessment rate then in effect (expressed in basis points), and Minimum Rate is the minimum initial base assessment rate then in effect (expressed in basis points).

The calculation of an initial base assessment rate is based on an approximated statistical relationship between large institutions' total scores and their estimated three-year cumulative failure probabilities, as shown in Appendix 3.

Chart 4 illustrates the initial base assessment rate for a range of total scores, assuming minimum and maximum initial base assessment rates of 5 basis points and 35 basis points, respectively.

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[71] 12 CFR 327.9(d)(4) (2010).

[72] Scores of 30 and 90 equal about the 13th and about the 99th percentile values, respectively, based

on scorecard results as of first quarter 2006 through fourth quarter 2007.

[73] The assessment rates that the FDIC will apply to large and highly complex insured depository

institutions pursuant to this final rule are set out in Section IV above.

[74] The initial base assessment rate (in basis points) will be rounded to two decimal points.

Chart 4

Initial Base Assessment Rates

Initial Assessment Rate (bps)
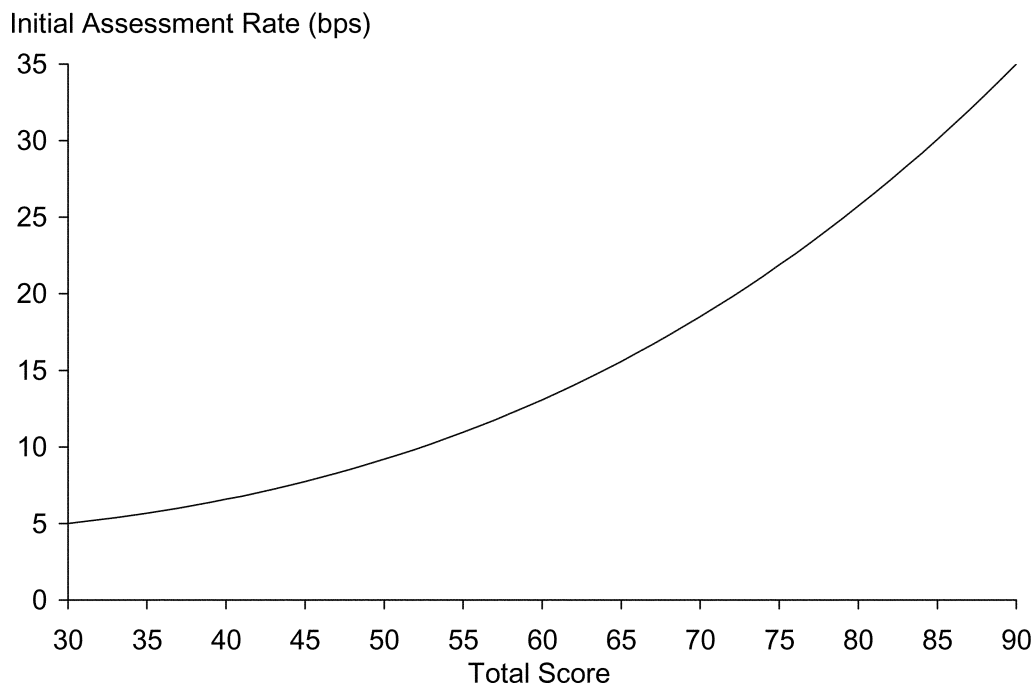
The initial base assessment rate of a large or highly complex institution can be adjusted as a result of the unsecured debt adjustment, the depository institution debt adjustment, and the brokered deposit adjustment, as discussed above.

F. Large Bank Adjustment to the Total Score

1. Adjustment to Total Score for Large or Highly Complex Institutions

The FDIC will retain the ability to adjust the total score for large institutions and highly complex institutions by a maximum of 15 points, up or down, based upon significant risk factors that are not captured in the scorecards. While the scorecards should improve the relative risk ranking of large institutions, the FDIC believes that it is important that it have the ability to consider idiosyncratic factors or other relevant risk factors that are not adequately captured in the scorecards. This large bank adjustment will be similar to the assessment rate adjustment that large institutions and insured branches of foreign banks

within Risk Category I have been subject to in recent years.[75]

In general, the adjustments to the total score will have a proportionally greater effect on the assessment rate of those institutions with a higher total score since the assessment rate rises at an increasing rate as the total score rises.

In determining whether to make a large bank adjustment, the FDIC may consider such information as financial performance and condition information and other market or supervisory information. The FDIC will also consult with an institution's primary federal regulator and, for state chartered institutions, state banking supervisor.

The FDIC acknowledges the need to clarify its processes for making adjustments to ensure fair treatment and accountability and plans to propose and seek comment on updated guidelines. As noted in the Large Bank NPR, the FDIC will not adjust assessment rates until the updated guidelines are published for comment and approved by the Board. In addition, the FDIC will publish aggregate statistics on adjustments each quarter.

Similar to the current adjustment process, the FDIC will notify a large

[75] 12 CFR 327.9(d)(4) (2010).

institution or highly complex institution before an upward adjustment to the institution's assessment rate takes effect, so that the institution will have an opportunity to respond to the FDIC's rationale for proposing an upward adjustment. An adjustment will be implemented only after considering the institution's response and any subsequent changes to the inputs or other risk factors that informed the FDIC's decision.[76]

2. Comments on the Large Bank Adjustment

Several commenters voiced concern that the large bank adjustment is disproportionately large, given the detail and complexity of the scorecard. Two commenters questioned the need for any large bank adjustment. Two commenters recommended that the adjustment should be only used to lower an institution's score.

The FDIC disagrees. Based on statistical analysis, the FDIC believes that the scorecard will generally improve the relative risk ranking of

[76] The final rule does not affect the procedures or timetable for appealing assessment rates. The procedures and timetable are described on the FDIC's Web site: *http://www.fdic.gov/deposit/ insurance/assessments/requests_review.html.*

large institutions, particularly based on their long-term performance. However, the scorecard relies on only a limited number of quantitative ratios and applies a standardized set of assumptions, and it does not consider firm-specific idiosyncratic or qualitative factors that can have significant bearing on an institution's probability of failure or loss given failure. In fact, many commenters criticized the scorecard for not considering qualitative factors such as underwriting, collateral, or other risk mitigants. The FDIC agrees that these qualitative factors should be considered in assessments, and believes that it needs the flexibility to consider them. In addition, the FDIC believes that the complexity and the dynamic nature of many large institutions warrant a large bank adjustment that is significant enough for the FDIC to consider current or future risk factors not adequately captured in the scorecard.

Several commenters maintained that the large bank adjustment is too subjective and not transparent. The FDIC disagrees. Currently, the FDIC determines the large bank adjustment following the process set forth in the guidelines that were adopted in 2007.[77] The guidelines detail broad-based and focused benchmarks used to determine whether the adjustment should be made to an institution's assessment rate and set out adjustment processes. The FDIC consults with an institution's primary federal regulator and notifies the institution one quarter in advance of the FDIC's intent to make an upward adjustment to the institution's rate, so that the institution will have an opportunity to respond and provide additional information. The FDIC implements the adjustment only after considering the response and any subsequent changes to the inputs or other risk factors that informed the FDIC's decision.[78] This process will remain unchanged in this rulemaking. In addition, as proposed in the Large Bank NPR, the FDIC will not adjust a large or highly complex institution's assessment rates until the updated guidelines are published for comment and approved by the Board.

G. Data Sources

1. Data Sources in Final Rule

In most cases, the FDIC will use data that are publicly available to compute

scorecard measures. Data elements required to compute four scorecard measures—higher-risk assets, top 20 counterparty exposures, the largest counterparty exposure and criticized and classified items—are gathered during the examination process. Rather than relying on the examination process, the FDIC will collect the data elements for these four scorecard measures directly from each institution. The FDIC anticipates that the necessary changes will be made to Call Reports and TFRs beginning with second quarter of 2011. These data elements will remain confidential.

2. Comments on the Data Sources

A bank commented that the data reported for use in scorecard calculations may not be consistent among banks and is subject to definitional interpretation. The final rule incorporates detailed definitions and industry recommendations for various data elements, which should eliminate any significant inconsistencies among the data collected. Another commenter stated that nonpublic data used in the scorecard may be incorrect. The FDIC will collect all data through the Call Reports and TFRs, and each institution's management will attest to the accuracy of the information.

H. Updating the Scorecard

The FDIC will have the flexibility to update the minimum and maximum cutoff values used in each scorecard annually without further rulemaking as long as the method of selecting cut-off values remains unchanged. The FDIC can add new data for subsequent years to its analysis and can, from time to time, exclude some earlier years from its analysis. Updating the minimum and maximum cutoff values and weights will allow the FDIC to use the most recent data, thereby improving the accuracy of the scorecard method.

If, as a result of its review and analysis, the FDIC concludes that measures should be used to determine risk-based assessments, that the method of additional or alternative selecting cutoff values should be revised, that the weights assigned to the scorecard measures should be recalibrated, or that a new method should be used to differentiate risk among large institutions or highly complex institutions, changes will be made through a future rulemaking.

The data used to calculate scorecard measures for any given quarter will be calculated from the Call Reports and TFRs filed by each insured depository institution as of the last day of the

quarter. CAMELS component rating changes will be effective as of the date that the rating change is transmitted to the insured depository institution for purposes of determining assessment rates.[79]

I. Additional Comments

The FDIC received approximately 25 comments related to the Large Bank NPR. Most commenters opposed the rule because they claimed it is not risk-based when combined with the proposed new assessment base, is too complex and is not transparent. Two commenters expressed support for the proposal, including the elimination of long-term debt issuer ratings and risk-based categories for large banks. In addition to the comments described above, responders also commented on other issues discussed below.

1. Risk-Based Assessment System

Some commenters stated that the rule unfairly penalizes large insured depository institutions without demonstrating that they pose greater risk to the DIF. Several commenters argued that the FDIC should lower rates applicable to large banks because the proposed rates, when applied to the new assessment base, increase large banks' assessments and misrepresent the actual risk posed by large banks and, therefore, violate the statutory requirement that the assessment system be risk-based. One commenter argued that large banks should not be penalized with a greater share of overall assessments because large banks caused little of the recent losses to the DIF. Some commenters argued that the assessment rates and the new large bank pricing system result in assessments for small banks that are too low, thus underpricing risk and creating moral hazard.

In the FDIC's view, the final rule preserves and improves the risk-based assessment system. Under the FDI Act, the FDIC's Board of Directors must establish a risk-based assessment system so that a depository institution's deposit insurance assessment is calculated based on the probability that the DIF will incur a loss with respect to the institution (taking into consideration the

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[77] 72 FR 27122 (May 14, 2007); *http://edocket.access.gpo.gov/2007/pdf/E7-9196.pdf.*

[78] The final rule does not affect the procedures or timetable for appealing assessment rates. The procedures and timetable are described on the FDIC's Web site: *http://www.fdic.gov/deposit/insurance/assessments/requests_review.html.*

[79] Pursuant to existing supervisory practice, the FDIC does not assign a different component rating from that assigned by an institution's primary federal regulator, even if the FDIC disagrees with a CAMELS component assigned by an institution's primary federal regulator, unless: (1) The disagreement over the component rating also involves a disagreement over a CAMELS composite rating; and (2) the disagreement over the CAMELS composite rating is not a disagreement over whether the CAMELS composite rating should be a 1 or a 2. The FDIC has no plans to alter this practice.

risks attributable to different categories and concentrations of assets, different categories and concentrations of liabilities, and any other relevant factors regarding loss); the likely amount of any loss to the DIF; and the revenue needs of the DIF.

The assessment system complies with this requirement. For a large insured depository institution, the performance score (which explicitly takes into consideration the risks attributable to different categories and concentrations of assets, different categories and concentrations of liabilities, and many other relevant factors regarding loss), the loss severity score, the assessment rate adjustments (the unsecured debt adjustment, the depository institution debt adjustment and the brokered deposit adjustment) and the Dodd-Frank-required assessment base, taken together, reasonably represent both the probability that the DIF will incur a loss with respect to the institution and the likely amount of any such loss.

For a small institution, capital levels and CAMELS ratings (both of which correlate with probability of failure) and, if the institution is well capitalized and well managed, the financial ratios method (which measures the probability that an institution's supervisory CAMELS rating will decline to a CAMELS 3, 4 or 5), combined with the assessment rate adjustments and the new assessment base determine the probability that the DIF will incur a loss with respect to the institution and the likely amount of any such loss.[80]

For several reasons, the FDIC disagrees with any implication that new assessment base mandated by Dodd-Frank is a poorer measure of exposure to loss than domestic deposits. In most instances, when an institution fails, the great majority of its liabilities are insured deposits and secured liabilities, both of which expose the FDIC to loss. Unlike the old assessment base, the new assessment base captures both types of liabilities. In addition, the new assessment base includes other liabilities (uninsured deposits, foreign deposits, and short-term unsecured liabilities) that, in large part, are either paid before the institution fails, reducing the assets available to the DIF to cover losses, or are replaced by insured deposits or secured liabilities. Thus, including short-term unsecured

debt and foreign deposits in the assessment base makes sense, since this kind of debt provides no cushion to absorb losses in the event of failure. While Congress also included long-term unsecured debt in the assessment base, the unsecured debt adjustment for long-term debt recognizes that this form of liability provides a cushion to absorb losses ahead of the FDIC in the event of failure.

Using data as of September 30, 2010, under the current assessment system, the 110 large insured depository institutions hold about 70 percent of the assessment base and pay about 70 percent of total assessments. Under the new assessment base and large bank pricing system, they will hold about 78 percent of the assessment base and pay about 79 percent of total assessments.

Congress expressly intended this result and viewed the new assessment base as a better measure of risk than the previous base of domestic deposits:

Community banks with less than $10 billion in assets rely heavily on customer deposits for funding. This penalizes safe institutions by forcing them to pay deposit insurance premiums above and beyond the risk they pose to the banking system.

Despite making up just 20 percent of the Nation's assets, these community banks contribute 30 percent of the premiums to the deposit insurance fund. At the same time, large banks hold 80 percent of the banking industry's assets. Yet they just pay 70 percent of the premiums. There is no reason for community banks to have to make up this gap.

What we need is a level playing field. * * * Community banks didn't cause the problems. To have them pay more proportionately in FDIC insurance than the big banks do is unfair.

Statements of Senator Hutchison, 156 Cong. Rec. S3154 (May 5, 2010) (Co-Sponsor of Amendment No. 3749, which contains the new assessment base).

We must fix this inequality. That is what the Tester-Hutchison measure does. It will do so by requiring the FDIC to change the assessment base to a more accurate measure: a bank's total assets, less tangible capital. This change will broaden the assessment base and will better measure the risk a bank poses.

A bank's assets include its loans outstanding and securities held. One need only look back to the last 2 years to know those are the assets that are more likely to show a bank's exposure to risk than just plain deposits. It wasn't a bank's deposits that contributed to the financial meltdown. The meltdown was caused by bad mortgages which were packaged into risky mortgage-backed securities which were used to create derivatives. These risky financial instruments and the large institutions that created and held them are what led to our financial crisis.

Statements of Senator Hutchison, 156 Cong. Rec. S3297 (May 6, 2010).[81]

Consequently, the FDIC's assessment system fully comports with the requirements of the FDI Act.[82] Furthermore, the combined effect of the new assessment base, assessment rates and the large bank pricing system does not result in uniformly higher assessments for all large institutions. Based on September 30, 2010 data, for 59 of the 110 large depository institutions, assessments will decline as a result of this combined effect of changes to the assessment base, assessment rates, and the large bank pricing system.

The changes in the assessment system applicable to large insured depository institutions are intended to increase risk differentiation, with safer institutions paying less and riskier ones paying more. As a result of the recent financial crisis, the FDIC is now better able to measure and price for risks that result in failures and losses at large institutions. Higher assessments for some of these institutions are entirely consistent with the express intent of Congress that Dodd-Frank would revise "the FDIC's assessment base for deposit insurance, maintaining the risk-based nature of the assessment structure but transitioning to a broader assessment base for bank premiums based on total assets (minus tangible equity)." U.S. House. *Dodd-Frank Wall Street Reform and Consumer Protection Act, Conference Report* (to Accompany H.R. 4173) (111 H. Rpt. 517).

2. Complexity of the Scorecard

Several commenters, including an industry trade group, criticized the proposed scorecard for being overly complex, making it difficult to make meaningful suggestions on how to improve the model and to accurately predict assessments. An industry trade group stated that, given the overall complexity, the FDIC should demonstrate that the model fairly differentiates risk consistent with the risk-based model for small banks.

The FDIC recognizes that the scorecards remain somewhat complex despite simplifying revisions made in response to comments on the April NPR. However, many large insured depository institutions themselves use a scorecard approach to assess

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[80] This system is simpler than the system that will be applied to large insured depository institutions, but large depository institutions are much more complex and pose more complex risks. The FDI Act explicitly allows the FDIC to create different risk-based assessment systems for small and large insured depository institutions. 12 U.S.C. 1817(b)(1)(D).

[81] Similar arguments in favor of the amendment were made by co-sponsor Senator Tester and Senators Johanns and Brown. Statements of Senators Tester, Senator Johanns and Senator Brown, 156 Cong. Rec. S3296, S3297, S3298 (May 6, 2010).

[82] As discussed earlier, the assessment system also takes into account the DIF's revenue needs.

counterparty risk. Moreover, given the complexity of large institutions—both in terms of their operations and activities—the FDIC believes that further simplifying the scorecard would materially reduce its ability to differentiate risk among large institutions.

The FDIC also believes that the measures that best assess a large institution's ability to withstand stress are different from those for small institutions. As discussed above and in the Large Bank NPR, statistical analysis supports the conclusion that scorecard measures predict the long-term performance of large institutions significantly better than the measures included in the small bank model, which is calibrated on the performance of smaller institutions.

3. Weights of the Scorecard Measures

Several commenters suggested that several of the weights assigned to a scorecard measure or a scorecard component should be altered. Scorecard measures and the weights assigned to each measure are based on the statistical analysis of historical performance over the 2005 to 2008 period, focusing on how well these measures predict a large institution's long-term performance. Altering the weights without empirical support would reduce the scorecard's ability to differentiate institution's long-term risk to the DIF and add subjectivity to the model. If future statistical analysis should indicate that the weights assigned to the scorecard measures should be recalibrated, recalibration will be undertaken through rulemaking.

4. Lack of Transparency

Several comments mentioned the lack of transparency in the model, stating that validation is difficult given that all of the information in the scorecard is not publicly available. Another comment stated that the FDIC should periodically seek bids in the reinsurance market (for aggregate and large bank exposures) as an independent verification of the accuracy of the FDIC's deposit insurance pricing.

While most of the measures used to calculate an institution's score are publicly available, a few are not. Nevertheless, each institution has the information it needs to determine the effect of the scorecard on its own assessment. In addition, the FDIC has published the assessment calculator so that a large institution can determine how its assessment rate is calculated and analyze the sensitivity of its assessments to changes in scorecard measure values. Appendix 2 contains

the detailed description of the scorecard model, the result of statistical analysis, and the derivation of weights.

The FDIC has previously investigated the possibility of seeking bids in the reinsurance market, and has not found a practicable way to implement it for large institutions.

5. Pro-Cyclicality

Several commenters stated that although the FDIC's stated intent is to reduce pro-cyclicality in the assessment system, the proposed system remains pro-cyclical since many of the scorecard measures, including the CAMELS ratings, would be worse under adverse economic conditions.

In selecting scorecard measures and assigning respective weights, the FDIC relied on statistical analysis that identified how well each measure predicts a large institution's long-term performance. While some of scorecard measures have pro-cyclical features, the FDIC believes that, by focusing on long-term performance, the scorecard, which combines these measures with other more forward looking measures, is less procyclical than the system it replaces.

6. Request to Extend the Comment Period and Delay Implementation

Several commenters stated that the FDIC should extend the comment period and delay implementation of this rulemaking so that the industry can fully analyze the complex proposed system and study the effects that the proposed pricing and assessment base rules would have on the banking industry and the economy. The FDIC believes that the industry has had ample time to analyze the proposal given that the Large Bank NPR is very similar to the April NPR, on which institutions had an opportunity to review and provide comments. Furthermore, delaying implementation would adversely affect those institutions that will benefit from lower assessments under the new system.

7. Ceiling on Dollar Amount of Assessments

Two commenters stated that the dollar amount of assessments paid should not exceed the amount of insured deposits. Another commenter noted that the proposed assessment base and scorecard are causing unreasonably high assessments for banks with small deposit bases.

The FDIC believes that a ceiling on the assessment rate or total assessment is not consistent with the intent of Congress to change the assessment base from one based on deposits to one based on assets. In addition, it could create an

incentive for an institution to hold risky assets or to move assets among its various affiliates to avoid higher deposit insurance assessments. Therefore, the final rule does not include a ceiling on the total assessment payment.

8. Cliff Effect

Two commenters criticized the proposal for unfairly punishing institutions that are close to the $10 billion asset threshold, claiming that assessments increase significantly once the institution's assets exceed $10 billion. The same commenters suggested that the FDIC should develop a plan that incrementally increases assessment rates for banks that exceed the $10 billion asset threshold.

The FDIC disagrees. Analysis based on September 2010 data show that under the final rule, as under the existing system, some institutions' assessment rates would increase, while others would decrease, when changing size classification. However, movement from one size category to another will not occur without warning. To reduce potential volatility in assessment rates, a small institution does not become large until it reports assets of $10 billion or greater for four consecutive quarters; similarly, a large institution does not become small until it reports assets of less than $10 billion for four consecutive quarters.

9. Statistical Analysis

Several commenters questioned the validity of the statistical analysis used to support the proposed changes. In particular, commenters expressed concern that the scorecard was calibrated using data on small bank failures and CAMELS downgrades, which would not reflect the risks and behaviors of large institutions. Commenters also noted that, since the analysis only covers the most recent period of heightened bank failures, it may fail to identify or adequately weight factors that are likely to lead to problems in the future. One commenter was critical of including failures in the sample that did not result in a loss to the DIF.

The FDIC agrees that using the recent experience of small banks to determine the scorecard factors and weights would likely result in a system that misprices the risk posed by large institutions. For this reason, the FDIC chose not to use small bank failures or downgrades as the basis for its statistical analysis. Instead, as described in Appendix 1 of the NPR, the risk measures included in the performance score and the weights assigned to those measures were generally based on results from a

regression (OLS) model using FDIC expert judgment rankings of large institutions. In addition, the FDIC tested the robustness of scorecard measures in predicting a large institution's long-term performance using a logistic regression model that estimates the ability of those same measures to predict whether a large institution would fail or receive significant government support prior to year-end 2009. The analysis included institutions that failed but did not cause a loss to the DIF in the sample, since these models were used to select measures and assign appropriate weights for the performance score, not the loss severity score.

The FDIC recognizes that any statistical analysis is necessarily backward looking and that risks may arise in the future that are not adequately captured in the scorecard. However, the FDIC feels that the proposed framework is more comprehensive and reduces the likelihood of such an occurrence compared to the current system, which was less effective in capturing the risks that resulted in recent failures. The FDIC believes that the scorecard should allow us to differentiate risk during periods of good economic and banking conditions based on how institutions would fare during periods of economic stress. To achieve that goal, the FDIC focused on risk measures that best predicted how institutions fared during the period of most recent stress using the data during the period of favorable economic conditions.

A few commenters suggested that regression results provided in Appendix 1 of the Large Bank NPR actually undermine support for the performance score factors. In particular, one commenter stated that the estimated OLS coefficients for several ratios had the wrong sign, and concluded that the regression was mis-specified. Further, the commenter stated that the relationship between the expert judgment rankings and true risk to the DIF was unsupported. Another commenter stated that Chart 2.1 in Appendix 2 to the Large Bank NPR (showing the relationship between total scores and failures) demonstrates that the scorecard does a poor job of discriminating between failures and non-failures, and should, therefore, be abandoned until a more robust model is developed.

The FDIC disagrees with this assessment. As described in Appendix B to this final rule, the FDIC normalized all scorecard measures into a score that ranges between 0 and 100—0 indicating the lowest risk and 100 indicating the highest risk, before conducting the

statistical analysis—both OLS and logistic regression. Once normalized in such a way, all scorecard measures should be and were positively correlated with risk, that is, a high score indicates high risk and a low score indicates low risk, and the relative difference in coefficients can be easily converted to weights.

In addition, Chart 3.1 in Appendix 3 to this final rule shows that large institutions with a total score in the top decile as of year-end 2006 represented a disproportionately high percentage of failures between 2006 and 2009. Given that the performance score factors and weights were largely calibrated to the FDIC's expert judgment rankings, this result also provides indirect support for a relationship between the FDIC's expert view and actual risk to.

VII. Effective Date

Except as specifically noted above, the final rule will take effect for the quarter beginning April 1, 2011, and will be reflected in the invoices for assessments due September 30, 2011. The FDIC has considered the possibility of making the application of the new assessment base, the revised assessment rates, and the changes to the assessment rate adjustments retroactive to passage of Dodd-Frank. However, as this rule details, implementation of Dodd-Frank requires that a number of changes be made to the Call Report and TFR that render a retroactive application operationally infeasible. Additionally, retroactively applying these changes would introduce significant legal complexity as well as unacceptable levels of litigation risk. The FDIC is committed to implementing Dodd-Frank in the most expeditious manner possible and is contemporaneously pursuing necessary changes to the Call Report and TFR. The effective date is contingent upon these changes being made; if there is a delay in changing the Call Report and TFR, the effective date of this rule may be delayed.

VIII. Regulatory Analysis and Procedure

A. Regulatory Flexibility Act

Under the Regulatory Flexibility Act (RFA), each federal agency must prepare a final regulatory flexibility analysis in connection with the promulgation of a final rule,[83] or certify that the final rule will not have a significant economic impact on a substantial number of small entities.[84] Certain types of rules, such as rules of particular applicability relating to rates or corporate or financial

structures, or practices relating to such rates or structures, are expressly excluded from the definition of "rule" for purposes of the RFA.[85] The final rule relates to the rates imposed on insured depository institutions for deposit insurance, to the risk-based assessment system components that measure risk and weigh that risk in determining an insured depository institution's assessment rate and to the assessment base on which rates are charged. Consequently, a regulatory flexibility analysis is not required. Nevertheless, the FDIC is voluntarily undertaking a regulatory flexibility analysis.

As of September 30, 2010, of the 7,770 insured commercial banks and savings associations, there were 4,229 small insured depository institutions as that term is defined for purposes of the RFA (*i.e.,* institutions with $175 million or less in assets).

The final rule will adopt the Dodd-Frank definition of assessment base and alter assessment rates and the adjustments to those rates at the same time that the new assessment base takes effect. Under this part of the rule, 99 percent of small institutions will be subject to lower assessments. In effect, the rule will decrease small institution assessments by an average of $10,320 per quarter and will alter the present distribution of assessments by reducing the percentage of the assessments borne by small institutions. As of September 30, 2010, small institutions, as that term is defined for purposes of the RFA, actually accounted for 3.7 percent of total assessments. Also as of that date, but applying the new assessment rates against an estimate of the new assessment base, small institutions would have accounted for 2.4 percent of the total cost of insurance assessments.

Other parts of the final rule will progressively lower assessment rates when the reserve ratio reaches 1.15 percent, 2 percent and 2.5 percent. Pursuant to section 605(b) of the RFA, the FDIC certifies that the rule will not have a significant economic effect on small entities unless and until the DIF reserve ratio exceeds specific thresholds of 1.15, 1.5, 2, and 2.5 percent. The reserve ratio is unlikely to reach these levels for many years. When it does, the overall effect of the rule will be positive for entities of all sizes. All entities, including small entities, will receive a net benefit as a result of lower assessments paid. The rate reductions in the rule should not alter the distribution of the assessment burden between small entities and all others. It is difficult to realistically quantify the benefit at the

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[83] 5 U.S.C. 604.
[84] *See* 5 U.S.C. 605(b).

[85] *See* 5 U.S.C. 601.

present time. However, the initial magnitude of the benefit (when the reserve ratio reaches 1.15 percent) is likely to be less than a 2 percent increase in after-tax income and less than a 20 basis point increase in capital.

The portion of the final rule that relates to the assessment system applicable to large insured depository institutions applies only to institutions with $10 billion or greater in total assets. Consequently, small institutions will experience no significant economic impact as the result of this portion of the final rule.

B. Small Business Regulatory Enforcement Fairness Act

The Office of Management and Budget has determined that the final rule is not a "major rule" within the meaning of the relevant sections of the Small Business Regulatory Enforcement Act of 1996 (SBREFA) Public Law 110–28 (1996). As required by law, the FDIC will file the appropriate reports with Congress and the Government Accountability Office so that the final rule may be reviewed.

C. Paperwork Reduction Act

No collections of information pursuant to the Paperwork Reduction Act (44 U.S.C. Ch. 3501 *et seq.*) are contained in the final rule.

D. Solicitation of Comments on Use of Plain Language

Section 722 of the Gramm-Leach-Bliley Act, Public Law 106–102, 113 Stat. 1338, 1471 (Nov. 12, 1999), requires the federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. The FDIC invited comments on how to make this proposal easier to understand. No comments addressing this issue were received.

E. The Treasury and General Government Appropriation Act, 1999— Assessment of Federal Regulations and Policies on Families

The FDIC has determined that the final rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, enacted as part of the Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999 (Pub. L. 105–277, 112 Stat. 2681).

List of Subjects in 12 CFR Part 327

Bank deposit insurance, Banks, Banking, Savings associations.

For the reasons set forth in the preamble the FDIC proposes to amend chapter III of title 12 of the Code of Federal Regulations as follows:

PART 327—ASSESSMENTS

■ 1. The authority citation for part 327 continues to read as follows:

Authority: 12 U.S.C. 1441, 1813, 1815, 1817–19, 1821.

■ 2. Amend § 327.4 by revising paragraphs (c) and (f) to read as follows:

§ 327.4 Assessment rates.

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(c) *Requests for review.* An institution that believes any assessment risk assignment provided by the Corporation pursuant to paragraph (a) of this section is incorrect and seeks to change it must submit a written request for review of that risk assignment. An institution cannot request review through this process of the CAMELS ratings assigned by its primary federal regulator or challenge the appropriateness of any such rating; each federal regulator has established procedures for that purpose. An institution may also request review of a determination by the FDIC to assess the institution as a large, highly complex, or a small institution (§ 327.9(e)(3)) or a determination by the FDIC that the institution is a new institution (§ 327.9(f)(5)). Any request for review must be submitted within 90 days from the date the assessment risk assignment being challenged pursuant to paragraph (a) of this section appears on the institution's quarterly certified statement invoice. The request shall be submitted to the Corporation's Director of the Division of Insurance and Research in Washington, DC, and shall include documentation sufficient to support the change sought by the institution. If additional information is requested by the Corporation, such information shall be provided by the institution within 21 days of the date of the request for additional information. Any institution submitting a timely request for review will receive written notice from the Corporation regarding the outcome of its request. Upon completion of a review, the Director of the Division of Insurance and Research (or designee) or the Director of the Division of Supervision and Consumer Protection (or designee) or any successor divisions, as appropriate, shall promptly notify the institution in writing of his or her determination of whether a change is warranted. If the institution requesting review disagrees with that determination, it may appeal to the FDIC's Assessment Appeals Committee. Notice of the procedures applicable to appeals will be included with the written determination.

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(f) *Effective date for changes to risk assignment.* Changes to an insured institution's risk assignment resulting from a supervisory ratings change become effective as of the date of written notification to the institution by its primary federal regulator or state authority of its supervisory rating (even when the CAMELS component ratings have not been disclosed to the institution), if the FDIC, after taking into account other information that could affect the rating, agrees with the rating. If the FDIC does not agree, the FDIC will notify the institution of the FDIC's supervisory rating; resulting changes to an insured institution's risk assignment become effective as of the date of written notification to the institution by the FDIC.

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■ 3. Revise § 327.5 to read as follows:

§ 327.5 Assessment base.

(a) *Assessment base for all insured depository institutions.* Except as provided in paragraphs (b), (c), and (d) of this section, the assessment base for an insured depository institution shall equal the average consolidated total assets of the insured depository institution during the assessment period minus the average tangible equity of the insured depository institution during the assessment period.

(1) *Average consolidated total assets defined and calculated.* Average consolidated total assets are defined in the schedule of quarterly averages in the Consolidated Reports of Condition and Income, using either a daily averaging method or a weekly averaging method as described in paragraphs (a)(1)(i) or (ii) of this section. The amounts to be reported as daily averages are the sum of the gross amounts of consolidated total assets for each calendar day during the quarter divided by the number of calendar days in the quarter. The amounts to be reported as weekly averages are the sum of the gross amounts of consolidated total assets for each Wednesday during the quarter divided by the number of Wednesdays in the quarter. For days that an office of the reporting institution (or any of its subsidiaries or branches) is closed (e.g., Saturdays, Sundays, or holidays), the amounts outstanding from the previous business day will be used. An office is considered closed if there are no transactions posted to the general ledger as of that date. For institutions that begin operating during the calendar quarter, the amounts to be reported as daily averages are the sum of the gross amounts of consolidated total assets for each calendar day the institution was

operating during the quarter divided by the number of calendar days the institution was operating during the quarter.

(i) *Institutions that must report average consolidated total assets using a daily averaging method.* All insured depository institutions that report $1 billion or more in quarter-end consolidated total assets on their March 31, 2011 Consolidated Report of Condition and Income or Thrift Financial Report (or successor report), and all institutions that become insured after March 31, 2011, shall report average consolidated total assets as of the close of business for each day of the calendar quarter.

(ii) *Institutions that may report average consolidated total assets using a weekly averaging method.* All insured depository institutions that report less than $1 billion in quarter-end consolidated total assets on their March 31, 2011, Consolidated Report of Condition and Income or Thrift Financial Report may report average consolidated total assets as an average of the balances as of the close of business on each Wednesday during the calendar quarter, or may at any time opt permanently to report average consolidated total assets on a daily basis as set forth in paragraph (a)(1)(i) of this section. Once an institution that reports average consolidated total assets using a weekly average reports average consolidated total assets equal to or greater than $1 billion for two consecutive quarters, it shall permanently report average consolidated total assets using daily averaging starting in the next quarter.

(iii) *Mergers and consolidations.* The average calculation of the assets of the surviving or resulting institution in a merger or consolidation shall include the assets of all the merged or consolidated institutions for the days in the quarter prior to the merger or consolidation, whether reported by the daily or weekly method.

(2) *Average tangible equity defined and calculated.* Tangible equity is defined as Tier 1 capital.

(i) *Calculation of average tangible equity.* Except as provided in paragraph (a)(2)(ii) of this section, average tangible equity shall be calculated using monthly averaging. Monthly averaging means the average of the three month-end balances within the quarter.

(ii) *Alternate calculation of average tangible equity.* Institutions that report less than $1 billion in quarter-end consolidated total assets on their March 31, 2011 Consolidated Reports of Condition and Income or Thrift Financial Reports may report average

tangible equity using an end-of-quarter balance or may at any time opt permanently to report average tangible equity using a monthly average balance. An institution that reports average tangible equity using an end-of-quarter balance and reports average daily or weekly consolidated assets of $1 billion or more for two consecutive quarters shall permanently report average tangible equity using monthly averaging starting in the next quarter. Newly insured institutions shall report using monthly averaging.

(iii) *Calculation of average tangible equity for the surviving institution in a merger or consolidation.* For the surviving institution in a merger or consolidation, Tier 1 capital shall be calculated as if the merger occurred on the first day of the quarter in which the merger or consolidation occurred.

(3) *Consolidated subsidiaries—* (i) *Reporting for insured depository institutions with consolidated subsidiaries that are not insured depository institutions.* For insured institutions with consolidated subsidiaries that are not insured depository institutions, assets, including assets eliminated in consolidation, shall be calculated using a daily or weekly averaging method, corresponding to the daily or weekly averaging requirement of the parent institution. The Consolidated Reports of Condition and Income instructions in effect for the quarter for which data is being reported shall govern calculation of the average amount of subsidiaries' assets, including those assets eliminated in consolidation. An insured depository institution that reports average tangible equity using a monthly averaging method and that has subsidiaries that are not insured depository institutions shall use monthly average reporting for the subsidiaries. The monthly average data for these subsidiaries, however, may be calculated for the current quarter or for the prior quarter consistent with the method used to report average consolidated total assets and in conformity with Consolidated Reports of Condition and Income requirements. Once the method of reporting the subsidiaries' assets and tangible equity is chosen, however (current quarter or prior quarter), insured depository institutions cannot change the reporting method from quarter to quarter. An institution that reports consolidated assets and tangible equity using data for the prior quarter may switch to concurrent reporting on a permanent basis.

(ii) *Reporting for insured depository institutions with consolidated insured depository subsidiaries.* Insured

depository institutions that consolidate with other insured depository institutions for financial reporting purposes shall report for the parent and for each subsidiary individually, daily average consolidated total assets or weekly average consolidated total assets, as appropriate under paragraph (a)(1)(i) or (ii) above, and tangible equity, without consolidating their insured depository institution subsidiaries into the calculations. Investments in insured depository institution subsidiaries should be included in total assets using the equity method of accounting.

(b) *Assessment base for banker's banks*—(1) *Bankers bank defined.* A banker's bank for purposes of calculating deposit insurance assessments shall meet the definition of banker's bank as that term is used in 12 U.S.C. 24. Banker's banks that have funds from government capital infusion programs (such as TARP and the Small Business Lending Fund), and stock owned by the FDIC resulting from banks failures, as well as non-bank-owned stock resulting from equity compensation programs, are not thereby excluded from the definition of banker's banks.

(2) *Self-certification.* Institutions that meet the requirements of paragraph (b)(1) of this section shall so certify to that effect each quarter on the Consolidated Reports of Condition and Income or Thrift Financial Report or successor report.

(3) *Assessment base calculation for banker's banks.* A banker's bank shall pay deposit insurance assessments on its assessment base as calculated in paragraph (a) of this section provided that it conducts 50 percent or more of its business with entities other than its parent holding company or entities other than those controlled (control has the same meaning as in section 3(w)(5) of the FDI Act) either directly or indirectly by its parent holding company. The assessment base will exclude the average (daily or weekly depending on how the institution calculates its average consolidated total assets) amount of reserve balances passed through to the Federal Reserve, the average amount of reserve balances held at the Federal Reserve for its own account (including all balances due from the Federal Reserve as described in the instructions to line 4 of Schedule RC–A of the Consolidated Report of Condition and Income as of December 31, 2010), and the average amount of the institution's federal funds sold, but in no case shall the amount excluded exceed the sum of the bank's average amount of total deposits of commercial

banks and other depository institutions in the United States and the average amount of its federal funds purchased.

(c) *Assessment base for custodial banks*—(1) *Custodial bank defined.* A custodial bank for purposes of calculating deposit insurance assessments shall be an insured depository institution with previous calendar-year trust assets (fiduciary and custody and safekeeping assets, as described in the instructions to Schedule RC–T of the Consolidated Report of Condition and Income as of December 31, 2010) of at least $50 billion or an insured depository institution that derived more than 50 percent of its total revenue (interest income plus non-interest income) from trust activity over the previous calendar year.

(2) *Assessment base calculation for custodial banks.* A custodial bank shall pay deposit insurance assessments on its assessment base as calculated in paragraph (a) of this section, but the FDIC will exclude from that assessment base the daily or weekly average (depending on how the bank reports its average consolidated total assets) of all asset types described in the instructions to lines 34, 35, 36, and 37 of Schedule RC–R of the Consolidated Report of Condition and Income as of December 31, 2010 with a Basel risk weighting of 0 percent, regardless of maturity, plus 50 percent of those asset types described in lines 34, 35, 36, and 37 of Schedule RC–R as of December 31, 2010 with a Basel risk weighting of 20 percent regardless of maturity subject to the limitation that the daily or weekly average value of these assets cannot exceed the daily or weekly average value of those deposits classified as transaction accounts in the instructions to Schedule RC–E of the Consolidated Report of Condition and Income as of December 31, 2010, and identified by the institution as being directly linked to a fiduciary or custodial and safekeeping account asset.

(d) *Assessment base for insured branches of foreign banks.* Average consolidated total assets for an insured branch of a foreign bank are defined as total assets of the branch (including net due from related depository institutions) in accordance with the schedule of assets and liabilities in the Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks as of the assessment period for which the assessment is being calculated, but measured using the definition for reporting total assets in the schedule of quarterly averages in the Consolidated Reports of Condition and Income, and calculated using the appropriate daily or

weekly averaging method under paragraph (a)(1)(i) or (ii) of this section. Tangible equity for an insured branch of a foreign bank is eligible assets (determined in accordance with § 347.210 of the FDIC's regulations) less the book value of liabilities (exclusive of liabilities due to the foreign bank's head office, other branches, agencies, offices, or wholly owned subsidiaries) calculated on a monthly or end-of-quarter basis, according to the branch's size.

(e) *Newly insured institutions.* A newly insured institution shall pay an assessment for the assessment period during which it became insured. The FDIC will prorate the newly insured institution's assessment amount to reflect the number of days it was insured during the period.

■ 4. Revise § 327.6 to read as follows:

§ 327.6 Mergers and consolidations; other terminations of insurance.

(a) *Final quarterly certified invoice for acquired institution.* An institution that is not the resulting or surviving institution in a merger or consolidation must file a report of condition for every assessment period prior to the assessment period in which the merger or consolidation occurs. The surviving or resulting institution shall be responsible for ensuring that these reports of condition are filed and shall be liable for any unpaid assessments on the part of the institution that is not the resulting or surviving institution.

(b) *Assessment for quarter in which the merger or consolidation occurs.* For an assessment period in which a merger or consolidation occurs, consolidated total assets for the surviving or resulting institution shall include the consolidated total assets of all insured depository institutions that are parties to the merger or consolidation as if the merger or consolidation occurred on the first day of the assessment period. Tier 1 capital shall be reported in the same manner.

(c) *Other termination.* When the insured status of an institution is terminated, and the deposit liabilities of such institution are not assumed by another insured depository institution—

(1) *Payment of assessments; quarterly certified statement invoices.* The depository institution whose insured status is terminating shall continue to file and certify its quarterly certified statement invoice and pay assessments for the assessment period its deposits are insured. Such institution shall not be required to certify its quarterly certified statement invoice and pay further assessments after it has paid in

full its deposit liabilities and the assessment to the Corporation required to be paid for the assessment period in which its deposit liabilities are paid in full, and after it, under applicable law, goes out of business or transfers all or substantially all of its assets and liabilities to other institutions or otherwise ceases to be obliged to pay subsequent assessments.

(2) *Payment of deposits; certification to Corporation.* When the deposit liabilities of the depository institution have been paid in full, the depository institution shall certify to the Corporation that the deposit liabilities have been paid in full and give the date of the final payment. When the depository institution has unclaimed deposits, the certification shall further state the amount of the unclaimed deposits and the disposition made of the funds to be held to meet the claims. For assessment purposes, the following will be considered as payment of the unclaimed deposits:

(i) The transfer of cash funds in an amount sufficient to pay the unclaimed and unpaid deposits to the public official authorized by law to receive the same; or

(ii) If no law provides for the transfer of funds to a public official, the transfer of cash funds or compensatory assets to an insured depository institution in an amount sufficient to pay the unclaimed and unpaid deposits in consideration for the assumption of the deposit obligations by the insured depository institution.

(3) *Notice to depositors.* (i) The depository institution whose insured status is terminating shall give sufficient advance notice of the intended transfer to the owners of the unclaimed deposits to enable the depositors to obtain their deposits prior to the transfer. The notice shall be mailed to each depositor and shall be published in a local newspaper of general circulation. The notice shall advise the depositors of the liquidation of the depository institution, request them to call for and accept payment of their deposits, and state the disposition to be made of their deposits if they fail to promptly claim the deposits.

(ii) If the unclaimed and unpaid deposits are disposed of as provided in paragraph (c)(2)(i) of this section, a certified copy of the public official's receipt issued for the funds shall be furnished to the Corporation.

(iii) If the unclaimed and unpaid deposits are disposed of as provided in paragraph (c)(2)(ii) of this section, an affidavit of the publication and of the mailing of the notice to the depositors, together with a copy of the notice and a certified copy of the contract of

assumption, shall be furnished to the Corporation.

(4) *Notice to Corporation.* The depository institution whose insured status is terminating shall advise the Corporation of the date on which it goes out of business or transfers all or substantially all of its assets and liabilities to other institutions or otherwise ceases to be obligated to pay subsequent assessments and the method whereby the termination has been effected.

(d) *Resumption of insured status before insurance of deposits ceases.* If a depository institution whose insured status has been terminated is permitted by the Corporation to continue or resume its status as an insured depository institution before the insurance of its deposits has ceased, the institution will be deemed, for assessment purposes, to continue as an insured depository institution and must thereafter file and certify its quarterly certified statement invoices and pay assessments as though its insured status had not been terminated. The procedure for applying for the continuance or resumption of insured status is set forth in § 303.248 of this chapter.

■ 5. Amend § 327.8 by:

■ A. Removing paragraphs (e) and (f);
■ B. Redesignating paragraphs (g) through (s) as paragraphs (e) through (q) respectively;
■ C. Revising newly redesignated paragraphs (e), (f), (g), (k), (l), (m), (n), (o), and (p); and
■ D. Adding new paragraphs (r), (s), (t), and (u) to read as follows:

§ 327.8   Definitions.

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(e) *Small Institution.* An insured depository institution with assets of less than $10 billion as of December 31, 2006, and an insured branch of a foreign institution shall be classified as a small institution. If, after December 31, 2006, an institution classified as large under paragraph (f) of this section (other than an institution classified as large for purposes of § 327.9(e)) reports assets of less than $10 billion in its quarterly reports of condition for four consecutive quarters, the FDIC will reclassify the institution as small beginning the following quarter.

(f) *Large Institution.* An institution classified as large for purposes of § 327.9(e) or an insured depository institution with assets of $10 billion or more as of December 31, 2006 (other than an insured branch of a foreign bank or a highly complex institution) shall be classified as a large institution. If, after December 31, 2006, an institution

classified as small under paragraph (e) of this section reports assets of $10 billion or more in its quarterly reports of condition for four consecutive quarters, the FDIC will reclassify the institution as large beginning the following quarter.

(g) *Highly Complex Institution.* (1) A highly complex institution is:

(i) An insured depository institution (excluding a credit card bank) that has had $50 billion or more in total assets for at least four consecutive quarters that is controlled by a U.S. parent holding company that has had $500 billion or more in total assets for four consecutive quarters, or controlled by one or more intermediate U.S. parent holding companies that are controlled by a U.S. holding company that has had $500 billion or more in assets for four consecutive quarters; or

(ii) A processing bank or trust company.

(2) Control has the same meaning as in section 3(w)(5) of the FDI Act. A U.S. parent holding company is a parent holding company incorporated or organized under the laws of the United States or any State, as the term "State" is defined in section 3(a)(3) of the FDI Act. If, after December 31, 2010, an institution classified as highly complex under paragraph (g)(1)(i) of this section falls below $50 billion in total assets in its quarterly reports of condition for four consecutive quarters, or its parent holding company or companies fall below $500 billion in total assets for four consecutive quarters, the FDIC will reclassify the institution beginning the following quarter. If, after December 31, 2010, an institution classified as highly complex under paragraph (a)(1)(ii) of this section falls below $10 billion in total assets for four consecutive quarters, the FDIC will reclassify the institution beginning the following quarter.

*   *   *   *   *

(k) *Established depository institution.* An established insured depository institution is a bank or savings association that has been federally insured for at least five years as of the last day of any quarter for which it is being assessed.

(1) *Merger or consolidation involving new and established institution(s).* Subject to paragraphs (k)(2), (3), (4), and (5) of this section and § 327.9(f)(3) and (4), when an established institution merges into or consolidates with a new institution, the resulting institution is a new institution unless:

(i) The assets of the established institution, as reported in its report of condition for the quarter ending

immediately before the merger, exceeded the assets of the new institution, as reported in its report of condition for the quarter ending immediately before the merger; and

(ii) Substantially all of the management of the established institution continued as management of the resulting or surviving institution.

(2) *Consolidation involving established institutions.* When established institutions consolidate, the resulting institution is an established institution.

(3) *Grandfather exception.* If a new institution merges into an established institution, and the merger agreement was entered into on or before July 11, 2006, the resulting institution shall be deemed to be an established institution for purposes of this part.

(4) *Subsidiary exception.* Subject to paragraph (k)(5) of this section, a new institution will be considered established if it is a wholly owned subsidiary of:

(i) A company that is a bank holding company under the Bank Holding Company Act of 1956 or a savings and loan holding company under the Home Owners' Loan Act, and:

(A) At least one eligible depository institution (as defined in 12 CFR 303.2(r)) that is owned by the holding company has been chartered as a bank or savings association for at least five years as of the date that the otherwise new institution was established; and

(B) The holding company has a composite rating of at least "2" for bank holding companies or an above average or "A" rating for savings and loan holding companies and at least 75 percent of its insured depository institution assets are assets of eligible depository institutions, as defined in 12 CFR 303.2(r); or

(ii) An eligible depository institution, as defined in 12 CFR 303.2(r), that has been chartered as a bank or savings association for at least five years as of the date that the otherwise new institution was established.

(5) *Effect of credit union conversion.* In determining whether an insured depository institution is new or established, the FDIC will include any period of time that the institution was a federally insured credit union.

(l) *Risk assignment.* For all small institutions and insured branches of foreign banks, risk assignment includes assignment to Risk Category I, II, III, or IV, and, within Risk Category I, assignment to an assessment rate or rates. For all large institutions and highly complex institutions, risk assignment includes assignment to an assessment rate or rates.

(m) *Unsecured debt*—For purposes of the unsecured debt adjustment as set forth in § 327.9(d)(1) and the depository institution debt adjustment as set forth in § 327.9(d)(2), unsecured debt shall include senior unsecured liabilities and subordinated debt.

(n) *Senior unsecured liability*—For purposes of the unsecured debt adjustment as set forth in § 327.9(d)(1) and the depository institution debt adjustment as set forth in § 327.9(d)(2), senior unsecured liabilities shall be the unsecured portion of other borrowed money as defined in the quarterly report of condition for the reporting period as defined in paragraph (b) of this section, but shall not include any senior unsecured debt that the FDIC has guaranteed under the Temporary Liquidity Guarantee Program, 12 CFR Part 370.

(o) *Subordinated debt*—For purposes of the unsecured debt adjustment as set forth in § 327.9(d)(1) and the depository institution debt adjustment as set forth in § 327.9(d)(2), subordinated debt shall be as defined in the quarterly report of condition for the reporting period; however, subordinated debt shall also include limited-life preferred stock as defined in the quarterly report of condition for the reporting period.

(p) *Long-term unsecured debt*—For purposes of the unsecured debt adjustment as set forth in § 327.9(d)(1) and the depository institution debt adjustment as set forth in § 327.9(d)(2), long-term unsecured debt shall be unsecured debt with at least one year remaining until maturity; however, any such debt where the holder of the debt has a redemption option that is exercisable within one year of the reporting date shall not be deemed long-term unsecured debt.

* * * * *

(r) *Parent holding company*—A parent holding company has the same meaning as "depository institution holding company," as defined in § 3(w) of the FDI Act.

(s) *Processing bank or trust company*—A processing bank or trust company is an institution whose last three years' non-lending interest income, fiduciary revenues, and investment banking fees, combined, exceed 50 percent of total revenues (and its last three years fiduciary revenues are non-zero), and whose total fiduciary assets total $500 billion or more, and whose total assets for at least four consecutive quarters have been $10 billion or more.

(t) *Credit Card Bank*—A credit card bank is a bank for which credit card receivables plus securitized receivables

exceed 50 percent of assets plus securitized receivables.

(u) *Control*—Control has the same meaning as in section 2 of the Bank Holding Company Act of 1956, 12 U.S.C. 1841(a)(2).

■ 6. Revise § 327.9 to read as follows:

§ 327.9 Assessment pricing methods.

(a) *Small institutions*—(1) *Risk Categories.* Each small insured depository institution shall be assigned to one of the following four Risk Categories based upon the institution's capital evaluation and supervisory evaluation as defined in this section.

(i) *Risk Category I.* Small institutions in Supervisory Group A that are Well Capitalized will be assigned to Risk Category I.

(ii) *Risk Category II.* Small institutions in Supervisory Group A that are Adequately Capitalized, and small institutions in Supervisory Group B that are either Well Capitalized or Adequately Capitalized will be assigned to Risk Category II.

(iii) *Risk Category III.* Small institutions in Supervisory Groups A and B that are Undercapitalized, and small institutions in Supervisory Group C that are Well Capitalized or Adequately Capitalized will be assigned to Risk Category III.

(iv) *Risk Category IV.* Small institutions in Supervisory Group C that are Undercapitalized will be assigned to Risk Category IV.

(2) *Capital evaluations.* Each small institution will receive one of the following three capital evaluations on the basis of data reported in the institution's Consolidated Reports of Condition and Income or Thrift Financial Report (or successor report, as appropriate) dated as of March 31 for the assessment period beginning the preceding January 1; dated as of June 30 for the assessment period beginning the preceding April 1; dated as of September 30 for the assessment period beginning the preceding July 1; and dated as of December 31 for the assessment period beginning the preceding October 1.

(i) *Well Capitalized.* A Well Capitalized institution is one that satisfies each of the following capital ratio standards: Total risk-based ratio, 10.0 percent or greater; Tier 1 risk-based ratio, 6.0 percent or greater; and Tier 1 leverage ratio, 5.0 percent or greater.

(ii) *Adequately Capitalized.* An Adequately Capitalized institution is one that does not satisfy the standards of Well Capitalized under this paragraph but satisfies each of the following capital ratio standards: Total

risk-based ratio, 8.0 percent or greater; Tier 1 risk-based ratio, 4.0 percent or greater; and Tier 1 leverage ratio, 4.0 percent or greater.

(iii) *Undercapitalized.* An undercapitalized institution is one that does not qualify as either Well Capitalized or Adequately Capitalized under paragraphs (a)(2)(i) and (ii) of this section.

(3) *Supervisory evaluations.* Each small institution will be assigned to one of three Supervisory Groups based on the Corporation's consideration of supervisory evaluations provided by the institution's primary federal regulator. The supervisory evaluations include the results of examination findings by the primary federal regulator, as well as other information that the primary federal regulator determines to be relevant. In addition, the Corporation will take into consideration such other information (such as state examination findings, as appropriate) as it determines to be relevant to the institution's financial condition and the risk posed to the Deposit Insurance Fund. The three Supervisory Groups are:

(i) *Supervisory Group "A."* This Supervisory Group consists of financially sound institutions with only a few minor weaknesses;

(ii) *Supervisory Group "B."* This Supervisory Group consists of institutions that demonstrate weaknesses which, if not corrected, could result in significant deterioration of the institution and increased risk of loss to the Deposit Insurance Fund; and

(iii) *Supervisory Group "C."* This Supervisory Group consists of institutions that pose a substantial probability of loss to the Deposit Insurance Fund unless effective corrective action is taken.

(4) *Financial ratios method.* A small insured depository institution in Risk Category I shall have its initial base assessment rate determined using the financial ratios method.

(i) Under the financial ratios method, each of six financial ratios and a weighted average of CAMELS component ratings will be multiplied by a corresponding pricing multiplier. The sum of these products will be added to a uniform amount. The resulting sum shall equal the institution's initial base assessment rate; provided, however, that no institution's initial base assessment rate shall be less than the minimum initial base assessment rate in effect for Risk Category I institutions for that quarter nor greater than the maximum initial base assessment rate in effect for Risk Category I institutions for that quarter. An institution's initial base

assessment rate, subject to adjustment pursuant to paragraphs (d)(1), (2), and (3) of this section, as appropriate (resulting in the institution's total base assessment rate, which in no case can be lower than 50 percent of the institution's initial base assessment rate), and adjusted for the actual assessment rates set by the Board under § 327.10(f), will equal an institution's assessment rate. The six financial ratios are: Tier 1 Leverage Ratio; Loans past

due 30–89 days/gross assets; Nonperforming assets/gross assets; Net loan charge-offs/gross assets; Net income before taxes/risk-weighted assets; and the Adjusted brokered deposit ratio. The ratios are defined in Table A.1 of Appendix A to this subpart. The ratios will be determined for an assessment period based upon information contained in an institution's report of condition filed as of the last day of the assessment period

as set out in paragraph (a)(2) of this section. The weighted average of CAMELS component ratings is created by multiplying each component by the following percentages and adding the products: Capital adequacy—25%, Asset quality—20%, Management—25%, Earnings—10%, Liquidity—10%, and Sensitivity to market risk—10%. The following table sets forth the initial values of the pricing multipliers:

Risk measures *	Pricing multipliers **
Tier 1 Leverage Ratio	(0.056)
Loans Past Due 30–89 Days/Gross Assets	0.575
Nonperforming Assets/Gross Assets	1.074
Net Loan Charge-Offs/Gross Assets	1.210
Net Income before Taxes/Risk-Weighted Assets	(0.764)
Adjusted brokered deposit ratio	0.065
Weighted Average CAMELS Component Rating	1.095

* Ratios are expressed as percentages.
** Multipliers are rounded to three decimal places.

(ii) The six financial ratios and the weighted average CAMELS component rating will be multiplied by the respective pricing multiplier, and the products will be summed. To this result will be added the uniform amount. The resulting sum shall equal the institution's initial base assessment rate; provided, however, that no institution's initial base assessment rate shall be less than the minimum initial base assessment rate in effect for Risk Category I institutions for that quarter nor greater than the maximum initial base assessment rate in effect for Risk Category I institutions for that quarter.

(iii) *Uniform amount and pricing multipliers.* Except as adjusted for the actual assessment rates set by the Board under § 327.10(f), the uniform amount shall be:

(A) 4.861 whenever the assessment rate schedule set forth in § 327.10(a) is in effect;

(B) 2.861 whenever the assessment rate schedule set forth in § 327.10(b) is in effect;

(C) 1.861 whenever the assessment rate schedule set forth in § 327.10(c) is in effect; or

(D) 0.861 whenever the assessment rate schedule set forth in § 327.10(d) is in effect.

(iv) *Implementation of CAMELS rating changes—(A) Changes between risk categories.* If, during a quarter, a CAMELS composite rating change

occurs that results in a Risk Category I institution moving from Risk Category I to Risk Category II, III or IV, the institution's initial base assessment rate for the portion of the quarter that it was in Risk Category I shall be determined using the supervisory ratings in effect before the change and the financial ratios as of the end of the quarter, subject to adjustment pursuant to paragraphs (d)(1), (2), and (3) of this section, as appropriate, and adjusted for the actual assessment rates set by the Board under § 327.10(f). For the portion of the quarter that the institution was not in Risk Category I, the institution's initial base assessment rate, which shall be subject to adjustment pursuant to paragraphs (d)(1), (2), and (3), shall be determined under the assessment schedule for the appropriate Risk Category. If, during a quarter, a CAMELS composite rating change occurs that results in an institution moving from Risk Category II, III or IV to Risk Category I, then the financial ratios method shall apply for the portion of the quarter that it was in Risk Category I, subject to adjustment pursuant to paragraphs (d)(1), (2) and (3) of this section, as appropriate, and adjusted for the actual assessment rates set by the Board under § 327.10(f). For the portion of the quarter that the institution was not in Risk Category I, the institution's initial base assessment

rate, which shall be subject to adjustment pursuant to paragraphs (d)(1), (2), and (3) of this section shall be determined under the assessment schedule for the appropriate Risk Category.

(B) *Changes within Risk Category I.* If, during a quarter, an institution's CAMELS component ratings change in a way that will change the institution's initial base assessment rate within Risk Category I, the initial base assessment rate for the period before the change shall be determined under the financial ratios method using the CAMELS component ratings in effect before the change, subject to adjustment pursuant to paragraphs (d)(1), (2), and (3) of this section, as appropriate. Beginning on the date of the CAMELS component ratings change, the initial base assessment rate for the remainder of the quarter shall be determined using the CAMELS component ratings in effect after the change, again subject to adjustment pursuant to paragraphs (d)(1), (2), and (3) of this section, as appropriate.

(b) *Large and Highly Complex institutions—(1) Assessment scorecard for large institutions (other than highly complex institutions).* (i) A large institution other than a highly complex institution shall have its initial base assessment rate determined using the scorecard for large institutions.

SCORECARD FOR LARGE INSTITUTIONS

	Scorecard measures and components	Measure weights (percent)	Component weights (percent)
P	Performance Score		
P.1	Weighted Average CAMELS Rating	100	30
P.2	Ability to Withstand Asset-Related Stress	....	50
	Tier 1 Leverage Ratio	10	....
	Concentration Measure	35	....
	Core Earnings/Average Quarter-End Total Assets *	20	....
	Credit Quality Measure	35	....
P.3	Ability to Withstand Funding-Related Stress	....	20
	Core Deposits/Total Liabilities	60	....
	Balance Sheet Liquidity Ratio	40	....
L	Loss Severity Score	....	....
L.1	Loss Severity Measure	....	100

* Average of five quarter-end total assets (most recent and four prior quarters)

(ii) The scorecard for large institutions produces two scores: performance score and loss severity score.

(A) *Performance score for large institutions.* The performance score for large institutions is a weighted average of the scores for three measures: the weighted average CAMELS rating score, weighted at 30 percent; the ability to withstand asset-related stress score, weighted at 50 percent; and the ability to withstand funding-related stress score, weighted at 20 percent.

(1) Weighted average CAMELS rating score. (i) To compute the weighted average CAMELS rating score, a weighted average of an institution's CAMELS component ratings is calculated using the following weights:

CAMELS Component	Weight
C	25%
A	20%
M	25%
E	10%
L	10%
S	10%

(ii) A weighted average CAMELS rating converts to a score that ranges from 25 to 100. A weighted average rating of 1 equals a score of 25 and a weighted average of 3.5 or greater equals a score of 100. Weighted average CAMELS ratings between 1 and 3.5 are assigned a score between 25 and 100. The score increases at an increasing rate as the weighted average CAMELS rating increases. Appendix B of this subpart describes the conversion of a weighted average CAMELS rating to a score.

(*2*) *Ability to withstand asset-related stress score.* (i) The ability to withstand asset-related stress score is a weighted average of the scores for four measures: Tier 1 leverage ratio; concentration measure; the ratio of core earnings to average quarter-end total assets; and the credit quality measure. Appendices A and C of this subpart define these measures.

(ii) The Tier 1 leverage ratio and the ratio of core earnings to average quarter-end total assets are described in Appendix A and the method of calculating the scores is described in Appendix C of this subpart.

(iii) The score for the concentration measure is the greater of the higher-risk assets to Tier 1 capital and reserves score or the growth-adjusted portfolio concentrations score. Both ratios are described in Appendix C.

(*iv*) The score for the credit quality measure is the greater of the criticized and classified items to Tier 1 capital and reserves score or the underperforming assets to Tier 1 capital and reserves score.

(*v*) The following table shows the cutoff values and weights for the measures used to calculate the ability to withstand asset-related stress score. Appendix B of this subpart describes how each measure is converted to a score between 0 and 100 based upon the minimum and maximum cutoff values, where a score of 0 reflects the lowest risk and a score of 100 reflects the highest risk.

CUTOFF VALUES AND WEIGHTS FOR MEASURES TO CALCULATE ABILITY TO WITHSTAND ASSET-RELATED STRESS SCORE

Measures of the ability to withstand asset-related stress	Cutoff values		Weights (percent)
	Minimum (percent)	Maximum (percent)	
Tier 1 Leverage Ratio	6	13	10

CUTOFF VALUES AND WEIGHTS FOR MEASURES TO CALCULATE ABILITY TO WITHSTAND ASSET-RELATED STRESS SCORE—Continued

Measures of the ability to withstand asset-related stress	Cutoff values		Weights (percent)
	Minimum (percent)	Maximum (percent)	
Concentration Measure	....	....	35
Higher–Risk Assets to Tier 1 Capital and Reserves; or	0	135	....
Growth-Adjusted Portfolio Concentrations	4	56	....
Core Earnings/Average Quarter-End Total Assets*	0	2	20
Credit Quality Measure	....	....	35
Criticized and Classified Items/Tier 1 Capital and Reserves; or	7	100	....
Underperforming Assets/Tier 1 Capital and Reserves	2	35	....

*Average of five quarter-end total assets (most recent and four prior quarters).

(*vi*) The score for each measure in the table in paragraph (b)(1)(ii)(A)(2)(v) is multiplied by its respective weight and the resulting weighted score is summed to arrive at the score for an ability to withstand asset-related stress, which can range from 0 to 100, where a score of 0 reflects the lowest risk and a score of 100 reflects the highest risk.

(*3*) *Ability to withstand funding-related stress score.* Two measures are used to compute the ability to withstand funding-related stress score: a core deposits to total liabilities ratio, and a balance sheet liquidity ratio. Appendix A of this subpart describes these measures. Appendix B of this subpart describes how these measures are converted to a score between 0 and 100,

where a score of 0 reflects the lowest risk and a score of 100 reflects the highest risk. The ability to withstand funding-related stress score is the weighted average of the scores for the two measures. In the following table, cutoff values and weights are used to derive an institution's ability to withstand funding-related stress score:

CUTOFF VALUES AND WEIGHTS TO CALCULATE ABILITY TO WITHSTAND FUNDING-RELATED STRESS SCORE

Measures of the ability to withstand funding-related stress	Cutoff values		Weights (percent)
	Minimum (percent)	Maximum (percent)	
Core Deposits/Total Liabilities	5	87	60
Balance Sheet Liquidity Ratio	7	243	40

(*4*) *Calculation of Performance Score.* In paragraph (b)(1)(ii)(A)(3), the scores for the weighted average CAMELS rating, the ability to withstand asset-related stress, and the ability to withstand funding-related stress are multiplied by their respective weights (30 percent, 50 percent and 20 percent, respectively) and the results are

summed to arrive at the performance score. The performance score cannot be less than 0 or more than 100, where a score of 0 reflects the lowest risk and a score of 100 reflects the highest risk.

(B) *Loss severity score.* The loss severity score is based on a loss severity measure that is described in Appendix D of this subpart. Appendix B also

describes how the loss severity measure is converted to a score between 0 and 100. The loss severity score cannot be less than 0 or more than 100, where a score of 0 reflects the lowest risk and a score of 100 reflects the highest risk. Cutoff values for the loss severity measure are:

CUTOFF VALUES TO CALCULATE LOSS SEVERITY SCORE

Measure of loss severity	Cutoff values	
	Minimum (percent)	Maximum (percent)
Loss Severity	0	28

(C) *Total Score.* The performance and loss severity scores are combined to produce a total score. The loss severity score is converted into a loss severity factor that ranges from 0.8 (score of 5 or lower) to 1.2 (score of 85 or higher). Scores at or below the minimum cutoff of 5 receive a loss severity factor of 0.8, and scores at or above the maximum cutoff of 85 receive a loss severity factor of 1.2. The following linear

interpolation converts loss severity scores between the cutoffs into a loss severity factor: (*Loss Severity Factor* = 0.8 + [0.005 * (*Loss Severity Score* − 5)]). The performance score is multiplied by the loss severity factor to produce a total score (total score = performance score * loss severity factor). The total score can be up to 20 percent higher or lower than the performance score but cannot be less than 30 or more than 90. The total score

is subject to adjustment, up or down, by a maximum of 15 points, as set forth in paragraph (b)(3) of this section. The resulting total score after adjustment cannot be less than 30 or more than 90.

(D) *Initial base assessment rate.* A large institution with a total score of 30 pays the minimum initial base assessment rate and an institution with a total score of 90 pays the maximum initial base assessment rate. For total

scores between 30 and 90, initial base assessment rates rise at an increasing rate as the total score increases,

calculated according to the following formula:

$$Rate = Minimum\ Rate + \left[\left(\left(1.4245 \times \left(\frac{Score}{100} \right)^3 \right) - 0.0385 \right) \times \left(Maximum\ Rate - Minimum\ Rate \right) \right]$$

where Rate is the initial base assessment rate (expressed in basis points), Maximum Rate is the maximum initial base assessment rate then in effect (expressed in basis points), and Minimum Rate is the minimum initial base assessment rate then in effect (expressed in basis points). Initial base assessment rates are subject to

adjustment pursuant to paragraphs (b)(3), (d)(1), (d)(2), of this section; large institutions that are not well capitalized or have a CAMELS composite rating of 3, 4 or 5 shall be subject to the adjustment at paragraph (d)(3); these adjustments shall result in the institution's total base assessment rate, which in no case can be lower than 50

percent of the institution's initial base assessment rate.

(2) *Assessment scorecard for highly complex institutions.* (i) A highly complex institution shall have its initial base assessment rate determined using the scorecard for highly complex institutions.

SCORECARD FOR HIGHLY COMPLEX INSTITUTIONS

	Measures and components	Measure weights (percent)	Component weights (percent)
P	Performance Score		
P.1	Weighted Average CAMELS Rating	100	30
P.2	Ability To Withstand Asset-Related Stress	....	50
	Tier 1 Leverage Ratio	10	....
	Concentration Measure	35	....
	Core Earnings/Average Quarter-End Total Assets	20	....
	Credit Quality Measure and Market Risk Measure	35	....
P.3	Ability To Withstand Funding-Related Stress	....	20
	Core Deposits/Total Liabilities	50	....
	Balance Sheet Liquidity Ratio	30	....
	Average Short-Term Funding/Average Total Assets	20	....
L	Loss Severity Score	....	....
L.1	Loss Severity	....	100

(ii) The scorecard for highly complex institutions produces two scores: performance and loss severity.

(A) *Performance score for highly complex institutions.* The performance score for highly complex institutions is the weighted average of the scores for

three components: weighted average CAMELS rating, weighted at 30 percent; ability to withstand asset-related stress score, weighted at 50 percent; and ability to withstand funding-related stress score, weighted at 20 percent.

(*1*) *Weighted average CAMELS rating score.* (*i*) To compute the score for the weighted average CAMELS rating, a weighted average of an institution's CAMELS component ratings is calculated using the following weights:

CAMELS Component	Weight
C	25%
A	20%
M	25%
E	10%
L	10%
S	10%

(*ii*) A weighted average CAMELS rating converts to a score that ranges from 25 to 100. A weighted average rating of 1 equals a score of 25 and a weighted average of 3.5 or greater equals a score of 100. Weighted average

CAMELS ratings between 1 and 3.5 are assigned a score between 25 and 100. The score increases at an increasing rate as the weighted average CAMELS rating increases. Appendix B of this subpart

describes the conversion of a weighted average CAMELS rating to a score.

(*2*) *Ability to withstand asset-related stress score.* (*i*) The ability to withstand asset-related stress score is a weighted average of the scores for four measures:

Tier 1 leverage ratio; concentration measure; ratio of core earnings to average quarter-end total assets; credit quality measure and market risk measure. Appendix A of this subpart describes these measures.

(*ii*) The Tier 1 leverage ratio and the ratio of core earnings to average quarter-end total assets are described in Appendix A and the method of calculating the scores is described in Appendix B of this subpart.

(*iii*) The score for the concentration measure for highly complex institutions is the greatest of the higher-risk assets to the sum of Tier 1 capital and reserves score, the top 20 counterparty exposure to the sum of Tier 1 capital and reserves score, or the largest counterparty exposure to the sum of Tier 1 capital

and reserves score. Each ratio is described in Appendix A of this subpart. The method used to convert the concentration measure into a score is described in Appendix C of this subpart.

(*iv*) The credit quality score is the greater of the criticized and classified items to Tier 1 capital and reserves score or the underperforming assets to Tier 1 capital and reserves score. The market risk score is the weighted average of three scores—the trading revenue volatility to Tier 1 capital score, the market risk capital to Tier 1 capital score, and the level 3 trading assets to Tier 1 capital score. All of these ratios are described in Appendix A of this subpart and the method of calculating the scores is described in Appendix B.

Each score is multiplied by its respective weight, and the resulting weighted score is summed to compute the score for the market risk measure. An overall weight of 35 percent is allocated between the scores for the credit quality measure and market risk measure. The allocation depends on the ratio of average trading assets to the sum of average securities, loans and trading assets (trading asset ratio) as follows:

(*v*) Weight for credit quality score = 35 percent * (1—trading asset ratio); and,

(*vi*) Weight for market risk score = 35 percent * trading asset ratio.

(*vii*) Each of the measures used to calculate the ability to withstand asset-related stress score is assigned the following cutoff values and weights:

CUTOFF VALUES AND WEIGHTS FOR MEASURES TO CALCULATE THE ABILITY TO WITHSTAND ASSET-RELATED STRESS SCORE

Measures of the ability to withstand asset-related stress	Cutoff values		Market risk measure (percent)	Weights (percent)
	Minimum (percent)	Maximum (percent)		
Tier 1 Leverage Ratio	6	13	....	10.
Concentration Measure	....	....	....	35.
Higher Risk Assets/Tier 1 Capital and Reserves;	0	135	....	
Top 20 Counterparty Exposure/Tier 1 Capital and Reserves; or ..	0	125	....	
Largest Counterparty Exposure/Tier 1 Capital and Reserves	0	20	....	
Core Earnings/Average Quarter-end Total Assets	0	2	....	20.
Credit Quality Measure*	....	....	....	35* (1 − Trading Asset Ratio).
Criticized and Classified Items to Tier 1 Capital and Reserves; or	7	100	....	
Underperforming Assets/Tier 1 Capital and Reserves	2	35	....	
Market Risk Measure*	....	....	....	35* Trading Asset Ratio.
Trading Revenue Volatility/Tier 1 Capital	0	2	60	
Market Risk Capital/Tier 1 Capital	0	10	20	
Level 3 Trading Assets/Tier 1 Capital	0	35	20	

*Combined, the credit quality measure and the market risk measure are assigned a 35 percent weight. The relative weight of each of the two scores depends on the ratio of average trading assets to the sum of average securities, loans and trading assets (trading asset ratio).

(*ix*) The score of each measure is multiplied by its respective weight and the resulting weighted score is summed to compute the ability to withstand asset-related stress score, which can range from 0 to 100, where a score of 0 reflects the lowest risk and a score of 100 reflects the highest risk.

(*3*) *Ability to withstand funding related stress score.* Three measures are used to calculate the score for the ability to withstand funding-related stress: a core deposits to total liabilities ratio, a balance sheet liquidity ratio, and average short-term funding to average total assets ratio. Appendix A of this subpart describes these ratios. Appendix

B of this subpart describes how each measure is converted to a score. The ability to withstand funding-related stress score is the weighted average of the scores for the three measures. In the following table, cutoff values and weights are used to derive an institution's ability to withstand funding-related stress score:

CUTOFF VALUES AND WEIGHTS TO CALCULATE ABILITY TO WITHSTAND FUNDING-RELATED STRESS MEASURES

Measures of the ability to withstand funding-related stress	Cutoff values		Weights (percent)
	Minimum (percent)	Maximum (percent)	
Core Deposits/Total Liabilities	5	87	50
Balance Sheet Liquidity Ratio	7	243	30
Average Short-term Funding/Average Total Assets	2	19	20

(*4*) *Calculation of Performance Score.* The weighted average CAMELS score, the ability to withstand asset-related stress score, and the ability to withstand funding-related stress score are multiplied by their respective weights (30 percent, 50 percent and 20 percent, respectively) and the results are summed to arrive at the performance score, which cannot be less than 0 or more than 100.

(B) *Loss severity score.* The loss severity score is based on a loss severity measure described in Appendix D of this subpart. Appendix B of this subpart also describes how the loss severity measure is converted to a score between 0 and 100. Cutoff values for the loss severity measure are:

CUTOFF VALUES FOR LOSS SEVERITY MEASURE

Measure of loss severity	Cutoff values	
	Minimum (percent)	Maximum (percent)
Loss Severity	0	28

(C) *Total Score.* The performance and loss severity scores are combined to produce a total score. The loss severity score is converted into a loss severity factor that ranges from 0.8 (score of 5 or lower) to 1.2 (score of 85 or higher). Scores at or below the minimum cutoff of 5 receive a loss severity factor of 0.8, and scores at or above the maximum cutoff of 85 receive a loss severity factor of 1.2. The following linear interpolation converts loss severity scores between the cutoffs into a loss severity factor: (Loss Severity Factor = 0.8 + [0.005 * (Loss Severity Score − 5)]. The performance score is multiplied by the loss severity factor to produce a total score (total score = performance score * loss severity factor). The total score can be up to 20 percent higher or lower than the performance score but cannot be less than 30 or more than 90. The total score is subject to adjustment, up or down, by a maximum of 15 points, as set forth in paragraph (b)(3) of this section. The resulting total score after adjustment cannot be less than 30 or more than 90.

(D) *Initial base assessment rate.* A highly complex institution with a total score of 30 pays the minimum initial base assessment rate and an institution with a total score of 90 pays the maximum initial base assessment rate. For total scores between 30 and 90, initial base assessment rates rise at an increasing rate as the total score increases, calculated according to the following formula:

$$Rate = Minimum\ Rate + \left[\left(\left(1.4245 \times \left(\frac{Score}{100} \right)^3 \right) - 0.0385 \right) \times \left(Maximum\ Rate - Minimum\ Rate \right) \right]$$

where Rate is the initial base assessment rate (expressed in basis points), Maximum Rate is the maximum initial base assessment rate then in effect (expressed in basis points), and Minimum Rate is the minimum initial base assessment rate then in effect (expressed in basis points). Initial base assessment rates are subject to adjustment pursuant to paragraphs (b)(3), (d)(1), and (d)(2) of this section; highly complex institutions that are not well capitalized or have a CAMELS composite rating of 3, 4 or 5 shall be subject to the adjustment at paragraph (d)(3); these adjustments shall result in the institution's total base assessment rate, which in no case can be lower than 50 percent of the institution's initial base assessment rate.

(3) *Adjustment to total score for large institutions and highly complex institutions.* The total score for large institutions and highly complex institutions is subject to adjustment, up or down, by a maximum of 15 points, based upon significant risk factors that are not adequately captured in the appropriate scorecard. In making such adjustments, the FDIC may consider such information as financial performance and condition information and other market or supervisory information. The FDIC will also consult with an institution's primary federal regulator and, for state chartered institutions, state banking supervisor.

(i) *Prior notice of adjustments*—(A) *Prior notice of upward adjustment.* Prior to making any upward adjustment to an institution's total score because of considerations of additional risk information, the FDIC will formally notify the institution and its primary federal regulator and provide an opportunity to respond. This notification will include the reasons for the adjustment and when the adjustment will take effect.

(B) *Prior notice of downward adjustment.* Prior to making any downward adjustment to an institution's total score because of considerations of additional risk information, the FDIC will formally notify the institution's primary federal regulator and provide an opportunity to respond.

(ii) *Determination whether to adjust upward; effective period of adjustment.* After considering an institution's and the primary federal regulator's responses to the notice, the FDIC will determine whether the adjustment to an institution's total score is warranted, taking into account any revisions to scorecard measures, as well as any actions taken by the institution to address the FDIC's concerns described in the notice. The FDIC will evaluate the need for the adjustment each subsequent assessment period. Except as provided in paragraph (b)(3)(iv) of this section, the amount of adjustment cannot exceed the proposed adjustment amount contained in the initial notice unless additional notice is provided so that the primary federal regulator and the institution may respond.

(iii) *Determination whether to adjust downward; effective period of adjustment.* After considering the primary federal regulator's responses to the notice, the FDIC will determine whether the adjustment to total score is warranted, taking into account any revisions to scorecard measures. Any downward adjustment in an institution's total score will remain in effect for subsequent assessment periods until the FDIC determines that an

adjustment is no longer warranted. Downward adjustments will be made without notification to the institution. However, the FDIC will provide advance notice to an institution and its primary federal regulator and give them an opportunity to respond before removing a downward adjustment.

(iv) *Adjustment without notice.* Notwithstanding the notice provisions set forth above, the FDIC may change an institution's total score without advance notice under this paragraph, if the institution's supervisory ratings or the scorecard measures deteriorate.

(c) *Insured branches of foreign banks*—(1) *Risk categories for insured branches of foreign banks.* Insured branches of foreign banks shall be assigned to risk categories as set forth in paragraph (a)(1) of this section.

(2) *Capital evaluations for insured branches of foreign banks.* Each insured branch of a foreign bank will receive one of the following three capital evaluations on the basis of data reported in the institution's Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks dated as of March 31 for the assessment period beginning the preceding January 1; dated as of June 30 for the assessment period beginning the preceding April 1; dated as of September 30 for the assessment period beginning the preceding July 1; and dated as of December 31 for the assessment period beginning the preceding October 1.

(i) *Well Capitalized.* An insured branch of a foreign bank is Well Capitalized if the insured branch:

(A) Maintains the pledge of assets required under § 347.209 of this chapter; and

(B) Maintains the eligible assets prescribed under § 347.210 of this chapter at 108 percent or more of the average book value of the insured branch's third-party liabilities for the quarter ending on the report date specified in paragraph (c)(2) of this section.

(ii) *Adequately Capitalized.* An insured branch of a foreign bank is Adequately Capitalized if the insured branch:

(A) Maintains the pledge of assets required under § 347.209 of this chapter; and

(B) Maintains the eligible assets prescribed under § 347.210 of this chapter at 106 percent or more of the average book value of the insured branch's third-party liabilities for the quarter ending on the report date specified in paragraph (c)(2) of this section; and

(C) Does not meet the definition of a Well Capitalized insured branch of a foreign bank.

(iii) *Undercapitalized.* An insured branch of a foreign bank is undercapitalized institution if it does not qualify as either Well Capitalized or Adequately Capitalized under paragraphs (c)(2)(i) and (ii) of this section.

(3) *Supervisory evaluations for insured branches of foreign banks.* Each insured branch of a foreign bank will be assigned to one of three supervisory groups as set forth in paragraph (a)(3) of this section.

(4) *Assessment method for insured branches of foreign banks in Risk Category I.* Insured branches of foreign banks in Risk Category I shall be assessed using the weighted average ROCA component rating.

(i) *Weighted average ROCA component rating.* The weighted average ROCA component rating shall equal the sum of the products that result from multiplying ROCA component ratings by the following percentages: Risk Management—35%, Operational Controls—25%, Compliance—25%, and Asset Quality—15%. The weighted average ROCA rating will be multiplied by 5.076 (which shall be the pricing multiplier). To this result will be added a uniform amount. The resulting sum— the initial base assessment rate—will equal an institution's total base assessment rate; provided, however, that no institution's total base assessment rate will be less than the minimum total base assessment rate in effect for Risk Category I institutions for that quarter nor greater than the maximum total base assessment rate in effect for Risk Category I institutions for that quarter.

(ii) *Uniform amount.* Except as adjusted for the actual assessment rates set by the Board under § 327.10(f), the uniform amount for all insured branches of foreign banks shall be:

(A) −3.127 whenever the assessment rate schedule set forth in § 327.10(a) is in effect;

(B) −5.127 whenever the assessment rate schedule set forth in § 327.10(b) is in effect;

(C) −-6.127 whenever the assessment rate schedule set forth in § 327.10(c) is in effect; or

(D) −7.127 whenever the assessment rate schedule set forth in § 327.10(d) is in effect.

(iii) *Insured branches of foreign banks not subject to certain adjustments.* No insured branch of a foreign bank in any risk category shall be subject to the adjustments in paragraphs (b)(3), (d)(1), or (d)(3) of this section.

(iv) *Implementation of changes between Risk Categories for insured branches of foreign banks.* If, during a quarter, a ROCA rating change occurs that results in an insured branch of a foreign bank moving from Risk Category I to Risk Category II, III or IV, the institution's initial base assessment rate for the portion of the quarter that it was in Risk Category I shall be determined using the weighted average ROCA component rating. For the portion of the quarter that the institution was not in Risk Category I, the institution's initial base assessment rate shall be determined under the assessment schedule for the appropriate Risk Category. If, during a quarter, a ROCA rating change occurs that results in an insured branch of a foreign bank moving from Risk Category II, III or IV to Risk Category I, the institution's assessment rate for the portion of the quarter that it was in Risk Category I shall equal the rate determined as provided using the weighted average ROCA component rating. For the portion of the quarter that the institution was not in Risk Category I, the institution's initial base assessment rate shall be determined under the assessment schedule for the appropriate Risk Category.

(v) *Implementation of changes within Risk Category I for insured branches of foreign banks.* If, during a quarter, an insured branch of a foreign bank remains in Risk Category I, but a ROCA component rating changes that will affect the institution's initial base assessment rate, separate assessment rates for the portion(s) of the quarter before and after the change(s) shall be determined under this paragraph (c)(4) of this section.

(d) *Adjustments*—(1) *Unsecured debt adjustment to initial base assessment rate for all institutions.* All institutions, except new institutions as provided under paragraphs (f)(1) and (2) of this section and insured branches of foreign banks as provided under paragraph (c)(4)(iii) of this section, shall be subject to an adjustment of assessment rates for unsecured debt. Any unsecured debt adjustment shall be made after any adjustment under paragraph (b)(3) of this section.

(i) *Application of unsecured debt adjustment.* The unsecured debt adjustment shall be determined as the sum of the initial base assessment rate plus 40 basis points; that sum shall be multiplied by the ratio of an insured depository institution's long-term unsecured debt to its assessment base. The amount of the reduction in the assessment rate due to the adjustment is equal to the dollar amount of the

adjustment divided by the amount of the assessment base.

(ii) *Limitation*—No unsecured debt adjustment for any institution shall exceed the lesser of 5 basis points or 50 percent of the institution's initial base assessment rate.

(iii) *Applicable quarterly reports of condition*—Unsecured debt adjustment ratios for any given quarter shall be calculated from quarterly reports of condition (Consolidated Reports of Condition and Income and Thrift Financial Reports, or any successor reports to either, as appropriate) filed by each institution as of the last day of the quarter.

(2) *Depository institution debt adjustment to initial base assessment rate for all institutions.* All institutions shall be subject to an adjustment of assessment rates for unsecured debt held that is issued by another depository institution. Any such depository institution debt adjustment shall be made after any adjustment under paragraphs (b)(3) and (d)(1) of this section.

(i) *Application of depository institution debt adjustment.* An insured depository institution shall pay a 50 basis point adjustment on the amount of unsecured debt it holds that was issued by another insured depository institution to the extent that such debt exceeds 3 percent of the institution's Tier 1 capital. The amount of long-term unsecured debt issued by another insured depository institution shall be calculated using the same valuation methodology used to calculate the amount of such debt for reporting on the asset side of the balance sheets.

(ii) *Applicable quarterly reports of condition.* Depository institution debt adjustment ratios for any given quarter shall be calculated from quarterly reports of condition (Consolidated Reports of Condition and Income and Thrift Financial Reports, or any successor reports to either, as appropriate) filed by each institution as of the last day of the quarter.

(3) *Brokered Deposit Adjustment.* All small institutions in Risk Categories II, III, and IV, all large institutions and all highly complex institutions, except large and highly complex institutions (including new large and new highly complex institutions) that are well capitalized and have a CAMELS composite rating of 1 or 2, shall be subject to an assessment rate adjustment for brokered deposits. Any such brokered deposit adjustment shall be made after any adjustment under paragraphs (b)(3), (d)(1), and (d)(2) of this section. The brokered deposit adjustment includes all brokered deposits as defined in Section 29 of the Federal Deposit Insurance Act (12 U.S.C. 1831f), and 12 CFR 337.6, including reciprocal deposits as defined in § 327.8(p), and brokered deposits that consist of balances swept into an insured institution from another institution. The adjustment under this paragraph is limited to those institutions whose ratio of brokered deposits to domestic deposits is greater than 10 percent; asset growth rates do not affect the adjustment. Insured branches of foreign banks are not subject to the brokered deposit adjustment as provided in paragraph (c)(4)(iii) of this section.

(i) *Application of brokered deposit adjustment.* The brokered deposit adjustment shall be determined by multiplying 25 basis points by the ratio of the difference between an insured depository institution's brokered deposits and 10 percent of its domestic deposits to its assessment base.

(ii) *Limitation.* The maximum brokered deposit adjustment will be 10 basis points; the minimum brokered deposit adjustment will be 0.

(iii) *Applicable quarterly reports of condition.* Brokered deposit ratios for any given quarter shall be calculated from the quarterly reports of condition (Call Reports and Thrift Financial Reports, or any successor reports to either, as appropriate) filed by each institution as of the last day of the quarter.

(e) *Request to be treated as a large institution*—(1) *Procedure.* Any institution with assets of between $5 billion and $10 billion may request that the FDIC determine its assessment rate as a large institution. The FDIC will consider such a request provided that it has sufficient information to do so. Any such request must be made to the FDIC's Division of Insurance and Research. Any approved change will become effective within one year from the date of the request. If an institution whose request has been granted subsequently reports assets of less than $5 billion in its report of condition for four consecutive quarters, the institution shall be deemed a small institution for assessment purposes.

(2) *Time limit on subsequent request for alternate method.* An institution whose request to be assessed as a large institution is granted by the FDIC shall not be eligible to request that it be assessed as a small institution for a period of three years from the first quarter in which its approved request to be assessed as a large institution became effective. Any request to be assessed as a small institution must be made to the FDIC's Division of Insurance and Research.

(3) An institution that disagrees with the FDIC's determination that it is a large, highly complex, or small institution may request review of that determination pursuant to § 327.4(c).

(f) *New and established institutions and exceptions*—(1) *New small institutions.* A new small Risk Category I institution shall be assessed the Risk Category I maximum initial base assessment rate for the relevant assessment period. No new small institution in any risk category shall be subject to the unsecured debt adjustment as determined under paragraph (d)(1) of this section. All new small institutions in any Risk Category shall be subject to the depository institution debt adjustment as determined under paragraph (d)(2) of this section. All new small institutions in Risk Categories II, III, and IV shall be subject to the brokered deposit adjustment as determined under paragraph (d)(3) of this section.

(2) *New large institutions and new highly complex institutions.* All new large institutions and all new highly complex institutions shall be assessed under the appropriate method provided at paragraph (b)(1) or (2) of this section and subject to the adjustments provided at paragraphs (b)(3), (d)(2), and (d)(3) of this section. No new highly complex or large institutions are entitled to adjustment under paragraph (d)(1) of this section. If a large or highly complex institution has not yet received CAMELS ratings, it will be given a weighted CAMELS rating of 2 for assessment purposes until actual CAMELS ratings are assigned.

(3) *CAMELS ratings for the surviving institution in a merger or consolidation.* When an established institution merges with or consolidates into a new institution, if the FDIC determines the resulting institution to be an established institution under § 327.8(k)(1), its CAMELS ratings for assessment purposes will be based upon the established institution's ratings prior to the merger or consolidation until new ratings become available.

(4) *Rate applicable to institutions subject to subsidiary or credit union exception.* A small Risk Category I institution that is established under § 327.8(k)(4) or (5), but does not have CAMELS component ratings, shall be assessed at 2 basis points above the minimum initial base assessment rate applicable to Risk Category I institutions until it receives CAMELS component ratings. Thereafter, the assessment rate will be determined by annualizing, where appropriate, financial ratios

obtained from all quarterly reports of condition that have been filed, until the institution files four quarterly reports of condition. If a large or highly complex institution is considered established under § 327.8(k)(4) or (5), but does not have CAMELS component ratings, it will be given a weighted CAMELS rating of 2 for assessment purposes until actual CAMELS ratings are assigned.

(5) *Request for review.* An institution that disagrees with the FDIC's determination that it is a new institution may request review of that determination pursuant to § 327.4(c).

(g) *Assessment rates for bridge depository institutions and conservatorships.* Institutions that are bridge depository institutions under 12 U.S.C. 1821(n) and institutions for which the Corporation has been appointed or serves as conservator shall, in all cases, be assessed at the Risk Category I minimum initial base assessment rate, which shall not be subject to adjustment under paragraphs (b)(3), (d)(1), (2) or (3) of this section.

■ 7. Revise § 327.10 to read as follows:

§ 327.10 Assessment rate schedules.

(a) *Assessment rate schedules before the reserve ratio of the DIF reaches 1.15 percent—*

(1) *Applicability.* The assessment rate schedules in paragraph (a) of this section will cease to be applicable when the reserve ratio of the DIF first reaches 1.15 percent.

(2) *Initial Base Assessment Rate Schedule.* Before the reserve ratio of the DIF reaches 1.15 percent, the initial base assessment rate for an insured depository institution shall be the rate prescribed in the following schedule:

INITIAL BASE ASSESSMENT RATE SCHEDULE BEFORE THE RESERVE RATIO OF THE DIF REACHES 1.15 PERCENT

	Risk category I	Risk category II	Risk category III	Risk category IV	Large and highly complex institutions
Initial base assessment rate	5–9	14	23	35	5–35

* All amounts for all risk categories are in basis points annually. Initial base rates that are not the minimum or maximum rate will vary between these rates.

(i) *Risk Category I Initial Base Assessment Rate Schedule.* The annual initial base assessment rates for all institutions in Risk Category I shall range from 5 to 9 basis points.

(ii) *Risk Category II, III, and IV Initial Base Assessment Rate Schedule.* The annual initial base assessment rates for Risk Categories II, III, and IV shall be 14, 23, and 35 basis points, respectively.

(iii) All institutions in any one risk category, other than Risk Category I, will be charged the same initial base assessment rate, subject to adjustment as appropriate.

(iv) *Large and Highly Complex Institutions Initial Base Assessment Rate Schedule.* The annual initial base assessment rates for all large and highly

complex institutions shall range from 5 to 35 basis points.

(3) *Total Base Assessment Rate Schedule after Adjustments.* Before the reserve ratio of the DIF reaches 1.15 percent, the total base assessment rates after adjustments for an insured depository institution shall be as prescribed in the following schedule.

TOTAL BASE ASSESSMENT RATE SCHEDULE (AFTER ADJUSTMENTS)* BEFORE THE RESERVE RATIO OF THE DIF REACHES 1.15 PERCENT **

	Risk category I	Risk category II	Risk category III	Risk category IV	Large and highly complex institutions
Initial base assessment rate	5–9	14	23	35	5–35
Unsecured debt adjustment	(4.5)–0	(5)–0	(5)–0	(5)–0	(5)–0
Brokered deposit adjustment	....	0–10	0–10	0–10	0–10
Total base assessment rate	2.5–9	9–24	18–33	30–45	2.5–45

* All amounts for all risk categories are in basis points annually. Total base rates that are not the minimum or maximum rate will vary between these rates.

** Total base assessment rates do not include the depository institution debt adjustment.

(i) *Risk Category I Total Base Assessment Rate Schedule.* The annual total base assessment rates for all institutions in Risk Category I shall range from 2.5 to 9 basis points.

(ii) *Risk Category II Total Base Assessment Rate Schedule.* The annual total base assessment rates for Risk Category II shall range from 9 to 24 basis points.

(iii) *Risk Category III Total Base Assessment Rate Schedule.* The annual total base assessment rates for Risk

Category III shall range from 18 to 33 basis points.

(iv) *Risk Category IV Total Base Assessment Rate Schedule.* The annual total base assessment rates for Risk Category IV shall range from 30 to 45 basis points.

(v) *Large and Highly Complex Institutions Total Base Assessment Rate Schedule.* The annual total base assessment rates for all large and highly complex institutions shall range from 2.5 to 45 basis points.

(b) *Assessment rate schedules once the reserve ratio of the DIF first reaches 1.15 percent, and the reserve ratio for the immediately prior assessment period is less than 2 percent—* (1) *Initial Base Assessment Rate Schedule.* Once the reserve ratio of the DIF first reaches 1.15 percent, and the reserve ratio for the immediately prior assessment period is less than 2 percent, the initial base assessment rate for an insured depository institution shall be the rate prescribed in the following schedule:

INITIAL BASE ASSESSMENT RATE SCHEDULE ONCE THE RESERVE RATIO OF THE DIF REACHES 1.15 PERCENT AND THE RESERVE RATIO FOR THE IMMEDIATELY PRIOR ASSESSMENT PERIOD IS LESS THAN 2 PERCENT

	Risk category I	Risk category II	Risk category III	Risk category IV	Large and highly complex institutions
Initial base assessment rate	3–7	12	19	30	3–30

* All amounts for all risk categories are in basis points annually. Initial base rates that are not the minimum or maximum rate will vary between these rates.

(i) *Risk Category I Initial Base Assessment Rate Schedule.* The annual initial base assessment rates for all institutions in Risk Category I shall range from 3 to 7 basis points.

(ii) *Risk Category II, III, and IV Initial Base Assessment Rate Schedule.* The annual initial base assessment rates for Risk Categories II, III, and IV shall be 12, 19, and 30 basis points, respectively.

(iii) All institutions in any one risk category, other than Risk Category I, will be charged the same initial base assessment rate, subject to adjustment as appropriate.

(iv) *Large and Highly Complex Institutions Initial Base Assessment Rate Schedule.* The annual initial base assessment rates for all large and highly complex institutions shall range from 3 to 30 basis points.

(2) *Total Base Assessment Rate Schedule after Adjustments.* Once the reserve ratio of the DIF first reaches 1.15 percent, and the reserve ratio for the immediately prior assessment period is less than 2 percent, the total base assessment rates after adjustments for an insured depository institution shall be as prescribed in the following schedule.

TOTAL BASE ASSESSMENT RATE SCHEDULE (AFTER ADJUSTMENTS) * ONCE THE RESERVE RATIO OF THE DIF REACHES 1.15 PERCENT AND THE RESERVE RATIO FOR THE IMMEDIATELY PRIOR ASSESSMENT PERIOD IS LESS THAN 2 PERCENT **

	Risk category I	Risk category II	Risk category III	Risk category IV	Large and highly complex institutions
Initial base assessment rate	3–7	12	19	30	3–30
Unsecured debt adjustment	(3.5)–0	(5)–0	(5)–0	(5)–0	(5)–0
Brokered deposit adjustment	....	0–10	0–10	0–10	0–10
Total base assessment rate	1.5–7	7–22	14–29	25–40	1.5–40

* All amounts for all risk categories are in basis points annually. Total base rates that are not the minimum or maximum rate will vary between these rates.
** Total base assessment rates do not include the depository institution debt adjustment.

(i) *Risk Category I Total Base Assessment Rate Schedule.* The annual total base assessment rates for institutions in Risk Category I shall range from 1.5 to 7 basis points.

(ii) *Risk Category II Total Base Assessment Rate Schedule.* The annual total base assessment rates for Risk Category II shall range from 7 to 22 basis points.

(iii) *Risk Category III Total Base Assessment Rate Schedule.* The annual total base assessment rates for Risk

Category III shall range from 14 to 29 basis points.

(iv) *Risk Category IV Total Base Assessment Rate Schedule.* The annual total base assessment rates for Risk Category IV shall range from 25 to 40 basis points.

(v) *Large and Highly Complex Institutions Total Base Assessment Rate Schedule.* The annual total base assessment rates for all large and highly complex institutions shall range from 1.5 to 40 basis points.

(c) *Assessment rate schedules if the reserve ratio of the DIF for the prior assessment period is equal to or greater than 2 percent and less than 2.5 percent—*(1) *Initial Base Assessment Rate Schedule.* If the reserve ratio of the DIF for the prior assessment period is equal to or greater than 2 percent and less than 2.5 percent, the initial base assessment rate for an insured depository institution, except as provided in paragraph (e) of this section, shall be the rate prescribed in the following schedule:

INITIAL BASE ASSESSMENT RATE SCHEDULE IF RESERVE RATIO FOR PRIOR ASSESSMENT PERIOD IS EQUAL TO OR GREATER THAN 2 PERCENT BUT LESS THAN 2.5 PERCENT

	Risk category I	Risk category II	Risk category III	Risk category IV	Large and highly complex institutions
Initial base assessment rate	2–6	10	17	28	2–28

* All amounts for all risk categories are in basis points annually. Initial base rates that are not the minimum or maximum rate will vary between these rates.

(i) *Risk Category I Initial Base Assessment Rate Schedule.* The annual initial base assessment rates for all

institutions in Risk Category I shall range from 2 to 6 basis points.

(ii) *Risk Category II, III, and IV Initial Base Assessment Rate Schedule.* The

annual initial base assessment rates for Risk Categories II, III, and IV shall be 10, 17, and 28 basis points, respectively.

(iii) All institutions in any one risk category, other than Risk Category I, will be charged the same initial base assessment rate, subject to adjustment as appropriate.

(iv) *Large and Highly Complex Institutions Initial Base Assessment Rate Schedule.* The annual initial base assessment rates for all large and highly complex institutions shall range from 2 to 28 basis points.

(2) *Total Base Assessment Rate Schedule after Adjustments.* If the reserve ratio of the DIF for the prior assessment period is equal to or greater than 2 percent and less than 2.5 percent, the total base assessment rates after adjustments for an insured depository institution, except as provided in paragraph (e) of this section, shall be as prescribed in the following schedule.

TOTAL BASE ASSESSMENT RATE SCHEDULE (AFTER ADJUSTMENTS) * IF RESERVE RATIO FOR PRIOR ASSESSMENT PERIOD IS EQUAL TO OR GREATER THAN 2 PERCENT BUT LESS THAN 2.5 PERCENT **

	Risk category I	Risk category II	Risk category III	Risk category IV	Large and highly complex institutions
Initial base assessment rate	2–6	10	17	28	2–38
Unsecured debt adjustment	(3)–0	(5)–0	(5)–0	(5)–0	(5)–0
Brokered deposit adjustment	....	0–10	0–10	0–10	0–10
Total base assessment rate	1–6	5–20	12–27	23–38	1–38

* All amounts for all risk categories are in basis points annually. Total base rates that are not the minimum or maximum rate will vary between these rates.

** Total base assessment rates do not include the depository institution debt adjustment.

(i) *Risk Category I Total Base Assessment Rate Schedule.* The annual total base assessment rates for institutions in Risk Category I shall range from 1 to 6 basis points.

(ii) *Risk Category II Total Base Assessment Rate Schedule.* The annual total base assessment rates for Risk Category II shall range from 5 to 20 basis points.

(iii) *Risk Category III Total Base Assessment Rate Schedule.* The annual total base assessment rates for Risk

Category III shall range from 12 to 27 basis points.

(iv) *Risk Category IV Total Base Assessment Rate Schedule.* The annual total base assessment rates for Risk Category IV shall range from 23 to 38 basis points.

(v) *Large and Highly Complex Institutions Total Base Assessment Rate Schedule.* The annual total base assessment rates for all large and highly complex institutions shall range from 1 to 38 basis points.

(d) *Assessment rate schedules if the reserve ratio of the DIF for the prior assessment period is greater than 2.5 percent*—(1) *Initial Base Assessment Rate Schedule.* If the reserve ratio of the DIF for the prior assessment period is greater than 2.5 percent, the initial base assessment rate for an insured depository institution, except as provided in paragraph (e) of this section, shall be the rate prescribed in the following schedule:

INITIAL BASE ASSESSMENT RATE SCHEDULE IF RESERVE RATIO FOR PRIOR ASSESSMENT PERIOD IS GREATER THAN OR EQUAL TO 2.5 PERCENT

	Risk category I	Risk category II	Risk category III	Risk category IV	Large and highly complex institutions
Initial base assessment rate	1–5	9	15	25	1–25

* All amounts for all risk categories are in basis points annually. Initial base rates that are not the minimum or maximum rate will vary between these rates.

(i) *Risk Category I Initial Base Assessment Rate Schedule.* The annual initial base assessment rates for all institutions in Risk Category I shall range from 1 to 5 basis points.

(ii) *Risk Category II, III, and IV Initial Base Assessment Rate Schedule.* The annual initial base assessment rates for Risk Categories II, III, and IV shall be 9, 15, and 25 basis points, respectively.

(iii) All institutions in any one risk category, other than Risk Category I, will be charged the same initial base assessment rate, subject to adjustment as appropriate.

(iv) *Large and Highly Complex Institutions Initial Base Assessment Rate Schedule.* The annual initial base assessment rates for all large and highly complex institutions shall range from 1 to 25 basis points.

(2) *Total Base Assessment Rate Schedule after Adjustments.* If the reserve ratio of the DIF for the prior assessment period is greater than 2.5 percent, the total base assessment rates after adjustments for an insured depository institution, except as provided in paragraph (e) of this section, shall be the rate prescribed in the following schedule.

TOTAL BASE ASSESSMENT RATE SCHEDULE (AFTER ADJUSTMENTS) * IF RESERVE RATIO FOR PRIOR ASSESSMENT PERIOD IS GREATER THAN OR EQUAL TO 2.5 PERCENT **

	Risk category I	Risk category II	Risk category III	Risk category IV	Large and highly complex institutions
Initial base assessment rate	1–5	9	15	25	1–25

TOTAL BASE ASSESSMENT RATE SCHEDULE (AFTER ADJUSTMENTS) * IF RESERVE RATIO FOR PRIOR ASSESSMENT PERIOD IS GREATER THAN OR EQUAL TO 2.5 PERCENT **—Continued

	Risk category I	Risk category II	Risk category III	Risk category IV	Large and highly complex institutions
Unsecured debt adjustment	(2.5)–0	(4.5)–0	(5)–0	(5)–0	(5)–0
Brokered deposit adjustment	....	0–10	0–10	0–10	0–10
Total Base Assessment Rate	0.5–5	4.5–19	10–25	20–35	0.5–35

* All amounts for all risk categories are in basis points annually. Total base rates that are not the minimum or maximum rate will vary between these rates.

**Total base assessment rates do not include the depository institution debt adjustment.

(i) *Risk Category I Total Base Assessment Rate Schedule.* The annual total base assessment rates for institutions in Risk Category I shall range from 0.5 to 5 basis points.

(ii) *Risk Category II Total Base Assessment Rate Schedule.* The annual total base assessment rates for Risk Category II shall range from 4.5 to 19 basis points.

(iii) *Risk Category III Total Base Assessment Rate Schedule.* The annual total base assessment rates for Risk Category III shall range from 10 to 25 basis points.

(iv) *Risk Category IV Total Base Assessment Rate Schedule.* The annual total base assessment rates for Risk Category IV shall range from 20 to 35 basis points.

(v) *Large and Highly Complex Institutions Total Base Assessment Rate Schedule.* The annual total base assessment rates for all large and highly complex institutions shall range from 0.5 to 35 basis points.

(e) *Assessment Rate Schedules for New Institutions.* New depository institutions, as defined in 327.8(j), shall be subject to the assessment rate schedules as follows:

(1) *Prior to the reserve ratio of the DIF first reaching 1.15 percent after September 30, 2010.* After September 30, 2010, if the reserve ratio of the DIF has not reached 1.15 percent, new institutions shall be subject to the initial and total base assessment rate schedules provided for in paragraph (a) of this section.

(2) *Assessment rate schedules once the DIF reserve ratio first reaches 1.15 percent after September 30, 2010.* After September 30, 2010, once the reserve ratio of the DIF first reaches 1.15 percent, new institutions shall be subject to the initial and total base assessment rate schedules provided for in paragraph (b) of this section, even if the reserve ratio equals or exceeds 2 percent or 2.5 percent.

(f) *Total Base Assessment Rate Schedule adjustments and procedures— (1) Board Rate Adjustments.* The Board may increase or decrease the total base assessment rate schedule in paragraphs (a) through (d) of this section up to a maximum increase of 2 basis points or a fraction thereof or a maximum decrease of 2 basis points or a fraction thereof (after aggregating increases and decreases), as the Board deems necessary. Any such adjustment shall apply uniformly to each rate in the total base assessment rate schedule. In no case may such rate adjustments result in a total base assessment rate that is mathematically less than zero or in a total base assessment rate schedule that, at any time, is more than 2 basis points above or below the total base assessment schedule for the Deposit Insurance Fund in effect pursuant to paragraph (b) of this section, nor may any one such adjustment constitute an increase or decrease of more than 2 basis points.

(2) *Amount of revenue.* In setting assessment rates, the Board shall take into consideration the following:

(i) Estimated operating expenses of the Deposit Insurance Fund;

(ii) Case resolution expenditures and income of the Deposit Insurance Fund;

(iii) The projected effects of assessments on the capital and earnings of the institutions paying assessments to the Deposit Insurance Fund;

(iv) The risk factors and other factors taken into account pursuant to 12 U.S.C. 1817(b)(1); and

(v) Any other factors the Board may deem appropriate.

(3) *Adjustment procedure.* Any adjustment adopted by the Board pursuant to this paragraph will be adopted by rulemaking, except that the Corporation may set assessment rates as necessary to manage the reserve ratio, within set parameters not exceeding cumulatively 2 basis points, pursuant to paragraph (f)(1) of this section, without further rulemaking.

(4) *Announcement.* The Board shall announce the assessment schedules and the amount and basis for any adjustment thereto not later than 30 days before the quarterly certified statement invoice date specified in § 327.3(b) of this part for the first assessment period for which the adjustment shall be effective. Once set, rates will remain in effect until changed by the Board.

■ 8. Revise appendices A, B, and C to subpart A of part 327 to read as follows:

Appendix A to Subpart A of Part 327— Description of Scorecard Measures

Tier 1 Leverage Ratio	Tier 1 capital for Prompt Corrective Action (PCA) divided by adjusted average assets based on the definition for prompt corrective action.
Concentration Measure for Large Insured depository institutions (excluding Highly Complex Institutions).	The concentration score for large institutions is the higher of the following two scores:
(1) Higher-Risk Assets/Tier 1 Capital and Reserves	Sum of construction and land development (C&D) loans (funded and unfunded), leveraged loans (funded and unfunded), nontraditional mortgages, and subprime consumer loans divided by Tier 1 capital and reserves. See Appendix C for the detailed description of the ratio.
(2) Growth-Adjusted Portfolio Concentrations	The measure is calculated in the following steps:
	(1) Concentration levels (as a ratio to Tier 1 capital and reserves) are calculated for each broad portfolio category:

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	• C&D, • Other commercial real estate loans, • First lien residential mortgages (including non-agency residential mortgage-backed securities), • Closed-end junior liens and home equity lines of credit (HELOCs), • Commercial and industrial loans, • Credit card loans, and • Other consumer loans. (2) Risk weights are assigned to each loan category based on historical loss rates. (3) Concentration levels are multiplied by risk weights and squared to produce a risk-adjusted concentration ratio for each portfolio. (4) Three-year merger-adjusted portfolio growth rates are then scaled to a growth factor of 1 to 1.2 where a 3-year cumulative growth rate of 20 percent or less equals a factor of 1 and a growth rate of 80 percent or greater equals a factor of 1.2. If three years of data are not available, a growth factor of 1 will be assigned. (5) The risk-adjusted concentration ratio for each portfolio is multiplied by the growth factor and resulting values are summed. See Appendix C for the detailed description of the measure.
Concentration Measure for Highly Complex Institutions	Concentration score for highly complex institutions is the highest of the following three scores:
(1) Higher-Risk Assets/Tier 1 Capital and Reserves	Sum of C&D loans (funded and unfunded), leveraged loans (funded and unfunded), nontraditional mortgages, and subprime consumer loans divided by Tier 1 capital and reserves. See Appendix C for the detailed description of the measure.
(2) Top 20 Counterparty Exposure/Tier 1 Capital and Reserves	Sum of the total exposure amount to the largest 20 counterparties (in terms of exposure amount) divided by Tier 1 capital and reserves. Counterparty exposure is equal to the sum of Exposure at Default (EAD) associated with derivatives trading and Securities Financing Transactions (SFTs) and the gross lending exposure (including all unfunded commitments) for each counterparty or borrower at the consolidated entity level.[1]
(3) Largest Counterparty Exposure/Tier 1 Capital and Reserves	The amount of exposure to the largest counterparty (in terms of exposure amount) divided by Tier 1 capital and reserves. Counterparty exposure is equal to the sum of Exposure at Default (EAD) associated with derivatives trading and Securities Financing Transactions (SFTs) and the gross lending exposure (including all unfunded commitments) for each counterparty or borrower at the consolidated entity level.
Core Earnings/Average Quarter-End Total Assets	Core earnings are defined as net income less extraordinary items and tax-adjusted realized gains and losses on available-for-sale (AFS) and held-to-maturity (HTM) securities, adjusted for mergers. The ratio takes a four-quarter sum of merger-adjusted core earnings and divides it by an average of five quarter-end total assets (most recent and four prior quarters). If four quarters of data on core earnings are not available, data for quarters that are available will be added and annualized. If five quarters of data on total assets are not available, data for quarters that are available will be averaged.
Credit Quality Measure	The credit quality score is the higher of the following two scores:
(1) Criticized and Classified Items/Tier 1 Capital and Reserves	Sum of criticized and classified items divided by the sum of Tier 1 capital and reserves. Criticized and classified items include items an institution or its primary federal regulator have graded "Special Mention" or worse and include retail items under Uniform Retail Classification Guidelines, securities, funded and unfunded loans, other real estate owned (ORE), other assets, and marked-to-market counterparty positions, less credit valuation adjustments.[2] Criticized and classified items exclude loans and securities in trading books, and the amount recoverable from the U.S. government, its agencies, or government-sponsored agencies, under guarantee or insurance provisions.
(2) Underperforming Assets/Tier 1 Capital and Reserves	Sum of loans that are 30 days or more past due and still accruing interest, nonaccrual loans, restructured loans (including restructured 1–4 family loans), and ORE, excluding the maximum amount recoverable from the U.S. government, its agencies, or government-sponsored agencies, under guarantee or insurance provisions, divided by a sum of Tier 1 capital and reserves.
Core Deposits/Total Liabilities	Total domestic deposits excluding brokered deposits and uninsured non-brokered time deposits divided by total liabilities.

Balance Sheet Liquidity Ratio	Sum of cash and balances due from depository institutions, federal funds sold and securities purchased under agreements to resell, and the market value of available for sale and held to maturity agency securities (excludes agency mortgage-backed securities but includes all other agency securities issued by the U.S. Treasury, U.S. government agencies, and U.S. government sponsored enterprises) divided by the sum of federal funds purchased and repurchase agreements, other borrowings (including FHLB) with a remaining maturity of one year or less, 5 percent of insured domestic deposits, and 10 percent of uninsured domestic and foreign deposits.[3]
Potential Losses/Total Domestic Deposits (Loss Severity Measure)	Potential losses to the DIF in the event of failure divided by total domestic deposits. Appendix D describes the calculation of the loss severity measure in detail.
Market Risk Measure for Highly Complex Institutions	The market risk score is a weighted average of the following three scores:
(1) Trading Revenue Volatility/Tier 1 Capital	Trailing 4-quarter standard deviation of quarterly trading revenue (merger-adjusted) divided by Tier 1 capital.
(2) Market Risk Capital/Tier 1 Capital	Market risk capital divided by Tier 1 capital.[4]
(3) Level 3 Trading Assets/Tier 1 Capital	Level 3 trading assets divided by Tier 1 capital.
Average Short-term Funding/Average Total Assets	Quarterly average of federal funds purchased and repurchase agreements divided by the quarterly average of total assets as reported on Schedule RC–K of the Call Reports.

[1] EAD and SFTs are defined and described in the compilation issued by the Basel Committee on Banking Supervision in its June 2006 document, "International Convergence of Capital Measurement and Capital Standards." The definitions are described in detail in Annex 4 of the document. Any updates to the Basel II capital treatment of counterparty credit risk would be implemented as they are adopted. *http://www.bis.org/publ/bcbs128.pdf.*

[2] A marked-to-market counterparty position is equal to the sum of the net marked-to-market derivative exposures for each counterparty. The net marked-to-market derivative exposure equals the sum of all positive marked-to-market exposures net of legally enforceable netting provisions and net of all collateral held under a legally enforceable CSA plus any exposure where excess collateral has been posted to the counterparty. For purposes of the Criticized and Classified Items/Tier 1 Capital and Reserves definition a marked-to-market counterparty position less any credit valuation adjustment can never be less than zero.

[3] Deposit runoff rates for the balance sheet liquidity ratio reflect changes issued by the Basel Committee on Banking Supervision in its December 2010 document, "Basel III: International Framework for liquidity risk measurement, standards, and monitoring," *http://www.bis.org/publ/bcbs188.pdf.*

[4] Market risk capital is defined in Appendix C of Part 325 of the FDIC Rules and Regulations,. *http://www.fdic.gov/regulations/laws/rules/2000-4800.html#fdic2000appendixctopart325.*

Appendix B to Subpart A of Part 327—Conversion of Scorecard Measures into Score

1. Weighted Average CAMELS Rating

Weighted average CAMELS ratings between 1 and 3.5 are assigned a score between 25 and 100 according to the following equation:

$S = 25 + [(20/3) * (C^2 - 1)]$,

where:

S = the weighted average CAMELS score; and
C = the weighted average CAMELS rating.

2. Other Scorecard Measures

For certain scorecard measures, a lower ratio implies lower risk and a higher ratio implies higher risk. These measures include:

• Concentration measure;
• Credit quality measure;
• Market risk measure;
• Average short-term funding to average total assets ratio; and
• Potential losses to total domestic deposits ratio (loss severity measure).

For those measures, a value between the minimum and maximum cutoff values is converted linearly to a score between 0 and 100 according to the following formula:

$S = (V - Min) * 100/(Max - Min)$,

where S is score (rounded to three decimal points), V is the value of the measure, Min is the minimum cutoff value and Max is the maximum cutoff value.

For other scorecard measures, a lower value represents higher risk and a higher value represents lower risk. These measures include:

• Tier 1 leverage ratio;
• Core earnings to average quarter-end total assets ratio;
• Core deposits to total liabilities ratio; and
• Balance sheet liquidity ratio.

For those measures, a value between the minimum and maximum cutoff values is converted linearly to a score between 0 and 100, according to the following formula:

$S = (Max - V) * 100/(Max - Min)$,

where S is score (rounded to three decimal points), V is the value of the measure,

Max is the maximum cutoff value and Min is the minimum cutoff value.

Appendix C to Subpart A to Part 327—Concentration Measures

The concentration score is the higher of the higher-risk assets to Tier 1 capital and reserves score or the growth-adjusted portfolio concentrations score. The concentration score for highly complex institutions is the highest of the higher-risk assets to Tier 1 capital and reserves score, the Top 20 counterparty exposure to Tier 1 capital and reserves score, or the largest counterparty to Tier 1 capital and reserves score. The higher-risk assets to Tier 1 capital and reserve ratio and the growth-adjusted portfolio concentration measure are described below.

A. Higher-Risk Assets/Tier 1 Capital and Reserves

The higher-risk assets to Tier 1 capital and reserves ratio is the sum of the concentrations in each of four risk areas described below and is calculated as:

$$H_i = \sum_{k=1}^{4} \left(\frac{\text{Amount of Exposure}_{i,k}}{\text{Tier 1 Capital} + \text{Reserves}_i} \right)$$

where:

H is institution i's higher-risk concentration measure and

k is a risk area.[1] The four risk areas (k) are defined as:

• Construction and land development loans (funded and unfunded);

• Leveraged loans (funded and unfunded);[2]

• Nontraditional mortgage loans; and

• Subprime consumer loans.[3]

The risk areas are defined according to the interagency guidance for a given product with specific modifications made to minimize reporting discrepancies. The definitions for each risk area are as follows:

1. *Construction and Land Development Loans:* Construction and development loans include construction and land development loans outstanding and unfunded commitments.

2. *Leveraged Loans*: Leveraged loans include: (1) All commercial loans (funded and unfunded) with an original amount greater than $1 million that meet any one of the conditions below at either origination or renewal, except real estate loans; (2) securities issued by commercial borrowers that meet any one of the conditions below at either origination or renewal, except securities classified as trading book; and (3) and securitizations that are more than 50 percent collateralized by assets that meet any one of the conditions below at either

origination or renewal, except securities classified as trading book.[4][5]

• Loans or securities where borrower's total or senior debt to trailing twelve-month EBITDA[6] (i.e. operating leverage ratio) is greater than 4 or 3 times, respectively. For purposes of this calculation, the only permitted EBITDA adjustments are those adjustments specifically permitted for that borrower in its credit agreement; or

• Loans or securities that are designated as highly leveraged transactions (HLT) by syndication agent.[7]

3. *Nontraditional Mortgage Loans:* Nontraditional mortgage loans includes all residential loan products that allow the borrower to defer repayment of principal or interest and includes all interest-only products, teaser rate mortgages, and negative amortizing mortgages, with the exception of home equity lines of credit (HELOCs) or reverse mortgages.[8][9][10]

For purposes of the higher-risk concentration ratio, nontraditional mortgage loans include securitizations where more than 50 percent of the assets backing the securitization meet one or more of the preceding criteria for nontraditional mortgage loans, with the exception of those securities classified as trading book.

4. *Subprime Loans:* Subprime loans include loans made to borrowers that display one or more of the following credit risk characteristics (excluding subprime loans that are previously included as

nontraditional mortgage loans) at origination or upon refinancing, whichever is more recent.

• Two or more 30-day delinquencies in the last 12 months, or one or more 60-day delinquencies in the last 24 months;

• Judgment, foreclosure, repossession, or charge-off in the prior 24 months;

• Bankruptcy in the last 5 years; or

• Debt service-to-income ratio of 50 percent or greater, or otherwise limited ability to cover family living expenses after deducting total monthly debt-service requirements from monthly income.[11]

Subprime loans also include loans identified by an insured depository institution as subprime loans based upon similar borrower characteristics and securitizations where more than 50 percent of assets backing the securitization meet one or more of the preceding criteria for subprime loans, excluding those securities classified as trading book.

B. Growth-Adjusted Portfolio Concentration Measure

The growth-adjusted concentration measure is the sum of the concentration ratio for each of seven portfolios, adjusted for risk weights and growth. The product of the risk weight and the concentration ratio for each portfolio is first squared and then multiplied by the growth factor for each. The measure is calculated as:

$$\mathrm{N}_i = \sum_{k=1}^{7}\left[w_k * \left(\frac{\text{Amount of exposure}_{i,k}}{\text{Tier 1 Capital} + \text{Reserves}_i} \right)\right]^2 * g_k$$

where:

N is institution *i*'s growth-adjusted portfolio concentration measure;[12]

k is a portfolio;

g is a growth factor for institution i's portfolio k; and,

w is a risk weight for portfolio *k*.

The seven portfolios (k) are defined based on the Call Report/TFR data and they are:

• Construction and land development loans;

• Other commercial real estate loans;

• First-lien residential mortgages and non-agency residential mortgage-backed securities (excludes CMOs, REMICS, CMO and REMIC residuals, and stripped MBS issued by non-U.S. Government issuers for which the collateral consists of MBS issued or guaranteed by U.S. government agencies);

• Closed-end junior liens and home equity lines of credit (HELOCs);

• Commercial and industrial loans;

• Credit card loans; and

• Other consumer loans.[13][14]

The growth factor, g, is based on a three-year merger-adjusted growth rate for a given portfolio; g ranges from 1 to 1.2 where a 20 percent growth rate equals a factor of 1 and an 80 percent growth rate equals a factor of 1.2.[15] For growth rates less than 20 percent, g is 1; for growth rates greater than 80 percent, g is 1.2. For growth rates between 20 percent and 80 percent, the growth factor is calculated as:

[1] The high-risk concentration ratio is rounded to two decimal points.

[2] Unfunded amounts include irrevocable and revocable commitments.

[3] Each loan concentration category should include purchased credit impaired loans and should exclude the amount recoverable from the U.S. government, its agencies, or government-sponsored agencies, under guarantee or insurance provisions.

[4] The following guidelines should be used to determine the "original amount" of a loan:

(1) For loans drawn down under lines of credit or loan commitments, the "original amount" of the loan is the size of the line of credit or loan commitment when the line of credit or loan commitment was most recently approved, extended, or renewed prior to the report date. However, if the amount currently outstanding as of the report date exceeds this size, the "original amount" is the amount currently outstanding on the report date.

(2) For loan participations and syndications, the "original amount" of the loan participation or syndication is the entire amount of the credit originated by the lead lender.

(3) For all other loans, the "original amount" is the total amount of the loan at origination or the amount currently outstanding as of the report date, whichever is larger.

[5] Leveraged loans criteria are consistent with guidance issued by the Office of the Comptroller of the Currency in its Comptroller's Handbook, *http://www.occ.gov/static/publications/handbook/LeveragedLending.pdf,* but do not include all of the criteria in the handbook.

[6] Earnings before interest, taxes, depreciation, and amortization.

[7] *http://www.fdic.gov/news/news/press/2001/pr2801.html.*

[8] For purposes of this rule making, a teaser-rate mortgage loan is defined as a mortgage with a discounted initial rate where the lender offers a lower rate and lower payments for part of the mortgage term.

[9] *http://www.fdic.gov/regulations/laws/federal/2006/06noticeFINAL.html.*

[10] A mortgage loan is no longer considered a nontraditional mortgage once the teaser rate has expired. An interest only loan is no longer considered nontraditional once the loan begins to amortize.

[11] *http://www.fdic.gov/news/news/press/2001/pr0901a.html;* however, the definition in the text above excludes any reference to FICO or other credit bureau scores.

[12] The growth-adjusted portfolio concentration measure is rounded to two decimal points.

[13] All loan concentrations should include the fair value of purchased credit impaired loans.

[14] Each loan concentration category should exclude the amount of loans recoverable from the U.S. government, its agencies, or government-sponsored agencies, under guarantee or insurance provisions.

[15] The growth factor is rounded to two decimal points.

$$g_{i,k} = 1 + \left[\frac{1}{3} \left(G_{i,k} - 0.20 \right) \right]$$

where $G_{i,k} = \dfrac{V_{i,k,t}}{V_{i,k,t-12}} - 1$, V is the portfolio amount as reported on the Call Report or TFR

The risk weight for each portfolio reflects relative peak loss rates for banks at the 90th percentile during the 1990–2009 period.[16] These loss rates were converted into equivalent risk weights as shown in Table C.1.

TABLE C.1—90TH PERCENTILE ANNUAL LOSS RATES FOR 1990–2009 PERIOD AND CORRESPONDING RISK WEIGHTS

Portfolio	Loss rates (90th percentile) (percent)	Risk weights
First-Lien Mortgages	2.3	0.5
Second/Junior Lien Mortgages	4.6	0.9
Commercial and Industrial (C&I) Loans	5.0	1.0
Construction and Development (C&D) Loans	15.0	3.0
Commercial Real Estate Loans, excluding C&D	4.3	0.9
Credit Card Loans	11.8	2.4
Other Consumer Loans	5.9	1.2

■ 9. Add appendix D to subpart A of part 327 to read as follows:

Appendix D to Subpart A of Part 327—Description of the Loss Severity Measure

The loss severity measure applies a standardized set of assumptions to an institution's balance sheet to measure possible losses to the FDIC in the event of an institution's failure. To determine an institution's loss severity rate, the FDIC first applies assumptions about uninsured deposit and other unsecured liability runoff, and growth in insured deposits, to adjust the size and composition of the institution's liabilities. Assets are then reduced to match any reduction in liabilities.[1] The institution's asset values are then further reduced so that the Tier 1 leverage ratio reaches 2 percent.[2] In both cases, assets are adjusted pro rata to preserve the institution's asset composition. Assumptions regarding loss rates at failure for a given asset category and the extent of secured liabilities are then applied to estimated assets and liabilities at failure to determine whether the institution has enough unencumbered assets to cover domestic deposits. Any projected shortfall is divided by current domestic deposits to obtain an end-of-period loss severity ratio. The loss severity measure is an average loss severity ratio for the three most recent quarters of data available.

Runoff and Capital Adjustment Assumptions

Table D.1 contains run-off assumptions.

TABLE D.1—RUNOFF RATE ASSUMPTIONS

Liability type	Runoff rate * (percent)
Insured Deposits	(10)
Uninsured Deposits	58
Foreign Deposits	80
Federal Funds Purchased	100
Repurchase Agreements	75
Trading Liabilities	50
Unsecured Borrowings <= 1 Year	75
Secured Borrowings <= 1 Year	25
Subordinated Debt and Limited Liability Preferred Stock	15

* A negative rate implies growth.

Given the resulting total liabilities after runoff, assets are then reduced pro rata to preserve the relative amount of assets in each of the following asset categories and to achieve a Tier 1 leverage ratio of 2 percent:
• Cash and Interest Bearing Balances;

• Trading Account Assets;
• Federal Funds Sold and Repurchase Agreements;
• Treasury and Agency Securities;
• Municipal Securities;
• Other Securities;

• Construction and Development Loans;
• Nonresidential Real Estate Loans;
• Multifamily Real Estate Loans;
• 1–4 Family Closed-End First Liens;
• 1–4 Family Closed-End Junior Liens;
• Revolving Home Equity Loans; and

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[16] The risk weights are based on loss rates for each portfolio relative to the loss rate for C&I loans, which is given a risk weight of 1. The peak loss rates were derived as follows. The loss rate for each loan category for each bank with over $5 billion in total assets was calculated for each of the last twenty calendar years (1990–2009). The highest value of the 90th percentile of each loan category over the twenty year period was selected as the peak loss rate.

[1] In most cases, the model would yield reductions in liabilities and assets prior to failure. Exceptions may occur for institutions primarily funded through insured deposits, which the model assumes to grow prior to failure.

[2] Of course, in reality, runoff and capital declines occur more or less simultaneously as an institution approaches failure. The loss severity measure assumptions simplify this process for ease of modeling.

- Agricultural Real Estate Loans.

Recovery Value of Assets at Failure

Table D.2 shows loss rates applied to each of the asset categories as adjusted above.

TABLE D.2—ASSET LOSS RATE ASSUMPTIONS

Asset category	Loss rate (percent)
Cash and Interest Bearing Balances	0.0
Trading Account Assets	0.0
Federal Funds Sold and Repurchase Agreements	0.0
Treasury and Agency Securities	0.0
Municipal Securities	10.0
Other Securities	15.0
Construction and Development Loans	38.2
Nonresidential Real Estate Loans	17.6
Multifamily Real Estate Loans	10.8
1–4 Family Closed-End First Liens	19.4
1–4 Family Closed-End Junior Liens	41.0
Revolving Home Equity Loans	41.0
Agricultural Real Estate Loans	19.7
Agricultural Loans	11.8
Commercial and Industrial Loans	21.5
Credit Card Loans	18.3
Other Consumer Loans	18.3
All Other Loans	51.0
Other Assets	75.0

Secured Liabilities at Failure

Federal home loan bank advances, secured federal funds purchased and repurchase agreements are assumed to be fully secured. Foreign deposits are treated as fully secured because of the potential for ring fencing.

Loss Severity Ratio Calculation

The FDIC's loss given failure (LGD) is calculated as:

$$LGD = \frac{InsuredDeposits_{Failure}}{DomesticDeposits_{Failure}} \times \left(DomesticDeposits_{Failure} - RecoveryValueofAssets_{Failure} + SecuredLiabilities_{Failure}\right)$$

An end-of-quarter loss severity ratio is LGD divided by total domestic deposits at quarter-end and the loss severity measure for the scorecard is an average of end-of-period loss severity ratios for three most recent quarters.

■ 10. Revise § 327.50 to read as follows:

§ 327.50 Dividends.

(a) *Suspension of Dividends.* The Board will suspend dividends indefinitely whenever the DIF reserve ratio exceeds 1.50 percent at the end of any year.

(b) *Assessment Rate Schedule if DIF Reserve Ratio Exceeds 1.50 Percent.* In lieu of dividends, when the DIF reserve ratio exceeds 1.50 percent, assessment rates shall be determined as set forth in section 327.10, as appropriate.

§§ 327.51 through 327.54   [Removed]

■ 11. Remove §§ 327.51 through 327.54.

Note: The following appendices will not appear in the Code of Federal Regulations:

Appendices

Appendix 1—Analysis of the Projected Effects of the Payment of Assessments on the Capital and Earnings of Insured Depository Institutions

I. Introduction

This analysis estimates the effect of the changes in deposit insurance assessments adopted in the final rule on the equity capital and profitability of insured institutions. These changes include the new assessment base and assessment rates effective April 1, 2011. The FDIC set the rates in the final rule (shown in Table 4) to maintain approximate revenue neutrality upon adoption of the new assessment base required by Dodd-Frank. Therefore, for insured institutions in aggregate, the changes in assessment rates and the assessment base will not affect aggregate earnings and capital. This analysis, therefore, focuses on the magnitude of increases or decreases to individual institutions' earnings and capital resulting from the adoption of the final rule.

II. Assumptions and Data

The analysis assumes that pre-tax income for the next four quarters (beginning in the fourth quarter of 2010) for each institution is equal to annualized income in the second and third quarters of 2010, adjusted for mergers. The analysis also assumes that the effects of changes in assessments are not transferred to customers in the form of changes in borrowing rates, deposit rates, or service fees. Since deposit insurance assessments are a tax-deductible operating expense, increases in the assessment expense can lower taxable income and decreases in the assessment expense can increase taxable income. Therefore, the analysis considers the effective after-tax cost of assessments in calculating the effect on capital.[3]

The effect of the change in assessments on an institution's income is measured by the change in deposit insurance assessments as a percent of income before assessments, taxes, and extraordinary items (hereafter referred to as "income"). This income measure is used in order to eliminate the potentially transitory effects of extraordinary items and taxes on profitability. In order to facilitate a comparison of the impact of assessment changes, institutions were assigned to one of two groups: Those that were profitable and those that were unprofitable in the period covering the second and third quarters of 2010.

For this analysis, data as of September 30, 2010 are used to calculate each bank's assessment base and risk-based assessment rate, both absent the changes in the final rule and under the final rule. The base and rate

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[3] The analysis does not incorporate any tax effects from an operating loss carry forward or carry back.

are assumed to remain constant throughout the one year projection period.[4]

An institution's earnings retention and dividend policies also influence the extent to which assessments affect equity levels. If an institution maintains the same dollar amount of dividends when it pays a higher deposit insurance assessment under the final rule, equity (retained earnings) will be less by the full amount of the after-tax cost of the increase in the assessment. This analysis instead assumes that an institution will maintain its dividend rate (that is, dividends as a fraction of net income) unchanged from the weighted average rate reported over the four quarters ending September 30, 2010. In

the event that the ratio of equity to assets falls below 4 percent, however, this assumption is modified such that an institution retains the amount necessary to achieve a 4 percent minimum and distributes any remaining funds according to the dividend payout rate.[5]

III. Projected Effects on Capital and Earnings

The analysis indicates that projected decreases in assessments prevent 3 institutions from becoming under-capitalized (i.e., from falling below 4 percent equity to assets) that were projected to do so otherwise. Lower assessments would also prevent 1 institution from declining below 2

percent equity to assets that would have otherwise. No bank facing an increase in assessments would, as a result of the assessment increase, fall below the 4 percent or 2 percent thresholds.

Table 1.1 shows that approximately 84 percent of profitable institutions are projected to have a decrease in assessments in an amount between 0 and 10 percent of income. Another 14 percent of profitable institutions would have a reduction in assessments exceeding 10 percent of their income. Only 91 institutions would have an increase in assessments, with all but 12 of them between facing assessment increases between 0 and 10 percent of their income.

Table 1.1 - CHANGE IN ASSESSMENTS AS A PERCENT OF INCOME				
(Number and assets of profitable institutions)				
Change in Assessments as percent of income	Number of Institutions	Percent of Institutions	Assets of Institutions ($ billions)	Percent of Assets
Decrease over 40%	128	2	54	0
Decrease 20% to 40%	173	3	47	0
Decrease 10% to 20%	506	9	167	2
Decrease 5% to 10%	1,370	24	703	6
Decrease 0% to 5%	3,367	60	4,292	39
Increase 0% to 5%	71	1	5,172	47
Increase 5% to 10%	8	0	225	2
Increase 10% to 20%	7	0	99	1
Increase 20% to 40%	3	0	159	1
Increase over 40%	2	0	0	0
Total	5,635	100	10,919	100
(1) Income is defined as income before taxes and extraordinary items.				
(2) Profitable institutions are defined as those having positive merger-adjusted income for the six months ending September 30, 2010.				
(3) Excludes 10 insured branches of foreign banks and 3 institutions having less than 4 quarters of reported earnings.				

Table 1.2 provides the same analysis for institutions that were unprofitable during the period covering the second and third quarters of 2010. Table 1.2 shows that about 65 percent of unprofitable institutions are

projected to have a decrease in assessments in an amount between 0 and 10 percent of their losses. Another 33 percent will have lower assessments in amounts exceeding 10 percent income. Only 42 unprofitable banks

will face assessment increases, all but 10 of them in amounts between 0 and 10 percent of losses.

[4] All income statement items used in this analysis were adjusted for the effect of mergers. Institutions for which four quarters of non-zero earnings data were unavailable, including insured branches of foreign banks, were excluded from this analysis.

[5] The analysis uses 4 percent as the threshold because an insured institution generally needs to maintain Tier 1 capital of at least 4 percent of assets to be considered "adequately capitalized" under Prompt Corrective Action standards (12 CFR

325.103). In this analysis, equity to assets is used as the measure of capital adequacy.

Table 1.2 - CHANGE ASSESSMENTS AS A PERCENT OF LOSSES (Number and assets of unprofitable institutions)				
Change in Assessments as percent of losses	Number of Institutions	Percent of Institutions	Assets of Institutions ($ billions)	Percent of Assets
Decrease over 40%	171	8	205	8
Decrease 20% to 40%	194	9	247	10
Decrease 10% to 20%	344	16	119	5
Decrease 5% to 10%	368	17	411	17
Decrease 0% to 5%	1,001	47	580	24
Increase 0% to 5%	26	1	344	14
Increase 5% to 10%	6	0	301	12
Increase 10% to 20%	5	0	24	1
Increase 20% to 40%	1	0	31	1
Increase over 40%	4	0	180	7
Total	2,120	100	2,442	100

(1) Income is defined as income before taxes and extraordinary items.

(2) Unprofitable institutions are defined as those having negative merger-adjusted income for the six months ending September 30, 2010.

(3) Excludes 10 insured branches of foreign banks and 3 institutions having less than 4 quarters of reported earnings.

Appendix 2—Statistical Analysis of Measures

The risk measures included in the performance score and the weights assigned to those measures are generally based on the results of an ordinary least square (OLS) model, and in some cases, a logistic regression model. The OLS model estimates how well a set of risk measures in 2005 through 2008 can predict the FDIC's view, based on its experience and judgment, of the proper rank ordering of risk (the expert judgment ranking) for large institutions as of year-end 2009.

The OLS model is specified as:

$$E(Ranking_{i,2009}) = \beta_0 + \sum_{k=1}^{n} \beta_k * Score_{i,k,t}$$

where:
k is a risk measure;
n is the number of risk measures; and
t is the quarter that is being assessed.

The logistic regression model estimates how well the same set of risk measures in 2005 through 2008 can predict whether a large bank fails and it is specified as:

$$\Pr(Fail_i) = \frac{1}{1 + e^{-(\beta_0 + \sum_{k=1}^{n} \beta_k * Score_{i,k,t})}}$$

where:
Fail is whether an institution i failed on or prior to year-end 2009 or not.[1]

To select the risk measures for the scorecard, the FDIC first considered those measures deemed to be most relevant in assessing large institutions' ability to withstand stress. These candidate risk measures were converted to a score between 0 and 100, using specified minimum and maximum cutoff values, and then tested for statistical significance in both the expert judgment ranking and failure prediction models.

Table 2.1 provides descriptive statistics for all risk measures used in the large institution scorecard and highly complex institution scorecard. Most but not all of the minimum and maximum cutoff values for each scorecard measure equal the 10th and 90th percentile values among large institutions based upon data from 2000 through 2009.

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[1] For the purpose of regression analysis, large institutions that received significant government support or that came close to failure are deemed to have failed.

Table 2.1—Descriptive Statistics for Risk Measures

Risk Measure	Average	Median	Standard Deviation	Percentile Values			
				10th	25th	75th	90th
Weighted Average CAMELS	1.7	1.7	0.5	1.1	1.4	2.0	2.2
Asset Related Stress Measures							
Tier 1 Leverage Ratio	10.0	7.6	10.3	6.0	6.6	8.9	13.0
High Risk Concentration	105.6	74.5	125.8	0.0	11.8	143.5	238.6
Growth Adjusted Concentration	29.7	16.7	51.6	3.7	10.0	29.4	56.0
Core Earnings	1.1	1.1	1.9	0.0	0.7	1.5	2.3
Criticized And Classified	57.1	45.6	51.6	6.6	18.2	81.5	122.2
Underperforming Assets	18.4	13.0	32.7	2.3	7.1	20.9	35.0
Top 20 Counterparty	93.8	57.4	84.4	23.0	25.5	129.5	235.9
Largest Counterparty	11.0	7.7	8.6	2.6	3.8	19.0	22.7
Trading Volatility	1.0	0.4	2.7	0.1	0.2	0.8	1.6
Market Risk Capital	2.8	0.9	4.6	0.0	0.1	3.5	9.0
Level 3 Trading Assets	17.9	1.5	27.3	0.0	0.1	33.5	72.5
Funding Related Stress Measures							
Core Deposits	54.9	62.6	28.3	5.2	35.7	75.8	86.7
Balance Sheet Liquidity Ratio	602.0	49.1	10,956.9	7.1	20.7	108.3	242.9
Short Term Funding Ratio	9.8	8.6	7.4	1.7	3.3	15.4	19.1
Loss Severity Measure	12.7	10.2	13.3	0.0	2.1	17.0	28.0

Note: Statistics for those measures used exclusively in the Highly Complex Institution scorecard are based on data for those institutions only.

Table 2.2 provides the same statistics for each of the scored risk measures used in the expert judgment ranking and failure prediction models.[2] The figures are based on data from 2005 through 2008. The loss severity measure was excluded from the analysis, since neither of the dependent variables in the two regressions reflect the expected (or actual) loss given failure. Most of the performance measures, other than concentration and credit quality measures, are based on Call Report or TFR data and are defined in Appendix A. The concentration measure is described in detail in Appendix C.

Table 2.2—Descriptive Statistics for Risk Measure Scores

Risk Measure	Average Score	Median Score	Standard Deviation	Percentile Values			
				10th	25th	75th	90th
Weighted Average CAMELS	39.3	39.9	11.3	26.4	30.5	45.0	47.7
Tier 1 Leverage Ratio	66.7	77.0	31.0	1.3	55.1	89.9	99.0
Concentration Measure	67.8	85.0	35.7	7.4	37.3	100.0	100.0
Core Earnings / Average Assets	46.3	43.6	30.1	0.0	25.5	66.3	95.7
Credit Quality Measure	36.5	27.9	31.7	0.0	11.6	53.1	100.0
Core Deposits / Total Liabilities	40.7	31.5	31.9	2.0	16.7	62.8	98.6
Balance Sheet Liquidity Ratio	72.6	84.8	30.7	7.8	61.9	95.6	100.0

OLS Model Results and Derivation of Weights

Table 2.3 shows the results of the OLS model using the scored measures for years 2005 through 2008. The dependent variable for the model is an expert judgment ranking as of year-end 2009. All of the measures are statistically significant in several years at the 5 percent level. Three of the seven measures—the weighted average CAMELS rating, concentration measure, and core deposits ratio—are significant at the 1 percent level in all years. All of the estimated coefficients have a positive sign, which is consistent with expectations since each measure was normalized into a score that increases with risk.

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[2] The FDIC has conducted a number of robustness tests with alternative ratios for capital and earnings, a log transformation of several variables—the balance sheet liquidity and growth-adjusted concentration measures—and alternative dependent variables—CAMELS and the FDIC's internal risk ratings. These robustness tests show that the same set of variables are generally statistically significant in most models; that converting to a score from a raw ratio generally resolves any potential concern related to a nonlinear relationship between the dependent variable and several explanatory variables; and, finally, that alternative ratios for capital and earnings are not better in predicting expert judgment ranking or failure.

Table 2.3—OLS Regression Results: Scorecard Measures

Dependent Variable = Expert Judgment Ranking as of Year-end 2009

Risk Measure (Scored)	2005	2006	2007	2008
Weighted Average CAMELS	0.69 ***	0.54 ***	0.55 ***	0.48 ***
	(0.14)	(0.13)	(0.12)	(0.08)
Tier 1 Leverage Ratio	0.11 ***	0.11 ***	0.05	0.04
	(0.04)	(0.04)	(0.04)	(0.03)
Concentration Measure	0.42 ***	0.40 ***	0.40 ***	0.26 ***
	(0.04)	(0.04)	(0.04)	(0.03)
Core Earnings / Average Assets	0.11 **	0.18 ***	0.21 ***	0.21 ***
	(0.05)	(0.05)	(0.04)	(0.03)
Credit Quality Measure	0.13 **	0.19 ***	0.28 ***	0.33 ***
	(0.06)	(0.05)	(0.04)	(0.04)
Core Deposits / Total Liabilities	0.26 ***	0.23 ***	0.11 ***	0.19 ***
	(0.04)	(0.04)	(0.03)	(0.03)
Balance Sheet Liquidity Ratio	0.14 ***	0.14 ***	0.12 ***	0.06 **
	(0.04)	(0.04)	(0.04)	(0.03)
No. Obs	442	450	452	445
Adjust. R2	0.44	0.46	0.56	0.67

Note: Standard error in parenthesis

* Significant at the 10% level ** Significant at the 5% Level *** Significant at the 1% Level

The weight for each scorecard measure was generally based on the weight implied by coefficients for 2005 to 2008, with some adjustments to account for more recent experience. The implied weights are computed by dividing the average of scorecard measure coefficients for 2005 to 2008 by the sum of the average coefficients.

For example, the average coefficient on the weighted average CAMELS rating was 0.56, which is about 32 percent of the sum of the average coefficients (1.74). The current proposal assigns a weight of 30 percent to this measure. Similarly, the average coefficient of 0.37 on the concentration measure implies a weight of 21 percent (0.37/

1.74 = 0.21). The proposal effectively assigns a weight of 17.5 percent (50 percent weight on the ability to withstand asset-related stress score × 35 percent weight on the concentration measure). Table 2.4 shows the average coefficients and implied and actual weights.

Table 2.4—Derivation of Scorecard Weights

Risk Measure (Scored)	Average Coefficients	Implied Weights	Scorecard Weights
Weighted Average CAMELS	0.56	32%	30%
Tier 1 Leverage Ratio	0.08	4%	5%
Concentration Measure	0.37	21%	18%
Core Earnings / Average Assets	0.18	10%	10%
Credit Quality Measure	0.23	13%	18%
Core Deposits / Total Liabilities	0.20	11%	12%
Balance Sheet Liquidity Ratio	0.11	7%	8%
Total	1.74	100%	100%

Logistic Model Results

Table 2.5 shows the results of the logistic regression model, where the dependent variable for the model is whether an institution failed before year-end 2009. The weighted average CAMELS rating, Tier 1 leverage ratio, concentration measure, and core deposits ratio are significant at the 5 percent level in all years and have the expected sign. The core earnings ratio, credit quality measure, and balance sheet liquidity

ratio are not statistically significant in several years.

Table 2.5—Logistic Regression Results
Dependent Variable (1 = Failed; 0= Not failed)

Risk Measure (Scored)	2005	2006	2007	2008
Weighted Average CAMELS	0.03 **	0.06 ***	0.08 ***	0.05 ***
	(0.02)	(0.02)	(0.02)	(0.01)
Tier 1 Leverage Ratio	0.02 ***	0.03 ***	0.03 ***	0.03 ***
	(0.01)	(0.01)	(0.01)	(0.01)
Concentration Measure	0.09 ***	0.11 ***	0.16 ***	0.04 ***
	(0.02)	(0.03)	(0.04)	(0.01)
Core Earnings / Average Assets	0.01	0.00	0.00	0.02 **
	(0.01)	(0.01)	(0.01)	(0.01)
Credit Quality Measure	-0.01	0.00	0.02 ***	0.03 **
	(0.01)	(0.01)	(0.01)	(0.01)
Core Deposits / Total Liabilities	0.03 ***	0.03 ***	0.03 ***	0.04 ***
	(0.01)	(0.01)	(0.01)	(0.01)
Balance Sheet Liquidity Ratio	0.00	0.01	0.00	-0.01
	(0.01)	(0.01)	(0.01)	(0.01)
No. Obs	638	616	570	523
-2 Log Likelihood	296.0	275.1	247.4	204.9

Note: Standard error in parenthesis

* Significant at the 10% level ** Significant at the 5% Level *** Significant at the 1% Level

OLS Regression Results: CAMELS and the Current Small Bank Financial Ratios

Table 2.6 shows the results of the OLS regression model with the weighted average CAMELS rating only. These results show that while the weighted average CAMELS rating is statistically significant in predicting an expert judgment ranking as of year-end 2009, it only explains a small percentage of the variation in the year-end 2009 expert judgment ranking—particularly in models for 2005 (10 percent) through 2007 (19 percent).

Table 2.6—OLS Regression Results: Weighted Average CAMELS
Dependent Variable = Expert Judgment Ranking as of Year-end 2009

Variable	2005	2006	2007	2008
Weighted Average CAMELS	27.40 ***	30.44 ***	34.51 ***	36.08 ***
	(3.78)	(3.65)	(3.34)	(2.13)
No. Obs	439	445	446	439
Adjust. R2	0.10	0.13	0.19	0.40

Note: Standard error in parenthesis

* Significant at the 10% level ** Significant at the 5% Level *** Significant at the 1% Level

Table 2.7 shows the results of the OLS regression model with a weighted average CAMELS rating and the current small bank financial ratios. These results show that adding the current small bank model financial ratios improves the ability to predict the year-end 2009 expert judgment ranking; however, the improvement is not as significant as in the model with scorecard model. For example, in 2006, the model using small bank financial ratios explained 21 percent of the variation in the current expert judgment ranking. This compares to 46 percent for the scorecard.

Table 2.7—OLS Regression Results: Measures in Current Small Bank Method
Dependent Variable = Expert Judgment Ranking as of Year-end 2009

Risk Measures	2005	2006	2007	2008
Weighted average CAMELS rating	24.53 *** (3.73)	23.18 *** (3.78)	22.92 *** (3.70)	22.19 *** (2.96)
Tier 1 Leverage Ratio	-0.43 ** (0.19)	-0.47 ** (0.22)	-1.23 *** (0.31)	-0.45 (0.36)
Loans Past Due 30-89 Days/Gross Assets	7.81 ** (3.90)	16.02 *** (3.53)	9.32 *** (1.86)	8.81 *** (2.22)
Nonperforming Assets/Gross Assets	30.00 *** (6.36)	9.97 *** (3.32)	5.00 *** (1.60)	2.15 ** (0.91)
Net Loan Charge-Offs/Gross Assets	-14.21 *** (2.88)	-12.38 *** (2.91)	-3.89 (2.51)	-3.03 ** (1.45)
Net Income before Taxes/Risk-Weighted Asse	-0.03 (0.67)	-0.58 (0.63)	-1.94 ** (0.80)	-0.95 ** (0.43)
Adjusted Brokered Deposit Ratio	0.16 *** (0.06)	0.12 ** (0.06)	0.17 *** (0.05)	0.12 *** (0.04)
No. Obs	445	451	452	445
Adjust. R2	0.19	0.21	0.32	0.48

Note: Standard error in parenthesis
* Significant at the 10% level ** Significant at the 5% Level *** Significant at the 1% Level

Appendix 3—Conversion of Total Score into Initial Base Assessment Rate

The formula for converting an insured depository institution (IDI's) total score into an initial assessment rate is based on a single-variable logistic regression model, which uses a large IDI's total score as of year-end 2006 to predict whether the large IDI has failed on or before year-end 2009. The logistic model is estimated as:

$$\Pr(Fail_i) = \frac{1}{1 + e^{-(-7.7191 + 0.1064 * Score_{i,2006})}}$$

where
Fail is whether a large IDI *i.* failed on or before year-end 2009 or not; and [1]
Score is a large IDI *i's* total score as of year-end 2006.

Chart 3.1 below shows that the total score can reasonably differentiate large insured depository institutions that failed after 2006. The worst 12 percent of insured depository institutions in terms of their total score as of year-end 2006 accounted for more than 60 percent of failures over the next three years. This indicates a high correlation between the year-end 2006 total score and risk of failure, as results show that the failure rate was five times higher for institutions in the top 12 percent.

[1] For the purpose of regression analysis, large institutions that received significant government support or that came close to failure are deemed to have failed.

Chart 3.1—Percentage of Large Bank Failures Predicted by Total Score as of Year-end 2006
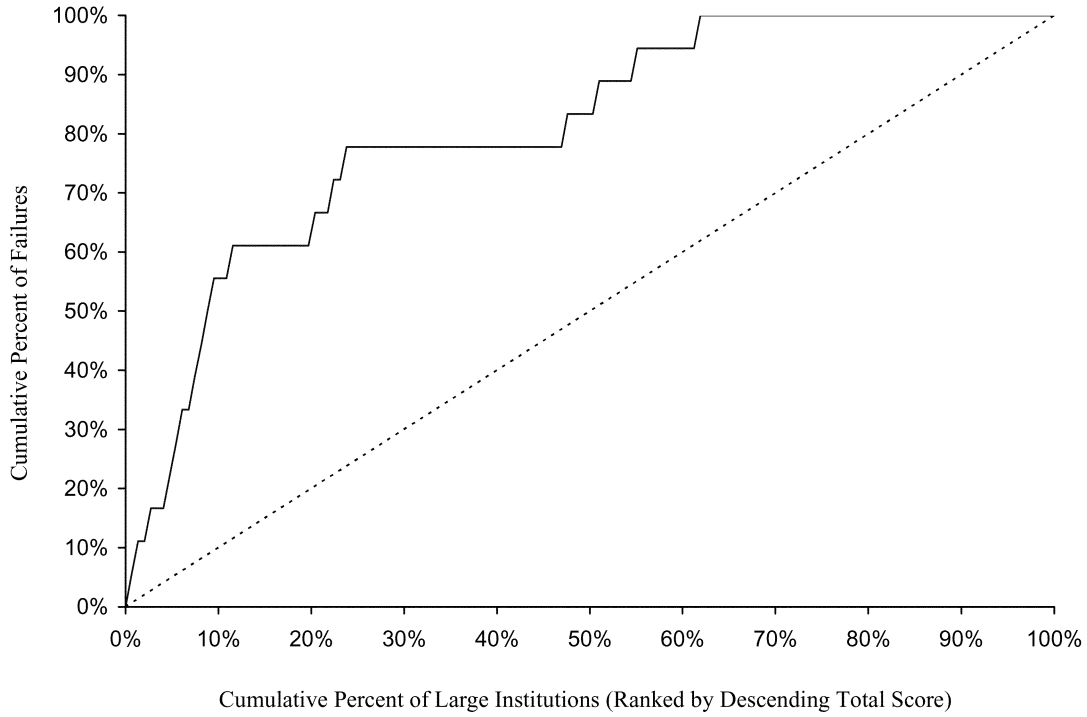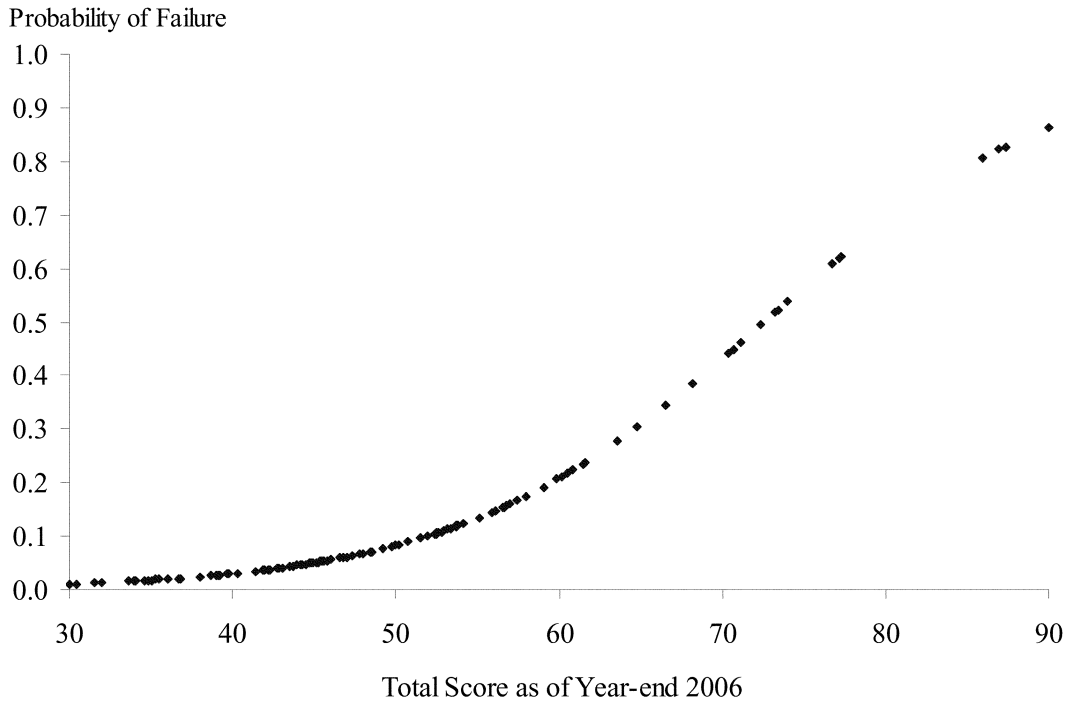

The plotted points in Chart 3.2 show the large bank failure probabilities estimated from the total scores using the logistic model and the results are nonlinear.

Chart 3.2—Estimated Large Bank Failure Probabilities Based on Total Score as of Year-end 2006

Probability of Failure

Total Score as of Year-end 2006

The calculation of the initial assessment rates approximates this nonlinear relationship for scores between 30 and 90.[2] A score of 30 or lower results in the minimum initial base assessment rate and a score of 90 or higher results in the maximum initial base assessment rate. Assuming an assessment rate range of 40 basis points, the initial base assessment rate for an IDI with a score greater than 30 and less than 90 is:

$$Rate = Minimum\ Rate + \left[\left(\left(1.4245 \times \left(\frac{Score}{100}\right)^3\right) - 0.0385\right) \times \left(Maximum\ Rate - Minimum\ Rate\right)\right]$$

Dated at Washington, DC, this 7th day of February 2011.

By order of the Board of Directors.

Federal Deposit Insurance Corporation.

Robert E. Feldman,

Executive Secretary.

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[2] The initial assessment rate formula is simplified while maintaining the nonlinear relationship.