

Act.¹ At the time, the FDIC stated its intention to initiate a second, more comprehensive notice-and-comment rulemaking on dividends beginning with an advance notice of proposed rulemaking to explore alternative methods for distributing future dividends after the temporary dividend rules expire on December 31, 2008.

The possibility of a dividend before the temporary rule expires appears remote. In fact, because the FDIC has the ability to lower assessment rates below the base assessment rate schedule (2 to 4 basis points for institutions in Risk Category I), the FDIC can, if it chooses, reduce the probability of a dividend occurring thereafter.

Reform Act Requirements

The Federal Deposit Insurance Act (FDI Act), as amended by the Reform Act,² requires that the FDIC, under most circumstances, declare dividends from the Deposit Insurance Fund (DIF or fund) when the reserve ratio at the end of a calendar year exceeds 1.35 percent, but is no greater than 1.5 percent.³ In that event, the FDIC generally must declare one-half of the amount in the DIF in excess of the amount required to maintain the reserve ratio at 1.35 percent as dividends to be paid to insured depository institutions. However, the FDIC's Board of Directors (Board) may suspend or limit dividends to be paid, if the Board determines in writing, after taking a number of statutory factors into account, that:

1. The DIF faces a significant risk of losses over the next year; and

2. It is likely that such losses will be sufficiently high as to justify a finding by the Board that the reserve ratio should temporarily be allowed to grow without requiring dividends when the reserve ratio is between 1.35 and 1.5 percent or exceeds 1.5 percent.⁴

In addition, the statute requires that the FDIC, except in certain limited circumstances, declare a dividend from the DIF when the reserve ratio at the end of a calendar year exceeds 1.5 percent. In that event, the FDIC generally must declare the amount in the DIF in excess of the amount required to maintain the reserve ratio at 1.5

percent as dividends to be paid to insured depository institutions.

The FDI Act directs the FDIC to consider each insured depository institution's relative contribution to the DIF (or any predecessor deposit insurance fund) when calculating an institution's share of any dividend. More specifically, when allocating dividends, the Board must consider:

1. The ratio of the assessment base of an insured depository institution (including any predecessor) on December 31, 1996, to the assessment base of all eligible insured depository institutions on that date (the 1996 assessment base ratio);

2. The total amount of assessments paid on or after January 1, 1997, by an insured depository institution (including any predecessor) to the DIF (and any predecessor fund);

3. That portion of assessments paid by an insured depository institution (including any predecessor) that reflects higher levels of risk assumed by the institution; and

4. Such other factors as the Board deems appropriate.

The statute does not define the term "predecessor" (of a depository institution) for purposes of distributing dividends. Predecessor deposit insurance funds are the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF), as those were the deposit insurance funds that existed after 1996 until their merger into the DIF pursuant to the Reform Act. The merger was effective March 31, 2006.

Among other things, the statute expressly requires the FDIC to prescribe by regulation the method for calculating, declaring, and paying dividends.⁵ In May 2006 the FDIC issued a proposed rule to implement the dividend requirements of the Reform Act.⁶ After considering the comments received on the proposed rule, the FDIC, as noted above, issued a temporary final rule on assessment dividends, with a sunset date of December 31, 2008.

The Temporary Final Rule

The temporary final rule mirrors the dividend provisions of the Reform Act, provides definitions (including the definition of a "predecessor" depository institution) to implement the statute and details how an institution may request the FDIC's Division of Finance (DOF) to

review the FDIC's determination of the institution's dividend amount and how an institution may appeal DOF's response to that request. In the temporary final rule, the FDIC adopted a simple system for allocating any dividends that might be declared during the two-year duration of the regulation. Any dividends awarded before January 1, 2009, will be distributed in proportion to an institution's 1996 assessment base ratio, as determined pursuant to the one-time assessment credit rule.⁷

The sole focus of this ANPR is on the type of assessment dividend allocation method that the FDIC should adopt. Whether and how the FDIC should retain or revise the other aspects of the temporary final rule (such as the timetable for determining and paying dividends and institutions' requests for review) will be addressed in the notice of proposed rulemaking that will follow the ANPR.

II. Alternative Methods

The ANPR presents two general approaches to allocating dividends—the fund balance method and the payments method. These methods are described below.⁸

The allocation methods potentially differ most significantly in the way they balance two of the statutory factors that the FDIC must consider when allocating dividends—institutions' relative 1996 assessment bases and assessments paid after 1996—and, thus, in the way each method treats older versus newer institutions. The fund balance method implicitly balances the two factors; the payments method requires explicit decision making.

"Older" and "Newer" Institutions

In this context, the terms "older" and "newer" do not simply refer to age. For purposes of this ANPR, the smaller an institution's 1996 assessment base is compared to its current assessment base, the "newer" it is. Thus, an institution that was chartered after 1996 and had no 1996 assessment base is a newer institution. An institution chartered before 1996 that has since grown greatly—and whose 1996 assessment base is, therefore, small compared to its current assessment base—is also a newer institution. Conversely, the larger an institution's 1996 assessment base is compared to its current assessment base, the "older" it is.

⁷ 12 CFR 327.53.

⁸ Appendix A describes the two methods in more detail, using formulas.

¹ 71 FR 61385 (October 18, 2006).

² The Reform Act was included as Title II, Subtitle B, of the Deficit Reduction Act of 2005, Public Law 109-171, 120 Stat. 9, which was signed into law by the President on February 8, 2006.

³ 12 U.S.C. 1817(e)(2).

⁴ This provision would allow the FDIC's Board to suspend or limit dividends in circumstances where the reserve ratio has exceeded 1.5 percent, if the Board made a determination to continue a suspension or limitation that it had imposed initially when the reserve ratio was between 1.35 and 1.5 percent.

⁵ The dividend regulation must also include provisions allowing a bank or thrift a reasonable opportunity to challenge administratively the amount of dividends it is awarded. Any review by the FDIC pursuant to these administrative procedures is final and not subject to judicial review.

⁶ 71 FR 28804 (May 18, 2006).

Relative Dividend Shares

For purposes of analyzing the effects of each allocation method on older and newer institutions, the notion of an institution's *relative dividend share* is useful. An institution's relative dividend share at a given time is the ratio of its share of any potential dividend to its share of the current aggregate assessment base. A high relative dividend share means that an institution would receive more than its proportional share of a dividend given its current assessment base; a low relative dividend share means that an institution would receive less than its proportional share of a dividend given its current assessment base.

The notion of a relative dividend share allows comparison of dividend allocation methods by eliminating the effect of size. A newer institution would initially have a zero or low relative dividend share, whatever its size, while an older institution (as that term is used in this ANPR) would initially have a high relative dividend share, again regardless of size.

Some of the most important potential differences between the dividend allocation methods are how quickly and under what circumstances the relative dividend share of a newer institution would equal the relative dividend share of an older institution. Equal shares imply that what an institution paid prior to 1997 (using the 1996 assessment base as a proxy) no longer affects its dividend share. Under most variations of the dividend allocation methods, the relative dividend shares of older and newer institutions may never be exactly equal, but they may become approximately equal; that is, over time, for both older and newer institutions, shares of any potential dividend may approximately equal shares of the current aggregate assessment base. For purposes of the analysis in this ANPR, relative dividends shares will be deemed to be approximately equal (or be said to have *converged*) when the average relative dividend share of the group of institutions that have the highest relative dividend shares as of January 1, 2007, are no more than 15 percent greater (or less) than the average relative dividend shares of newer institutions that initially have no dividend shares.⁹ Under both allocation methods, the average relative dividend share of the group of institutions that

⁹ This group is determined by dividing all institutions into 1 of 10 unequally sized groups, based on the size of their relative dividend shares as of January 1, 2007. Because this date is the beginning of the new risk-based assessment system, initial dividend shares are proportional to shares of the 1996 assessment base.

would have the highest relative dividend shares as of January 1, 2007, would be 2.2; that is, in this group, on average, an institution's share of any potential dividend would be 2.2 times its share of the current assessment base.

The Fund Balance Method

Description

Under the fund balance method, every quarter, each institution would be assigned a dollar portion of the fund balance (its fund allocation), solely for purposes of determining the institution's dividend share. Each institution's most recent fund allocation (as a percentage of the fund balance) would determine its share of any dividend. The fund allocation would increase or decrease each quarter depending upon fund performance and assessments paid by each institution. Specifically:

- Initially, the December 31, 2006 fund balance would be divided up among institutions in proportion to 1996 assessment bases. Thus, initially, each institution's fund allocation would equal its 1996 ratio times the December 31, 2006 fund balance.

- A variant on this method would divide only a portion of the December 31, 2006 fund balance among institutions. The remainder of the fund balance would be unallocated.

- Thereafter, from quarter to quarter, fund allocations would grow or shrink depending upon the performance of the fund.

- Fund losses, FDIC operating expenses and dividends from the fund would diminish an institution's fund allocation, all else equal.

- Fund gains (for example, from investment income or "ineligible" premium income, which is discussed immediately below) would increase an institution's fund allocation, all else equal.

- In addition, each "eligible" premium would increase an institution's fund allocation, dollar for dollar. An "eligible" premium (which would need to be defined) would be the portion of an institution's premium that would count toward increasing its share of dividends.

- Possible definitions for an eligible premium include: (1) All premiums charged; (2) premiums charged up to the lowest rate charged a Risk Category I institution; or (3) something in between, for example, premiums charged up to the maximum rate for a Risk Category I institution, in all cases minus any credit use.¹⁰ Ineligible premiums would be

¹⁰ However, an eligible premium would never be negative.

those paid through the use of credits or those paid in cash at rates in excess of the eligible premium rate.

- Eligible premiums would include surcharges in a restoration plan.¹¹

Risk Reduction Incentives

As set forth above, when allocating dividends the FDIC is required to take into account the portion of assessments paid by an insured depository institution that reflects higher levels of risk assumed by that institution.

Consequently, in defining eligible premiums, an important consideration (which applies to any approach) is the degree to which dividend allocation should reinforce the risk incentives of the risk-based premium system. Would an institution in the riskiest category, for example, get credit for dividend purposes for the full premium it paid or just for some smaller portion? If an eligible premium were defined as a premium paid at the lowest (least-risky) rate, an institution paying the highest assessment rate and an institution paying the lowest assessment rate would increase their dividend shares at the same rate, all else equal. Thus, the institution paying the lower assessment rate on this base would benefit more, thereby increasing the incentives for an institution to lower the risk it poses. On the other hand, if the FDIC defined an eligible premium as any cash premium, dividend awards, per se, would not provide an institution with an incentive to reduce the risk it poses. If the FDIC defined an eligible premium as something in between (for example, cash premiums up to the maximum rate charged to an institution in Risk Category I), the dividend system would give those institutions paying higher rates than the eligible premium rate some incentive to lower risk.

The Treatment of Older Versus Newer Institutions

Fund performance and assessment rates. Under the basic form of the fund balance method, in which the entire fund would be allocated among institutions, *low to moderate* fund losses would lead to older institutions retaining a relatively large share of any dividends for decades, while newer institutions would take decades to obtain a relatively similar share of dividends. In other words, the assessments paid by an institution prior

¹¹ The Reform Act requires that the FDIC adopt a restoration plan whenever the DIF reserve ratio is below 1.15 percent or is expected to be below 1.15 percent within 6 months. The plan must provide that the reserve ratio of the DIF will return to 1.15 percent, ordinarily within 5 years. 12 U.S.C. 1817(b)(3)(E).

$$f_i = \frac{ab_{96i}}{\sum_{j=1}^N ab_{96j}} \quad (3)$$

where ab_{96i} is 1996 assessment base for institution i and $j = 1$ through N represents all institutions. Institutions that did not exist

on December 31, 1996 or are not successors to institutions in existence then would have 1996 ratios set to zero.

An institution's dividend share for each succeeding quarter ($DS_{i,t}$) would be:

$$DS_{i,t} = \frac{a_{i,t}}{F_t} \quad (4)$$

where $DS_{i,t}$ is institution i 's dividend share at time t , t is the end of the most recent quarter for which the fund balance is

available, $a_{i,t}$ is institution i 's fund allocation at time t and F_t is the adjusted fund balance at time t .

Institution i 's fund allocation at time t , $a_{i,t}$, in the equation (4) is derived as:

$$a_{i,t} = (a_{i,t-1})(h_t)(r_t) + p_{i,t} \quad (5)$$

where h_t is an adjustment factor accounting for the growth or shrinkage of the adjusted fund balance (as defined above) from $t-1$ to t after excluding eligible premiums for the quarter ending at time $t-1$ that were collected

at time t , r_t is a redistribution factor that redistributes the shares of institutions that failed after time $t-1$ but before time t and $p_{i,t}$ is eligible premiums paid by institution i at time t for the quarter ending at time $t-1$.

The adjustment factor for the growth or shrinkage of the adjusted fund balance, h_t , is calculated as:

$$h_t = \frac{F_t - \sum_{i=1}^{m_t} p_{i,t}}{F_{t-1}} \quad (6)$$

where m_t is all institutions in existence at time t . The redistribution factor, r_t , is calculated as:²²

$$r_t = \frac{\sum_{i=1}^{m_{t-1}} a_{i,t}}{\sum_{i=1}^{m_t} a_{i,t-1}} \quad (7)$$

$$DS_{i,B} = \frac{a_{i,t}}{\sum_{i=1}^{m_B} a_{i,t}} \quad (8)$$

Definition and Description of the Payments Method

An institution's dividend share, $DS_{i,t}$, would be defined as:

²² However, an institution might fail after the end of the quarter on which dividend shares are calculated (which will always be the fourth quarter), but before distribution of a dividend. Consequently, a final adjustment of dividend shares

may be necessary. This share would be calculated as follows:

See equation 8 above.

where $DS_{i,B}$ is institution i 's dividend share at the time a dividend is distributed, B is the time at which a dividend is distributed, and m_B is all institutions at time t that had not failed as of time B .

$$DS_{i,T} = \frac{w_T(ab_{96,i}) + (1 - w_T) \sum_{t=T-k}^T p_{i,t}}{w_T \left(\sum_{j=1}^{m_T} ab_{96,j} \right) + (1 - w_T) \sum_{j=1}^{m_T} \sum_{t=T-k}^T p_{j,t}}, \text{ s.t. } 0 \leq w_T \leq 1 \quad (9)$$

where $DS_{i,T}$ is institution i 's current dividend share, T is the end of the most recent quarter for which assessment base data is available, w_T is the weight assigned to the 1996 ratio for period T , $ab_{96,i}$ is the 1996 assessment base for institution i , $T-k$ is the earliest period to be covered, which could be all periods after 2006 or some recent period, such as the most recent 3, 5, 10 or 15 years, $p_{i,t}$ is eligible premiums paid by institution i at time t for the quarter ending at time $t-1$, and m_T is total institutions as of time T .^{23, 24}

Appendix B—Model Assumptions

Among other things, the model assumes the following:

1. Investment income in 2007 equals 4.7 percent of the start-of-year fund balance. For each year thereafter, it equals 4.57 percent of that year's starting fund balance. These estimates are based on projections from an investment model that relies on Blue Chip forecasts of the yield curve through 3rd quarter 2008.

2. The initial assessment rate schedule is 3 basis points above the base rate schedule; thus, the initial minimum rate is 5 basis points. Rates fall to base rates the year after the fund reserve ratio reaches or exceeds 1.25 percent. Risk Category I institutions that pay rates between the minimum and maximum rate for the category are assumed to pay 0.6 basis points above the minimum rate, which reflects the current weighted average rate for the group.

3. Any restoration plan is assumed to be a 5 year plan. Surcharges in a restoration plan are estimated using an iterative procedure to account for the effect of credit use. During a restoration plan, an institution may use no more than 3 basis points in credit use.

4. Operating expenses for 2007 are \$988 million and grow at an annual rate of 5 percent thereafter.

5. Insured and domestic deposits are assumed to grow at 5 percent per year.

6. The beginning fund balance at 2007 equals \$50,165 million.

7. Credit use is limited by the 90 percent rule during 2008, 2009, and 2010. (No institution may apply credits to offset more

than 90 percent of an assessment for these years.)

8. Institutions are assigned to 1 of 10 credit groups and 1 of 6 assessment rate groups based on December 31, 2006 Call Report and TFR data, CAMELS information, and one-time credits. An institution's credits are determined by its share of the December 31, 1996 assessment base. An institution's credit group is determined by the ratio of its credits to its December 31, 2006 deposits. Because an institution's initial relative dividend share is determined analogously, based upon the ratio of its share of the December 31, 1996 assessment base to its share of the December 31, 2006 deposits, institutions in the same credit group will have similar relative dividend shares. In the tables and charts in the text comparing the relative dividend shares under alternative allocation methods, the "oldest" group refers to the credit group with the most credits relative to their December 31, 2006 deposits, those whose credits are more than 12 basis points of their December 31, 2006 deposits. The initial weighted average of credits-to-deposits for the credit group is 15.6 basis points.

9. High fund losses correspond to the losses incurred by the Bank Insurance Fund from 1987 to 1994, with losses measured relative to total domestic deposits. Low fund losses assume losses are equal to 0.1 basis points of domestic deposits each year.

Dated at Washington, DC, this 11th day of September, 2007.

By order of the Board of Directors.
Federal Deposit Insurance Corporation.

Robert E. Feldman,
Executive Secretary.

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DEPARTMENT OF TRANSPORTATION

Federal Aviation Administration

14 CFR Part 23

[Docket No. CE273; Notice No. 23-07-03-SC]

Special Conditions: Adam Aircraft Industries Model A700; External Fuel Tank Protection During Gear-Up or Emergency Landing

AGENCY: Federal Aviation Administration (FAA), DOT.

ACTION: Notice of proposed special conditions.

SUMMARY: This notice proposes special conditions for the Adam Aircraft

Industries Model A700 airplane. This airplane will have a novel or unusual design feature(s) associated with an External Centerline Fuel Tank (ECFT) that increases the total capacity of fuel by 184 gallons. The tank is located below the fuselage pressure shell immediately below the wing. The Adam A700 ECFT is a novel, unusual and a potentially unsafe design feature that may pose a hazard to the occupants during a gear-up or emergency landing due to fuel leakage and subsequent fire. Traditional aircraft construction places the fuel tanks in a protected area within the wings and/or fuselage. Fuel tanks located in these areas are well above the fuselage skin and are inherently protected by the wing and fuselage structure. The applicable airworthiness regulations do not contain adequate or appropriate safety standards for this design feature. These proposed special conditions contain the additional safety standards that the Administrator considers necessary to establish a level of safety equivalent to that established by the existing airworthiness standards.

DATES: Comments must be received on or before November 19, 2007.

ADDRESSES: Comments on this proposal may be mailed in duplicate to: Federal Aviation Administration (FAA), Regional Counsel, ACE-7, Attention: Rules Docket, Docket No. CE273, 901 Locust, Room 506, Kansas City, Missouri 64106, or delivered in duplicate to the Regional Counsel at the above address. Comments must be marked: CE273. Comments may be inspected in the Rules Docket weekdays, except Federal holidays, between 7:30 a.m. and 4 p.m.

FOR FURTHER INFORMATION CONTACT: Mr. Peter L. Rouse, Federal Aviation Administration, Aircraft Certification Service, Small Airplane Directorate, ACE-111, 901 Locust, Kansas City, Missouri, 816-329-4135, fax 816-329-4090.

SUPPLEMENTARY INFORMATION:

Comments Invited

Interested persons are invited to participate in the making of these proposed special conditions by submitting such written data, views, or arguments, as they may desire. Communications should identify the

²³ Under Variation 2 described in the text, $T-k$ would not include any year before 2007. When a dividend share in any year depended upon premiums paid before 1997, the premiums would be factored into w_T rather than being included in $p_{i,t}$.

²⁴ If an institution failed after the end of the quarter on which dividend shares were calculated (which will always be the fourth quarter), but before distribution of a dividend, a final adjustment of dividend shares may be necessary. This share would be calculated simply by deleting the failed institution's payments and 1996 ratio from the preceding formulas.