

Holding Company Act of 1956, as amended, the Home Owners' Loan Act, as amended, or the Change in Bank Control Act, as amended, have been submitted to the applicant's appropriate Federal banking agency in connection with the proposed issuance; and

(F) any other relevant information that the FDIC deems appropriate.

(3) The factors to be considered by the FDIC in evaluating applications filed pursuant to paragraphs (h)(1)(i) through (h)(1)(iii) and (h)(1)(v) of this section include: the financial condition and supervisory history of the eligible/surviving entity. * * *

(4) * * * Applications made pursuant to paragraph (h)(1)(v) of this section must be filed with the FDIC no later than June 30, 2009.

* * * * *

■ 4. In part 370, amend § 370.5 as follows:

■ a. At the end of paragraph (h)(2), remove the last italicized sentence and add in its place two new sentences; and

■ b. Add new paragraph (j) as follows:

§ 370.5 Participation.

* * * * *

(h) * * *

(2) * * * [If the debt being issued is mandatory convertible debt, add: *The expiration date of the FDIC's guarantee is the earlier of the mandatory conversion date or June 30, 2012*. [If the debt being issued is any other senior unsecured debt, add: *The expiration date of the FDIC's guarantee is the earlier of the maturity date of the debt or June 30, 2012*.]

* * * * *

(j) No mandatory convertible debt may be issued without obtaining the FDIC's prior written approval.

■ 5. In part 370, amend § 370.6 as follows:

■ a. Revise paragraphs (d)(1).

■ b. Revise the first sentence of (d)(3).

■ c. Revise (d)(5) as follows:

§ 370.6 Assessments under the Debt Guarantee Program.

* * * * *

(d) * * *

(1) *Calculation of assessment.* Except as provided in paragraph (d)(3) of this section, the amount of assessment will be determined by multiplying the amount of FDIC-guaranteed debt times the term of the debt or, in the case of mandatory convertible debt, the time period from issuance to the mandatory conversion date, times an annualized assessment rate determined in accordance with the following table.

For debt with a maturity or time period to conversion date of—	The annualized assessment rate (in basis points) is—
180 days or less (excluding overnight debt)	50
181–364 days	75
365 days or greater	100

* * * * *

(3) The amount of assessment for an eligible entity, other than an insured depository institution, that controls, directly or indirectly, or is otherwise affiliated with, at least one insured depository institution will be determined by multiplying the amount of FDIC-guaranteed debt times the term of the debt or, in the case of mandatory convertible debt, the time period from issuance to the mandatory conversion date, times an annualized assessment rate determined in accordance with the rates set forth in the table in paragraph (d)(1) of this section, except that each such rate shall be increased by 10 basis points, if the combined assets of all insured depository institutions affiliated with such entity constitute less than 50 percent of consolidated holding company assets. * * *

* * * * *

(5) *No assessment reduction for early retirement of guaranteed debt.* A participating entity's assessment shall not be reduced if guaranteed debt is retired prior to its scheduled maturity date or conversion date.

* * * * *

■ 6. In part 370, amend § 370.12 to add a new sentence immediately after the first sentence in paragraph (b)(2); as follows:

§ 370.12 Payment on the guarantee.

* * * * *

(b) * * *

(2) * * * For purposes of mandatory convertible debt, principal payment shall be limited to amounts paid by holders under the issuance. * * *

* * * * *

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FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 327

RIN 3064–AD35

Assessments

AGENCY: Federal Deposit Insurance Corporation (FDIC).

ACTION: Final rule.

SUMMARY: The FDIC is amending our regulation to alter the way in which it differentiates for risk in the risk-based assessment system; revise deposit insurance assessment rates, including base assessment rates; and make technical and other changes to the rules governing the risk-based assessment system.

DATES: *Effective Date:* April 1, 2009.

FOR FURTHER INFORMATION CONTACT:

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SUPPLEMENTARY INFORMATION:

I. Background

The Reform Act

On February 8, 2006, the President signed the Federal Deposit Insurance Reform Act of 2005 into law; on February 15, 2006, he signed the Federal Deposit Insurance Reform Conforming Amendments Act of 2005 (collectively, the Reform Act).¹ The Reform Act enacted the bulk of the reform recommendations made by the FDIC in 2001.² The Reform Act, among other things, required that the FDIC, “prescribe final regulations, after notice and opportunity for comment * * * providing for assessments under section 7(b) of the Federal Deposit Insurance Act, as amended * * *,” thus giving the FDIC, through its rulemaking authority, the opportunity to better price deposit insurance for risk.³

The Federal Deposit Insurance Act, as amended by the Reform Act, continues to require that the assessment system be risk-based and allows the FDIC to define risk broadly. It defines a risk-based system as one based on an institution's probability of causing a loss to the deposit insurance fund due to the composition and concentration of the institution's assets and liabilities, the amount of loss given failure, and revenue needs of the Deposit Insurance Fund (the fund or DIF).⁴

¹ Federal Deposit Insurance Reform Act of 2005, Public Law 109–171, 120 Stat. 9; Federal Deposit Insurance Conforming Amendments Act of 2005, Public Law 109–173, 119 Stat. 3601.

² After a year long review of the deposit insurance system, the FDIC made several recommendations to Congress to reform the deposit insurance system. See <http://www.fdic.gov/deposit/insurance/initiative/directrecommendations.html> for details.

³ Section 2109(a)(5) of the Reform Act. Section 7(b) of the Federal Deposit Insurance Act (12 U.S.C. 1817(b)).

⁴ 12 Section 7(b)(1)(C) of the Federal Deposit Insurance Act (12 U.S.C. 1817(b)(1)(C)). The Reform Act merged the former Bank Insurance Fund and Savings Association Insurance Fund into the Deposit Insurance Fund.

Before passage of the Reform Act, the deposit insurance funds' target reserve ratio—the designated reserve ratio (DRR)—was generally set at 1.25 percent. Under the Reform Act, however, the FDIC may set the DRR within a range of 1.15 percent to 1.50 percent of estimated insured deposits. If the reserve ratio drops below 1.15 percent—or if the FDIC expects it to do so within six months—the FDIC must, within 90 days, establish and implement a plan to restore the DIF to 1.15 percent within five years (absent extraordinary circumstances).⁵

The Reform Act also restored to the FDIC's Board of Directors the discretion to price deposit insurance according to risk for all insured institutions regardless of the level of the fund reserve ratio.⁶

The Reform Act left in place the existing statutory provision allowing the FDIC to “establish separate risk-based assessment systems for large and small

members of the Deposit Insurance Fund.”⁷ Under the Reform Act, however, separate systems are subject to a new requirement that “[n]o insured depository institution shall be barred from the lowest-risk category solely because of size.”⁸

The 2006 Assessments Rule

Overview

On November 30, 2006, pursuant to the requirements of the Reform Act, the FDIC published in the **Federal Register** a final rule on the risk-based assessment system (the 2006 assessments rule).⁹ The rule became effective on January 1, 2007.

The 2006 assessments rule created four risk categories and named them Risk Categories I, II, III and IV. These four categories are based on two criteria: capital levels and supervisory ratings. Three capital groups—well capitalized, adequately capitalized, and undercapitalized—are based on the

leverage ratio and risk-based capital ratios for regulatory capital purposes. Three supervisory groups, termed A, B, and C, are based upon the FDIC's consideration of evaluations provided by the institution's primary federal regulator and other information the FDIC deems relevant.¹⁰ Group A consists of financially sound institutions with only a few minor weaknesses; Group B 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 insurance fund; and Group C consists of institutions that pose a substantial probability of loss to the insurance fund unless effective corrective action is taken.¹¹ Under the 2006 assessments rule, an institution's capital and supervisory groups determine its risk category as set forth in Table 1 below. (Risk categories appear in Roman numerals.)

TABLE 1—DETERMINATION OF RISK CATEGORY

Capital category	Supervisory group		
	A	B	C
Well Capitalized	I		III
Adequately Capitalized	II		
Undercapitalized	III		IV

The 2006 assessments rule established the following base rate schedule and allowed the FDIC Board to adjust rates uniformly from one quarter to the next up to three basis points above or below

the base schedule without further notice-and-comment rulemaking, provided that no single change from one quarter to the next can exceed three basis points.¹² Base assessment rates

within Risk Category I varied from 2 to 4 basis points, as set forth in Table 2 below.

TABLE 2—2007–08 BASE ASSESSMENT RATES

	Risk category				
	I*		II	III	IV
	Minimum	Maximum			
Annual Rates (in basis points)	2	4	7	25	40

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

⁵ Section 7(b)(3)(E) of the Federal Deposit Insurance Act (12 U.S.C. 1817(b)(3)(E)).

⁶ The Reform Act eliminated the prohibition against charging well-managed and well-capitalized institutions when the deposit insurance fund is at or above, and is expected to remain at or above, the designated reserve ratio (DRR). This prohibition was included as part of the Deposit Insurance Funds Act of 1996, Public Law 104–208, 110 Stat. 3009, 3009–479. However, while the Reform Act allows the DRR to be set between 1.15 percent and 1.50 percent, it also generally requires dividends of one-half of any amount in the fund in excess of the amount required to maintain the reserve ratio at 1.35 percent when the insurance fund reserve ratio exceeds 1.35 percent at the end of any year. The Board can suspend these dividends under certain circumstances. The Reform Act also requires dividends of all of the amount in excess of the

amount needed to maintain the reserve ratio at 1.50 percent at the end of any year. 12 U.S.C. 1817(e)(2).

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

⁸ Section 2104(a)(2) of the Reform Act amending Section 7(b)(2)(D) of the Federal Deposit Insurance Act (12 U.S.C. 1817(b)(2)(D)).

⁹ 71 FR 69282. The FDIC also adopted several other final rules implementing the Reform Act, including a final rule on operational changes to part 327. 71 FR 69270.

¹⁰ The term “primary federal regulator” is synonymous with the statutory term “appropriate federal banking agency.” Section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)).

¹¹ The capital groups and the supervisory groups have been in effect since 1993. In practice, the

supervisory group evaluations are based on an institution's composite CAMELS rating, a rating assigned by the institution's supervisor at the end of a bank examination, with 1 being the best rating and 5 being the lowest. CAMELS is an acronym for component ratings assigned in a bank examination: Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk. A composite CAMELS rating combines these component ratings, which also range from 1 (best) to 5 (worst). Generally, institutions with a CAMELS rating of 1 or 2 are assigned to supervisory group A, those with a CAMELS rating of 3 to group B, and those with a CAMELS rating of 4 or 5 to group C.

¹² The Board cannot adjust rates more than 2 basis points below the base rate schedule because rates cannot be less than zero.

TABLE 2—2007–08 BASE ASSESSMENT RATES

	Risk category				
	I*		II	III	IV
	Minimum	Maximum			
Annual Rates (in basis points)	2	4	7	25	40

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

The 2006 assessments rule set actual rates beginning January 1, 2007, as set out in Table 3 below.

TABLE 3—2007–08 ACTUAL ASSESSMENT RATES

	Risk category				
	I*		II	III	IV
	Minimum	Maximum			
Annual Rates (in basis points)	5	7	10	28	43

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

Risk Category I

Within Risk Category I, the 2006 assessments rule charges those institutions that pose the least risk a minimum assessment rate and those that pose the greatest risk a maximum assessment rate two basis points higher than the minimum rate. The rule charges other institutions within Risk Category I a rate that varies incrementally by institution between the minimum and maximum.

Within Risk Category I, the 2006 assessments rule combines supervisory ratings with other risk measures to further differentiate risk and determine assessment rates. The *financial ratios method* determines the assessment rates for most institutions in Risk Category I using a combination of weighted CAMELS component ratings and the following financial ratios:

- The Tier 1 Leverage Ratio;
 - Loans past due 30–89 days/gross assets;
 - Nonperforming assets/gross assets;
 - Net loan charge-offs/gross assets;
- and
- Net income before taxes/risk-weighted assets.

The weighted CAMELS components and financial ratios are multiplied by statistically derived pricing multipliers and the products, along with a uniform amount applicable to all institutions subject to the financial ratios method, are summed to derive the assessment rate under the base rate schedule. If the rate derived is below the minimum for Risk Category I, however, the institution will pay the minimum assessment rate for the risk category; if the rate derived

is above the maximum rate for Risk Category I, then the institution will pay the maximum rate for the risk category.

The multipliers and uniform amount were derived in such a way to ensure that, as of June 30, 2006, 45 percent of small Risk Category I institutions (other than institutions less than 5 years old) would have been charged the minimum rate and approximately 5 percent would have been charged the maximum rate. While the FDIC has not changed the multipliers and uniform amount since adoption of the 2006 assessments rule, the percentages of institutions that have been charged the minimum and maximum rates have changed over time as institutions' CAMELS component ratings and financial ratios have changed. Based upon June 30, 2008 data, approximately 28 percent of small Risk Category I institutions (other than institutions less than 5 years old) were charged the minimum rate and approximately 19 percent were charged the maximum rate.¹³

The *supervisory and debt ratings method* (or *debt ratings method*) determines the assessment rate for large institutions that have a long-term debt issuer rating.¹⁴ Long-term debt issuer

¹³ Based upon September 30, 2008 data, approximately 26 percent of small Risk Category I institutions (other than institutions less than 5 years old) were charged the minimum rate and approximately 23 percent were charged the maximum rate.

¹⁴ The final rule defined a large institution as an institution (other than an insured branch of a foreign bank) that has \$10 billion or more in assets as of December 31, 2006 (although an institution with at least \$5 billion in assets may also request treatment as a large institution). If, after December 31, 2006, an institution classified as small reports

ratings are converted to numerical values between 1 and 3 and averaged. The weighted average of an institution's CAMELS components and the average converted value of its long-term debt issuer ratings are multiplied by a common multiplier and added to a uniform amount applicable to all institutions subject to the supervisory and debt ratings method to derive the assessment rate under the base rate schedule. Again, if the rate derived is below the minimum for Risk Category I, the institution will pay the minimum assessment rate for the risk category; if the rate derived is above the maximum for Risk Category I, then the institution will pay the maximum rate for the risk category.

The multipliers and uniform amount were derived in such a way to ensure that, as of June 30, 2006, about 45 percent of Risk Category I large institutions (other than institutions less than 5 years old) would have been charged the minimum rate and approximately 5 percent would have been charged the maximum rate. These percentages have changed little from quarter to quarter thereafter even though industry conditions have changed. Based upon June 30, 2008, data, and ignoring the large bank adjustment (described below), approximately 45

assets of \$10 billion or more in its reports of condition for four consecutive quarters, the FDIC will reclassify the institution as large beginning the following quarter. If, after December 31, 2006, an institution classified as large reports assets of less than \$10 billion in its reports of condition for four consecutive quarters, the FDIC will reclassify the institution as small beginning the following quarter. 12 CFR 327.8(g) and (h) and 327.9(d)(6).

percent of Risk Category I large institutions (other than institutions less than 5 years old) were charged the minimum rate and approximately 11 percent were charged the maximum rate.¹⁵

Assessment rates for insured branches of foreign banks in Risk Category I are determined using ROCA components.¹⁶

For any Risk Category I large institution or insured branch of a foreign bank, initial assessment rate determinations may be modified up to half a basis point upon review of additional relevant information (the large bank adjustment).¹⁷

With certain exceptions, beginning in 2010, the 2006 assessments rule charges new institutions in Risk Category I (those established for less than five years), regardless of size, the maximum rate applicable to Risk Category I institutions. Until then, new institutions are treated like all others, except that a well-capitalized institution that has not yet received CAMELS component ratings is assessed at one basis point above the minimum rate applicable to Risk Category I institutions until it receives CAMELS component ratings.

The Need for a Restoration Plan

As part of a separate rule making in November 2006, the FDIC also set the DRR at 1.25 percent, effective January 1, 2007.¹⁸ In November 2006, the FDIC projected that the assessment rate schedule established by the 2006 assessments rule would raise the reserve ratio from 1.23 percent at the end of the second quarter of 2006 to 1.25 percent by 2009. At the time, insured institution failures were at historic lows (no insured institution had failed in almost two-and-a-half years prior to the rulemaking, the longest period in the FDIC's history without a failure) and industry returns on assets (ROAs) were

near all time highs. The FDIC's projection assumed the continued strength of the industry. By March 2008, the condition of the industry had deteriorated, and FDIC projected higher insurance losses compared to recent years. However, even with this increase in projected failures and losses, the reserve ratio was still estimated to reach the Board's target of 1.25 percent in 2009. Therefore, the Board voted in March 2008 to maintain the then existing assessment rate schedule.

Recent failures of FDIC-insured institutions caused the reserve ratio of the Deposit Insurance Fund (DIF) to decline from 1.19 percent as of March 30, 2008, to 1.01 percent as of June 30, 0.76 percent as of September 30, and 0.40 percent (preliminary) as of December 31. Twenty-five institutions failed in 2008, and the FDIC expects a substantially higher rate of institution failures in the next few years, leading to a further decline in the reserve ratio. Already, 14 institutions have failed in 2009. Because the fund reserve ratio fell below 1.15 percent as of June 30, 2008, and was expected to remain below 1.15 percent, the Reform Act required the FDIC to establish and implement a Restoration Plan to restore the reserve ratio to at least 1.15 percent within five years.

The Proposed Rule

On October 7, 2008, the FDIC established a Restoration Plan for the DIF.¹⁹ In the FDIC's view, restoring the reserve ratio to at least 1.15 percent within five years required an increase in assessment rates. Since rates were already three basis points above the base rate schedule, a new rulemaking was required. Consequently, on October 7, 2008, the FDIC Board of Directors also adopted a notice of proposed rulemaking with request for comments on revisions to the FDIC's assessment regulations (the proposed rule or NPR).²⁰ The NPR proposed that, effective January 1, 2009, assessment rates would increase uniformly by seven basis points for the first quarter 2009 assessment period. Effective April 1, 2009, the NPR proposed to alter the way in which the FDIC's risk-based assessment system differentiates for risk and set new deposit insurance assessment rates. Also effective on April 1, 2009, the NPR proposed to make technical and other changes to the rules governing the risk-based assessment system. The proposed rule was published concurrently with the Restoration Plan on October 16, 2008,

with a comment period scheduled to end on November 17, 2008.²¹

On November 7, 2008, the FDIC Board approved an extension of the comment period until December 17, 2008, on the parts of the proposed rulemaking that would become effective on April 1, 2009. The comment period for the proposed 7 basis point rate increase for the first quarter of 2009, with its separate proposed effective date of January 1, 2009, was not extended and expired on November 17, 2008. The final rule on the rate increase for the first quarter of 2009 was approved as proposed by the FDIC Board on December 16, 2008.²²

The FDIC received almost 5,000 comments on the parts of the proposed rule that would become effective on April 1, 2009, including proposed changes in how the FDIC's risk-based assessment system differentiates for risk and corresponding new assessment rates. This final rule implements the remaining changes that the FDIC proposed in the October notice of proposed rulemaking, with some alteration.

II. Overview of the Final Rule

In this rulemaking, the FDIC seeks to improve the way the assessment system differentiates risk among insured institutions by drawing upon measures of risk that were not included when the FDIC first revised its assessment system pursuant to the Reform Act. The FDIC believes that the rulemaking will make the assessment system more sensitive to risk. The rulemaking should also make the risk-based assessment system fairer, by limiting the subsidization of riskier institutions by safer ones. The assessment rate schedule established in this rule should provide sufficient revenue to cover losses resulting from a large volume of institution failures and raise the insurance fund's reserve ratio over time. However, as explained below, the FDIC is simultaneously issuing an interim rule to impose a 20 basis point special assessment (and possible additional special assessments of up to 10 basis points thereafter). The final rule, which differs in several ways from the proposed rule, is set out in detail in ensuing sections, but is briefly summarized here. The final rule will take effect April 1, 2009, and will apply to assessments for the second quarter of 2009 (which will be collected in September 2009) and thereafter.

¹⁵ Based upon September 30, 2008, data, and ignoring the large bank adjustment (described below), approximately 41 percent of Risk Category I large institutions (other than institutions less than 5 years old) were charged the minimum rate and approximately 11 percent were charged the maximum rate.

¹⁶ ROCA stands for Risk Management, Operational Controls, Compliance, and Asset Quality. Like CAMELS components, ROCA component ratings range from 1 (best rating) to a 5 rating (worst rating). Risk Category 1 insured branches of foreign banks generally have a ROCA composite rating of 1 or 2 and component ratings ranging from 1 to 3.

¹⁷ The FDIC has issued additional Guidelines for Large Institutions and Insured Foreign Branches in Risk Category I (the large bank guidelines) governing the large bank adjustment. 72 FR 27122 (May 14, 2007).

¹⁸ In November 2007 and October 2008, the Board again voted to maintain the DRR at 1.25 percent for 2008 and 2009, respectively. 71 FR 69325 (Nov. 30, 2006) and 72 FR 65576 (Nov. 21, 2007).

¹⁹ 73 FR 61,598 (Oct. 16, 2008).

²⁰ 12 CFR 327.

²¹ See 73 FR 61,560 (Oct. 16, 2008).

²² 73 FR 78,155 (Dec. 22, 2008).

Risk Category I

The final rule introduces a new financial ratio into the financial ratios method. This new ratio will capture certain brokered deposits (in excess of 10 percent of domestic deposits) that are used to fund rapid asset growth. The new financial ratio in the final rule differs from the one proposed in the NPR in two ways. It excludes deposits that an insured depository institution receives through a deposit placement network on a reciprocal basis, such that: (1) For any deposit received, the institution (as agent for depositors) places the same amount with other insured depository institutions through the network; and (2) each member of the network sets the interest rate to be paid on the entire amount of funds it places with other network members (henceforth referred to as reciprocal deposits). It also raises the asset growth threshold from that proposed in the NPR. The final rule also updates the uniform amount and the pricing multipliers for the weighted average CAMELS component ratings and financial ratios.

The final rule provides that the assessment rate for a large institution with a long-term debt issuer rating will be determined using a combination of the institution's weighted average CAMELS component ratings, its long-term debt issuer ratings (converted to numbers and averaged) and the financial ratios method assessment rate, each equally weighted. The new method will be known as the large bank method.

Under the final rule, the financial ratios method or the large bank method, whichever is applicable, will determine a Risk Category I institution's *initial* base assessment rate. The final rule will broaden the spread between minimum and maximum initial base assessment rates in Risk Category I from 2 basis points to an initial range of 4 basis points and adjust the percentage of institutions subject to these initial minimum and maximum rates.

Adjustments

Under the final rule, an institution's total base assessment rate can vary from the initial base rate as the result of possible adjustments. The final rule also increases the maximum possible Risk Category I large bank adjustment from one-half basis point to one basis point. Any such adjustment up or down will be made before any other adjustment

and will be subject to certain limits, which are described in detail below.

Under the final rule, an institution's unsecured debt adjustment—the institution's ratio of long-term unsecured debt (and, for small institutions, certain amounts of its Tier 1 capital) to domestic deposits—will lower the institution's base assessment rate.²³ Any decrease in base assessment rates will be limited to five basis points. The unsecured debt adjustment differs from the adjustment proposed in the NPR in several ways. The adjustment is larger for a given amount of unsecured debt (and, for small institutions, Tier 1 capital) and the maximum adjustment of five basis points is larger than the proposed maximum of two basis points in the NPR. The adjustment excludes senior unsecured debt that the FDIC has guaranteed under its Temporary Liquidity Guarantee Program. Finally, the adjustment lowers the threshold for inclusion of a small institution's Tier 1 capital.

Also, under the final rule, an institution's secured liability adjustment—which is based on the institution's ratio of secured liabilities to domestic deposits—will raise its base assessment rate. An institution's ratio of secured liabilities to domestic deposits (if greater than 25 percent), will increase its assessment rate, but the resulting base assessment rate after any such increase can be no more than 50 percent greater than it was before the adjustment. The secured liability adjustment will be made after any large bank adjustment or unsecured debt adjustment. This adjustment also differs from the adjustment proposed in the NPR in that an institution's ratio of secured liabilities to domestic deposits must be greater than 25 percent for an adjustment to exist, rather than 15 percent as proposed in the NPR.

Institutions in all risk categories will be subject to the unsecured debt adjustment and secured liability adjustment. In addition, the final rule makes a final adjustment for brokered deposits (the brokered deposit adjustment) for institutions in Risk Category II, III or IV. An institution's ratio of brokered deposits to domestic deposits (if greater than 10 percent) will increase its assessment rate, but any increase will be limited to no more than 10 basis points. The brokered deposit adjustment is as proposed in the NPR and will *include* reciprocal deposits.

Insured Branches of Foreign Banks

The final rule makes conforming changes to the pricing multipliers and uniform amount for insured branches of foreign banks in Risk Category I. The insured branch of a foreign bank's initial base assessment rate will be subject to any large bank adjustment, but not to the unsecured debt adjustment or secured liability adjustment. In fact, no insured branch of a foreign bank in any risk category will be subject to the unsecured debt adjustment, secured liability adjustment or brokered deposit adjustment.

New Institutions

The final rule makes conforming changes in the treatment of new insured depository institutions.²⁴ For assessment periods beginning on or after January 1, 2010, any new institutions in Risk Category I will be assessed at the maximum initial base assessment rate applicable to Risk Category I institutions.

For assessments for the last three quarters of 2009, until a Risk Category I new institution received CAMELS component ratings, it will have an initial base assessment rate that is two basis points above the minimum initial base assessment rate applicable to Risk Category I institutions, rather than one basis point above the minimum rate, as under the final rule adopted in 2006. For these three quarters, all other new institutions in Risk Category I will be treated as established institutions, except as provided in the next paragraph.

Either before or after January 1, 2010: no new institution, regardless of risk category, will be subject to the unsecured debt adjustment; any new institution, regardless of risk category, will be subject to the secured liability adjustment; and a new institution in Risk Categories II, III or IV will be subject to the brokered deposit adjustment. After January 1, 2010, no new institution in Risk Category I will be subject to the large bank adjustment.

Assessment Rates

As explained below, estimated losses from projected institution failures have risen considerably since the NPR was published last fall. Consequently, initial base assessment rates as of April 1, 2009, which are set forth in Table 4 below, are slightly higher than proposed in the NPR.

²³ Long-term unsecured debt includes senior unsecured and subordinated debt.

²⁴ As discussed below, subject to exceptions, the final rule defines a new insured depository institution as a bank or thrift that has not been

federally insured for at least five years as of the last day of any quarter for which it is being assessed.

TABLE 4—INITIAL BASE ASSESSMENT RATES AS OF APRIL 1, 2009

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

* Initial base rates that were not the minimum or maximum rate will vary between these rates.

After applying all possible adjustments, minimum and maximum total base assessment rates for each risk

category will be as set out in Table 5 below.

TABLE 5—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	7–24.0	17–43.0	27–58.0	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.

These rates and other revisions to the assessment rules take effect for the quarter beginning April 1, 2009, and will be reflected in the fund balance as of June 30, 2009, and assessments due September 30, 2009 and thereafter.

Because the outlook for losses to the insurance fund has deteriorated significantly since publication of the NPR last fall, the FDIC is simultaneously issuing an interim rule that provides for a 20 basis point special assessment on June 30, 2009. The interim rule also provides that the Board may impose additional special assessments of up to 10 basis points thereafter if the reserve ratio of the DIF is estimated to fall to a level that the Board believes would adversely affect public confidence or to a level which shall be close to zero or negative at the end of a calendar quarter.

The final rule continues to allow the FDIC Board to adopt actual rates that are higher or lower than total base assessment rates without the necessity of further notice and comment rulemaking, provided that: (1) the Board cannot increase or decrease total rates from one quarter to the next by more than three basis points without further notice-and-comment rulemaking; and (2) cumulative increases and decreases cannot be more than three basis points higher or lower than the total base rates without further notice-and-comment rulemaking.

Technical and Other Changes

The final rule also makes technical changes and one minor non-technical change to the assessments rules. These changes are detailed below.

III. Risk Category I: Financial Ratios Method

Brokered Deposits and Asset Growth

The final rule adds a new financial measure to the financial ratios method. This new financial measure, the adjusted brokered deposit ratio, will measure the extent to which brokered deposits are funding rapid asset growth. The adjusted brokered deposit ratio will affect only those established Risk Category I institutions whose total gross assets are more than 40 percent greater than they were four years previously, after adjusting for mergers and acquisitions, rather than 20 percent greater as proposed in the NPR, and whose brokered deposits (less reciprocal deposits) make up more than 10 percent of domestic deposits.^{25 26 27} Generally

²⁵ As discussed below, subject to exceptions, the final rule defines an established depository institution as a bank or thrift that has been federally insured for at least five years as of the last day of any quarter for which it is being assessed.

²⁶ An institution that four years previously had filed no report of condition or had reported no assets would be treated as having no growth unless it was a participant in a merger or acquisition (either as the acquiring or acquired institution) with an institution that had reported assets four years previously.

²⁷ References hereafter to “asset growth” or “growth in assets” refer to growth in gross assets.

speaking, the greater an institution’s asset growth and the greater its percentage of brokered deposits, the greater will be the increase in its initial base assessment rate. Small changes in asset growth rate or brokered deposits as a percentage of domestic deposits will lead to small changes in assessment rates.

If an institution’s ratio of brokered deposits to domestic deposits is 10 percent or less or if the institution’s asset growth over the previous four years is less than 40 percent, the adjusted brokered deposit ratio will be zero and will have no effect on the institution’s assessment rate. If an institution’s ratio of brokered deposits to domestic deposits exceeds 10 percent and its asset growth over the previous four years is more than 70 percent (rather than 40 percent as proposed in the NPR), the adjusted brokered deposit ratio will equal the institution’s ratio of brokered deposits to domestic deposits less the 10 percent threshold. If an institution’s ratio of brokered deposits to domestic deposits exceeds 10 percent but its asset growth over the previous four years is between 40 percent and 70 percent, overall asset growth rates will be converted into an asset growth rate factor ranging between 0 and 1, so that the adjusted brokered deposit ratio will equal a gradually increasing fraction of the ratio of brokered deposits to domestic deposits (minus the 10 percent threshold). The asset growth rate factor is derived by multiplying by $3^{1/3}$ an

amount equal to the overall rate of growth minus 40 percent and expressing the result as a decimal fraction rather than as a percentage (so that, for

example, $3\frac{1}{3}$ times 10 percent equals $0.33 * * *$).²⁸ The adjusted brokered deposit ratio will never be less than zero. Appendix A contains a detailed

mathematical definition of the ratio. Table 6 gives examples of how the adjusted brokered deposit ratio would be determined.

TABLE 6—ADJUSTED BROKERED DEPOSIT RATIO

A	B	C	D	E	F
Example	Ratio of brokered deposits to domestic deposits	Ratio of brokered deposits to domestic deposits minus 10 percent threshold (column B minus 10 percent)	Cumulative asset growth rate over four years	Asset growth rate factor	Adjusted brokered deposit ratio (column C times column E)
1	5.0%	0.0%	5.0%		0.0%
2	15.0%	5.0%	5.0%		0.0%
3	5.0%	0.0%	35.0%		0.0%
4	35.0%	25.0%	55.0%	0.500	12.5%
5	25.0%	15.0%	80.0%	1.000	15.0%

In Examples 1, 2 and 3, either the institution has a ratio of brokered deposits to domestic deposits that is less than 10 percent (Column B) or its four-year asset growth rate is less than 40 percent (Column D). Consequently, the adjusted brokered deposit ratio is zero (Column F). In Example 4, the institution has a ratio of brokered deposits to domestic deposits of 35 percent (Column B), which, after subtracting the 10 percent threshold, leaves 25 percent (Column C). Its assets are 55 percent greater than they were four years previously (Column D), so the fraction applied to obtain the adjusted brokered deposit ratio is 0.5 (Column E) (calculated as $3\frac{1}{3}$ (55 percent—40 percent, with the result expressed as a decimal fraction rather than as a percentage)). Its adjusted brokered deposit ratio is, therefore, 12.5 percent (Column F) (which is 0.5 times 25 percent). In Example 5, the institution has a lower ratio of brokered deposits to domestic deposits (25 percent in Column B) than in Example 4 (35 percent). However, its adjusted brokered deposit ratio (15 percent in Column F) is larger than in Example 4 (12.5 percent) because its assets are more than 70 percent greater than they were four years previously (Column D). Therefore, its adjusted brokered deposit ratio is equal to its ratio of brokered deposits to domestic deposits of 25 percent minus the 10 percent threshold (Column F).

The FDIC is adding this new risk measure for a couple of reasons. A number of costly institution failures,

including some recent failures, involved rapid asset growth funded through brokered deposits. Moreover, statistical analysis reveals a significant correlation between rapid asset growth funded by brokered deposits and the probability of an institution's being downgraded from a CAMELS composite 1 or 2 rating to a CAMELS composite 3, 4 or 5 rating within a year. A significant correlation is the standard the FDIC used when it adopted the financial ratios method in the 2006 assessments rule.

The adjusted brokered deposit ratio generally will include brokered deposits as defined in Section 29 of the Federal Deposit Insurance Act (12 U.S.C. 1831f), and as implemented in 12 CFR 337.6, which is the definition used in banks' quarterly Reports of Condition and Income (Call Reports) and thrifts' quarterly Thrift Financial Reports (TFRs). However, for assessment purposes in Risk Category I, the ratio will not include reciprocal deposits (that is, deposits that an insured depository institution receives through a deposit placement network on a reciprocal basis, such that: (1) for any deposit received, the institution (as agent for depositors) places the same amount with other insured depository institutions through the network; and (2) each member of the network sets the interest rate to be paid on the entire amount of funds it places with other network members. All other brokered deposits will be included in an institution's ratio of brokered deposits to domestic deposits used to determine

its adjusted brokered deposit ratio, including brokered deposits that consist of balances swept into an insured institution by another institution, such as balances swept from a brokerage account.

Based on data as of September 30, 2008, approximately 8.7 percent of institutions in Risk Category I would have exceeded both the 10 percent brokered deposit threshold and 40 percent minimum 4-year cumulative asset growth threshold, so that their adjusted brokered deposit ratio would be greater than zero. A smaller percentage of institutions would actually have been charged a higher rate solely due to the adjusted brokered deposit ratio because the minimum or maximum initial rates applicable to Risk Category I would continue to apply to some institutions both before and after accounting for the effect of this ratio. Only 1.1 percent of Risk Category I institutions would have had an initial base assessment rate more than 1 basis point higher as a result of the adjusted brokered deposit ratio.²⁹

Comments

The FDIC received many comments arguing that brokered deposits should not increase assessment rates for Risk Category I institutions and that the brokered deposit provisions in the NPR do not account for the use to which institutions put these deposits. The FDIC is not persuaded by the arguments. Recent data show that institutions with a combination of brokered deposit reliance and robust asset growth tend to

²⁸ The ratio of brokered deposits to domestic deposits and four-year asset growth rate would remain unrounded (to the extent of computer capabilities) when calculating the adjusted brokered deposit ratio. The adjusted brokered deposit ratio

itself (expressed as a percentage) would be rounded to three digits after the decimal point prior to being used to calculate the assessment rate.

²⁹ These estimates do not exclude deposits that an institution receives through a deposit placement

network on a reciprocal basis and, thus, might overstate the effects on assessment rates for some institutions.

have a greater concentration in higher risk assets. In addition, there is a statistically significant correlation between the adjusted brokered deposit ratio, on the one hand, and the probability that an institution will be downgraded to a CAMELS rating of 3, 4, or 5 within a year, on the other, independent of the other measures of asset quality contained in the financial ratios method.

The FDIC received several comments, including comments from several industry trade groups, arguing that institutions should be able to have a ratio of brokered deposits to domestic deposits greater than 10 percent without triggering the adjusted brokered deposit ratio and that the minimum asset growth rate required to trigger the adjusted brokered deposit ratio should be greater than 20 percent. The comments disputed the characterization of 20 percent cumulative asset growth over four years as "rapid." One trade association noted that the proposed minimum growth rate (20 percent) was lower than the nominal GDP growth between third quarter 2004 and third quarter 2007.

The FDIC is persuaded in part. The final rule raises the minimum 4-year asset growth rate required to trigger the adjusted brokered deposit ratio from 20 percent to 40 percent. The final rule also increases from 40 percent to 70 percent the asset growth rate required to make an institution's adjusted brokered deposit ratio equal to its institution's ratio of brokered deposits to domestic deposits less the 10 percent threshold. Additional analysis has revealed that these growth rates are as predictive of downgrade probabilities as those originally proposed and are more consistent with the intent of the ratio, which was to capture only those institutions with rapid asset growth.

However, in the FDIC's view, a ratio of brokered deposits to domestic deposits greater than 10 percent is a significant amount of brokered deposits. Still, for institutions in Risk Category I, brokered deposits alone will not trigger higher rates, but must be combined with significant asset growth.

The FDIC received over 3,300 comment letters arguing that certain reciprocal deposits should not be included in the adjusted brokered deposit ratio.³⁰ Most of the comments

were form letters. Commenters argued that these reciprocal deposits are a stable source of funding. According to the comments, most customers (83 percent) are not seeking the highest rate of interest available and choose to keep their deposit at the same institution when it matures. The commenters also argued that these deposits are local deposits and not out-of-market funds and stated that 80 percent of these deposits are placed with an insured institution within 25 miles of a branch location of the relationship bank. The commenters further argued that the interest rate on these deposits reflects that of local markets since the insured institution that originates the deposit sets the interest rate, rather than a third-party broker. Commenters also argued that these deposits may have franchise value in the event of a bank failure.

The FDIC is persuaded that reciprocal deposits like those described in the comment letters should not be included in the adjusted brokered deposit ratio applicable to institutions in Risk Category I.³¹ (However, as discussed below, reciprocal deposits will be included in the brokered deposits adjustment applicable to institutions in Risk Categories II, III and IV.) The FDIC recognizes that reciprocal deposits may be a more stable source of funding for healthy banks than other types of brokered deposits and that they may not be as readily used to fund rapid asset growth.

The FDIC also received several comments arguing that brokered deposits that consist of balances swept into an insured institution by a nondepository institution, such as balances swept into an insured institution from a brokerage account at a broker-dealer, should be excluded from the adjusted brokered deposit ratio.³² Commenters argued that these sweep accounts are stable, relationship-based accounts. Commenters also stated that the aggregate flows in and out of the sweep accounts tend to offset one another and are thus predictable. Some commenters differentiated between sweeps from affiliated brokerage firms and those from non-affiliated firms. These commenters argued that broker-

brokered deposit adjustment applicable to these risk categories is discussed below.

³¹ Excluding these deposits from the Call Report and TFR will require changes to these forms. The FDIC anticipates that the necessary changes will be made beginning with the June 30, 2009 reports of condition.

³² Many of these comment letters also argued that these swept deposits should not be included in the brokered deposit adjustment applicable to institutions in Risk Categories II, III and IV. The brokered deposit adjustment for these risk categories is discussed below.

dealer affiliated sweeps are not rate-sensitive accounts and are not designed to compete with the high rates of interest paid by other insured institutions and, therefore, do not raise the same concerns as other brokered deposits about the high cost of funding of risky banks. The commenters maintained that these accounts are typically used for idle investment funds or as a safe investment and are designed to better manage excess cash. Some commenters suggested that bankers would be willing to separately report sweep balances from an affiliated brokerage.

Some commenters supported excluding brokered deposits swept from *unaffiliated* brokerages through a sweep program, since the deposits have the characteristics of core deposits and are not driven by yield. According to the commenters, there is no price competition; deposits from unaffiliated brokerages are used for the convenience and safety of the customer.

The FDIC is not persuaded by these arguments. In the FDIC's view, deposits swept from broker-dealers can and have contributed to high rates of insured depository institution asset growth and, thus, fall squarely within the type of brokered deposits that the adjusted brokered deposit ratio was meant to capture. In addition, as noted in the NPR, many sweep programs can be structured so that swept balances are not brokered deposits.

Pricing Multipliers, the Uniform Amount, and the Range of Rates

The final rule contains a recalculated uniform amount and recalculated pricing multipliers for the weighted average CAMELS component rating and financial ratios. The uniform amount and pricing multipliers under the final rule adopted in 2006 were derived from a statistical estimate of the probability that an institution will be downgraded to CAMELS 3, 4 or 5 at its next examination using data from the end of the years 1984 to 2004.³³ These probabilities were then converted to pricing multipliers for each risk measure. The new pricing multipliers were derived using essentially the same statistical techniques, but based upon data from the end of the years 1988 to 2006.³⁴ The new pricing multipliers are set out in Table 7 below.

³³ Data on downgrades to CAMELS 3, 4 or 5 is from the years 1985 to 2005. The "S" component rating was first assigned in 1997. Because the statistical analysis relies on data from before 1997, the "S" component rating was excluded from the analysis.

³⁴ For the adjusted brokered deposit ratio, assets at the end of each year are compared to assets at

³⁰ When an institution receives a deposit through a network on a reciprocal basis, it must place the same amount (but owed to a different depositor) with another institution through the network. Many of the comment letters also argued that these reciprocal deposits should not be included in the brokered deposit adjustment applicable to institutions in Risk Categories II, III and IV. The

TABLE 7—NEW PRICING MULTIPLIERS—Continued

Risk measures *	Pricing multipliers **
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.

To determine an institution's initial assessment rate under the base assessment rate schedule, each of these risk measures (that is, each institution's financial measures and weighted average CAMELS component rating) will continue to be multiplied by the corresponding pricing multipliers. The sum of these products will be added to a new uniform amount, 11.861.³⁵ The new uniform amount is also derived from the same statistical analysis.³⁶ As under the final rule adopted in 2006, no initial base assessment rate within Risk Category I will be less than the minimum initial base assessment rate applicable to the category or higher than the initial base maximum assessment rate applicable to the category. The final rule sets the initial minimum base assessment rate for Risk Category I at 12

basis points and the maximum initial base assessment rate for Risk Category I at 16 basis points.

To compute the values of the uniform amount and pricing multipliers shown above, the FDIC chose cutoff values for the predicted probabilities of downgrade such that, using June 30, 2008 Call Report and TFR data: (1) 25 percent of small institutions in Risk Category I (other than institutions less than 5 years old) would have been charged the minimum initial assessment rate; and (2) 15 percent of small institutions in Risk Category I (other than institutions less than 5 years old) would have been charged the maximum initial assessment rate.³⁷ These cutoff values will be used in future periods, which could lead to different percentages of institutions being

charged the minimum and maximum rates.

In comparison, under the system in place on June 30, 2008: (1) Approximately 28 percent of small institutions in Risk Category I (other than institutions less than 5 years old) were charged the existing minimum assessment rate; and (2) approximately 19 percent of small institutions in Risk Category I (other than institutions less than 5 years old) were charged the existing maximum assessment rate based on June 30, 2008 data.³⁸

Table 8 gives initial base assessment rates for three institutions with varying characteristics, given the new pricing multipliers above, using initial base assessment rates for institutions in Risk Category I of 12 basis points to 16 basis points.³⁹

TABLE 8—INITIAL BASE ASSESSMENT RATES FOR THREE INSTITUTIONS *

A	B	C	D	E	F	G	H
			Institution 1		Institution 2		Institution 3
	Pricing multiplier	Risk measure value	Contribution to assessment rate	Risk measure value	Contribution to assessment rate	Risk measure value	Contribution to assessment rate
Uniform Amount	11.861		11.861		11.861		11.861
Tier 1 Leverage Ratio (%)	(0.056)	9.590	(0.537)	8.570	(0.480)	7.500	(0.420)
Loans Past Due 30–89 Days/Gross Assets (%)	0.575	0.400	0.230	0.600	0.345	1.000	0.575
Nonperforming Loans/Gross Assets (%)	1.074	0.200	0.215	0.400	0.430	1.500	1.611
Net Loan Charge-Offs/Gross Asset (%) ..	1.210	0.147	0.177	0.079	0.096	0.300	0.363
Net Income before Taxes/Risk-Weighted Assets (%)	(0.764)	2.500	(1.910)	1.951	(1.491)	0.518	(0.396)
Adjusted Brokered Deposit Ratio (%)	0.065	0.000	0.000	12.827	0.834	24.355	1.583
Weighted Average CAMELS Component Ratings	1.095	1.200	1.314	1.450	1.588	2.100	2.300
Sum of Contributions			11.35		13.18		17.48
Initial Base Assessment Rate			12.00		13.18		16.00

*Figures may not multiply or add to totals due to rounding.⁴⁰

³⁵ Appendix A provides the derivation of the pricing multipliers and the uniform amount to be added to compute an assessment rate. The rate derived will be an annual rate, but will be determined every quarter.

³⁶ The uniform amount would be the same for all institutions in Risk Category I (other than large institutions that have long-term debt issuer ratings, insured branches of foreign banks and, beginning in 2010, new institutions).

³⁷ The cutoff value for the minimum assessment rate is a predicted probability of downgrade of approximately 2 percent. The cutoff value for the maximum assessment rate is approximately 15 percent.

³⁸ For the assessment period ending September 30, 2008, approximately 26 percent of small Risk Category I institutions (other than institutions less than 5 years old) were charged the minimum rate

and approximately 23 percent were charged the maximum rate.

³⁹ These are the initial base rates for Risk Category I proposed below.

⁴⁰ Under the proposed rule, pricing multipliers, the uniform amount, and financial ratios will continue to be rounded to three digits after the decimal point. Resulting assessment rates will be rounded to the nearest one-hundredth (1/100th) of a basis point.

TABLE 8—INITIAL BASE ASSESSMENT RATES FOR THREE INSTITUTIONS *—Continued

A	B	C	D	E	F	G	H
			Institution 1		Institution 2		Institution 3
	Pricing multiplier	Risk measure value	Contribution to assessment rate	Risk measure value	Contribution to assessment rate	Risk measure value	Contribution to assessment rate
Initial Base Assessment Rate			12.00		13.18		16.00

*Figures may not multiply or add to totals due to rounding.⁴⁰

The initial base assessment rate for an institution in the table is calculated by multiplying the pricing multipliers (Column B) by the risk measure values (Column C, E or G) to produce each measure's contribution to the assessment rate. The sum of the products (Column D, F or H) plus the uniform amount (the first item in Column D, F and H) yields the initial base assessment rate. For Institution 1 in the table, this sum actually equals 11.35 basis points, but the table reflects the initial base minimum assessment rate of 12 basis points. For Institution 3 in the table, the sum actually equals 17.48 basis points, but the table reflects the initial base maximum assessment rate of 16 basis points.

Under the final rule, the FDIC will continue to have the flexibility to update the pricing multipliers and the uniform amount annually, without further notice-and-comment rulemaking. In particular, the FDIC will be able to add data from each new year to its analysis and could, from time to time, exclude some earlier years from its analysis. Because the analysis will continue to use many earlier years' data as well, pricing multiplier changes from year to year should usually be relatively small.

On the other hand, as a result of the annual review and analysis, the FDIC may conclude, as it has in this rulemaking, that *additional or alternative* financial measures, ratios or other risk factors should be used to determine risk-based assessments or that a new method of differentiating for risk should be used. In any of these events, the FDIC would again make changes through notice-and-comment rulemaking.

Financial measures for any given quarter will continue to be calculated from the report of condition filed by each institution as of the last day of the quarter.⁴¹ CAMELS component rating changes will continue to be effective as of the date that the rating change is transmitted to the institution for

purposes of determining assessment rates for all institutions in Risk Category I.⁴²

Comments

One industry trade group noted that some banks expressed a concern that the expanded range of rates for Risk Category I, particularly in combination with the proposed adjustment for secured liabilities (discussed below), could result in differences in rates among institutions that are too large compared to differences in risk. This could lead to some institutions bearing disproportionate costs and being competitively disadvantaged. However, another trade group expressed concerns that the range of rates for Risk Category I is too narrow, insufficiently reflecting differences in risk and creating a cross subsidy within the risk category.⁴³ The FDIC considers the 4-basis point range for the initial base assessment rate in Risk Category I to be appropriate.

IV. Risk Category I: Large Bank Method

For large Risk Category I institutions now subject to the debt ratings method, the final rule derives assessment rates from the financial ratios method as well as long-term debt issuer ratings and CAMELS component ratings. The new method is known as the large bank method. The rate using the financial ratios method is first converted from the range of initial base rates (12 to 16 basis points) to a scale from 1 to 3 (financial ratios score).⁴⁴ The financial ratios score

is then given a 33⅓ percent weight in determining the large bank method assessment rate, as are both the weighted average CAMELS component rating and debt-agency ratings.

The weights of the CAMELS components remain the same as in the final rule adopted in 2006. The values assigned to the debt issuer ratings also remain the same. The weighted CAMELS components and debt issuer ratings will continue to be converted to a scale from 1 to 3.

The initial base assessment rate under the large bank method will be derived as follows: (1) An assessment rate computed using the financial ratios method will be converted to a financial ratios score; (2) the weighted average CAMELS rating, converted long-term debt issuer ratings, and the financial ratios score will each be multiplied by a pricing multiplier and the products summed; and (3) a uniform amount will be added to the result. The resulting initial base assessment rate will be subject to a minimum and a maximum assessment rate. The pricing multiplier for the weighted average CAMELS ratings, converted long-term debt issuer rating and financial ratios score is 1.692, and the uniform amount is 3.873.⁴⁵

In recent periods, assessment rates for some large institutions have not responded in a timely manner to rapid changes in these institutions' financial conditions. For the assessment period ending June 30, 2008, under the assessment system then in place: (1) 45 percent of large institutions in Risk Category I (other than institutions less than 5 years old) were charged the minimum assessment rate (ignoring large bank adjustments), compared with 28 percent of small institutions; and (2) 11 percent of large institutions in Risk Category I (other than institutions less than 5 years old) were charged the maximum assessment rate (ignoring

multiplying the result by one-half. For example, if an institution had an initial base assessment rate of 13, 10 would be subtracted from 13 and the result would be multiplied by one-half to produce a financial ratios score of 1.5.

⁴⁵ Appendix 1 provides the derivation of the pricing multipliers and the uniform amount.

⁴¹ Reports of condition include Reports of Income and Condition and Thrift Financial Reports.

⁴² 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 rating 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.

⁴³ The same trade group argued that rates for Risk Categories III and IV should be higher than proposed.

⁴⁴ The assessment rate computed using the financial ratios method would be converted to a financial ratios score by first subtracting 10 from the financial ratios method assessment rate and then

large bank adjustments), compared with 19 percent of small institutions.⁴⁶ The FDIC's proposed values for pricing multipliers and the uniform amount are such that, using June 30, 2008, data, the percentages of large institutions in Risk Category I (other than new institutions less than 5 years old) that would have been charged the minimum and maximum initial base assessment rates would be the same as the percentages of small institutions that would have been charged these rates (25 percent at the minimum rate and 15 percent at the maximum rate).^{47 48} These cutoff values would be used in future periods, which could lead to different percentages of institutions being charged the minimum and maximum rates.

Under the final rule adopted in 2006, large institutions that lack a long-term debt issuer rating are assessed using the financial ratios method by itself, subject to the large bank adjustment. This will continue under the final rule.

Under the final rule, the initial base assessment rate for an institution with a weighted average CAMELS converted value of 1.70, a debt issuer ratings converted value of 1.65 and a financial ratios method assessment rate of 13.50 basis points would be computed as follows:

- The financial ratios method assessment rate less 10 basis points would be multiplied by one-half (calculated as $(13.5 \text{ basis points} - 10 \text{ basis points}) \times 0.5$) to produce a financial ratios score of 1.75.
- The weighted average CAMELS score, debt ratings score and financial ratios score will each be multiplied by 1.692 and summed (calculated as $1.70 \times 1.692 + 1.65 \times 1.692 + 1.75 \times 1.692$) to produce 8.629.

⁴⁶ For the assessment period ending September 30, 2008, under the assessment system then in place: (1) 41 percent of large institutions in Risk Category I (other than institutions less than 5 years old) were charged the minimum assessment rate (again ignoring large bank adjustments), compared with 26 percent of small institutions; and (2) 11 percent of large institutions in Risk Category I (other than institutions less than 5 years old) were charged the maximum assessment rate (ignoring large bank adjustments), compared with 23 percent of small institutions.

⁴⁷ The cutoff value for the minimum assessment rate is an average score of approximately 1.601. The cutoff value for the maximum assessment rate is approximately 2.389.

⁴⁸ A "new" institution, as defined in 12 CFR 327.8(l), is generally one that is less than 5 years old, but there are several exceptions, including, for example, an exception for certain otherwise new institutions in certain holding company structures. 12 CFR 327.9(d)(7). The calculation of percentages of small institutions, however, was determined strictly by excluding institutions less than 5 years old, rather than by using the definition of a "new" institution and its regulatory exceptions, since determination of whether an institution meets an exception to the definition of "new" requires a case-by-case investigation.

- A uniform amount of 3.873 would be added, resulting in an initial base assessment rate of 12.50 basis points.

The FDIC anticipates that incorporating the financial ratios score into the large bank method assessment rate will result in a more accurate distribution of initial assessment rates and in timelier assessment rate responses to changing risk profiles, while retaining the market and supervisory perspectives that debt and CAMELS ratings provide. While the number of potential discretionary adjustments under this revised large bank method cannot be known with certainty, the revised method should create a more accurate distribution of initial rates and, thus, should minimize the number of necessary discretionary adjustments.⁴⁹

Comments

One trade group supported the proposal and specifically noted that the FDIC should move away from the debt rating method. Other comments, including comments from trade groups, argued that the proposed rule would make it harder for a large bank to be eligible for the lowest assessment rates. A commenting bank argued that:

Structuring the rules with a goal to maintain parity between large and small banks would be in violation of [12 U.S.C. 1817(b)(2)(D)]. Arbitrarily establishing targets for percentages of institutions that fall into a given assessment rate is inconsistent with not only the governing statute but the whole concept of risk-based pricing. * * * The fact that, under objective criteria, large banks may have a greater percentage of institutions that qualify for the lowest rate is not an indication that the rule is flawed and needs to change, but may just be a factual representation of the strength of large banks.⁵⁰

The FDIC disagrees with the commenting bank. The purpose of the new large bank method is to create an assessment system for large Risk Category I institutions that will respond more timely to changing risk profiles, will improve the accuracy of initial assessment rates, relative risk rankings, and will create a greater parity between small and large Risk Category I institutions. The recalibration of the percentages of large institutions that would have been charged the minimum and maximum rates applicable to Risk Category I is intended to better reflect the actual risk posed by large

institutions. Under the debt ratings method, the percentage of large Risk Category I institutions that were charged the minimum assessment rate changed little over time despite deteriorating financial conditions. If the financial ratios method, which is based on a combination of objective financial ratios and supervisory ratings, were applied to large Risk Category I institutions, only about 19 percent would have been charged the minimum assessment rate. While the FDIC continues to believe that the financial ratios method alone does not adequately provide the appropriate risk ranking for large and complex institutions, the deterioration in financial ratios is highly indicative of rapidly changing risk profiles, which are not fully reflected in the debt ratings method on a timely basis.

Furthermore, 12 U.S.C. 1817(b)(2)(D) does not prohibit the FDIC from calibrating a risk-based assessment system so that, at a given point in time, an equal percentage of small and large institutions would have been charged the minimum assessment rate, provided that the risks posed were equal, as, in the FDIC's view, they were.

V. Adjustment for Large Institutions and Insured Branches of Foreign Banks in Risk Category I

Under the final rule adopted in 2006, within Risk Category I, large institutions and insured branches of foreign banks are subject to an assessment rate adjustment (the large bank adjustment). In determining whether to make such an adjustment for a large institution or an insured branch of a foreign bank, the FDIC may consider such information as financial performance and condition information, other market or supervisory information, potential loss severity, and stress considerations. Any large bank adjustment is limited to a change in assessment rate of up to 0.5 basis points higher or lower than the rate determined using the supervisory ratings and financial ratios method, the supervisory and debt ratings method, or the weighted average ROCA component rating method, whichever is applicable. Adjustments are meant to preserve consistency in the orderings of risk indicated by assessment rates, to ensure fairness among all large institutions, and to ensure that assessment rates take into account all available information that is relevant to the FDIC's risk-based assessment decision.

The final rule will increase the maximum possible large bank adjustment to one basis point. The adjustment will be made to an institution's initial base assessment rate before any other adjustments are made.

⁴⁹ The FDIC has issued additional Guidelines for Large Institutions and Insured Foreign Branches in Risk Category I (the large bank guidelines) governing these large bank adjustments. 72 FR 27122 (May 14, 2007).

⁵⁰ 12 U.S.C. 1817(b)(2)(D) provides that, "No insured depository institution shall be barred from the lowest-risk category solely because of size."

The adjustment cannot: (1) Decrease any rate so that the resulting rate would be less than the minimum initial base assessment rate; or (2) increase any rate above the maximum initial base assessment rate.

The FDIC is amending the maximum size of the adjustment for two primary reasons. First, under the final rule adopted in 2006, the difference between the minimum and maximum base assessment rates in Risk Category I is two basis points. The maximum one-half basis point large bank adjustment represents 25 percent of the difference between the minimum and maximum rates. While an adjustment of this size is generally sufficient to preserve consistency in the orderings of risk indicated by assessment rates and to ensure fairness, there have been circumstances where more than a half a basis point adjustment would have been warranted. The difference between the minimum and maximum base assessment rates will increase from two basis points to four basis points under the final rule. A half basis point large bank adjustment would represent only 12.5 percent of the difference between the minimum and maximum rates and would not be sufficient to preserve consistency in the orderings of risk indicated by assessment rates or to ensure fairness. The increase in the maximum possible large bank adjustment will continue to represent 25 percent of the difference between the minimum and maximum rates, minimizing the potential number of instances where the large bank adjustment is insufficient to fully and accurately reflect the risk that an institution poses.

The purpose of the large bank adjustment is to improve the relative risk ranking of large Risk Category I institutions with respect to their initial assessment rates, not total assessment rates. The FDIC expects that, under the final rule, large bank adjustments will continue to be made infrequently and for a limited number of institutions.⁵¹ The FDIC's view is that the use of supervisory ratings, financial ratios and agency ratings (when available) will sufficiently reflect the risk profile and rank orderings of risk in large Risk

Category I institutions in most (but not all) cases.

The FDIC expects to further clarify its *Assessment Rate Adjustment Guidelines for Large Institutions and Insured Foreign Branches in Risk Category I* (the Guidelines).⁵² The Guidelines will discuss in detail the quantitative and qualitative factors that the FDIC will rely upon when deciding whether to make a large bank adjustment. Until then, the Guidelines will be applied taking into account the changes resulting from this rulemaking.

Comments

An industry trade group and a bank objected to the increase in the large bank adjustment, arguing that the adjustment is arbitrary and subjective. The FDIC disagrees. The large bank method appropriately recognizes the need for subjective, expert judgment-based risk assessments for large banks. Because large institutions are usually complex and often have unique operations, an entirely formulaic approach, while objective, has yielded a distribution of assessment rates that is not sufficiently reflective of the risk. When the FDIC decides to increase or decrease a large institution's assessment rate based upon the large bank adjustment, it does so after reviewing a large set of financial and performance data in addition to making qualitative assessments. While the decision to apply an adjustment cannot be reduced to a formula, the set of data that the FDIC reviews is consistent from one institution to the next and the FDIC strives to make its decisions based on the data as consistent as possible and the reasons for the decisions as clear as possible for the institutions affected. As stated above, the FDIC intends to publish revised Guidelines to further clarify the large bank adjustment process.

Despite the existence of a long-established appeals process for assessment rates, one industry trade group stated that "[B]ankers felt that they were not allowed to effectively challenge the adjustments through the FDIC's appeals process." The FDIC notes, however, that no institution has yet appealed an adjustment (or the lack thereof) to the Assessment Appeals Committee.⁵³

VI. Adjustment for Unsecured Debt for all Risk Categories

Under the final rule, an institution's base assessment rate (after making any large bank adjustment) will be reduced from the initial rate using the institution's ratio of long-term unsecured debt (and, for small institutions, certain amounts of Tier 1 capital) to domestic deposits.⁵⁴ Any decrease in base assessment rates as a result of this unsecured debt adjustment will be limited to five basis points (rather than two basis points as proposed in the NPR). Unsecured debt will not include any senior unsecured debt that the FDIC has guaranteed under the Temporary Liquidity Guarantee Program.

The unsecured debt adjustment will be determined by multiplying an institution's long-term unsecured debt (plus, if the institution is a small institution, "qualified" amounts of Tier 1 capital as explained below) as a percentage of domestic deposits by 40 basis points (rather than 20 basis points as proposed in the NPR). For example, an institution with a ratio of long-term unsecured debt (plus, if the institution is small, qualified amounts of Tier 1 capital) to domestic deposits of 3.0 percent will see its initial base assessment rate reduced by 1.20 basis points (calculated as 40 basis points $\times$ 0.03). An institution with a ratio of long-term unsecured debt (plus, if the institution is small, qualified amounts of Tier 1 capital) to domestic deposits of 13.0 percent will have its assessment rate reduced by five basis points, since the maximum possible reduction will be five basis points. (40 basis points $\times$ 0.13 = 5.20 basis points, which exceeds the maximum possible reduction.)

For a small institution, the amount of qualified Tier 1 capital that will be added to long-term unsecured debt will be a portion of the amount of Tier 1 capital that exceeds a ratio of Tier 1 capital to adjusted average assets of 5.0%.⁵⁵ The percentage of Tier 1 capital that is qualified increases as the amount of Tier 1 capital held by a small institution increases. The qualified amount is set forth in Table 9.

⁵¹ In the seven quarters for which institutions have been assessed since the 2006 assessment rule went into effect, the total number of adjustments in any one quarter has ranged from 2 to 16. For the third quarter of 2008, the FDIC continued or implemented assessment rate adjustments for 16 large Risk Category I institutions, 14 to increase an institution's assessment rate, and 2 to decrease an institution's assessment rate. Additionally, the FDIC sent 2 institutions advance notification of a potential upward adjustment in their assessment rate.

⁵² 72 FR 27,122 (May 14, 2007).

⁵³ Only one institution has requested review of its assessment rate; it asked for an adjustment when the FDIC had not given one. However, this institution did not appeal the denial of its request for review to the Assessment Appeals Committee. The FDIC has also received 9 responses to the 29 advance notices of intent to increase an assessment rate using the large bank adjustment that the FDIC has sent out.

⁵⁴ For this purpose, an institution would be "small" if it met the definition of a small institution in 12 CFR 327.8(g)—generally, an institution with less than \$10 billion in assets—except that it would not include an institution that would otherwise meet the definition for which the FDIC had granted a request to be treated as a large institution pursuant to 12 CFR 327.9(d)(6).

⁵⁵ Adjusted average assets will be used for Call Report filers; adjusted total assets will be used for TFR filers.

TABLE 9—AMOUNT OF QUALIFIED TIER 1 CAPITAL

Range of Tier 1 capital to adjusted average assets	Amount of Tier 1 capital within range which is qualified (percent)
≤ 5%	0
> 5% and ≤ 6%	10
> 6% and ≤ 7%	20
> 7% and ≤ 8%	30
> 8% and ≤ 9%	40
> 9% and ≤ 10%	50
> 10% and ≤ 11%	60

TABLE 9—AMOUNT OF QUALIFIED TIER 1 CAPITAL—Continued

Range of Tier 1 capital to adjusted average assets	Amount of Tier 1 capital within range which is qualified (percent)
> 11% and ≤ 12%	70
> 12% and ≤ 13%	80
> 13% and ≤ 14%	90
> 14%	100

The amount of qualified Tier 1 capital within each of the ranges is summed to

determine the total amount of qualified Tier 1 capital for this institution. The sum of qualified Tier 1 capital and long-term unsecured debt as a percentage of domestic deposits will be multiplied by 40 basis points to produce the unsecured debt adjustment.⁵⁶

To illustrate the calculation of qualified Tier 1 capital, consider a small institution with a Tier 1 leverage ratio of 20.0 percent and Tier 1 capital of \$2.0 million. The amount of qualified Tier 1 capital is illustrated in Table 10.

TABLE 10—EXAMPLE OF QUALIFIED TIER 1 CAPITAL FOR THE UNSECURED DEBT ADJUSTMENT

Leverage ratio band	Tier 1 capital within band (\$000)	×	Qualified percentage of Tier 1 capital (percent)	=	Qualified Tier 1 capital (\$000)
0–5%	500		0		0
5%–6%	100		10		10
6%–7%	100		20		20
7%–8%	100		30		30
8%–9%	100		40		40
9%–10%	100		50		50
10%–11%	100		60		60
11%–12%	100		70		70
12%–13%	100		80		80
13%–14%	100		90		90
> 14%	600		100		600
Total	2,000				1,050

As can be seen in Table 10, each band of the Tier 1 leverage ratio (up to the last band) contains \$100,000 in Tier 1 capital and the qualified percentage increases linearly until it reaches 100 percent for amounts over 14.0 percent. The total qualified Tier 1 capital for this small institution is \$1.05 million, which will be added to any long-term unsecured debt to calculate the institution's unsecured debt adjustment.

The final rule includes more Tier 1 capital in qualified Tier 1 capital than proposed in the NPR. The NPR proposed including the sum of one-half of the amount of Tier 1 capital between 10 percent and 15 percent of adjusted average assets and the full amount of Tier 1 capital exceeding 15 percent of

adjusted average assets. The FDIC has concluded, based in part on comments, that the proposal did not give small institutions sufficient credit for Tier 1 capital.

Ratios for any given quarter will be calculated from the report of condition filed by each institution as of the last day of the quarter.

Unsecured debt will consist of senior unsecured liabilities and subordinated debt. A senior unsecured liability is defined as the unsecured portion of other borrowed money.⁵⁷ Subordinated debt is defined in the report of condition for the reporting period.⁵⁸ Long-term unsecured debt is defined as unsecured debt with at least one year remaining until maturity. However,

unsecured debt will not include any debt that the FDIC has guaranteed pursuant to the Temporary Liquidity Guarantee Program, since this kind of debt will not decrease FDIC losses in the event an institution fails.

At present, institutions separately report neither long-term senior unsecured liabilities nor long-term subordinated debt in the report of condition. In a separate notice of proposed rulemaking, the Federal Financial Institution Examination Council has proposed revising the Call Report to report separately long-term senior unsecured liabilities and subordinated debt that meet this definition. The Office of Thrift Supervision (OTS) has also published a

⁵⁶ The percentage of qualified Tier 1 capital and long-term unsecured debt to domestic deposits will remain unrounded (to the extent of computer capabilities). The unsecured debt adjustment will be rounded to two digits after the decimal point prior to being applied to the base assessment rate. Appendix 2 describes the unsecured debt adjustment for a small institution mathematically.

⁵⁷ Other borrowed money is reported on the Call Report in Schedule RC, item 16 and on the Thrift Financial Report as the sum of items SC720, SC740, and SC760.

⁵⁸ The definition of "subordinated debt" in the Call Report is contained in the Glossary under "Subordinated Notes and Debentures." For the June

30, 2008 Call Report, the definition read, in pertinent part, as follows:

Subordinated Notes and Debentures: A subordinated note or debenture is a form of debt issued by a bank or a consolidated subsidiary. When issued by a bank, a subordinated note or debenture is not insured by a federal agency, is subordinated to the claims of depositors, and has an original weighted average maturity of five years or more. Such debt shall be issued by a bank with the approval of, or under the rules and regulations of, the appropriate federal bank supervisory agency. * * *

When issued by a subsidiary, a note or debenture may or may not be explicitly subordinated to the deposits of the parent bank. * * *

For purposes of the final rule, subordinated debt would also include limited-life preferred stock as defined in the report of condition for the reporting period. The definition of "limited-life preferred stock" in the Call Report is contained in the Glossary under "Preferred Stock." For the June 30, 2008 Call Report, the definition read, in pertinent part, as follows:

Limited-life preferred stock is preferred stock that has a stated maturity date or that can be redeemed at the option of the holder. It excludes those issues of preferred stock that automatically convert into perpetual preferred stock or common stock at a stated date.

notice of proposed rulemaking that would adopt similar reporting requirements. The FDIC anticipates that these revisions will be made beginning with the June 30, 2009 Call Report and TFR. However, if they are not, until banks separately report these amounts in the Call Report, the FDIC will use subordinated debt included in Tier 2 capital and will not include any amount of senior unsecured liabilities. These adjustments will also be made for TFR filers until thrifts separately report these amounts in the TFR.

At present, institutions also do not report debt that the FDIC has guaranteed pursuant to the Temporary Liquidity Guarantee Program.⁵⁹ The FDIC is pursuing the necessary changes to the Call Report and TFR to ensure that these amounts are excluded from the separate report of long-term senior unsecured liabilities and subordinated debt beginning with the June 30, 2009 Call Report and TFR.

When an institution fails, holders of unsecured claims, including subordinated debt, receive distributions from the receivership estate only if all secured claims, administrative claims and deposit claims have been paid in full. Consequently, greater amounts of long-term unsecured claims provide a cushion that can reduce the FDIC's loss in the event of failure.

For small institutions (but not large ones), the unsecured debt adjustment includes a portion of Tier 1 capital for two primary reasons. First, cost concerns and lack of demand generally make it difficult for small institutions to issue unsecured debt in the market. For reasons of fairness, the FDIC believes that small institutions that have large amounts of Tier 1 capital should receive an equivalent benefit for that capital. Second, the FDIC does not want to create an incentive for small institutions to convert existing Tier 1 capital into subordinated debt, for example, by having a shareholder in a closely held corporation redeem shares and receive subordinated debt.

Comments

The FDIC received several comments on the proposed unsecured debt adjustment. One commenter found the proposal fair and appropriate.

⁵⁹ Institutions report this debt to the FDIC shortly after issuing it and also file monthly reports on the amount of this debt outstanding as of the end of each month. However, neither of these reports contains all of the information the FDIC needs to deduct this debt from the unsecured debt adjustment, since neither uses the definition of "unsecured debt" contained in the text. In addition, the monthly report does not contain maturity information.

Another commenter, however, claimed that the proposal would penalize institutions that do not issue long-term unsecured debt. A commenter recommended that the FDIC abandon the separate risk adjustment for unsecured debt. A commenter argued that the proposal uses arbitrary measures when adjusting for risk and ignores the probability of default. The FDIC disagrees with these comments. As noted earlier, greater amounts of long-term unsecured debt provide a cushion that can reduce the FDIC's loss in the event of failure, thus reducing the FDIC's risk.

The FDIC specifically sought comments on the size of the unsecured debt adjustment and whether it should be larger or smaller. Several commenters argued that the proposed two basis point reduction in base assessment rates, which was the maximum reduction possible under the proposal, was arbitrary and too low. Some also argued that the proposed 20 basis point multiplier should be increased. Several noted that the maximum proposed unsecured debt adjustment was much smaller than the maximum proposed secured liability adjustment.

The FDIC has concluded that the proposed 20 basis point multiplier and two basis point maximum reduction were too small. Spreads on depository institution unsecured debt have, on average, approximately doubled since the NPR was published. The FDIC has, therefore, doubled the size of the multiplier, partly to reflect the recent increase in debt spreads and partly to create greater parity between the size of the unsecured debt adjustment and the size of the secured liability adjustment. The FDIC has more than doubled the maximum possible unsecured debt adjustment to ensure that institutions will retain an incentive to issue unsecured debt and, again, to create greater parity between the unsecured debt adjustment and the secured liability adjustment.

Under the final rule, the FDIC estimates that the reduction in industry average assessments arising from the unsecured debt adjustment will exceed the industry average increase in assessments arising from the secured liability adjustment and (for Risk Categories II, III, and IV) the brokered deposit adjustment.

An industry trade group recommended that the unsecured debt adjustment for small institutions include larger amounts of Tier 1 capital. The trade group argued that small institutions should be rewarded for their additional capital and that the proposal did not sufficiently reward them. The

trade group suggested that the adjustment include the sum of one-half of the amount of Tier 1 capital between 8 percent and 12 percent of adjusted average assets and the full amount of Tier 1 capital exceeding 12 percent of adjusted average assets. The FDIC agrees that small institutions should receive more credit for Tier 1 capital and, and discussed above, has so provided in the final rule.

Another industry trade group suggested that institutions subject to the large bank method should also be given credit for capital in the unsecured debt adjustment. However, in the FDIC's view, doing so would undo the one of the purposes of including a portion of Tier 1 capital in the unsecured debt adjustment for small banks, which was to give small banks, which generally do not (and generally cannot) issue much unsecured debt, a benefit equivalent to that of large banks. If a large institution's assessment rate does not appropriately factor its capital, the FDIC can use the large bank adjustment to alter the rate (although the FDIC anticipates that the need to do so will seldom arise).

Some comments suggested that the FDIC include all unsecured and subordinated debt in the unsecured debt adjustment, regardless of maturity. One suggested using all unencumbered assets. The FDIC disagrees. Short-term debt is likely to be paid prior to failure and, thus, is unlikely to provide a cushion against FDIC losses.

Some commenters argued that it would be more appropriate to use a ratio of long-term unsecured debt (or unencumbered debt) to *insured* deposits, since insured deposits are the true proxy for the FDIC's risk. The FDIC disagrees. Numerous studies have shown that, as an institution approaches failure, uninsured depositors tend to demand payment. In effect, these uninsured depositors receive full payment on their claims (as if they were insured depositors at failure), leaving the failed institution with fewer assets to satisfy the FDIC's claims.

VII. Adjustment for Secured Liabilities for All Risk Categories

Under the final rule, an institution's base assessment rate may increase depending upon its ratio of secured liabilities to domestic deposits (the secured liability adjustment). An institution's ratio of secured liabilities to domestic deposits, if greater than 25 percent (rather than 15 percent as proposed in the NPR), will increase its assessment rate, but the resulting base assessment rate after any such increase will be no more than 50 percent greater

than it was before the adjustment. The secured liability adjustment will be made after any large bank adjustment or unsecured debt adjustment.

Specifically, for an institution that has a ratio of secured liabilities to domestic deposits of greater than 25 percent, the secured liability adjustment will be the institution's base assessment rate (after taking into account previous adjustments) multiplied by the ratio of its secured liabilities to domestic deposits minus 0.25. However, the resulting adjustment cannot be more than 50 percent of the institution's base assessment rate (after taking into account previous adjustments). For example, if an institution had a ratio of secured liabilities to domestic deposits of 35 percent, and a base assessment rate before the secured liability adjustment of 14 basis points, the secured liability adjustment would be the base rate multiplied by 0.10 (calculated as $0.35 - 0.25$), resulting in an adjustment of 1.4 basis points. However, if the institution had a ratio of secured liabilities to domestic deposits of 80 percent, its base rate before the secured liability adjustment of 14 basis points would be multiplied by 0.50 rather than 0.55 (calculated as $0.80 - 0.25$), since the resulting adjustment can be no greater than 50 percent of the base assessment rate before the secured liability adjustment.⁶⁰

Ratios of secured liabilities to domestic deposits for any given quarter will be calculated from the report of condition filed by each institution as of the last day of the quarter. For banks, secured liabilities include Federal Home Loan Bank advances, securities sold under repurchase agreements, secured Federal funds purchased and "other secured borrowings," as reported in banks' quarterly Call Reports. Thrifts also report Federal Home Loan Bank advances in their quarterly TFR, but, at present, do not separately report securities sold under repurchase agreements, secured Federal funds purchased or "other secured borrowings." The OTS has published a notice of proposed rulemaking to revise the TFR so that thrifts will separately report these items and the FDIC anticipates that this revision will be effective for the June 30, 2009 TFR. Until the TFR is revised, however, any of these secured amounts not reported separately from unsecured or other liabilities by a thrift in its TFR will be

imputed based on simple averages for Call Report filers as of June 30, 2008. As of that date, on average, 63.0 percent of the sum of Federal funds purchased and securities sold under repurchase agreements reported by Call Report filers were secured, and 49.4 percent of other borrowings were secured.

Under the final rule adopted in 2006, an institution's secured liabilities do not directly affect its assessments. The 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.

To illustrate with a simple example, assume that Bank A has \$100 million in insured deposits, while Bank B has \$50 million in insured deposits and \$50 million in secured liabilities. Each poses the same risk of failure and is charged the same assessment rate. At failure, each has assets with a market value of \$80 million. The loss to the DIF would be identical for Bank A and Bank B (\$20 million each). The total assessments paid by Bank A and Bank B, however, would not be identical. Because secured liabilities do not figure into an institution's assessment under the final rule adopted in 2006, the DIF would receive twice as much assessment revenue from Bank A as from Bank B over a given period (despite identical FDIC losses at failure).

In general, under the final rule adopted in 2006, substituting secured liabilities for unsecured liabilities (including subordinated debt) raises the FDIC's loss in the event of failure without providing increased assessment revenue. Substituting secured liabilities for deposits can also lower an institution's franchise value in the event of failure, which increases the FDIC's losses, all else equal.⁶¹

Comments

The vast majority of commenters were opposed to the secured liability adjustment. The few commenters that supported the FDIC's proposal called the secured liability adjustment fair and appropriate, and viewed the logic for the increased charge as clear and compelling. One of the supportive commenters stated that core deposits are more advantageous to an institution than secured liabilities, as they are

cheaper and allow cross-selling of products. As a result, prudent institutions show a preference for core funding. The commenter found the proposed threshold to be reasonable.

Many of the commenters opposed to the adjustment suggested that the NPR gave too much weight to risk adjustments based on arbitrary measures, and ignored the probability of default. Commenters argued that the true risk of a bank lies in the quality of its assets, rather than how the assets are funded. Some noted that the presence of unsecured liabilities (as opposed to secured liabilities) is no guarantee of the quality of a bank's assets or that the assets would be sufficient to cover a bank's deposit liabilities in case of bank failure. Commenters believe that the FDIC should abandon the proposed approach of targeting certain funding sources.

Some commenters argued that the proposed secured liability adjustment appears to run contrary to established programs that have implied government support, including borrowings from the Federal Reserve through the Term Auction Facility. Commenters viewed the secured liability adjustment as unfair to institutions that have limited options for funding.

Many of the comments (over 1,100) were particularly concerned about the effect the FDIC's proposal would have on Federal Home Loan Bank (FHLB) advances. Commenters argued that FHLB advances are a stable, reliable source of liquidity, and a key tool for asset/liability management, interest rate risk and net interest margin maintenance. Many commenters suggested that the secured liability adjustment was counterproductive since banks benefit from FHLB dividend income. Many commenters cautioned that deterring the use of FHLB advances (and other secured liabilities) will lead to increased use of riskier funding sources, higher funding costs, and decreased lending. Most of the commenters viewed the proposal as unfairly penalizing institutions that use FHLB advances prudently. Several commenters suggested that FHLB advances should be excluded from any secured liability adjustment for at least five years since some FHLB advances do not mature before the effective date of the proposal.

Many commenters argued against the proposal because they believe it would impair the mission of the FHLB system. The commenters asserted that because the proposal discourages the use of FHLB advances, it would lead to a decline in FHLB earnings. Commenters representing community service groups

⁶⁰ Under the final rule, the ratio of secured liabilities to domestic deposits will be rounded to three digits after the decimal point. The resulting amount and adjusted assessment rate will be rounded to the nearest one-hundredth (1/100th) of a basis point.

⁶¹ Overall, whether substituting secured liabilities for deposits increases, decreases, or leaves unchanged the FDIC's loss given failure also depends on how the substitution affects the proportion of insured and uninsured deposits, but FDIC's assessment revenue will always decline with a substitution.

expressed concern that any decline in FHLB earnings would undermine FHLB contributions to community down payment and closing cost assistance programs, community investment programs, affordable housing programs, and foreclosure prevention programs. Commenters also noted that FHLBs already regulate the use of their advances.

Commenters also noted the effect the proposal would have on the use of repurchase agreements (repos). Many commenters argued that repos are a safe and effective source to manage liquidity. Others remarked that repos are an important tool used to attract commercial deposits, which can neither be secured nor bear interest. One commenter suggested that the definition of secured liabilities used in the proposal, exclude repos with state and local governments where the securities sold are federal government or agency securities. In addition, the commenter expressed concern that the proposal would put banks at a competitive disadvantage to non-depository institutions.

Commenters also expressed concern that the proposed secured liability adjustment would harm the covered bond market at a time when additional sources of mortgage funding are needed

and when bank regulatory agencies have supported development of this market.

Many commenters argued that the 15 percent threshold is arbitrary and simplistic. One commenter suggested raising the threshold to 30 percent. Some comments suggested adjusting the threshold by subtracting the balance that is secured by agency bonds or investment grade securities or by subtracting long-term advances. Other commenters recommended eliminating the secured liability adjustment if the bank has capital above a certain amount.

The FDIC remains generally unpersuaded by these comments, which do not respond to the reasons for the secured liability adjustment. The FDIC has not argued that secured liability funding makes a bank more likely to fail. Rather, as noted above, the primary purpose of the secured liability adjustment is to remedy an 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. This result is not fair to institutions that do not rely heavily on secured funding. Substituting secured liabilities for deposits can also lower an institution's franchise value in the event of failure,

which increases the FDIC's losses, all else equal. A risk-based system should take this likelihood into account. These arguments apply equally whether an institution's secured liabilities consist of FHLB advances, repurchase agreements or other forms of secured borrowing.

The FDIC intended the secured liability adjustment to apply only to those institutions that rely heavily on secured funding. The revenue loss to the DIF is relatively small until reliance on secured funding becomes significant. To ensure that the adjustment applies only to those institutions that rely heavily on secured funding and impose a significant revenue loss on the DIF, the final rule raises the ratio of secured liabilities to domestic deposits that will trigger the adjustment to 25 percent. As Table 11 demonstrates, as of September 30, 2008, only 10 percent of insured institutions would have had a secured liability adjustment and only 5 percent would have had an increase in assessment rate of greater than 10 percent. Consequently, the adjustment should have no effect on funding choices for the vast majority of institutions and is unlikely to have a significant overall effect on secured borrowing, the FHLB system, affordable housing or foreclosure prevention.

TABLE 11—PERCENTAGE OF INSTITUTIONS SUBJECT TO THE SECURED LIABILITY ADJUSTMENT USING DIFFERENT THRESHOLDS
[As of September 30, 2008]

	Minimum ratio of secured liabilities to domestic	
	15%	25%
Percentage of all institutions that would have been subject to the secured liability adjustment	24%	10%
Percentage of all institutions that would have had more than a 10% increase in assessment rate due to the secured liability adjustment	10%	5%

Some commenters noted that many states require that banks collateralize any public funds they have on deposit; since public funds pose no additional risk to the DIF, banks should not be penalized by the secured liability adjustment when pledging collateral for the public funds. The FDIC agrees. The FDIC did not, and did not intend to, include collateralized public funds among secured liabilities for purposes of the adjustment. For purposes of the secured liability adjustment, deposits, regardless of whether they are collateralized, are not considered a secured liability.

Many comments focused on the timing of the proposal. Most commenters noted that discouraging alternate funding sources would hurt

bank liquidity and tighten credit availability, which is inconsistent with market realities in the current economic downturn. Comments on the general timing of the proposal suggested that it should be delayed until at least the beginning of 2010; others commented that a phase-in schedule for the secured liability adjustment should be used. Commenters thought that a delay in the proposal would decrease the likelihood that the secured liability adjustment would conflict with other policy measures currently being used to increase liquidity. Additionally, commenters asserted that the proposal does not give institutions an opportunity to adjust their funding mix to account for the new assessment rate structure.

In the FDIC's view, the secured liability adjustment will not have any material effect on liquidity and will not conflict with other measures intended to increase liquidity. As noted above, the secured liability adjustment will affect only about 10 percent of the industry and will cause more than a 10 percent increase in assessment rates for only about 5 percent of the industry. The FDIC also sees no reason to delay implementation to allow institutions to adjust their funding mix. The NPR was published in October 2008 and the secured liability adjustment will be based upon data submitted as of June 30, 2009, which allows institutions over eight months to adjust their funding mix.

Some commenters were concerned that the proposed secured liability adjustment would result in sharp increases in assessments when amendments take effect to the Statement of Financial Accounting Standards No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (FAS 140) in 2010. FAS 140 will require banks to report assets in special-purpose vehicles and variable-interest entities, which often include securitized assets, on their balance sheets. These assets are presently accounted for off-balance sheet. As a result, commenters argue that the adoption of both FAS 140 and the proposed secured liability adjustment would result in an unintended increase in assessments to certain insured institutions.

FAS 140 has not yet been adopted. As proposed, it would not take effect until 2010. If and when FAS 140 is adopted in final form, the FDIC can then consider whether the secured liability adjustment needs to be modified.

VIII. Adjustment for Brokered Deposits for Risk Categories II, III and IV

In addition to the unsecured debt adjustment and the secured liability adjustment, the final rule states that an institution in Risk Category II, III, or IV will also be subject to an assessment rate adjustment for brokered deposits (the brokered deposit adjustment). This adjustment will be limited to those institutions whose ratio of brokered deposits to domestic deposits is greater than 10 percent; asset growth rates will not affect the adjustment. The adjustment will be determined by multiplying 25 basis points times the difference between an institution's ratio of brokered deposits to domestic deposits and 0.10.⁶² However, the adjustment will never be more than 10 basis points. The adjustment will be added to the base assessment rate after all other adjustments had been made. Ratios for any given quarter will be calculated from the Call Reports or TFRs filed by each institution as of the last day of the quarter.

Significant reliance on brokered deposits tends to increase an institution's risk profile, particularly as the institution's financial condition weakens. Insured institutions—particularly weaker ones—typically pay higher rates of interest on brokered deposits. When an institution becomes noticeably weaker or its capital

declines, the market or statutory restrictions may limit its ability to attract, renew or roll over these deposits, which can create significant liquidity challenges.⁶³

Also, significant reliance on brokered deposits tends to decrease greatly the franchise value of a failed institution. In a typical failure, the FDIC seeks to find a buyer for a failed institution's branches among the institutions located in or around the service area of the failed institution. A potential buyer usually seeks to increase its market share in the service area of the failed institution through the acquisition of the failed institution and its assets and deposits, but most brokered deposits originate from outside an institution's market area. The more core deposits that the buyer can obtain through the acquisition of the failed institution, the greater the market share of deposits (and the loans and other products that typically follow the core deposits) it can capture. Furthermore, brokered deposits may not be part of many potential buyers' business plans, limiting the field of buyers. Thus, the lower franchise value of the failed institution created by its reliance on brokered deposits leads to a lower price for the failed institution, which increases the FDIC's losses upon failure.

In addition, as noted earlier, several institutions that have recently failed have experienced rapid asset growth before failure and have funded this growth through brokered deposits. The FDIC believes that these reasons warrant the additional charge for significant levels of brokered deposits.

The brokered deposit adjustment, unlike the adjusted brokered deposit ratio applicable to Risk Category I, will include *all* brokered deposits as defined in Section 29 of the Federal Deposit Insurance Act (12 U.S.C. 1831f), and implemented by 12 CFR 337.6, which is the definition used in banks' quarterly Reports of Condition and Income (Call Reports) and thrifts' quarterly Thrift Financial Reports (TFRs), above 10 percent of an institution's assets. The adjustment will include reciprocal deposits, as well as brokered deposits that consist of balances swept into an insured institution by another institution, such as balances swept from a brokerage account.

The statutory restrictions on accepting, renewing or rolling over

brokered deposits when an institution becomes less than well capitalized apply to *all* brokered deposits, including reciprocal deposits. Market restrictions may also apply to these reciprocal deposits when an institution's condition declines. For these reasons, the final rule includes these reciprocal brokered deposits in the brokered deposit adjustment.

To illustrate the brokered deposit adjustment with a simple example, take a Risk Category II institution with an initial base assessment rate of 22 basis points and a ratio of brokered deposits to domestic deposits of 40 percent. Multiplying 25 basis points times the difference between the institution's ratio of brokered deposits to domestic deposits and 10 percent yields 7.5 basis points (calculated as 25 basis points $\cdot$ (0.4 – 0.1)). Because this amount is less than the maximum possible brokered deposit adjustment of 10 basis points, the brokered deposit adjustment will be as calculated, 7.5 basis points. Assuming that the secured liability adjustment for this institution is 2 basis points and that the institution has no other assessment rate adjustments, the total base assessment rate will be 31.5 basis points (calculated as (22 basis points + 2 basis points + 7.5 basis points)).

Comments

Most of the comments on the proposed adjusted brokered deposit ratio (applicable to Risk Category I) also applied to the proposed brokered deposit adjustment (applicable to the other risk categories). The FDIC's response to these comments is as set out in the discussion of the comments on the adjusted brokered deposit ratio, with one major exception. The FDIC has decided to include reciprocal deposits in the brokered deposit adjustment, unlike the adjusted brokered deposit ratio, applicable to Risk Category I, which excludes them. When an institution's condition declines and it falls out of Risk Category I, the statutory and market restrictions on brokered deposits become much more relevant. Even if such an institution remains well capitalized (and the statutory restrictions do not apply), the risk that an institution will become less than well capitalized has increased. These statutory restrictions can cause severe liquidity problems for institutions that rely heavily on brokered deposits. For this reason, the FDIC has decided to include all brokered deposits above 10 percent of an institution's assets in the brokered deposit adjustment.

⁶² Under the final rule, the ratio of brokered deposits to domestic deposits will be rounded to three digits after the decimal point. The resulting brokered deposit charge will be rounded to the nearest one-hundredth (1/100th) of a basis point.

⁶³ An adequately capitalized institution can accept, renew and rollover brokered deposits only by obtaining a waiver from the FDIC. Even then, interest rate restrictions apply. An undercapitalized institution may not accept, renew or rollover brokered deposits at all. Section 29 of the Federal Deposit Insurance Act (12 U.S.C. 1831f).

IX. Insured Branches of Foreign Banks

Because base assessment rates will be higher and the difference between the minimum and maximum initial base assessment rates will increase from two to four basis points under the final rule, the FDIC is making a conforming change for insured branches of foreign banks in Risk Category I. Under the final rule, an insured branch of a foreign bank's weighted average of ROCA component ratings will be multiplied by 5.076 (which will be the pricing multiplier) and 3.873 (which will be a uniform amount for all insured branches of foreign banks) will be added to the product.⁶⁴ The resulting sum will equal a Risk Category I insured branch of a foreign bank's initial base assessment rate, provided that the amount cannot be less than the minimum initial base assessment rate or greater than the maximum initial assessment rate. A Risk Category I insured branch of a foreign bank's initial base assessment rate will be subject to any large bank adjustment, but total base assessment rates cannot be less than the minimum initial base assessment rate applicable to Risk Category I institutions nor greater than the maximum initial base assessment rate applicable to Risk Category I institutions. Insured branches of a foreign bank not in Risk Category I will be charged the initial base

assessment rate for the risk category in which they are assigned. No insured branch of a foreign bank in any risk category will be subject to the unsecured debt adjustment, secured liability adjustment or brokered deposit adjustment. Insured branches of foreign banks are branches, not independent depository institutions. In the event of failure, the FDIC would not necessarily have access to the institution's capital or be protected by its subordinated debt or unsecured liabilities. Consequently, an unsecured debt adjustment appears to be inappropriate. At present, these branches do not report comprehensively on secured liabilities. In the FDIC's view, the burden of increased reporting on secured liabilities would outweigh any benefit.

X. New Institutions

The FDIC also making conforming changes in the treatment of new insured depository institutions.⁶⁵ For assessment periods beginning on or after January 1, 2010, new institutions in Risk Category I will be assessed at the maximum initial base assessment rate applicable to Risk Category I institutions, as under the final rule adopted in 2006. Effective for assessment periods beginning before January 1, 2010, until a Risk Category I new institution receives CAMELS component ratings, it will have an initial base assessment rate that is two basis points above the

minimum initial base assessment rate applicable to Risk Category I institutions, rather than one basis point above the minimum rate, as under the final rule adopted in 2006.⁶⁶ All other new institutions in Risk Category I will be treated as established institutions, except as provided in the next paragraph. Either before or after January 1, 2010: no new institution, regardless of risk category, will be subject to the unsecured debt adjustment; any new institution, regardless of risk category, will be subject to the secured liability adjustment; and a new institution in Risk Categories II, III or IV will be subject to the brokered deposit adjustment. After January 1, 2010, no new institution in Risk Category I will be subject to the large bank adjustment.

XI. Assessment Rate Schedule

As explained in the next section, estimated losses from projected institution failures have risen considerably since the NPR was published last fall. Furthermore, certain changes from the NPR made in response to public comments would have the effect of reducing total assessment revenue generated under the proposed rates. Consequently, initial base assessment rates as of April 1, 2009, which are set forth in Table 12 below, are slightly higher than proposed in the NPR.⁶⁷

TABLE 12—INITIAL BASE ASSESSMENT RATES

	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.

The FDIC projects that the minimum initial assessment rate would have to be 20 basis points beginning in the second quarter to increase the reserve ratio to

1.15 percent within 5 years (by the end of 2013). Under the rates shown in table 12 and adopted in this rule, the year-end 2013 reserve ratio is projected to be

0.58 percent. After making all possible adjustments under the final rule, total base assessment rates for each risk

⁶⁴ An insured branch of a foreign bank's weighted average ROCA component rating will continue to 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 uniform amount for insured branches is identical to the uniform amount under the large bank method. The pricing multiplier for insured branches is three times the amount of the pricing multiplier under the large bank method, since the initial base rate for an insured branch depends only on one factor (weighted average ROCA ratings), while the initial base rate under the large bank method depends on three factors, each equally weighted.

⁶⁵ As discussed below, subject to exceptions, the final rule defines a new insured depository institution as a bank or thrift that has not been federally insured for at least five years as of the last day of any quarter for which it is being assessed. ⁶⁶ Certain credit unions that convert to a bank or thrift charter and certain otherwise new insured institutions in a holding company structure may be considered established institutions. Both before and after January 1, 2010, any such institution that is well capitalized but has not yet received CAMELS component ratings will be assessed at two basis points above the minimum initial base assessment rate applicable to Risk Category I institutions. ⁶⁷ In the NPR, the FDIC noted that: [A]t the time of the issuance of the final rule, the FDIC may need to set a higher base rate schedule

based on information available at that time, including any intervening institution failures and updated failure and loss projections. A higher base rate schedule may also be necessary because of changes to the proposal in the final rule, if these changes have the overall effect of changing revenue for a given rate schedule. In order to fulfill the statutory requirement to return the fund reserve ratio to 1.15 percent, the base rate schedule in the final rule could be substantially higher than the proposed base assessment rate schedule (for example, if projected or actual losses at the time of the final rule greatly exceed the FDIC's current estimates). FR 61,560, 61,572–61,573 (Oct. 16, 2008).

category will be within the ranges set forth in Table 13 below.⁶⁸

TABLE 13—TOTAL BASE ASSESSMENT RATES AFTER ADJUSTMENTS*

	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	7–24.0	17–43.0	27–58.0	40–77.5

* All amounts for all risk categories are in basis points annually. Rates for institutions that do not pay the minimum or maximum rate will vary between these rates. Adjustments will be applied in the order listed in the table. The large bank adjustment will be made before any other adjustment.

The new base rate schedule is intended to improve the way the assessment system differentiates risk among insured institutions and make the risk-based assessment system fairer, by limiting the subsidization of riskier institutions by safer ones. They are also intended to increase assessment revenue while the Restoration Plan is in effect.

However, given the FDIC's estimated losses from projected institution failures, the assessment rates adopted in the final rule raise make it likely that the DIF balance and reserve ratio will fall to zero or below this year. The FDIC believes that it is important that the fund not decline to a level that could undermine public confidence in federal deposit insurance. Therefore, the FDIC is simultaneously issuing an interim rule to impose a 20 basis point special assessment on June 30, 2009.⁶⁹ The interim rule also provides that the Board may impose additional special assessments of up to 10 basis points thereafter, if the reserve ratio of the Deposit Insurance Fund is estimated to fall to a level that the Board believes would adversely affect public confidence or to a level which shall be close to zero or negative at the end of a calendar quarter.

Actual Rate Schedule, Ability To Adjust Rates and Effective Date

The final rule sets actual rates at the total base assessment rate schedule effective April 1, 2009. The FDIC projects an overall average assessment rate of 15.4 basis points beginning in April 2009. As of September 30, 2008, the average assessment rate (before accounting for credit use) was 6.4 basis

points for all institutions and 5.5 basis points for institutions in Risk Category I.

The rate schedule and the other revisions to the assessment rules will take effect for the quarter beginning April 1, 2009, and will be reflected in the June 30, 2009 fund balance and the invoices for assessments due September 30, 2009.

The final rule continues to allow the FDIC Board to adopt actual rates that are higher or lower than total base assessment rates without the necessity of further notice-and-comment rulemaking, provided that: (1) the Board cannot increase or decrease rates from one quarter to the next by more than three basis points; and (2) cumulative increases and decreases can not be more than three basis points higher or lower than the adjusted base rates. Continued retention of this flexibility will enable the Board to act in a timely manner to fulfill its mandate to raise the reserve ratio to at least 1.15 percent within the 5-year timeframe.

Comments

The FDIC received comments from several industry trade groups and many banks regarding the proposed increases in assessment rates. Two comments supported the proposal to increase risk-based assessments. Many other letters were critical. Several trade groups and other commenters argued that the proposed assessment rates are too high. Many commenters urged the FDIC to take advantage of the flexibility that Congress provided to extend the restoration period beyond five years under "extraordinary circumstances."

Among other things, commenters argued that the FDIC's invocation of its systemic risk authority to provide additional guarantees on non-interest bearing transaction deposits and senior unsecured debt is evidence of "extraordinary circumstances." Commenters argued that rates should be lower on the grounds that current economic conditions are severe, that lower rates would be consistent with the government's efforts to restore stability to the markets and the financial sector and would make more funds available to lend in local communities to small businesses and consumers. One trade group argued that the FDIC should assume slower insured deposit growth, which would support lower rates.

Several commenters urged the FDIC to withdraw the proposed rule and delay increasing assessment rates and overhauling the assessment system until the end of 2009. They argued that the delay would allow time for a thorough evaluation of the effectiveness of measures recently taken by the federal government to restore stability to the banking system.

The FDIC agrees that significant increases in deposit insurance premium rates in times of economic and financial stress are not desirable. However, the FDIC believes that it is important that the fund not decline to a level that could undermine public confidence in federal deposit insurance. The rates that the FDIC has set in this final rule, combined with the 20 basis point special assessment that the FDIC will impose on June 30, 2009 (and possible additional special assessments of up to 10 basis points thereafter), pursuant to

⁶⁸ These rates would be in addition to the approximately 1 to 1.2 basis point annual rates that institutions are assessed to pay the interest on Financing Corporation (FICO) bonds.

⁶⁹ 12 U.S.C. 1817(b)(5) provides:

Emergency special assessments.—In addition to the other assessments imposed on insured depository institutions under this subsection, the

Corporation may impose 1 or more special assessments on insured depository institutions in an amount determined by the Corporation if the amount of any such assessment is necessary—

(A) To provide sufficient assessment income to repay amounts borrowed from the Secretary of the Treasury under [12 U.S.C. 1824(a)] in accordance with the repayment schedule in effect under [12

U.S.C. 1824(c)] during the period with respect to which such assessment is imposed;

(B) To provide sufficient assessment income to repay obligations issued to and other amounts borrowed from insured depository institutions under [12 U.S.C. 1824(d)]; or

(C) For any other purpose that the Corporation may deem necessary.

the interim rule that the FDIC is also adopting, balance these goals.

A few comments asserted that the Restoration Plan penalizes safe and well-run community banks and urged the FDIC to require the largest institutions to recapitalize the DIF. In the FDIC's view, the final rule equitably balances assessments from small and large institutions.

One industry trade group called for assessments to be calculated on an individual institution basis for Risk Categories II, III, and IV. Implementing this suggestion would require considerable further investigation, but might be considered in a future rulemaking.

One trade group argued that rates for Risk Categories III and IV should be higher. Under the final rule, the highest possible assessment rate (after adjustments) applicable to Risk Category IV is 77.5 basis points. The FDIC believes that rates for these risk categories are appropriate.

XII. Assessment Revenue Needs Under the Restoration Plan

Summary

The FDIC projected last fall that adoption of a rate schedule with a minimum initial rate of 10 basis points would increase the reserve ratio to above 1.25 percent by the end of 2013. However, a deepening recession and continued severe problems in the housing and construction sectors, financial markets and commercial real estate, contribute to the FDIC's expectation of significantly higher losses for the insurance fund compared to the projections of last October included in the proposed rule. The insurance fund balance and reserve ratio are likely to decline significantly in 2009 before beginning a gradual recovery in subsequent years from the effects of new revenue and a declining rate of bank failures. Even under the rates adopted in the final rule, the FDIC projects that the reserve ratio may decline to close to zero—or may turn negative—by or before the end of 2009. The 20 basis point special assessment to be imposed under the interim rule on June 30, 2009 (and possible additional special assessments of up to 10 basis points thereafter) are intended to ensure that the reserve ratio does not decline to a level that could undermine public confidence in federal deposit insurance.

The FDIC's best estimate is that institution failures could cost the insurance fund approximately \$65 billion from 2009 to 2013, after incurring approximately \$18 billion in estimated costs for failures in 2008. The

FDIC bases its loss projections on: analysis of specific troubled institutions and risk factors that may adversely affect other institutions; analysis of recent and expected loss rates given failure; stress analyses of the effects of further housing price declines and a significant economic downturn in specific geographic areas on loan losses and bank capital; and recent and historic supervisory rating downgrade and failure rates.

The FDIC also assumes that insured deposits would increase by 7 percent in 2009 and by 5 percent thereafter. The annual average growth rate in insured deposits was almost 7 percent over the past 5 years and just over 5 percent over the past 10 years.

The FDIC recognizes that there is considerable uncertainty about its projections for losses and insured deposit growth, and that changes in assumptions about these and other factors could lead to different assessment revenue needs and rates. Under the terms of the Restoration Plan, the FDIC must update its projections for the insurance fund balance and reserve ratio at least semiannually while the Restoration Plan is in effect and adjust rates as necessary. In the event that losses exceed or fall below the FDIC's best estimate or insured deposit growth is more or less rapid than expected, the Board will be able to adjust assessment rates.

Factors Considered in Setting the Level of Assessment Rates

In setting assessment rates, the FDIC's Board of Directors has considered the following factors required by statute:

- (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.
- (v) Other factors the Board of Directors has determined to be appropriate.⁷⁰

⁷⁰ Section 2104 of the Reform Act (amending section 7(b)(2) of the Federal Deposit Insurance Act, 12 U.S.C. 1817(b)(2)(B)). The risk factors referred to in factor (iv) include:

The factors considered in setting assessment rates are discussed in more detail below.

Case Resolution Expenses (Insurance Fund Losses)

Insurance fund losses from recent insured institution failures and an expected higher rate of failures over the next few years will significantly reduce the fund balance and reserve ratio.

The financial market disruptions over the past year have increased the likelihood that the recession will be severe and prolonged. Declining housing and equity prices, financial market turmoil, and deteriorating economic conditions will continue to exert significant stress on banking industry earnings and credit quality, most notably in residential real estate and construction and development portfolios. Accelerating job losses and declining household wealth may weaken consumer credit performance, while slowing business activity increases the risks in commercial loan portfolios. Significant uncertainty remains about the outlook for recovery in securitization markets and the return of confidence to financial markets. Regional disparities in housing markets and economic conditions have led to variation in prospects among banks. Institutions most at risk include those with large volumes of subprime and nontraditional mortgages, particularly those heavily reliant on securitization, and those with heavy concentrations of residential real estate and construction and development loans in markets with the greatest housing price declines. Institutions that are heavily reliant on non-core funding are exposed to additional risks.

In developing its projections of losses to the insurance fund, the FDIC drew from several sources. First, the FDIC relied heavily on supervisory analysis of troubled institutions. Supervisors also identified risk factors present in currently troubled institutions (or that were present in institutions that recently failed) to help analyze the

(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)).

potential for other institutions with those risk factors to cause losses to the insurance fund. Second, the FDIC drew on its analysis of losses to the fund in the event of failure. Current financial market and economic difficulties make simple reliance on the historical average or model estimates based on historical data inappropriate for projecting loss rates given failure, particularly in the near term.

The FDIC also relied on an analysis of the expected widespread further decline in housing prices and deterioration in overall economic conditions on the capital positions and earnings of insured institutions. The analysis simulated high and rising loan loss rates due to increased non-current loan rates, rising unemployment rates, and falling collateral values, especially for loans backed by real estate. As the result of recent and expected deterioration in the U.S. economy and banking conditions, the projected loss rates have risen substantially from those contained in the NPR.

The FDIC projects that the costs of institution failures from 2009 through 2013 may total \$65 billion. These losses are in addition to the \$18 billion for the estimated costs of failures for 2008. The FDIC recognizes the considerable degree of uncertainty surrounding these projections and its analyses reveal that either higher or lower losses are plausible. This uncertainty underscores the need to update the outlook for insurance fund losses on a regular basis—at least semiannually—while the Restoration Plan is in effect and to consider adjustments to assessment rates.

Operating Expenses and Investment Income

The FDIC estimates that its operating expenses in 2009 will be \$1.1 billion. Thereafter, the FDIC projects that operating expenses will increase on average by 5 percent annually.

The FDIC projects that its investment contributions (investment income plus or minus unrealized gains or losses on available-for-sale securities) in 2008 will total \$4.7 billion, or 9 percent of the start-of-year fund balance. A one-time unrealized gain of \$1.6 billion from reclassifying the fund's held-to-maturity securities as available for sale on June 30, 2008, bolsters this figure. Near-term projections of investment income reflect the current outlook of constant to slightly rising Treasury yields.⁷¹ In addition, the FDIC expects that it will invest new funds in short-term securities (primarily overnight investments) to accommodate increased bank failure activity. These investments are expected to earn lower rates than the longer-term securities that they are replacing and will therefore result in less interest income to the fund. The FDIC projects investments to contribute an amount equal to 1.3 percent of the starting fund balance in 2009. The FDIC projects that investment contributions as a percent of the fund balance will rise gradually in later years.

Assessment Revenue, Credit Use, and the Distribution of Assessments

Assessment revenue in 2008 totaled \$3.0 billion: \$4.4 billion in gross assessments charged less \$1.4 billion in credits used. At the end of 2008, only 4 percent of the original \$4.7 billion in credits remained. As part of the Restoration Plan, the FDIC has the authority to restrict credit use while the plan is in effect, providing that institutions may still apply credits against their assessments equal to the lesser of their assessment or 3 basis

points.⁷² The FDIC has decided not to restrict credit use in the Restoration Plan. The FDIC projects that the amount of credits remaining at the time that the new rates go into effect will be very small and that their continued use will have very little effect on the assessment revenue necessary to meet the requirements of the plan.⁷³

Accounting for the use of remaining credits, the uniform increase to rates for the first quarter of 2009, and assuming that the assessment rates adopted in this rule were to remain in effect for the remainder of this year, the FDIC projects that the fund will earn assessment revenue of \$11.6 billion for all of 2009.⁷⁴

For the quarter beginning April 1, 2009, the FDIC has derived gross assessment revenue (i.e., before applying any remaining credits) by assigning each insured institution an assessment rate based on the proposed rate schedule and factors described above. Table 16 shows the distribution of institutions and domestic deposits by risk category (divided into four parts for Risk Category I) under the *initial* base rate schedule (effective April 1, 2009) based on data as of September 30, 2008; Table 17 shows the distribution of institutions and domestic deposits by bands of *total* base assessment rates.⁷⁵ For purposes of assessment revenue projections beginning in April, the FDIC relied on the data reflected in Table 17, but also accounted for projected migration of institutions across risk categories as supervisory ratings change.

⁷² Section 7(b)(3)(E)(iv) of the Federal Deposit Insurance Act (12 U.S.C. 1817(b)(3)(E)(iv)).

⁷³ For 2009 and 2010, credits may not offset more than 90 percent of an institution's assessment. Section 7(e)(3)(D)(ii) of the Federal Deposit Insurance Act (12 U.S.C. 1817(e)(3)(D)(ii)).

⁷⁴ The projection assumes 7 percent annual growth in the assessment base (which is approximately domestic deposits) in 2009.

⁷⁵ The assessment base is almost equal to total domestic deposits.

⁷¹ Future interest rate assumptions are based on consideration of recent Blue Chip Financial Forecasts as well as recent forward rate curves. Forward rates are expected yields on securities of varying maturities for specific future points in time that are derived from the term structure of interest rates. (The term structure of interest rates refers to the relationship between current yields on comparable securities with different maturities.)

TABLE 16—DISTRIBUTION OF INITIAL BASE ASSESSMENT RATES AND DOMESTIC DEPOSITS* DATA AS OF SEPTEMBER 30, 2008

Risk category	Initial assessment rate	Number of institutions	Percent of institutions	Domestic deposits (in billions of \$)	Percent of domestic deposits
I	12	1,577	19	860.1	12
	12.01–14	2,637	31	2,863.4	40
	14.01–15.99	1,815	22	1,765.2	24
	16	1,476	18	812.4	11
II	22	672	8	818.8	11
III	32	185	2	83.5	1
IV	45	21	0	18.8	0

* This table and the following two tables exclude insured branches of foreign banks.

TABLE 17—DISTRIBUTION OF TOTAL BASE ASSESSMENT RATES AND DOMESTIC DEPOSITS* DATA AS OF SEPTEMBER 30, 2008

Risk category	Total base assessment	Number of institutions	Percent of institutions	Domestic deposits (in billions of \$)	Percent of domestic deposits
I	7–12	2,649	32	3,381.4	47
	12.01–14	2,248	27	1,295.8	18
	14.01–16	2,367	28	1,177.2	16
	16.01–24	241	3	446.7	6
II	17–22	435	5	519.7	7
	22.01–43	237	3	299.0	4
III	27–32	107	1	44.3	1
	32.01–58	78	1	39.2	1
IV	40–45	9	0	1.2	0
	45.01–77.5	12	0	17.6	0

* Because of data limitations, secured liability adjustments for TFR filers are estimated using imputed values based on simple averages of Call Report filers as of September 30, 2008 (discussed above). Unsecured debt adjustments are estimated using reported subordinated debt and a portion of non-FHLB other borrowings.

Estimated Insured Deposits

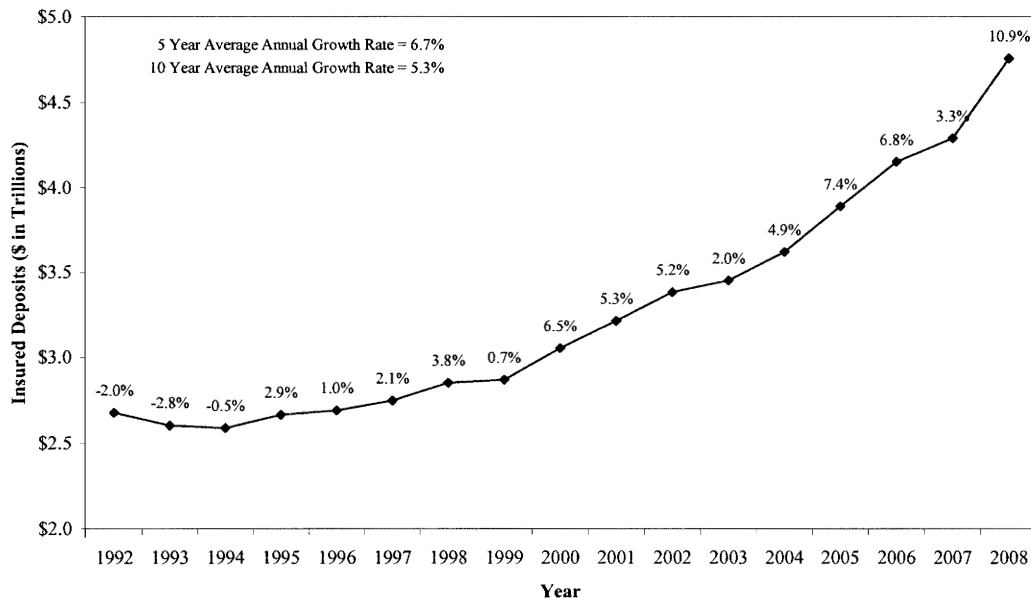
The FDIC believes that it is reasonable to plan for annual insured deposit growth of 7 percent in 2009 and 5 percent in subsequent years. During

2008, insured deposits increased by about 11 percent, with the troubles in the economy and financial markets making the safety of federally insured deposits an attractive option. The most

recent five year average growth rate was 6.7 percent and the ten year average growth rate was 5.3 percent. Chart 1 depicts insured deposit growth since 1992.

Chart 1

**Annual Insured Deposit Growth Rates
(December to December)**



Projections of insured deposits are subject to considerable uncertainty.⁷⁶ Insured deposit growth over the near term could continue to rise more rapidly due to a “flight to quality” attributable to financial and economic uncertainties. On the other hand, as the experience of the late 1980s and early 1990s demonstrated, lower overall growth in the banking industry and the economy could depress rates of growth of total domestic and insured deposits. A one percentage point increase or decrease in average annual insured deposit growth rates will not have a significant effect on the assessment rates necessary to meet the requirements of the Restoration Plan, other factors equal.

Effect on Capital and Earnings

Appendix 2 contains an analysis of the effect of the rates adopted in this rule on the capital and earnings of insured institutions based on a range of projected industry earnings. Given the assumptions in the analysis, for the industry as a whole, projected total assessments in 2009 would result in capital that would be 0.4 to 0.5 percent lower than if the FDIC did not charge

assessments. Based on the range of projected industry earnings, the proposed assessments would cause 8 to 12 institutions whose equity-to-assets ratio would have exceeded 4 percent in the absence of assessments to fall below that percentage and 6 to 9 institutions to fall below 2 percent.

For profitable institutions, assessments in 2009 would result in pre-tax income that would be between 6 and 8 percent lower than if the FDIC did not charge assessments. For unprofitable institutions, pre-tax losses would increase by an average of 3 to 5 percent. Appendix 2 also provides an analysis of the range of effects on capital and earnings for these groups of institutions.

Other Factors that the Board May Consider

In its consideration of proposed rates, the FDIC Board has considered another factor that it deems appropriate, as permitted by law.

Updating projections regularly. The FDIC recognizes that there is considerable uncertainty about its projections for losses and insured deposit growth, and that changes in assumptions about these and other factors could lead to different assessment revenue needs and rates. The FDIC projects that, under these rates, the reserve ratio will increase to

0.58 percent by year-end 2013.

Nonetheless, the FDIC expects to update its projections for the insurance fund balance and reserve ratio at least semiannually while the Restoration Plan is in effect and adjust rates as necessary.

XIII. Additional Comments

One large bank recommended that, in setting assessment rates, most weight should be given to probability of default, with particular emphasis on the liquidity strength of the bank, as reflected in its CAMELS. The commenter argued that if a bank has a low probability of default, assessments should be low and risk adjustments based on potential FDIC losses are not justified. The FDIC was urged to reconsider whether risk adjustments beyond the core measures (debt ratings, CAMELS, and capital ratios) should be used at all. Additionally, the writer criticized the FDIC for using proxies for unencumbered assets that are flawed substitutes.

In the FDIC’s view, probability of default is just one element of the risk posed by an institution. Loss given default is equally important. For the reasons given above, the FDIC is convinced of the need for the adjustments contained in the final rule.

⁷⁶ The FDIC estimates of insured deposits and projections do not consider the effect of the temporary increase in the deposit insurance coverage limit to \$250,000 or the guarantee of certain deposits under the Temporary Liquidity Guarantee Program.

XIV. Technical and Other Changes

The final rule will change the way assessment rates are determined for a large institution that is subject to the large bank method (or an insured branch of a foreign bank) when it moves from Risk Category I to Risk Category II, III or IV during a quarter.

Under the final rule adopted in 2006, if, during a quarter, a CAMELS (or ROCA) rating change occurs that results in a large institution that is subject to the supervisory and debt ratings method or an insured branch of a foreign bank moving from Risk Category I to Risk Category II, III or IV, the institution's assessment rate for the portion of the quarter that it was in Risk Category I is based upon its assessment rate at the end of the prior quarter. No new Risk Category I assessment rate is developed for the quarter in which the institution moves to Risk Category II, III or IV.⁷⁷

The opposite holds true for a small institution or a large institution subject to the financial ratios method when it moves from Risk Category I to Risk Category II, III or IV during a quarter. A new Risk Category I assessment rate is developed for the quarter in which the institution moves to Risk Category II, III or IV.⁷⁸

The final rule states that when a large institution subject to the large bank method or an insured branch of a foreign bank moves from Risk Category I to Risk Category II, III or IV during a quarter, a new Risk Category I assessment rate be developed for that quarter. That rate for the portion of the quarter that the institution was in Risk Category I will be determined as for any other institution in Risk Category I subject to the same pricing method, except that the rate will only apply for the portion of the quarter that the institution was actually in Risk Category I.

Since implementation of the 2006 assessments rule in 2007, several large institutions that were subject to the supervisory and debt ratings method have moved from Risk Category I to a Risk Category II or III. More than once, changes occurred in these institutions' debt ratings or CAMELS component ratings while the institution was in Risk

Category I, but the institutions' assessment rates for the quarter did not reflect these changes. In one case, an institution received a debt rating downgrade early in the quarter, but, because it fell to Risk Category II on the 89th day of the quarter, this debt rating downgrade did not affect its assessment rate. The final rule is intended to correct these outcomes and better ensure that an institution's assessment rate reflects the risk that it poses.

The FDIC is also amending its assessment regulations to correct technical errors and make clarifications to the regulatory language in several sections of Part 327 for the reasons set forth below.

The final rule makes a technical correction to the language of 12 CFR 327.3(a), the regulatory requirement that each depository institution pay an assessment to the Corporation. Language creating an exception "as provided in paragraph (b) of this section" was inadvertently retained in the initial clause of section 327.3(a) when the assessment regulations were amended in 2006. Formerly, paragraph (b) excepted newly insured institutions from payment of assessments for the semiannual period in which they became insured institutions; that exception was eliminated in 2006. Paragraph (b) now addresses quarterly certified statement invoices and payment dates. Accordingly, the final rule amends section 327.3(a) to eliminate the reference to paragraph (b).

Section 327.6(b)(1) addresses assessments for the quarter in which a terminating transfer occurs when the acquiring institution uses average daily balances to calculate its assessment base. In that situation, section 327.6(b)(1) provides that the terminating institution's assessment for that quarter is reduced by the percentage of the quarter remaining after the terminating transfer occurred, and calculated at the acquiring institution's assessment rate. Although it can be inferred that the terminating institution's assessment base for that quarter is to be used in the reduction calculation, the section is not explicit. Accordingly, the final rule amends the section to clarify that the reduction calculation is accomplished by applying the acquirer's rate to the terminating institution's assessment base for that quarter.

Section 327.8(i) defines *Long Term Debt Issuer Rating* as the "current rating" of an insured institution's long-term debt obligations by one of the named ratings companies. "Current rating" is defined in section 327.8(i) as "one that has been confirmed or assigned within 12 months before the

end of the quarter for which the assessment rate is being determined." The section also provides: "If no current rating is available, the institution will be deemed to have no long-term debt issuer rating." The language of section 327.8(i) requires the FDIC to disregard a long-term debt issuer rating that is still in effect—that is, it has not been withdrawn and replaced by another rating—if it is greater than 12 months old when the FDIC calculates an institution's assessment rate. To remedy this, the FDIC is amending section 327.8(i) to read as follows:

(i) *Long-Term Debt Issuer Rating.* A long-term debt issuer rating shall mean a rating of an insured depository institution's long-term debt obligations by Moody's Investor Services, Standard & Poor's, or Fitch Ratings that has not been withdrawn before the end of the quarter being assessed. A withdrawn rating shall mean one that has been withdrawn by the rating agency and not replaced with another rating by the same agency. A long-term debt issuer rating does not include a rating of a company that controls an insured depository institution, or an affiliate or subsidiary of the institution.

Consistent with this amendment, the final rule amends two references to long-term debt issuer rating, as defined in § 327.8(i), "*in effect at the end of the quarter being assessed*" that appear in 12 CFR 327.9(d) and 12 CFR 327.9(d)(2). The final rule amends these sections by deleting the phrase "*in effect at the end of the quarter being assessed*" and to add "*as defined in § 327.8(i)*" to section 327.9(d)(2) so that its construction parallels section 327.9(d).

Sections 327.8(l) and (m) define "*New depository institution*" and "*Established depository institution*." The former is "a bank or thrift that has not been chartered for at least five years as of the last day of any quarter for which it is being assessed"; the latter is "a bank or thrift that has been chartered for at least five years as of the last day of any quarter for which it is being assigned." In the FDIC's view, this regulatory language could allow a previously uninsured institution to be treated as an established institution based on charter date. To remedy this, the final rule amends sections 327.8(l) and (m) to read as follows:

(l) *New depository institution.* A new insured depository institution is a bank or thrift that has been federally insured for less than five years as of the last day of any quarter for which it is being assessed.

(m) *Established depository institution.* An established insured depository institution is a bank or thrift that has

⁷⁷ 12 CFR 327.9(d)(5).

⁷⁸ 12 CFR 327.9(d)(1)(ii). In fact, the FDIC had provided in the preamble to the 2006 assessments rule that no new Risk Category I assessment rate would be determined for any large institution for the quarter in which it moved to Risk Category II, III or IV, but, as the result of a drafting inconsistency, this intention was not realized in the regulatory text. 71 FR 69,282, 69,293 (Nov. 30, 2006). The FDIC now believes that a new Risk Category I assessment rate should be determined for any large institution for the quarter in which it moves to Risk Category II, III or IV.

been federally insured for at least five years as of the last day of any quarter for which it is being assessed.

Section 327.9(d)(7)(viii), which addresses rates applicable to institutions subject to the subsidiary or credit union exception, contains language making the section applicable “[o]n or after January 1, 2010. * * *” This language is redundant of language in section 327.9(d)(7)(i)(A) and the final rule deletes it.

XV. Effective Date

This final rule will become effective on April 1, 2009.

XVI. Regulatory Analysis and Procedure

A. 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 and received one response. The comment stated that the proposal was too complicated and should have included an executive summary in bullet point format. Making the risk-based assessment system more responsive to risk entailed some complexity, which we tried to minimize.

B. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) requires that each federal agency either certify that a final rule would not, if adopted in final form, have a significant economic impact on a substantial number of small entities or prepare an initial regulatory flexibility analysis of the rule and publish the analysis for comment.⁷⁹ 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.⁸⁰ The final rule relates directly to the rates imposed on insured depository institutions for deposit insurance, and to the risk-based assessment system components that measure risk and weigh that risk in determining each institution’s assessment rate, and includes technical and other changes to the FDIC’s assessment regulations. Nonetheless, the FDIC is voluntarily undertaking an initial regulatory flexibility analysis of the final rule for publication.

As of December 31, 2008, of the 8,305 insured commercial banks and savings associations, there were 4,567 small insured depository institutions as that term is defined for purposes of the RFA (*i.e.*, those with \$165 million or less in assets).

For purposes of this analysis, whether the FDIC were to collect needed assessments under the existing rule or under the final rule, the total amount of assessments collected would be the same. The FDIC’s total assessment needs

are driven by the statutory requirement that the FDIC adopt a restoration plan and by the FDIC’s aggregate insurance losses, expenses, investment income, and insured deposit growth, among other factors. Given the FDIC’s total assessment needs, the final rule would merely alter the distribution of assessments among insured institutions. Using the data as of December 31, 2008, the FDIC calculated the total assessments that would be collected under the base rate schedule in the final rule.

The economic impact of the final rule on each small institution for RFA purposes (*i.e.*, institutions with assets of \$165 million or less) was then calculated as the difference in annual assessments under the final rule compared to the existing rule as a percentage of the institution’s annual revenue and annual profits, assuming the same total assessments collected by the FDIC from the banking industry.^{81 82}

Based on the December 2008 data, under the final rule, for more than 75 percent of small institutions, the change in the assessment system would result in assessment changes (up or down) totaling five percent or less of annual revenue. Of the total of 4,567 small institutions, only eight percent would have experienced an increase equal to five percent or greater of their total revenue. These figures do not indicate a significant economic impact on revenues for a substantial number of small insured institutions. Table 18 below sets forth the results of the analysis in more detail.

TABLE 18—CHANGE IN ASSESSMENTS UNDER THE FINAL RULE AS A PERCENTAGE OF TOTAL REVENUE

Change in assessments as a percentage of total revenue	Number of institutions	Percent of institutions
More than 10 percent lower	240	5.26
5 to 10 percent lower	545	11.93
0 to 5 percent lower	2,306	50.49
0 to 5 percent higher	1,120	24.52
5 to 10 percent higher	239	5.23
More than 10 percent higher	117	2.56
Total	4,567	100.00

The FDIC performed a similar analysis to determine the impact on profits for small institutions. Based on December 2008 data, under the final

rule, 81 percent of the small institutions with reported profits would have experienced a change in their annual profits of 5 percent or less. Table 19 sets

forth the results of the analysis in more detail.

⁷⁹ See 5 U.S.C. 603, 604 and 605.

⁸⁰ 5 U.S.C. 601.

⁸¹ Throughout this regulatory flexibility analysis (unlike the rest of the final rule), a “small

institution” refers to an institution with assets of \$165 million or less.

⁸² An institution’s total revenue is defined as the sum of its annual net interest income and non-

interest income. An institution’s profit is defined as income before taxes and extraordinary items, gross of loan loss provisions.

TABLE 19—CHANGE IN ASSESSMENTS UNDER THE PROPOSAL AS A PERCENTAGE OF PROFIT *

Change in assessments as a percentage of profit	Number of institutions	Percent of institutions
More than 30 percent lower	451	14.77
20 to 30 percent lower	266	8.71
10 to 20 percent lower	616	20.18
5 to 10 percent lower	654	21.42
0 to 5 percent lower	477	15.62
0 to 10 percent more	276	9.04
Greater than 10 percent	313	10.25
Total	3,053	100.00

* Institutions with negative or no profit were excluded. These institutions are shown separately in Table 20.

Of those small institutions with reported profits, only 10 percent would have experienced a decrease in their total profits of 10 percent or greater. 65 percent of these small institutions would have a greater than five percent increase in their profits. Again, these figures do not indicate a significant

economic impact on profits for a substantial number of small insured institutions.

Table 19 excludes small institutions that either show no profit or show a loss, because a percentage cannot be calculated. The FDIC analyzed the effect of the final rule on these institutions by determining the annual assessment

change that would result. Table 20 below shows that only 17 percent (256) of the 1,514 small insured institutions in this category would have experienced an increase in annual assessments of \$10,000 or more. 14% of these institutions would have experienced a decrease of \$10,000 or more.

TABLE 20—CHANGE IN ASSESSMENTS UNDER THE FINAL RULE FOR INSTITUTIONS WITH NEGATIVE OR NO REPORTED PROFIT

Change in assessments	Number of institutions	Percent of institutions
\$20,000 decrease or more	97	6.40
\$10,000–\$20,000 decrease	108	7.13
\$5,000–\$10,000 decrease	131	8.65
\$1,000–\$5,000 decrease	203	13.41
\$0–\$1,000 decrease	78	5.15
\$0–\$10,000 increase	641	42.43
\$10,000–\$20,000 increase	124	8.19
\$20,000 increase or more	132	8.72
Total	1,514	100.0

The final rule does not directly impose any “reporting” or “recordkeeping” requirements within the meaning of the Paperwork Reduction Act. The compliance requirements for the final rule would not exceed existing compliance requirements for the present system of FDIC deposit insurance assessments, which, in any event, are governed by separate regulations.

The FDIC is unaware of any duplicative, overlapping or conflicting federal rules.

The initial regulatory flexibility analysis set forth above demonstrates that the final rule would not have a significant economic impact on a substantial number of small institutions within the meaning of those terms as used in the RFA.⁸³

C. Paperwork Reduction Act

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

D. 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 No. 110–28 (1996). As required by law, the FDIC will file the appropriate reports with Congress and the General Accounting Office so that the final rule may be reviewed.

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

The FDIC has determined that the proposed 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 amends 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, 1817–1819, 1821; Sec. 2101–2109, Public Law 109–171, 120 Stat. 9–21, and Sec. 3, Public Law 109–173, 119 Stat. 3605.

■ 2. Revise § 327.3(a)(1) to read as follows:

⁸³ 5 U.S.C. 605.

§ 327.3 Payment of assessments.

(a) *Required.* (1) *In general.* Each insured depository institution shall pay to the Corporation for each assessment period an assessment determined in accordance with this part 327.

* * * * *

■ 3. Revise § 327.6(b)(1) to read as follows:

§ 327.6 Terminating transfers; other terminations of insurance.

* * * * *

(b) *Assessment for quarter in which the terminating transfer occurs—(1) Acquirer using Average Daily Balances.* If an acquiring institution's assessment base is computed using average daily balances pursuant to § 327.5, the terminating institution's assessment for the quarter in which the terminating transfer occurs shall be reduced by the percentage of the quarter remaining after the terminating transfer and calculated at the acquiring institution's rate and using the assessment base reported in the terminating institution's quarterly report of condition for that quarter.

* * * * *

■ 4. In § 327.8, revise paragraphs (g), (h), (i), (l) and (m) and add paragraphs (o), (p), (q), (r) and (s) to read as follows:

§ 327.8 Definitions.

* * * * *

(g) *Small Institution.* An insured depository institution with assets of less than \$10 billion as of December 31, 2006 (other than an insured branch of a foreign bank or an institution classified as large for purposes of § 327.9(d)(8)) shall be classified as a small institution. If, after December 31, 2006, an institution classified as large under paragraph (h) of this section (other than an institution classified as large for purposes of § 327.9(d)(8)) 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.

(h) *Large Institution.* An institution classified as large for purposes of § 327.9(d)(8) 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) shall be classified as a large institution. If, after December 31, 2006, an institution classified as small under paragraph (g) 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.

(i) *Long-Term Debt Issuer Rating.* A long-term debt issuer rating shall mean

a rating of an insured depository institution's long-term debt obligations by Moody's Investor Services, Standard & Poor's, or Fitch Ratings that has not been withdrawn before the end of the quarter being assessed. A withdrawn rating shall mean one that has been withdrawn by the rating agency and not replaced with another rating by the same agency. A long-term debt issuer rating does not include a rating of a company that controls an insured depository institution, or an affiliate or subsidiary of the institution.

* * * * *

(l) *New depository institution.* 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.

(m) *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 (m)(2), (3), (4), and (5) of this section and § 327.9(d)(10)(ii), (iii), 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 (m)(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.

* * * * *

(o) *Unsecured debt.*—For purposes of the unsecured debt adjustment as set forth in § 327.9(d)(5), unsecured debt shall include senior unsecured liabilities and subordinated debt.

(p) *Senior unsecured liability.*—For purposes of the unsecured debt adjustment as set forth in § 327.9(d)(5), 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)), but shall not include any senior unsecured debt that the FDIC has guaranteed under the Temporary Liquidity Guarantee Program, 12 CFR Part 370.

(q) *Subordinated debt.*—For purposes of the unsecured debt adjustment as set forth in § 327.9(d)(5), 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.

(r) *Long-term unsecured debt.*—For purposes of the unsecured debt adjustment as set forth in § 327.9(d)(5), long-term unsecured debt shall be unsecured debt with at least one year remaining until maturity.

(s) *Reciprocal deposits.*—Deposits that an insured depository institution receives through a deposit placement network on a reciprocal basis, such that:

(1) for any deposit received, the institution (as agent for depositors) places the same amount with other insured depository institutions through the network; and (2) each member of the network sets the interest rate to be paid on the entire amount of funds it places with other network members.

■ 7. Revise § 327.9 to read as follows:

§ 327.9 Assessment risk categories and pricing methods.

(a) *Risk Categories.*—Each 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.

(1) *Risk Category I.* All institutions in Supervisory Group A that are Well Capitalized;

(2) *Risk Category II.* All institutions in Supervisory Group A that are Adequately Capitalized, and all institutions in Supervisory Group B that are either Well Capitalized or Adequately Capitalized;

(3) *Risk Category III.* All institutions in Supervisory Groups A and B that are Undercapitalized, and all institutions in Supervisory Group C that are Well Capitalized or Adequately Capitalized; and

(4) *Risk Category IV.* All institutions in Supervisory Group C that are Undercapitalized.

(b) *Capital evaluations.* An 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, Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks, or Thrift Financial Report 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.

(1) *Well Capitalized.* (i) Except as provided in paragraph (b)(1)(ii) of this section, 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) For purposes of this section, an insured branch of a foreign bank will be deemed to be 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 (b) of this section.

(2) *Adequately Capitalized.* (i) Except as provided in paragraph (b)(2)(ii) of this section, 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.

(ii) For purposes of this section, an insured branch of a foreign bank will be deemed to be 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 (b) of this section; and

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

(3) *Undercapitalized.* An undercapitalized institution is one that does not qualify as either Well Capitalized or Adequately Capitalized under paragraphs (b)(1) and (b)(2) of this section.

(c) *Supervisory evaluations.* Each 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:

(1) *Supervisory Group "A."* This Supervisory Group consists of

financially sound institutions with only a few minor weaknesses;

(2) *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

(3) *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.

(d) *Determining Initial Base Assessment Rates for Risk Category I Institutions.* Subject to paragraphs (d)(2), (4), (5), (6), (8), (9) and (10) of this section, an insured depository institution in Risk Category I, except for a large institution that has at least one long-term debt issuer rating, as defined in § 327.8(i), shall have its initial base assessment rate determined using the financial ratios method set forth in paragraph (d)(1) of this section. A large insured depository institution in Risk Category I that has at least one long-term debt issuer rating shall have its initial base assessment rate determined using the large bank method set forth in paragraph (d)(2) of this section (subject to paragraphs (d)(2), (4), (5), (6), (8), (9) and (10) of this section). The initial base assessment rate for a large institution whose assessment rate in the prior quarter was determined using the large bank method, but which no longer has a long-term debt issuer rating, shall be determined using the financial ratios method.

(1) *Financial ratios method.* Under the financial ratios method for Risk Category I institutions, 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 or subtracted from 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)(4), (5) and (6) of this section, as appropriate (which will produce the total base assessment rate), and adjusted for the actual assessment rates set by the Board under § 327.10(c), 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 § 327.9(b). 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.

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 of 11.861. 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. Appendix A to this subpart describes the derivation of the pricing multipliers and uniform amount and explains how they will be periodically updated.

(i) *Publication and uniform amount and pricing multipliers.* The FDIC will publish notice in the **Federal Register** whenever a change is made to the uniform amount or the pricing multipliers for the financial ratios method.

(ii) *Implementation of CAMELS rating changes—(A) Changes between risk categories.* If, during a quarter, a CAMELS composite rating change occurs that results in an institution whose Risk Category I assessment rate is determined using the financial ratios method 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)(4), (5), and (6) of this section, as appropriate, and adjusted for the actual assessment rates set by the

Board under § 327.10(c). 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)(5), (6) and (7), 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, and its initial base assessment rate would be determined using the financial ratios method, then that method shall apply for the portion of the quarter that it was in Risk Category I, subject to adjustment pursuant to paragraphs (d)(4), (5), and (6) of this section, as appropriate, and adjusted for the actual assessment rates set by the Board under § 327.10(c). 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)(5), (6) and (7), 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 would 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)(4), (5), and (6) 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)(4), (5), and (6) of this section, as appropriate.

(2) *Large bank method.* A large insured depository institution in Risk Category I that has at least one long-term debt issuer rating, as defined in § 327.8(i), shall have its initial base assessment rate determined using the large bank method. The initial base assessment rate under the large bank method shall be derived from three components, each given a 33⅓ percent weight: a component derived using the financial ratios method, a component derived using long-term debt issuer ratings, and a component derived using CAMELS component ratings. The institution's assessment rate computed using the financial ratios method shall be converted to a financial ratios score by first subtracting 10 from the financial ratios method assessment rate and then multiplying the result by ½. The result will equal an institution's financial ratios score. Its CAMELS component ratings will be weighted to derive a weighted average CAMELS rating using the same weights applied in the financial ratios method as set forth under paragraph (d)(1) of this section. Long-term debt issuer ratings will be converted to numerical values between 1 and 3 as provided in Appendix B to this subpart and the converted values will be averaged. The financial ratios score, the weighted average CAMELS rating and the average of converted long-term debt issuer ratings each will be multiplied by 1.692 (which shall be the pricing multiplier), and the products will be summed. To this result will be added 3.873 (which shall be a uniform

amount for all institutions subject to the large bank method). 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)(4), (5), and (6) of this section, as appropriate (which will produce the total base assessment rate), and adjusted for the actual assessment rates set by the Board pursuant to § 327.10(c), will equal an institution's assessment rate.

(i) *Implementation of Large Bank Method Changes between Risk Categories.* If, during a quarter, a CAMELS or ROCA rating change occurs that results in an institution whose Risk Category I initial base assessment rate is determined using the large bank method or 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 as for any other institution in Risk Category I whose initial base assessment rate is determined using the large bank method, subject to adjustments pursuant to paragraph (d)(4), (5), and (6) of this section, as appropriate or, if the institution is an insured branch of a foreign bank, using the weighted average ROCA component rating, subject to adjustment pursuant to paragraph (d)(4). For the portion of the quarter that the institution was not in Risk Category I, the institution's initial base assessment rate, which, unless the institution is an insured branch of a foreign bank, shall be subject to adjustment pursuant to paragraphs (d)(5), (6) and (7), shall be determined under the assessment schedule for the appropriate Risk Category. If, during a quarter, a CAMELS or ROCA rating change occurs that results in a large institution with a long-term debt issuer rating or 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 under paragraphs (d)(2) (and (d)(4), (5), and (6)) or (d)(3) (and (d)(4), (5), and (6)) of this section, as appropriate. 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)(5), (6) and (7), shall be determined under the assessment schedule for the appropriate Risk Category.

(ii) *Implementation of Large Bank Method Changes within Risk Category I.* If, during a quarter, an institution whose Risk Category I initial base assessment rate is determined using the large bank method remains in Risk Category I, but the financial ratios score, a CAMELS component or a long-term debt issuer rating changes that would affect the institution's initial base assessment rate, or if, during a quarter, an insured branch of a foreign bank remains in Risk Category I, but a ROCA component rating changes that would 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 paragraphs (d)(2) (and (d)(4), (5), and (6)) or (d)(3) (and (d)(4)) of this section, as appropriate.

(3) *Assessment rate for insured branches of foreign banks—(i) 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, as determined under paragraph (d)(3)(ii) of this section.

(ii) *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 3.873 (which shall be a uniform amount for all insured branches of foreign banks). The resulting sum—the initial base assessment rate—subject to adjustments pursuant to paragraph (d)(4) of this section 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.

(iii) No insured branch of a foreign bank in any risk category shall be subject to the unsecured debt adjustment, the secured liability adjustment, or the brokered deposit adjustment.

(4) *Adjustment for large banks or insured branches of foreign banks—(i) Basis for and size of adjustment.* Within Risk Category I, large institutions and insured branches of foreign banks except new institutions as provided under paragraph (d)(9)(i)(A) of this section, are subject to adjustment of their initial base assessment rate. Any such large bank adjustment shall be limited to a change in the initial base assessment rate of up to one basis point higher or lower than the rate determined using the financial ratios method, the large bank method, or the weighted average ROCA component rating method, whichever is applicable. In determining whether to make this initial base assessment rate adjustment for a large institution or an insured branch of a foreign bank, the FDIC may consider other relevant information in addition to the factors used to derive the risk assignment under paragraphs (d)(1), (2), or (3) of this section. Relevant information includes financial performance and condition information, other market or supervisory information, potential loss severity, and stress considerations, as described in Appendix C to this subpart.

(ii) *Adjustment subject to maximum and minimum rates.* No adjustment to the initial base assessment rate for large banks shall decrease any rate so that the resulting rate would be less than the minimum initial base assessment rate, or increase any rate above the maximum initial base assessment rate.

(iii) *Prior notice of adjustments—(A) Prior notice of upward adjustment.* Prior to making any upward large bank adjustment to an institution's initial base assessment rate 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 large bank adjustment to an institution's initial base assessment rate because of considerations of additional risk information, the FDIC will formally notify the institution's primary federal regulator and provide an opportunity to respond.

(iv) *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 large bank adjustment to an institution's initial base assessment rate is warranted,

taking into account any revisions to weighted average CAMELS component ratings, long-term debt issuer ratings, and financial ratios, 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, until it determines that an adjustment is no longer warranted. The amount of adjustment will in no event be larger than that contained in the initial notice without further notice to, and consideration of, responses from the primary federal regulator and the institution.

(v) *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 large bank adjustment to an institution's initial base assessment rate is warranted, taking into account any revisions to weighted average CAMELS component ratings, long-term debt issuer ratings, and financial ratios, as well as any actions taken by the institution to address the FDIC's concerns described in the notice. Any downward adjustment in an institution's initial base assessment rate 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.

(vi) *Adjustment without notice.* Notwithstanding the notice provisions set forth above, the FDIC may change an institution's initial base assessment rate without advance notice under this paragraph, if the institution's supervisory or agency ratings or the financial ratios set forth in Appendix A to this subpart deteriorate.

(5) *Unsecured debt adjustment to initial base assessment rate for all institutions.* All institutions within all risk categories, except new institutions as provided under paragraph (d)(9)(i)(C) of this section and insured branches of foreign banks as provided under paragraph (d)(3)(iii) of this section, are subject to downward adjustment of assessment rates for unsecured debt, based on the ratio of long-term unsecured debt (and, for small institutions as defined in paragraph (ii) below, specified amounts of Tier 1 capital) to domestic deposits. Any unsecured debt adjustment shall be

made after any adjustment under paragraph (d)(4) of this section.

(i) *Large institutions*—The unsecured debt adjustment for large institutions shall be determined by multiplying the institution's ratio of long-term unsecured debt to domestic deposits by 40 basis points.

(ii) *Small institutions*—The unsecured debt adjustment for small institutions will factor in an amount of Tier 1 capital (qualified Tier 1 capital) in addition to any long-term unsecured debt; the amount of qualified Tier 1 capital will be the sum of the amounts set forth below:

Range of Tier 1 capital to adjusted average assets	Amount of Tier 1 capital within range which is qualified (percent)
≤5%	0
>5% and ≤6%	10
>6% and ≤7%	20
>7% and ≤8%	30
>8% and ≤9%	40
>9% and ≤10%	50
>10% and ≤11%	60
>11% and ≤12%	70
>12% and ≤13%	80
>13% and ≤14%	90
>14%	100

For institutions that file Thrift Financial Reports, adjusted total assets will be used in place of adjusted average assets in the preceding table. The sum of qualified Tier 1 capital and long-term unsecured debt as a percentage of domestic deposits will be multiplied by 40 basis points to produce the unsecured debt adjustment for small institutions.

(iii) *Limitation*—No unsecured debt adjustment for any institution shall exceed five basis points.

(iv) *Applicable quarterly reports of condition*—Ratios for any given quarter shall be calculated from quarterly reports of condition (Call Reports and Thrift Financial Reports) filed by each institution as of the last day of the quarter. Until institutions separately report long-term senior unsecured liabilities and long-term subordinated debt in their quarterly reports of condition, the FDIC will use subordinated debt included in Tier 2 capital and will not include any amount of senior unsecured liabilities in calculating the unsecured debt adjustment.

(6) *Secured liability adjustment for all institutions.* All institutions within all risk categories, except insured branches of foreign banks as provided under paragraph (d)(3)(iii) of this section, are subject to upward adjustment of their assessment rate based upon the ratio of

their secured liabilities to domestic deposits. Any such adjustment shall be made after any applicable large bank adjustment or unsecured debt adjustment.

(i) *Secured liabilities for banks*—Secured liabilities for banks include Federal Home Loan Bank advances, securities sold under repurchase agreements, secured Federal funds purchased and other borrowings that are secured as reported in banks' quarterly Call Reports.

(ii) *Secured liabilities for savings associations*—Secured liabilities for savings associations include Federal Home Loan Bank advances as reported in quarterly Thrift Financial Reports ("TFRs"). Secured liabilities for savings associations also include securities sold under repurchase agreements, secured Federal funds purchased or other borrowings that are secured. Any of these secured amounts not reported separately from unsecured or other liabilities in the TFR will be imputed based on simple averages for Call Report filers as of June 30, 2008. As of that date, on average, 63.0 percent of the sum of Federal funds purchased and securities sold under repurchase agreements reported by Call Report filers were secured, and 49.4 percent of other borrowings were secured.

(iii) *Calculation*—An institution's ratio of secured liabilities to domestic deposits will, if greater than 25 percent, increase its assessment rate, but any such increase shall not exceed 50 percent of its assessment rate before the secured liabilities adjustment. For an institution that has a ratio of secured liabilities (as defined in paragraph (ii) above) to domestic deposits of greater than 25 percent, the institution's assessment rate (after taking into account any adjustment under paragraphs (d)(5) or (6) of this section) will be multiplied by the following amount: The ratio of the institution's secured liabilities to domestic deposits minus 0.25. Ratios of secured liabilities to domestic deposits shall be calculated from the report of condition, or similar report, filed by each institution.

(7) *Brokered Deposit Adjustment for Risk Categories II, III, and IV.* All institutions in Risk Categories II, III, and IV, except insured branches of foreign banks as provided under paragraph (d)(3)(iii) of this section, shall be subject to an assessment rate adjustment for brokered deposits. Any such brokered deposit adjustment shall be made after any adjustment under paragraph (d)(5) or (6). 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(r), and brokered deposits that consist of balances swept into an insured institution by 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. The adjustment is determined by multiplying by 25 basis points the difference between an institution's ratio of brokered deposits to domestic deposits and 0.10. The maximum brokered deposit adjustment will be 10 basis points. Brokered deposit ratios for any given quarter are calculated from the quarterly reports of condition filed by each institution as of the last day of the quarter.

(8) *Request to be treated as a large institution*—(i) *Procedure*. Any institution in Risk Category I with assets of between \$5 billion and \$10 billion may request that the FDIC determine its initial base assessment rate as a large institution. The FDIC will grant such a request if it determines that it has sufficient information to do so. The absence of long-term debt issuer ratings alone will not preclude the FDIC from granting a request. The initial base assessment rate for an institution without a long-term debt issuer rating will be derived using the financial ratios method, but will be subject to adjustment as a large institution under paragraph (d)(4) of this section. 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 FDIC will consider such institution to be a small institution subject to the financial ratios method.

(ii) *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 bank became

effective. Any request to be assessed as a small institution must be made to the FDIC's Division of Insurance and Research.

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

(9) *New and established institutions and exceptions*—(i) *New Risk Category I institutions*—(A) *Rule as of January 1, 2010*. Effective for assessment periods beginning on or after January 1, 2010, a new institution that is well capitalized shall be assessed the Risk Category I maximum initial base assessment rate for the relevant assessment period, except as provided in § 327.8(m)(1), (2), (3), (4), (5) and paragraphs (ii) and (iii) below. No new institution in Risk Category I shall be subject to the large bank adjustment as determined under paragraph (d)(4) of this section.

(B) *Rule prior to January 1, 2010*. Prior to January 1, 2010, a new institution's initial base assessment rate shall be determined under paragraph (d)(1) or (2) of this section, as appropriate. Prior to January 1, 2010, a Risk Category I institution that is well capitalized and has no CAMELS component ratings shall be assessed at two basis points above the minimum initial base assessment rate applicable to Risk Category I institutions until it receives CAMELS component ratings. The initial base assessment rate will be determined by annualizing, where appropriate, financial ratios obtained from the quarterly reports of condition that have been filed, until the institution files four such reports. Prior to January 1, 2010, assessment rates for new institutions in Risk Category I shall be subject to the large bank adjustment as determined under paragraph (d)(4) of this section.

(C) *Applicability of adjustments to new institutions prior to and as of January 1, 2010*. No new institution in any risk category shall be subject to the unsecured debt adjustment as determined under paragraph (d)(5) of this section. All new institutions in any Risk Category shall be subject to the secured liability adjustment as determined under paragraph (d)(6) of this section. All new institutions in Risk Categories II, III, and IV shall be subject

to the brokered deposit adjustment as determined under paragraph (d)(7) of this section.

(ii) *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(m)(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.

(iii) *Rate applicable to institutions subject to subsidiary or credit union exception*. If an institution is considered established under § 327.8(m)(4) and (5), but does not have CAMELS component ratings, it shall be assessed at two 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 or it receives a long-term debt issuer rating and it is a large institution.

(iv) *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).

(10) *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 (d)(4), (5), (6) or (7) of this section.

■ 8. Revise § 327.10 to read as follows:

§ 327.10 Assessment rate schedules.

(a) *Initial Base Assessment Rate Schedule*. The initial base assessment rate for an insured depository institution shall be the rate prescribed in the following schedule:

INITIAL BASE ASSESSMENT RATE SCHEDULE

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

* 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.

(1) *Risk Category I Initial Base Assessment Rate Schedule.* The annual initial base assessment rates for all institutions in Risk Category I shall range from 12 to 16 basis points.

(2) *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 22, 32, and 45 basis points, respectively.

(3) 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.

(b) *Total Base Assessment Rate Schedule after Adjustments.* The total base assessment rates after adjustments for an insured depository institution shall be the rate prescribed in the following schedule.

TOTAL BASE ASSESSMENT RATE SCHEDULE (AFTER ADJUSTMENTS) *

	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	7–24.0	17–43.0	27–58.0	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.

(1) *Risk Category I Total Base Assessment Rate Schedule.* The annual total base assessment rates for all institutions in Risk Category I shall range from 7 to 24 basis points.

(2) *Risk Category II Total Base Assessment Rate Schedule.* The annual total base assessment rates for Risk Category II shall range from 17 to 43 basis points.

(3) *Risk Category III Total Base Assessment Rate Schedule.* The annual total base assessment rates for Risk Category III shall range from 27 to 58 basis points.

(4) *Risk Category IV Total Base Assessment Rate Schedule.* The annual total base assessment rates for Risk Category IV shall range from 40 to 77.5 basis points.

(c) *Total Base Assessment Rate Schedule adjustments and procedures—*

(1) *Board Rate Adjustments.* 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.

(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 3 basis points, pursuant to paragraph (c)(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.

■ 9. Revise Appendix A to Subpart A of Part 327 to read as follows:

Appendix A to Subpart A**Method to Derive Pricing Multipliers and Uniform Amount****I. Introduction**

The uniform amount and pricing multipliers are derived from:

- A model (the Statistical Model) that estimates the probability that a Risk Category I institution will be downgraded to a composite CAMELS rating of 3 or worse within one year;

- Minimum and maximum downgrade probability cutoff values, based on data from June 30, 2008, that will determine which small institutions will be charged the minimum and maximum initial base assessment rates applicable to Risk Category I;

- The minimum initial base assessment rate for Risk Category I, equal to 12 basis points, and

• The maximum initial base assessment rate for Risk Category I, which is four basis points higher than the minimum rate.

II. The Statistical Model

The Statistical Model is defined in equations 1 and 3 below.

Equation 1

Downgrade(0,1)_{i,t} = β₀ + β₁ (Tier 1 Leverage Ratio_T) + β₂ (Loans past due 30 to 89 days ratio_{i,t}) + β₃ (Nonperforming asset ratio_{i,t}) + β₄ (Net loan charge-off ratio_{i,t}) + β₅ (Net income before taxes ratio_{i,t}) + β₆ (Adjusted brokered deposit ratio_{i,t}) + β₇ (Weighted average CAMELS component rating_{i,t}) where Downgrade(0,1)_{i,t} (the dependent variable—the event being explained) is the incidence of downgrade from a composite rating of 1 or 2 to a rating of

3 or worse during an on-site examination for an institution *i* between 3 and 12 months after time *t*. Time *t* is the end of a year within the multi-year period over which the model was estimated (as explained below). The dependent variable takes a value of 1 if a downgrade occurs and 0 if it does not.

The explanatory variables (regressors) in the model are six financial ratios and a weighted average of the “C,” “A,” “M,” “E” and “L” component ratings. The six financial ratios included in the model 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

• Brokered deposits/domestic deposits above the 10 percent threshold, adjusted for the asset growth rate factor

Table A.1 defines these six ratios along with the weighted average of CAMELS component ratings. The adjusted brokered deposit ratio (*B_{i,T}*) is calculated by multiplying the ratio of brokered deposits to domestic deposits above the 10 percent threshold by an asset growth rate factor that ranges from 0 to 1 as shown in Equation 2 below. The asset growth rate factor (*A_{i,T}*) is calculated by subtracting 0.4 from the four-year cumulative gross asset growth rate (expressed as a number rather than as a percentage), adjusted for mergers and acquisitions, and multiplying the remainder by 3^{1/3}. The factor cannot be less than 0 or greater than 1.

Equation 2

$$B_{i,T} = \left(\frac{\text{Brokered Deposits}_{i,T}}{\text{Domestic Deposits}_{i,T}} - 0.10 \right) * A_{i,T}$$

$$\text{where } A_{i,T} = \left[\left(\frac{\text{GrossAssets}_{i,T} - \text{GrossAssets}_{i,T-4}}{\text{GrossAssets}_{i,T-4}} - 0.4 \right) * \frac{10}{3} \right], \text{ subject to } 0 \leq A_{i,T} \leq 1 \text{ and } B_{i,T} \geq 0.$$

The component rating for sensitivity to market risk (the “S” rating) is not available for years prior to 1997. As a result, and as described in Table A.1, the Statistical Model is estimated using a weighted average of five component ratings excluding the “S” component. Delinquency and non-accrual data on government guaranteed loans are not

available before 1993 for Call Report filers and before the third quarter of 2005 for TFR filers. As a result, and as also described in Table A.1, the Statistical Model is estimated without deducting delinquent or past-due government guaranteed loans from either the loans past due 30–89 days to gross assets ratio or the nonperforming assets to gross

assets ratio. Reciprocal deposits are not presently reported in the Call Report or TFR. As a result, and as also described in Table A.1, the Statistical Model is estimated without deducting reciprocal deposits from brokered deposits in determining the adjusted brokered deposit ratio.

TABLE A.1—DEFINITIONS OF REGRESSORS

Regressor	Description
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.
Loans Past Due 30–89 Days/Gross Assets (%)	Total loans and lease financing receivables past due 30 through 89 days and still accruing interest divided by gross assets (gross assets equal total assets plus allowance for loan and lease financing receivable losses and allocated transfer risk).
Nonperforming Assets/Gross Assets (%)	Sum of total loans and lease financing receivables past due 90 or more days and still accruing interest, total nonaccrual loans and lease financing receivables, and other real estate owned divided by gross assets.
Net Loan Charge-Offs/Gross Assets (%)	Total charged-off loans and lease financing receivables debited to the allowance for loan and lease losses less total recoveries credited to the allowance for loan and lease losses for the most recent twelve months divided by gross assets.
Net Income before Taxes/Risk-Weighted Assets (%)	Income before income taxes and extraordinary items and other adjustments for the most recent twelve months divided by risk-weighted assets.
Adjusted brokered deposit ratio (%)	Brokered deposits divided by domestic deposits less 0.10 multiplied by the asset growth rate factor (which is the term <i>A_{i,T}</i> as defined in equation 2 above) that ranges between 0 and 1.
Weighted Average of C, A, M, E and L Component Ratings.	The weighted sum of the “C,” “A,” “M,” “E” and “L” CAMELS components, with weights of 28 percent each for the “C” and “M” components, 22 percent for the “A” component, and 11 percent each for the “E” and “L” components. (For the regression, the “S” component is omitted.)

The financial variable regressors used to estimate the downgrade probabilities are obtained from quarterly reports of condition (Reports of Condition and Income and Thrift Financial Reports). The weighted average of the “C,” “A,” “M,” “E” and “L” component ratings regressor is based on component ratings obtained from the most recent bank

examination conducted within 24 months before the date of the report of condition.

The Statistical Model uses ordinary least squares (OLS) regression to estimate downgrade probabilities. The model is estimated with data from a multi-year period (as explained below) for all institutions in Risk Category I, except for institutions

established within five years before the date of the report of condition.

The OLS regression estimates coefficients, β_j for a given regressor *j* and a constant amount, β₀, as specified in equation 1. As shown in equation 3 below, these coefficients are multiplied by values of risk measures at time *T*, which is the date of the report of

condition corresponding to the end of the quarter for which the assessment rate is computed. The sum of the products is then added to the constant amount to produce an estimated probability, d_{iT} , that an institution will be downgraded to 3 or worse within 3 to 12 months from time T.

The risk measures are financial ratios as defined in Table A.1, except that: (1) The loans past due 30 to 89 days ratio and the nonperforming asset ratio are adjusted to exclude the maximum amount recoverable from the U.S. Government, its agencies or government-sponsored agencies, under guarantee or insurance provisions; (2) the weighted sum of six CAMELS component ratings is used, with weights of 25 percent each for the "C" and "M" components, 20 percent for the "A" component, and 10 percent each for the "E," "L," and "S" components; and (3) reciprocal deposits are deducted from brokered deposits in determining the adjusted brokered deposit ratio.

Equation 3

$$d_{iT} = \beta_0 + \beta_1 (\text{Tier 1 Leverage Ratio}_{iT}) + \beta_2 (\text{Loans past due 30 to 89 days ratio}_{iT}) + \beta_3 (\text{Nonperforming asset ratio}_{iT}) + \beta_4 (\text{Net loan charge-off ratio}_{iT}) + \beta_5 (\text{Net income before taxes ratio}_{iT}) + \beta_6 (\text{Adjusted brokered deposit ratio}_{iT}) + \beta_7 (\text{Weighted average CAMELS component rating}_{iT})$$

and Equation 6

$$\alpha_1 = \frac{4}{(0.1506 - 0.0182)} = 30.211$$

Substituting equations 3, 5 and 6 into equation 4 produces an annual initial base assessment rate for institution i at time T, P_{iT} , in terms of the uniform amount, the pricing multipliers and the ratios and weighted average CAMELS component rating referred to in 12 CFR 327.9(d)(2)(i):

Equation 7

$$P_{iT} = [(\text{Min} - 0.550) + 30.211 * \beta_0] + 30.211 * [\beta_1 (\text{Tier 1 Leverage Ratio}_{iT}) + \beta_2 (\text{Loans past due 30 to 89 days ratio}_{iT}) + \beta_3 (\text{Nonperforming asset ratio}_{iT}) + \beta_4 (\text{Net loan charge-off ratio}_{iT}) + \beta_5 (\text{Net income before taxes ratio}_{iT}) + \beta_6 (\text{Adjusted brokered deposit ratio}_{iT}) + \beta_7 (\text{Weighted average CAMELS component rating}_{iT})]$$

again subject to $\text{Min} \leq P_{iT} \leq \text{Min} + 4$

where $(\text{Min} - 0.550) + 30.211 * \beta_0$ equals the uniform amount, $30.211 * \beta_j$ is a pricing multiplier for the associated risk measure j, and T is the date of the report of condition corresponding to the end of the quarter for which the assessment rate is computed.

III. Minimum and Maximum Downgrade Probability Cutoff Values

The pricing multipliers are also determined by minimum and maximum downgrade probability cutoff values, which will be computed as follows:

- The minimum downgrade probability cutoff value will be the maximum downgrade probability among the twenty-five percent of all small insured institutions in Risk Category I (excluding new institutions) with the lowest estimated downgrade probabilities, computed using values of the risk measures as of June 30, 2008.^{1 2} The minimum downgrade probability cutoff value is 0.0182.
- The maximum downgrade probability cutoff value will be the minimum downgrade probability among the fifteen percent of all small insured institutions in Risk Category I (excluding new institutions) with the highest estimated downgrade probabilities, computed using values of the risk measures as of June 30, 2008. The maximum downgrade probability cutoff value is 0.1506.

IV. Derivation of Uniform Amount and Pricing Multipliers

The uniform amount and pricing multipliers used to compute the annual base assessment rate in basis points, P_{iT} , for any such institution i at a given time T will be

$$\alpha_0 = \text{Min} - \frac{4 * 0.0182}{(0.1506 - 0.0182)} = \text{Min} - 0.550$$

V. Updating the Statistical Model, Uniform Amount, and Pricing Multipliers

The initial Statistical Model is estimated using year-end financial ratios and the weighted average of the "C," "A," "M," "E" and "L" component ratings over the 1988 to 2006 period and downgrade data from the 1989 to 2007 period. The FDIC may, from time to time, but no more frequently than annually, re-estimate the Statistical Model with updated data and publish a new formula for determining initial base assessment rates—equation 7—based on updated uniform amounts and pricing multipliers. However, the minimum and maximum downgrade probability cutoff values will not change without additional notice-and-comment rulemaking. The period covered by the analysis will be lengthened by one year each year; however, from time to time, the FDIC may drop some earlier years from its analysis.

■ 10. Revise Appendix B to Subpart A of Part 327 to read as follows:

determined from the Statistical Model, the minimum and maximum downgrade probability cutoff values, and minimum and maximum initial base assessment rates in Risk Category I as follows:

Equation 4

$$P_{iT} = \alpha_0 + \alpha_1 * d_{iT} \text{ subject to } \text{Min} \leq P_{iT} \leq \text{Min} + 4$$

where α_0 and α_1 are a constant term and a scale factor used to convert d_{iT} (the estimated downgrade probability for institution i at a given time T from the Statistical Model) to an assessment rate, respectively, and Min is the minimum initial base assessment rate expressed in basis points. (P_{iT} is expressed as an annual rate, but the actual rate applied in any quarter will be $P_{iT}/4$.) The maximum initial base assessment rate is 4 basis points above the minimum ($\text{Min} + 4$)

Solving equation 4 for minimum and maximum initial base assessment rates simultaneously,

$$\text{Min} = \alpha_0 + \alpha_1 * 0.0182 \text{ and } \text{Min} + 4 = \alpha_0 + \alpha_1 * 0.1506$$

where 0.0182 is the minimum downgrade probability cutoff value and 0.1506 is the maximum downgrade probability cutoff value, results in values for the constant amount, α_0 and the scale factor, α_1 :

Equation 5

Appendix B to Subpart A

NUMERICAL CONVERSION OF LONG-TERM DEBT ISSUER RATINGS

Current long-term debt issuer rating	Converted value
Standard & Poor's:	
AAA	1.00
AA+	1.05
AA	1.15
AA –	1.30
A+	1.50
A	1.80
A –	2.20
BBB+	2.70
BBB or worse	3.00
Moody's:	
Aaa	1.00
Aa1	1.05
Aa2	1.15
Aa3	1.30
A1	1.50
A2	1.80
A3	2.20
Baa1	2.70
Baa2 or worse	3.00
Fitch's:	
AAA	1.00
AA+	1.05
AA	1.15

domestic deposits are assumed to have no brokered deposits.

¹ As used in this context, a "new institution" means an institution that has been chartered as a bank or thrift for less than five years.

² For purposes of calculating the minimum and maximum downgrade probability cutoff values, institutions that have less than \$100,000 in

NUMERICAL CONVERSION OF LONG-TERM DEBT ISSUER RATINGS—Continued

Current long-term debt issuer rating	Converted value
AA—	1.30
A+	1.50
A	1.80

NUMERICAL CONVERSION OF LONG-TERM DEBT ISSUER RATINGS—Continued

Current long-term debt issuer rating	Converted value
A—	2.20
BBB+	2.70
BBB or worse	3.00

■ 11. Revise Appendix C to Subpart A of Part 327 to read as follows:

Appendix C to Subpart A

ADDITIONAL RISK CONSIDERATIONS FOR LARGE RISK CATEGORY I INSTITUTIONS

Information source	Examples of associated risk indicators or information
Financial Performance and Condition Information.	<i>Capital Measures (Level and Trend)</i> - Regulatory capital ratios. - Capital composition. - Dividend payout ratios. - Internal capital growth rates relative to asset growth. <i>Profitability Measures (Level and Trend)</i> - Return on assets and return on risk-adjusted assets. - Net interest margins, funding costs and volumes, earning asset yields and volumes. - Noninterest revenue sources. - Operating expenses. - Loan loss provisions relative to problem loans. - Historical volatility of various earnings sources. <i>Asset Quality Measures (Level and Trend)</i> - Loan and securities portfolio composition and volume of higher risk lending activities (e.g., sub-prime lending). - Loan performance measures (past due, nonaccrual, classified and criticized, and renegotiated loans) and portfolio characteristics such as internal loan rating and credit score distributions, internal estimates of default, internal estimates of loss given default, and internal estimates of exposures in the event of default. - Loan loss reserve trends. - Loan growth and underwriting trends. - Off-balance sheet credit exposure measures (unfunded loan commitments, securitization activities, counterparty derivatives exposures) and hedging activities. <i>Liquidity and Funding Measures (Level and Trend)</i> - Composition of deposit and non-deposit funding sources. - Liquid resources relative to short-term obligations, undisbursed credit lines, and contingent liabilities. <i>Interest Rate Risk and Market Risk (Level and Trend)</i> - Maturity and repricing information on assets and liabilities, interest rate risk analyses. - Trading book composition and Value-at-Risk information.
Market Information	- Subordinated debt spreads. - Credit default swap spreads. - Parent's debt issuer ratings and equity price volatility. - Market-based measures of default probabilities. - Rating agency watch lists. - Market analyst reports.
Stress Considerations	<i>Ability to Withstand Stress Conditions</i> - Internal analyses of portfolio composition and risk concentrations, and vulnerabilities to changing economic and financial conditions. - Stress scenario development and analyses. - Results of stress tests or scenario analyses that show the degree of vulnerability to adverse economic, industry, market, and liquidity events. Examples include: i. an evaluation of credit portfolio performance under varying stress scenarios. ii. an evaluation of non-credit business performance under varying stress scenarios. iii. an analysis of the ability of earnings and capital to absorb losses stemming from unanticipated adverse events. - Contingency or emergency funding strategies and analyses. - Capital adequacy assessments. <i>Loss Severity Indicators</i> - Nature of and breadth of an institution's primary business lines and the degree of variability in valuations for firms with similar business lines or similar portfolios. - Ability to identify and describe discreet business units within the banking legal entity. - Funding structure considerations relating to the order of claims in the event of liquidation (including the extent of subordinated claims and priority claims). - Extent of insured institutions assets held in foreign units. - Degree of reliance on affiliates and outsourcing for material mission-critical services, such as management information systems or loan servicing, and products. - Availability of sufficient information, such as information on insured deposits and qualified financial contracts, to resolve an institution in an orderly and cost-efficient manner.

By order of the Board of Directors.

Dated at Washington, DC, this 27th day of February, 2009.

Federal Deposit Insurance Corporation.

Robert E. Feldman,
Executive Secretary.

* * * * *

Appendix 1

Uniform Amount and Pricing Multipliers for Large Risk Category I Institutions Where Long-Term Debt Issuer Ratings are Available

The uniform amount and pricing multipliers for large Risk Category I institutions with long-term debt issuer ratings were derived from:

- The average long-term debt issuer rating, converted into a numeric value (the long-term debt score) ranging from 1 to 3;
- The weighted average CAMELS rating, as defined in Appendix A;
- The assessment rate calculated using the financial ratios method described in Appendix A, converted to a value ranging from 1 to 3 (the financial ratios score);
- Minimum and maximum cutoff values for an institution's score (the average of the long-term debt score, weighted average CAMELS rating and financial ratios score), based on data from June 30, 2008, which was used to determine the proportion of large banks charged the minimum and maximum initial base assessment rates applicable to Risk Category I; and

- Minimum and maximum initial base assessment rates for Risk Category I

The financial ratios assessment rate (A_f) calculated using the pricing multipliers and uniform amount described in Appendix A was converted to a financial ratios score (S_f), with a value ranging from 1 to 3 as shown in equation 1:

Equation 1

$$S_f = (A_f - 10) * 0.5$$

Each institution's score (S_i) was calculated by dividing its weighted average CAMELS rating (S_w), long-term issuer score (S_d) and financial ratios score (S_f) by 1/3 each, and summing the resulting values as shown in equation 2:

Equation 2

$$S_i = (1/3) * S_{w,i} + (1/3) * S_{d,i} + (1/3) * S_{f,i}$$

The pricing multipliers were determined by minimum and maximum score cutoff values, which were constructed so that fifteen percent of all large insured institutions in Risk Category I (excluding new institutions) are assessed the maximum base rate, while twenty-five percent are assessed the minimum base rate, when computed as of June 2008. The calculated thresholds are 1.601 for the minimum score cut-off value, and 2.389 for the maximum score cut-off value.

The uniform amount and pricing multipliers used to compute the annual base assessment rate in basis points, $P_{i,T}$, for a large

institution i (with a long-term debt rating) at a given time T were determined based on the minimum and maximum score cut-off values, and the minimum and maximum initial base assessment rates in Risk Category I as follows:

Equation 3

$$P_{i,T} = \alpha_0 + \alpha_1 * S_{i,T} \text{ subject to } \text{Min} \leq P_{i,T} \leq \text{Min} + 4$$

where α_0 and α_1 are, respectively, a constant term and a scale factor used to convert $S_{i,T}$ (an institution's score at time T) to an assessment rate, and Min is the minimum initial base assessment rate expressed in basis points. (Under the final rule, the minimum initial base assessment rate is 12 basis points, so Min equals 12.)

Substituting minimum and maximum score cutoff values (1.601 and 2.389, respectively) for $S_{i,T}$ and minimum and maximum initial base assessment rates (Min and $\text{Min} + 4$, respectively) for $P_{i,T}$ in equation 3 produces equations 4 and 5 below.

Equation 4

$$\text{Min} = \alpha_0 + \alpha_1 * 1.601$$

Equation 5

$$\text{Min} + 4 = \alpha_0 + \alpha_1 * 2.389$$

Solving both equations simultaneously results in:

Equation 6

$$\alpha_0 = \text{Min} - \frac{4 * 1.601}{(2.389 - 1.601)} = \text{Min} - 8.127$$

Equation 7

$$\alpha_1 = \frac{4}{(2.389 - 1.601)} = 5.076$$

Substituting equations 6 and 7 into equation 2 produces the following equation for $P_{i,T}$

Equation 8

$$P_{i,T} = (\text{Min} - 8.127) + 5.076 * [(1/3) * S_{w,iT} + (1/3) * S_{d,iT} + (1/3) * S_{f,iT}] = (\text{Min} - 8.127) + 1.692 * S_{w,iT} + 1.692 * S_{d,iT} + 1.692 * S_{f,iT}$$

where $\text{Min} - 8.127$ is the uniform amount and 1.692 is a pricing multiplier. Since Min equals 12 under the final rule, the uniform amount equals 3.873.

Appendix 2

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 in 2009 of deposit insurance assessments on the equity capital and profitability of all insured institutions, based on the assessment rates adopted in the final rule. Current economic, financial market, and banking industry conditions lend considerable uncertainty to

the outlook for earnings in 2009. Therefore, this analysis considers the following two scenarios for pre-tax, pre-assessment income in 2009: (1) Income in 2009 is equal to income for all of 2008, adjusted for mergers; (2) Income in 2009 is equal to the annualized income over the second half of 2008, also adjusted for mergers. The first scenario would result in an industry pre-tax, pre-assessment loss of \$7.5 billion. The second scenario would result in an industry pre-tax, pre-assessment loss of \$88.2 billion.

The financial data used in this analysis are the most recent available as of December 31, 2008. However, since each bank's risk-based assessment rate for the fourth quarter has not yet been finalized, each institution's rate under the rate schedule adopted in the final rule is based on data as of September 30, 2008.¹ The projected use of one-time credits authorized under the Reform Act is taken into consideration in determining the effective assessment for an institution.

¹ For purposes of this analysis, the assessment base (like income) is not assumed to increase, but is assumed to remain at December 2008 levels. All income statement items used in this analysis were adjusted for the effect of mergers. Institutions for which four quarters of earnings data were unavailable, including insured branches of foreign banks, were excluded from this analysis.

II. Analysis of the Projected Effects on Capital and Earnings

While deposit insurance assessment rates generally will result in reduced institution profitability and capitalization compared to the absence of assessments, the reduction will not necessarily equal the full amount of the assessment. Two factors can mitigate the effect of assessments on institutions' profits and capital. First, a portion of the assessment may be transferred to customers in the form of higher borrowing rates, increased service fees and lower deposit interest rates. Since information is not readily available on the extent to which institutions are able to share assessment costs with their customers, however, this analysis assumes that institutions bear the full after-tax cost of the assessment. Second, deposit insurance assessments are a tax-deductible operating expense; therefore, the assessment expense can lower taxable income. This analysis considers the effective after-tax cost of assessments in calculating the effect on capital.²

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 deposit

² The analysis does not incorporate any tax effects from an operating loss carry forward or carry back.

insurance assessment as when it does not, equity (retained earnings) will be less by the full amount of the after-tax cost of 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 December 31, 2008. 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.

The equity capital of insured institutions as of December 31, 2008 was \$1.3 trillion.³ Based on the assumptions for earnings and assessments described above, year-end 2009 equity capital is projected to equal between \$1.215 trillion and \$1.267 trillion. In the

absence of an assessment, total equity would be an estimated \$6 billion higher.

On an industry weighted average basis, projected total assessments in 2009 would result in capital that is between 0.44 percent and 0.47 percent less than in the absence of assessments. The analysis indicates that assessments would cause 8 to 12 institutions whose equity-to-assets ratio would have exceeded 4 percent in the absence of assessments to fall below that percentage and 6 to 9 institutions to have below 2 percent equity-to-assets that otherwise would not have.

The effect of assessments on institution income is measured by 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 assessments under the two scenarios for earnings, institutions were assigned to one of three groups: those who were profitable under both earnings scenarios, those who were unprofitable under both earnings scenarios, and those who were profitable in one scenario but unprofitable in the other.

Table A.1 shows that approximately 55 percent to 59 percent of profitable institutions are projected to owe assessments that are less than 10 percent of income. Table A.2 shows that profitable institutions facing an assessment of under 10 percent of income hold between 43 and 80 percent of all profitable institution assets, depending on the income scenario. The overall weighted average reduction in income for profitable institutions is between 5.8 percent and 7.7 percent.

TABLE A.1—ASSESSMENTS AS A PERCENT OF INCOME *

[Numbers of profitable institutions]

Assessments as percent of income	2009 income based on:			
	Results for all of 2008		Annualized results for 2nd half of 2008	
	Number of institutions	Percent of institutions	Number of institutions	Percent of institutions
0.0–5.0	1,087	19	1,029	18
5.0–10.0	2,305	40	2,108	37
10.0–20.0	1,493	26	1,441	25
20.0–40.0	534	9	629	11
40.0–100.0	200	4	316	6
>100.0	75	1	171	3
Total	5,694	100	5,694	100

TABLE A.2—ASSESSMENTS AS A PERCENT OF INCOME *

[Assets of profitable institutions]

[\$ in billions]

Assessments as percent of income	2009 income based on:			
	Results for all of 2008		Annualized results for 2nd half of 2008	
	Assets of institutions	Percent of assets	Assets of institutions	Percent of assets
0.0–5.0	1,783	28	1,479	23
5.0–10.0	3,303	52	1,295	20
10.0–20.0	936	15	2,297	36
20.0–40.0	223	4	886	14
40.0–100.0	45	1	288	5
> 100.0	65	1	110	2
Total	6,354	100	6,354	100

Notes:

(1) Income is defined as income before taxes, extraordinary items, and deposit insurance assessments. Assessments are adjusted for the use of one-time credits.

(2) Profitable institutions are defined as those having positive merger-adjusted income (as defined above) for all of 2008, the second half of 2008, and, by assumption, in 2009.

(3) 10 insured branches of foreign banks and 59 institutions having less than 4 quarters of reported earnings were excluded from this analysis.

³ This excludes equity for those mentioned in the note to Tables A.1 and A.2.

Tables A.3 and A.4 provide the same analysis for institutions that were unprofitable under both scenarios. Note that assessments will have a smaller percentage impact on the losses of unprofitable institutions as losses rise, so that such

institutions are, in percentage terms, less adversely affected under the scenario based on the results for the second half of 2008. Table A.3 shows that approximately 52 percent to 70 percent of unprofitable institutions are projected to owe assessments

that are less than 10 percent of losses. Table A.4 shows the corresponding asset distribution. The overall weighted average increase in losses for unprofitable institutions is between 2.6 and 4.6 percent.

TABLE A.3—ASSESSMENTS AS A PERCENT OF LOSSES *

[Numbers of unprofitable institutions]

Assessments as percent of losses	2009 income based on:			
	Results for all of 2008		Annualized results for 2nd half of 2008	
	Number of institutions	Percent of institutions	Number of institutions	Percent of institutions
0.0–5.0	523	29	801	44
5.0–10.0	411	23	479	26
10.0–20.0	401	22	312	17
20.0–40.0	243	13	111	6
40.0–100.0	147	8	76	4
> 100.0	93	5	39	2
Total	1,818	100	1,818	100

TABLE A.4—ASSESSMENTS AS A PERCENT OF LOSSES *

[Assets of unprofitable institutions]
[\$ in billions]

Assessments as percent of income	2009 income based on:			
	Results for all of 2008		Annualized results for 2nd half of 2008	
	Assets of institutions	Percent of assets	Assets of institutions	Percent of assets
0.0–5.0	2,235	48	3,181	68
5.0–10.0	1,316	28	1,350	29
10.0–20.0	626	13	115	2
20.0–40.0	372	8	32	1
40.0–100.0	50	1	14	0
> 100.0	100	2	6	0
Total	4,698	100	4,698	100

Notes:

(1) Income is defined as income before taxes, extraordinary items, and deposit insurance assessments. Assessments are adjusted for the use of one-time credits.

(2) Profitable institutions are defined as those having positive merger-adjusted income (as defined above) for all of 2008, the second half of 2008, and, by assumption, in 2009.

(3) 10 insured branches of foreign banks and 59 institutions having less than 4 quarters of reported earnings were excluded from this analysis.

In addition to those institutions that remained either profitable or unprofitable in both earnings scenarios, there were 734 institutions with \$2.79 trillion in assets that changed classification from one scenario to

the other. Of these 734 institutions, 634 were profitable when 2009 income equals the results for all 2008 but unprofitable when 2009 income equals the annualized results for the second half of 2008, while 100 were

unprofitable under the former scenario and profitable under the latter scenario.

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