Questions and Answers Pertaining to the Final Rule on Assessments, Dividends, Assessment Base and Large Bank Pricing

9/28/11

General

Q1. Where can I find a copy of the FDIC’s Final Rule on Assessments and Large Bank Pricing (“Final Rule”)?


Q2. When will an insured depository institution (IDI) see a change in its assessment as a result of the final rule?

A. The final rule took effect for the quarter beginning on April 1, 2011 (except where specifically noted in the Final Rule). The final rule will govern assessments due September 30, 2011.

Q3. Will the Call Report and TFR be changed?

A. Yes, changes are necessary to the Call Report and TFR as a result of the new assessment base required by the Dodd-Frank Act, and in order to collect the necessary information to complete the scorecard for large IDIs and highly complex IDIs. The reporting changes became effective beginning with the June 30, 2011 Call Report and TFR.

Q4: Is a document available that defines the scorecard elements in terms of the Call Report and Thrift Financial Report line items?

A: Yes. The mapping document is included in the zip file containing the assessment rate calculators for large and highly complex institutions. Calculators can be found at: http://www.fdic.gov/deposit/insurance/calculator.html.

Q5. What is the effect of the final rule on an IDI’s prepaid assessments?

A. The FDIC will continue to offset regular insurance assessments until the earlier of the exhaustion of the institution’s prepaid assessment or June 30, 2013. Any prepaid assessment remaining after collection of the amount due on June 30, 2013, shall be returned to the institution. (Once an institution’s prepaid assessments are exhausted, it will resume paying its insurance assessments via ACH).
Q6. How are new institutions treated under the final rule?

A. New Small Institutions

- New small IDIs in Risk Category I will be assessed at the Risk Category I maximum initial base assessment rate for the relevant assessment period.
- No new small institution in any Risk Category is subject to the unsecured debt adjustment.
- All new small institutions in any Risk Category are subject to the depository institution debt adjustment (DIDA).
- All new small institutions in Risk Categories II, III, and IV are subject to the brokered deposit adjustment.

New Large Institutions and New Highly Complex Institutions:

- All new large IDIs and all new highly complex IDIs will be assessed consistent with the method used for all other large IDIs and highly complex IDIs.
- If a large or highly complex institution has not received CAMELS ratings, it will be given a weighted average CAMELS rating of 2 for assessment purposes until actual CAMELS ratings are assigned.
- No new large IDI or highly complex IDI is subject to the unsecured debt adjustment.
- All new large IDIs and all new highly complex IDIs are subject to the DIDA.
- All large IDIs and all highly complex IDIs (including new large IDIs and new highly complex IDIs), except those that are well capitalized and have a CAMELS composite rating of 1 or 2, are subject to the brokered deposit adjustment.

Q7. Is the assessment base used to calculate payments on the Financing Corporation (FICO) Bonds changing?

A. Yes, the FICO assessment base will be defined consistent with the assessment base definition under the final rule.

Q8: Since the FICO base is increasing, will the FICO assessment rate decrease?

A: Yes. The FICO assessment rate is derived using the assessment base and amount needed to pay the FICO bondholders. Since the amount needed to pay the bondholders remains relatively constant, increasing the FICO base has the effect of decreasing the FICO assessment rate. The FICO assessments billed each quarter use the previous quarter's Call Report information for the assessment calculation. For instance, the March assessment is calculated using December data. Therefore, the effect of the change in the assessment base will first affect the FICO assessment due in September 2011.
Assessment Rate Adjustments

Q1. What is included in the Depository Institution Debt Adjustment (DIDA)?
A. The final rule provides for an adjustment to an institution’s assessment rate for unsecured debt held that is issued by another depository institution to the extent that such debt exceeds 3 percent of the institution’s Tier 1 capital. Unsecured debt for purposes of the DIDA is defined the same as it is for the unsecured debt adjustment and includes senior unsecured liabilities and subordinated debt. Debt held that is issued by a holding company is not subject to the DIDA.

Q2. What institutions are subject to the brokered deposit adjustment?
A. All small insured depository institutions in Risk Categories II, III, and IV, and all large IDIs and highly complex IDIs (including new large IDIs and new highly complex IDIs), except those that are well capitalized and have a CAMELS composite rating of 1 or 2, are subject to the brokered deposit adjustment.

Q3. What deposits are included in the definition of brokered deposit for the purposes of the brokered deposit adjustment under the final rule?
A. Brokered deposits include any deposit that is obtained, directly or indirectly, from or through a deposit broker, including reciprocal deposits, and deposits that consist of balances swept into an IDI from another institution. Note that the definition of “deposit broker” is subject to certain exceptions, including the primary purpose exception (see 12 C.F.R. § 337.6(a)(5)(ii)).

Changes in an Institution’s Designation

Q1: Is a notice provided to a bank when it changes from a small bank to a large or highly complex bank?
A: Yes. The FDIC will provide the bank with a letter notifying them of a change in their designation. This letter will be included with the bank’s deposit insurance pricing invoice received by the bank 15 days prior to the end of the quarter in which the change becomes effective. The bank’s first deposit insurance pricing invoice under the new designation will be received approximately 90 days after the notice date.

Request for Review of Assessment Rates

Q1: Please describe the process for submitting a request for review of a bank’s assessment rate.
A: These procedures are detailed in Part 327.4(c) of the FDIC Rules and Regulations. An IDI must submit a written request for review of its assessment rate. An IDI cannot request review of its CAMELS ratings as part of an assessment rate review; each primary federal regulator has procedures for that purpose. Assessment rate review requests must be made within 90 days from the date that the assessment rate assignment being challenged appears on the institution’s invoice. The request should be submitted to the Corporation’s Director of the Division of Insurance and Research in Washington, DC and must include documentation sufficient to support the change sought by the institution. If FDIC requests additional information, the IDI has 21 days to respond to the request. Upon completion of a review, the Director of the Division of Insurance and Research (or designee) or the Director of the Division of Supervision (or designee), will promptly notify the IDI in writing of his or her determination of whether a change is warranted. If the IDI requesting review disagrees with that determination, it has 30 days to appeal to the FDIC’s Assessment Appeals Committee.

Clarifications of Definitions

Transition Rule for Reporting Subprime Consumer and Leveraged Loans

Q1: What if a large or highly complex institution does not have systems in place to identify leveraged or subprime consumer loans in accordance with the FDIC’s Final Rule definitions or the institution has the information but it is contained in individual loan files and it would be too costly and burdensome for the institution to obtain?

A: The bank regulatory agencies have provided transition guidance for reporting loans originated or purchased prior to April 1, 2012, and securities where the underlying loans were originated predominantly prior to April 1, 2012.

- For such pre-April 1, 2012 loans and securities, if a large or highly complex institution does not have within its data systems the information necessary to determine subprime consumer or leveraged status in accordance with the definitions of these two higher-risk asset categories set forth in the FDIC’s final rule, the institution may use its existing internal methodology for identifying subprime consumer or leveraged loans and securities as the basis for reporting these assets for deposit insurance assessment purposes in its Call Reports or TFRs.

- Institutions that do not have an existing internal methodology in place to identify subprime consumer or leveraged loans (because they are not required to report on these exposures to their primary federal regulator for examination or other supervisory purposes or did not measure and monitor loans and securities with these characteristics for internal risk management purposes) may, as an alternative to applying the definitions in the FDIC’s final rule to pre-April 1, 2012 loans and securities, apply existing guidance provided by their primary federal regulator, the
agencies’ 2001 Expanded Guidance for Subprime Lending Programs,\(^1\) or the February 2008 Comptroller’s Handbook on Leveraged Lending\(^2\) for purposes of identifying subprime consumer and leveraged loans originated or purchased prior to April 1, 2012, and subprime consumer and leveraged securities where the underlying loans were originated predominantly prior to April 1, 2012.

- However for such pre-April 1, 2012 loans and securities, leveraged loans that are renewed or subprime consumer loans that are refinanced on or after April 1, 2012, must then be reported as subprime consumer or leveraged loans and securities (in the case of securitizations) according to the definitions of these higher-risk asset categories set forth in the FDIC’s assessment regulations and these instructions.

- All loans originated or purchased on or after April 1, 2012, and all securities where the underlying loans were originated predominantly on or after April 1, 2012, must be reported as subprime consumer or leveraged loans and securities according to the definitions of these higher-risk asset categories set forth in the FDIC’s final rule.\(^3\)

- Large and highly complex institutions may need to revise their data systems to support the reporting of newly originated or purchased subprime consumer and leveraged loans and securities for assessment purposes only in accordance with the definitions in the FDIC’s final rule on a going-forward basis beginning no later than April 1, 2012.

- Large and highly complex institutions relying on the transition guidance described above for reporting pre-April 1, 2012 subprime consumer and leveraged loans and securities will be expected to provide the FDIC qualitative descriptions of how the characteristics of the assets reported using their existing internal methodologies for identifying loans and securities in these higher-risk asset categories differ from those specified in the subprime consumer and leveraged loan definitions in the FDIC’s final rule, including the principal areas of difference between these two approaches for each higher-risk asset category.
  - The FDIC may review these descriptions of differences and assess the extent to which institutions’ existing internal methodologies align with the applicable supervisory policy guidance for categorizing these loans.
  - Any departures from such supervisory policy guidance discovered in these reviews, as well as institutions’ progress in planning and implementing necessary data systems changes, will be considered when forming supervisory strategies for remedying departures and exercising deposit insurance pricing discretion for individual large and highly complex institutions.

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\(^3\) For loans purchased on or after April 1, 2012, large and highly complex institutions may apply the transition guidance to loans originated prior to that date. Loans purchased on or after April 1, 2012, that also were originated on or after that date must be reported as subprime or leveraged according to the definitions of these higher-risk asset categories set forth in the FDIC’s final rule.
Q2: Institutions should follow the outstanding interagency guidance on leveraged and subprime lending, which requires institutions to have policies and procedures in place when the size and exposure of these types of loans is considered significant (for leveraged loans) and when an institution has a program in place to target subprime borrowers (for subprime loans). Given that some institutions do not have significant exposure to leveraged loans as leveraged loans are defined in the outstanding interagency guidance and they don’t have a program that targets subprime borrowers, would the institution need to report any loans that were originated or acquired prior to April 1, 2012 as leveraged or subprime for pricing purposes?

A: No. Per the transition guidance issued by the FDIC, for all loans and securitizations originated or acquired prior to April 1, 2012, institutions can report loans and securities as leveraged or subprime using their existing internal methodologies, which should be in conformance with interagency guidance. If the institution’s internal methodology does not identify any loans as leveraged or subprime, the institution can report zero leveraged or subprime loans on its Call Report or TFR. All loans originated or purchased on or after April 1, 2012 should be reported consistent with the definitions for leveraged and subprime contained in the final rule.

Determination of Higher-Risk Assets

Q1: Will higher-risk assets information be publically disclosed or remain confidential?

A: As noted in the Final Rule, this information will remain confidential.

Q2: When/how often should IDIs evaluate their loans to determine whether they meet the characteristics of higher-risk loans (construction and development (C&D), leveraged, nontraditional, or subprime)?

A: At origination and renewal for leveraged loans, at origination or refinancing for subprime consumer loans, and at origination for C&D and nontraditional mortgage loans. In addition, all troubled debt restructured loans should be evaluated at the time they are restructured to determine if they meet the criteria for higher-risk loans.

For purposes of the higher-risk assets measure, higher-risk assets include existing and new C&D, leveraged, non-traditional mortgages, and subprime loans.

A refinancing is determined by reference to whether the original obligation has been replaced by a new or modified obligation, based on the parties' contract and applicable law. The refinancing may involve the consolidation of several existing obligations, disbursement of new money to the consumer or on the consumer's behalf, or the rescheduling of payments under an existing obligation. New money is defined as an increase to the original amount of the line of credit, but is not considered a disbursement or draw on the line or the writing of convenience checks that is within the original draw limits of the line of credit. Changes in the terms of an existing
obligation that are not otherwise permitted under the terms of the loan agreement (other than the simple extension of the maturity date), such as the deferral of individual installments, a change in the interest rate, changes in collateral, etc. (when not permitted under the terms of the loan agreement), would also constitute a refinancing. As noted in the answer to question 3 below, when a change-in-terms agreement or other modification is used to extend only the maturity date of a loan, it is not considered a refinancing, but is considered a renewal. In the case of credit card loans, if the credit agreement allows for changes in the terms of the loan such as changes in the interest rate (increases or decreases), changes in the maturity date, changes in fees to be assessed against the borrower, changes (increases or decreases) in the available amount of the line of credit, this is not considered a refinancing. Additionally, for credit card loans, the regular replacement of existing cards because of, for example, security reasons or new technology or systems would not constitute a refinancing. In addition, the re-issuance of a credit card that has been suspended temporarily, but does not involve the opening of a new account after a previous account was closed, would also not be considered a refinancing.

A renewal is defined as a refinancing or a simple extension of the maturity date of a loan. A renewal also includes a transaction in which a change-in-terms agreement or other modification agreement is used to extend the maturity date of a loan. A loan renewal or modification that only extends the maturity date would not be counted as a loan origination or refinanced loan for pricing purposes. In the case of credit card loans, a renewal is the regular replacement of existing cards because of, for example, security reasons or new technology or systems. It also includes the re-issuance of cards that have been suspended temporarily, but does not include the opening of a new account after a previous account was closed.

Q3: If a bank determines at origination or refinancing that a particular loan meets the definition of a non-traditional mortgage loan, is the bank required to make the additional determination as to whether the loan also meets the definition of a subprime consumer loan, and if so, should the bank report such loan as a non-traditional mortgage loan on the Call Report?

A: At origination or refinancing, IDIs should evaluate mortgage loans to determine whether they meet the characteristics of higher-risk loans (subprime consumer loans as well as non-traditional mortgage loans). Mortgage loans displaying one or more characteristics of both subprime consumer loans and nontraditional mortgage loans (“subprime nontraditional mortgages”) should be reported as non-traditional mortgage loans.

Q4: Per footnote 10 of Appendix C of the Final Rule, a non-traditional mortgage loan, such as an interest only loan or a teaser rate loan, ceases to be non-traditional when the loan begins to amortize or the teaser rate expires. When a non-traditional mortgage loan ceases to be non-traditional, is the bank required to make a determination at that time whether the loan is a subprime consumer loan (assuming that a refinancing or modification does not occur at the same time)?
A: No, an IDI is not required to evaluate a non-traditional mortgage loan to determine whether it meets the characteristics of a higher-risk loan at the time the loan ceases to be non-traditional. Instead, the bank would begin reporting the loan consistent with its higher-risk loan evaluation (subprime consumer loan) at origination or refinancing. If the loan displayed one or more characteristics of a subprime consumer loan at origination or refinancing, then the bank would begin reporting the loan as a subprime consumer loan.

Q5: An IDI offers a number of interest rate discounts to borrowers in connection with its mortgage loan programs if a borrower meets certain criteria. The underlying agreement discloses both the discounted and undiscounted rates or margins, as applicable, and that when the client no longer meets the qualification requirements for preferred banking, the discount will be discontinued. When the discounted rate is discontinued and the non-discounted rate or margin is imposed, is such a rate considered to be a change in terms and considered a refinanced loan?

A: No, provided the discount was removed consistent with the language in the loan agreement, the change would not be considered a refinancing.

Q6: Is a loan modification or a troubled debt restructured loan considered a refinancing for the purposes of the higher-risk asset definitions?

A: When a change-in-terms agreement or other modification agreement is used to extend only the maturity date of a loan, it is not considered a refinancing, but it is considered a renewal. However, when a change-in-terms agreement or other modification agreement (including a TDR) is used to change other loan metrics (i.e., interest rates, collateral, etc.) then it is considered a refinancing for deposit insurance pricing purposes. As noted above, all loans that meet the definition of a TDR would be considered a refinanced loan and should be evaluated at the time of refinancing to determine if they meet the criteria for a higher-risk asset.

Q7: If the IDI offers a rate modification program to existing borrower where the borrower may request a reduction in the interest rate on his/her existing mortgage loan with the IDI to match a rate that is currently offered for the mortgage type to other borrowers for new loans, subject to the payment of a modification fee. This program was developed to be used in lieu of a true loan refinance (where new loan documents are drawn and a new loan replaces the existing loan in its entirety) for efficiency, time-saving and cost-saving purposes. Would such loans be considered refinanced under the Final Rule?

A: Yes, the reduction in the interest rate would be considered a refinancing as detailed in Q2, in the section titled: Determination of Higher-Risk Assets. The answer for Q2 states that a change in the interest rate, when not permitted under the terms of the loan agreement, would constitute a refinancing.
Q8: Should troubled debt restructurings (TDRs) be classified as leveraged or subprime? Would a TDR that was not classified as leveraged or subprime prior to the April 1, 2012 transition rule date, be grandfathered as not leveraged or subprime?

A: If the TDR loan meets any of the criteria for leveraged or subprime, it should be included as leveraged or subprime. The FDIC’s intent is that all commercial and industrial loans (as defined in the Call Report Instructions) should be evaluated at the time they are renewed to determine if they meet the criteria for leveraged, and all consumer loans (as defined in the Call Report Instructions) should be evaluated at the time they are refinanced to determine if they meet the criteria for subprime. A renewal is defined as a refinancing or a simple extension of the maturity date of a loan, or a transaction in which a change-in-terms agreement or other modification agreement is used to extend the maturity date of a loan. A refinancing is determined by reference to whether the original obligation has been replaced by a new or modified obligation. Changes in the terms of an existing obligation other than the maturity date, such as a deferral of individual installment payments (when not permitted under the terms of the loan agreement), a change in the interest rate, changes in collateral, etc. would also constitute a refinancing (please see Q2 above for definitions of renewal and refinancing). If an institution was correctly excluding a TDR from leveraged or subprime loan totals prior to the April 1, 2012 transition rule date, the institution could continue to exclude the loan from leveraged or subprime totals, provided that the loan has not been subsequently renewed or refinanced and now meets the Final Rule criteria for leveraged or subprime. Please see the leveraged and subprime sections below for guidance on these loans.

Q9: How is refinancing defined for purposes of open-end credit products such as credit card loans?

A: An open-end credit product that meets the definition of “refinancing” as described above would be considered a refinanced loan.

Q10: Is a student loan considered to be refinanced at the time the payment deferral option is exercised (because the borrower went back to school)?

A: No. If the payment deferral is part of the original terms of the loan and the borrower has the sole option to exercise the deferral, this is not considered a refinancing. Therefore, the loan would not have to be reevaluated at the time of payment deferral to determine if it meets the subprime criteria.

Q11: There are programs in which deployed active duty servicemembers qualify for automatic mortgage payment deferrals (Servicemembers Civil Relief Act) and or are eligible for forgiveness of a portion of interest. Would the deferral of mortgage payments or the forgiveness of some interest payments in accordance with government programs for active military personnel be considered a refinancing event?
A: No – the deferral of payments or forgiveness of some interest payments due to compliance with the Servicemembers Civil Relief Act would not constitute a refinancing for pricing purposes. FDIC recognizes that banks are not modifying these loans due to a performance issue, rather, they are modifying these loans to provide relief to servicemembers while they are on active duty and to comply with outstanding rules. If a loan to a servicemember was subprime before the servicemember reported for active duty, then the loans should be considered subprime. But if the loan was not considered subprime prior to the servicemember reporting for active duty, the loan should not be reported as subprime.

Q12: How would an IDI evaluate a loan for a leveraged or subprime designation if there are multiple borrowers or co-signers and some meet the characteristics of leveraged or subprime, but others do not?

A: If each co-borrower or co-signor has joint and several liability for the loan, if any one borrower does not meet the criteria for leveraged or subprime, the loan would not be considered subprime or leveraged. For leveraged loans, the bank can apply the leveraged loan criteria to the primary borrower (the entity that repayment is expected to come from) to determine if the loan is leveraged. In the case of a consumer loan in which there are multiple borrowers or there is a co-borrower or co-signor, the debt-service to-income calculation (listed as one criteria for determining if a loan is subprime) can be based on the combined income and debt service requirement of the borrower and co-borrower or co-signor, or the IDI can use the highest debt service to-income ratio that is calculated for each co-borrower and co-signor in determining if the loan meets the subprime criteria.

Q13: Are loans that are fully secured by savings and time deposits subject to the higher-risk loan designations (C&D, leveraged, non-traditional, or subprime loan) in the large bank scorecard? Are loans that are fully secured by other liquid assets such as stocks, corporate bonds, and government bonds subject to the higher risk designation?

A: Loans that meet the characteristics of a higher-risk loan as defined in Appendix C to 12 CFR Part 327, but that are fully secured by cash collateral in the form of an IDI’s own savings and time deposits, may be excluded from the higher-risk loan designations for pricing purposes, provided that the IDI has a collateral assignment of the deposit account signed by the borrower, the assignment is in place and is irrevocable as long as the loan or commitment is outstanding, and a hold is placed on the deposit account that alerts IDI employees should the depositor attempt to withdraw the funds. In the case of a revolving line of credit, the cash collateral must be equal to or greater than the amount of the total loan commitment (funded and unfunded balance of the loan) for the exclusion to apply. Loans that are secured by liquid assets other than cash would not be excluded from the higher-risk loan designation.

Q14: Should institutions apply a waterfall approach to identifying higher-risk assets? For example, if a residential loan is not considered non-traditional but it meets the
characteristics of subprime as described in the FDIC’s Final Rule, is it considered subprime?

A: Yes. A residential loan that is not considered non-traditional in accordance with the FDIC’s Final Rule definition should be evaluated to determine if it meets the characteristics of subprime. Similarly, a non-traditional mortgage loan should not be listed as both non-traditional and subprime, if it meets the characteristics of both. This loan should only be listed as non-traditional on the Call Report or TFR.

Q15: If a loan is designated as higher-risk for deposit insurance pricing purposes, should that higher-risk loan also be included in the criticized and classified items?

A: All loans, regardless of consumer or other loan types, or regardless of higher-risk designation, should be included in the criticized and classified numbers if they meet the definition of criticized and classified items as outlined in the final rule.

Q16: When an institution purchases a loan or security from another entity through an acquisition, from the FDIC as receiver, or otherwise, how would the purchasing institution evaluate the loan or security to determine if it meets the higher-risk asset criteria for either subprime or leveraged lending? Would the acquiring institution be required to make the evaluation at origination, refinance, or upon the date of (re)purchase?

A: There are a few methods of determining higher-risk asset status, depending on what type of entity the loans or securities are purchased from and the nature of the transaction.

1) If an IDI purchases loans or securities from another IDI and the assets purchased are not part of a program whereby the acquiring/purchasing IDI purchases loans or securities on a recurring basis, then the acquiring IDI should use the internal classification of the selling IDI in determining whether or not the loans or securities are higher-risk. If the selling IDI is a large bank and has identified a loan or security as subprime or leveraged for pricing purposes, the acquiring IDI should report the purchased asset as such. If the selling IDI is a small bank that does not report higher-risk loans or securities for pricing purposes, the purchasing IDI should report as subprime or leveraged those loans or securities that the selling IDI previously identified as subprime or leveraged according to the selling IDI’s internal guidance or the guidance of the selling IDI’s PFR.

For example, if the selling IDI is a small bank that does not identify any loans or securities as subprime or leveraged through its internal or PFR guidance, the acquiring IDI may report zero for subprime or leveraged for those assets that it purchased. If the selling entity is a large bank or the FDIC as receiver, and the selling IDI does/did not report any of the sold loans or securities as subprime or leveraged, the acquiring IDI may report zero for subprime or leveraged for those loans or securities that it purchased.
2) If an IDI purchases loans or securities on a recurring basis from another IDI as part of a program, then the purchasing IDI (acquiring bank) must obtain the information needed to make its own higher-risk determination of the purchased assets. The purchasing IDI cannot rely upon the subprime or leveraged designation of the selling IDI unless the selling IDI is a large bank that has identified subprime or leveraged loans or securities as defined for deposit insurance pricing purposes. The purchasing IDI can obtain the financial information needed to make a leveraged or subprime consumer loan or security determination directly from the selling IDI, or from the borrower. If the financial information is not available as of origination date or renewal (for leveraged loans or securitizations) or upon origination or refinance (for subprime consumer loans or securitizations), the IDI must obtain the necessary financial information to determine whether a loan is leveraged or subprime. The financial information must be dated within one year of the purchase transaction.

3) If an IDI purchases loans or securities from a non-IDI (third-party originator), the acquiring IDI must perform an analysis of the purchased loans or securities to determine the amount that is subprime or leveraged. The acquiring IDI may use either the financial statements for individual loans or securities that are available from the selling entity at the time of purchase or obtain updated financial statements to make higher-risk determinations on purchased assets. Any updated financial statements must be obtained and dated within one year of the purchase date.

Q17: Regarding inclusion of subprime and leveraged loans in securitizations, what consideration has been given to the advance rates of mark-to-market accounting for the underlying assets?

A: No consideration is given to the advance rates of mark-to-market accounting.

Leveraged Loans

Q1: Do leveraged loans include real estate loans, overdrafts, asset based loans, loans to equity real estate investment trusts (REITs), or lease financing receivables? Do they include commercial and industrial loans to municipalities or commercial and industrial loans guaranteed by or sponsored by foreign governmental institutions?

A: Leveraged loans do not include residential real estate loans, commercial real estate loans, farmland, agricultural loans, loans to equity REITs, or lease financing receivables. (Real estate loans are defined in the Instructions to the Reports of Condition and Income.) However, leveraged loans may include overdrafts or asset based loans that meet the criteria for a leveraged loan. Per the Final Rule definition, leveraged loans include commercial and industrial (C&I) loans (as defined in the Instructions to the Reports of Condition and Income with some exclusions) that meet certain criteria. Real estate loans, loans to equity REITs, and lease financing
receivables are not considered commercial and industrial loans. Loans to individuals for commercial purposes are also not considered a commercial and industrial loan, and cannot be considered a leveraged loan for pricing purposes. However, asset based loans that meet the definition of a commercial and industrial loan may be considered leveraged if they meet the leveraged loan criteria.

An overdraft may be considered a commercial and industrial loan if the overdraft is extended to a company and it otherwise meets the Call Report definition of a commercial and industrial loan. The institution would then have to determine if the commercial and industrial loan that was created by the overdraft meets the criteria for a leveraged loan.

Leveraged loans could include commercial and industrial loans guaranteed by foreign governmental institutions, provided the loans meet the criteria for leveraged loans as defined in the Final Rule and the loans are not guaranteed by the U.S. government, its agencies, or government-sponsored agencies, under guaranty or insurance provisions. Leveraged loans would not include loans to states or political subdivisions in the United States as these types of loans are not considered commercial and industrial loans. These loans are to be reported in line item 7 of RC-C of the Call Reports, Loans to Foreign Governments and Official Institutions (please see more details in the answer to the next question).

Q2: How are commercial loans defined for the leveraged loans definition in Appendix C to 12 CFR 327? Do they include loans to governmental agencies and financial institutions?

A: Commercial loans, as used in the definition of leveraged loans for deposit insurance pricing purposes, are generally defined the same as commercial and industrial loans are defined in Schedule RC-C of the Instructions to the Reports of Condition and Income. However, for pricing purposes, loans made to individuals for commercial purposes would not be considered commercial and industrial loans, or leveraged loans. Commercial loans also do not include loans to governmental agencies as these loans are to be reported in Call Report Schedule RC-C line items 7 (Loans to Foreign Governments and Official Institutions) and RC-C line item 8 (Obligations (other than securities and leases) of States and Political Subdivisions in the U.S.) as defined below. Commercial loans also do not include loans to depository and nondepository financial institutions as these loans are to be reported in Call Report Schedule RC-C line items 2 (Loans to Depository Institutions and Acceptances of Other Banks) and line item 9 (Loans to Nondepository Financial Institutions and Other Loans).

As noted in the instructions to Call Report Schedule RC-C of the Call Reports, commercial loans also do not include lease financing receivables, or commercial and industrial loans to foreign governments and official institutions. However, commercial and industrial loans, for purposes of the Final Rule definition include commercial and industrial loans guaranteed by foreign governmental institutions.
States and political subdivisions in the U.S. include:
(1) the fifty States of the United States and the District of Columbia and their counties, municipalities, school districts, irrigation districts, and drainage and sewer districts;
(2) the governments of Puerto Rico and of the U.S. territories and possessions and their political subdivisions; and
(3) Indian tribes in the U.S.

Q3: If an institution originates a commercial purpose, non real-estate loan to an individual or a limited liability company (LLC or a single asset entity), how does the institution determine if the loan is leveraged? The borrowing entities are assessed based upon the cash flow of the individual so there is no EBITDA.

A: Loans made to individuals for commercial purposes would not be considered commercial and industrial loans, or leveraged loans for pricing purposes. However, commercial purpose loans made to an LLC should be evaluated to determine if they meet the criteria for leveraged based upon the debt-to-EBITDA of the LLC. If a commercial purpose loan to an LLC meets the criteria for a leveraged loan, it should be reported as a leveraged loan on the institution’s Call Report or TFR.

Q4. Institutions should report as leveraged loans on their Call Report or TFR the funded and unfunded portion of commercial and industrial loans that meet the criteria for leveraged loans. Define unfunded commitments for purposes of the leveraged loan definition.

A: Unfunded commitments are defined consistent with the definition provided in Schedule RC-L of the Instructions for the Reports of Condition and Income. Only consider those unfunded commitments that meet the definition of leveraged loans for pricing purposes. For purposes of the Reports of Condition and Income and deposit insurance pricing, unfunded commitments are defined as follows:

(1) Commitments to make or purchase extensions of credit in the form of loans or participations in loans or similar transactions.
(2) Commitments for which the bank has charged a commitment fee or other consideration.
(3) Commitments that are legally binding.
(4) Loan proceeds that the bank is obligated to advance, such as:
   (a) Loan draws;
   (b) Construction progress payments; and
   (c) Seasonal or living advances to farmers under prearranged lines of credit.
(5) Rotating, revolving, and open-end credit arrangements, including, but not limited to, retail credit card lines and home equity lines of credit.
(6) Commitments to issue a commitment at some point in the future, where the bank has extended terms, the borrower has accepted the offered terms, and the extension and acceptance of the terms are in writing or, if not in writing, are...
legally binding on the bank and the borrower, even though the related loan agreement has not yet been signed.

Q5: If an IDI has multiple loans to one borrower that, when combined, exceed $1 million, is the IDI required to determine if the relationship meets the characteristics of leveraged lending?

A: Yes. Consistent with the “original amount” and “amount currently outstanding” definitions contained in RC-C, Part II, of the Instructions to the Reports of Condition and Income, when determining whether a loan meets the definition of “leveraged,” all loans to a single borrower, even loans below $1 million, should be combined to determine whether the relationship meets the leveraged loan criteria. The Instructions to the Reports of Condition and Income state, in part, that multiple loans to one borrower should be combined and reported on an aggregate basis rather than as separate individual loans to the extent that the loan systems can provide aggregate individual borrower data without undue cost. However, if the cost of such aggregation would be excessive, the institution may report multiple loans to one borrower as separate individual loans.

Q6: Would an institution report securitizations it has purchased or issued as leveraged (or subprime) if they meet the leveraged (or subprime) definitions detailed in the Final Rule?

A: If a securitization meets the criteria for leveraged (or subprime), it should be reported as such on the Call Report or TFR of the institution that holds that securitization. If an institution issued a securitization that met the characteristics of leveraged (or subprime), it should report on its Call Report or TFR the balance sheet amount of such securitizations. However, if an institution issued and sold 100% of a securitization that is considered leveraged (or subprime) as defined in the Final Rule and such securitization is not reported on the balance sheet, it would not report the sold securitization on its Call Report; instead the institution that purchased it would report the securitization on its Call Report or TFR.

Securitizations are defined consistent with Appendix A, Section II B of Part 325 of the FDIC Rules and Regulations, which reads: “Securitization means the pooling and repackaging by a special purpose entity of assets or other credit exposures into securities that can be sold to investors. Securitization includes transactions that create stratified credit risk positions whose performance is dependent upon an underlying pool of credit exposures, including loans and commitments.” Securitizations may also include interest only strips if these strips are backed by underlying pools of credit exposures. If the pools of credit exposures backing the interest only strip meet the criteria for leveraged or subprime as defined in the Final Rule, these interest only strips should be reported as leveraged or subprime on the institution’s Call Report or TFR.
Q7: Are short-term credit lines included in the debt-to-EBITDA ratio calculations for purposes of the leveraged lending definition? EBITDA is defined as earnings before interest, taxes, depreciation, and amortization expenses.

A: Yes, but only the funded amount of short-term credit lines would be included in the debt-to-EBITDA calculation.

Q8: How are undrawn credit lines treated in the debt-to-EBITDA ratio calculations?

A: Undrawn credit lines would not be included in the debt-to-EBITDA ratio calculations.

Q9: When calculating the debt-to-EBITDA ratio for purposes of determining if a loan is leveraged, would an institution include the “proforma” debt (the debt or the loan that the borrower is applying for) in the debt-to-EBITDA calculation?

A: Yes. An institution should calculate the borrower’s post financing debt-to-EBITDA and determine if it meets the criteria for leveraged as defined in the Final Rule.

Q10: When calculating the debt-to-EBITDA ratio for purposes of determining if a loan is leveraged, since the institution must include the “proforma” debt (the debt or the loan that the borrower is applying for - specifically post financing debt which would include debt incurred for the acquisition of a company or an operating segment) in the debt-to-EBITDA calculation, should the institution also include the trailing EBITDA for the two combined entities?

A: Yes. In the case of a merger or acquisition, the pro-forma debt would be utilized as well as the trailing proforma EBITDA for the two combined entities. When calculating the trailing proforma EBITDA for the combined entity, no synergies (adjustments) are allowed for economies of scale that may be realized subsequent to acquisition when calculating the trailing EBITDA.

Q11: In the context of the debt-to-EBITDA ratio calculation for leveraged loans, what is the definition of total and senior debt?

A: Total debt is defined as Short-Term Borrowings plus Long-Term Borrowings as described below. The definition of total debt is generally consistent with the Bloomberg definition as used in its debt-to-EBITDA ratio calculation. Only funded amounts of lines of credit should be considered when calculating either the senior debt-to-EBITDA ratio or the total debt-to-EBITDA ratio for the purposes of the leveraged loan definition.

Short-Term Borrowings include bank overdrafts, short-term debts and borrowings, repurchase agreements (repos), the short-term portion of long-term borrowings or debt, current obligations under capital (finance) leases, trust receipts and bankers acceptances.
Long-Term Borrowings or Long-Term Debt include all interest-bearing financial obligations that are not previously captured in short-term borrowings. These obligations include debentures, bonds, loans, mortgage debts, sinking funds, long-term bank overdrafts and capital (finance) lease obligations, including those obligations that are convertible, redeemable, or retractable. They also include mandatory redeemable preferred and trust preferred securities accounted for as liabilities in accordance with ASC Subtopic 480-10, Distinguishing Liabilities from Equity – Overall (formerly FASB Statement No. 150, “Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity”), and subordinated capital notes. Long-term borrowings exclude the short-term portion of long-term debt, pension obligations, deferred tax liabilities and preferred equity.

Senior debt includes any portion of total debt that has a priority claim on the assets of the company.

Q12: Are first lien secured debt and accounts receivable securitizations considered “senior debt” in the debt-to-EBITDA calculation?

A: Yes.

Q13: Are second lien debt and unsecured debt excluded from “senior debt” in the debt-to-EBITDA calculation?

A: Yes. However, they are included in total debt, when calculating the debt-to-EBITDA ratio.

Q14: In the case of a corporate borrower that is part of a larger organization, should an IDI consider the consolidated company financial statements to determine if a loan is leveraged (i.e., whether it meets the debt-to-EBITDA ratio thresholds) or the individual company's financial statements?

A: The IDI should consider the financial statements of the primary borrower when determining debt-to-EBITDA ratios.

Q15: Are both the total and senior debt-to-EBITDA tests meant to apply to both loans and securities?

A: Yes, both securities and loans should be tested to determine whether an obligor exceeds either the total or senior debt-to-EBITDA limits established.

Q16: In reporting “leveraged” loan exposures for usage and unused commitments under loan facilities, is it appropriate to include letters of credit (LCs) issued under committed revolvers but exclude LCs issued under uncommitted guidance lines. Is it incorrect to report LCs issued under committed loan facilities, such as revolvers?
A: Letters of credit that meet the criteria of unfunded commitments should be evaluated to determine if they meet the criteria for leveraged. The criteria to determine whether a letter of credit is considered an unfunded commitment is described in question 4 of this section.

Q17: Can a bank use reasonable discretion in evaluating whether a line of credit is leveraged if it is used to finance a seasonal build-up in a borrower's accounts receivable or inventory or for financing floor plans?

A: The loans should be evaluated at origination and renewal to determine whether they meet the criteria for leveraged. In order to preserve consistency among institutions, no discretion for seasonality is allowed.

Q18: Should troubled debt restructurings (TDRs) be classified as leveraged (or subprime)? Would a TDR that was not classified as leveraged (or subprime) prior to the April 1, 2012 transition rule date, be grandfathered as not leveraged (or subprime)?

A: If the TDR loan meets any of the criteria for leveraged (or subprime), it should be included as leveraged (or subprime). The FDIC’s intent is that all commercial and industrial loans (as defined in the Call Report Instructions) should be evaluated at the time they are renewed to determine if they meet the criteria for leveraged. A renewal is defined as a refinancing or a simple extension of the maturity date of a loan, or a transaction in which a change-in-terms agreement or other modification agreement is used to extend the maturity date of a loan. If an institution was correctly excluding a TDR from leveraged (or subprime) loan totals prior to the April 1, 2012 transition rule date, the institution could continue to exclude the loan from leveraged (or subprime) totals, provided that the loan has not been subsequently renewed or refinanced and now meets the Final Rule criteria for leveraged (or subprime). Please see subprime section below for the guidance for subprime loans, which is the same as the guidance provided in this response for leveraged loans.

Subprime Loans

Q1: Does the subprime definition only apply to consumer loans? Specifically, are business purpose loans secured by 1–4 family residential real estate included in the scope of this definition?

A: Yes subprime loans apply to consumer loans (loans secured by 1-4 family residential properties, and loans to individuals for household, family, and other personal expenditures). Business purpose loans that are secured by 1-4 family residential properties are not considered a consumer loan, and therefore, such loans would not be included in the subprime criteria.
Q2: Are overdrafts via an overdraft line considered consumer loans and required to be evaluated to determine if they meet the criteria to be declared subprime loans? What about unplanned overdrafts?

A: It depends. If the overdraft is a loan that meets the criteria for consumer loans per Call Report instructions (see definition of consumer loans above), the loan/overdraft should be evaluated for subprime. This applies to planned and or unplanned overdrafts.

Q3: Are automobile leases included in the subprime classification?

A: If the auto lease is included in Schedule RC-C, line item 10.a. of the Call Reports, it would not have to be evaluated to determine if it is subprime. However, leases for autos that would be included in Schedule RC-C, line item 6.c (loans to individuals for household, family, and other personal expenditures (consumer loans)) should be evaluated to determine if they meet the subprime criteria included in the final rule.

Q4: How should the subprime criteria be applied to student loans given that these borrowers typically have limited or no credit history and limited or no income?

A: Banks should use their best efforts when trying to determine if a student loan meets the criteria for subprime. If the borrower meets any of the subprime criteria described in the rule, including a debt to income ratio greater than 50%, the loan should be classified as subprime.

Q5: If a borrower had a judgment, foreclosure, repossession, or charge-off in the prior 24 months but the loan was paid or remediated, is the borrower’s loan still considered subprime?

A: Yes

Q6: If a borrower is disputing a judgment or charge-off which is on his/her credit report, does this count towards the subprime criteria?

A: Yes. In the case of a judgment, as long as the judgment is a final judgment and not a pending judgment, this is considered a subprime loan, regardless of whether or not it is in dispute. All charge-offs, whether in dispute or not, would be considered a charge-off for purposes of the final rule definition of subprime loans.

Q7: If a borrower’s charged-off debt is still outstanding (has not been collected) after 24 months, is the loan still considered subprime?

A: No. If the borrower did not have another charge-off in the prior 24 months, and did not meet any of the other criteria defined in the final rule for subprime, the loan would not be considered subprime.
Q8: Is there a materiality factor that institutions can consider when evaluating loans that have a “judgment, foreclosure, repossession, or charge-off in the past 24 months”? For example, if an applicant has a judgment against them for less than $100, does that constitute a judgment under the subprime loan definition of the Final Rule?

A: In order to preserve consistency among institutions in identifying subprime loans, there is no materiality factor for purposes of determining whether or not a loan meets the characteristics of subprime.

Q9: How are pending judgments or bankruptcy filings viewed?

A: Only final judgments (not pending) are considered judgments for purposes of the subprime loan definition as used in the final rule. A bankruptcy is considered a bankruptcy at the time it is filed, regardless of whether or not the bankruptcy has been dismissed or remediated.

Q10: How is a business bankruptcy viewed, such as Chapter 11?

A: The personal bankruptcy of the borrower is a criterion for subprime for assessment pricing purposes. If a borrower owned a business that filed Chapter 11 bankruptcy, and that business bankruptcy resulted in a judgment or bankruptcy against the borrower personally, then consumer loans to that borrower would be considered subprime.

Q11: Is a mechanic’s lien considered a judgment as used in the subprime loan definition for pricing purposes?

A: Yes a mechanic’s lien is considered a judgment and thus a criterion for a subprime loan.

Q12: Does the subprime criterion “two or more 30-day delinquencies in the last 12 months” include two or more delinquencies on the same debt (trade) or across multiple debts (trades)?

A: A borrower that has experienced two 30-day delinquencies on the same debt (trade) or separate 30-day delinquencies on two or more debts (trades) would be considered subprime.

Q13: Does the 30-day or 60-day delinquency criteria that is part of the subprime criteria apply to only mortgage debt or any debt reported on the credit bureau?

A: Any debt reported on the credit bureau should be considered when determining if the borrower has had a 30-day or 60-day delinquency.
Q14: How are rolling delinquencies considered (rolling delinquencies are delinquencies that are consistently over 30 or 60 days past due, but the balance of the delinquency changes as a result of partial payments or additional funds borrowed)?

A: A delinquency that continues to be/remains 30 days or 60 days past due, is considered delinquent each month in which it is 30 or 60 days past due, regardless of the loan amount that is past due.

Q15: In cases where a bank runs more than one credit bureau report (from different credit bureau reporting agencies) on a borrower, can the bank decide which credit report to apply the subprime criteria to?

No. If the bank’s underwriting process is to pull more than one credit report, if any one credit report reflects subprime criteria, the loan is considered subprime. The bank cannot decide which credit report to use.

Q16: How should a bank report consumer loans outstanding (as subprime or non-subprime) to a borrower who lives overseas, particularly if the borrower lives in a jurisdiction where there is no credit rating agency?

A: Institutions should make a best effort attempt to collect the needed data to make a determination as to whether or not these loans meet the subprime criteria detailed in the Final Rule. If an institution cannot gather the needed data, an institution should rely upon its internal subprime methodology to determine if a consumer loan made to a borrower who lives overseas is subprime.

Q17: Is an authorized user (i.e. someone that is not an obligor) on a credit card loan required to be tested for subprime criteria? For example, a college student is authorized to use his/her parent’s credit card, but is not obligated to re-pay the debt.

A: No, the bank would not have to analyze the authorized user to determine if he/she meets the subprime criteria.

Q18: Define the debt service-to-income ratio that is used in the subprime loan definition.

A: For the purposes of this rule, the debt service-to-income ratio (DTI Ratio) measures a borrower or co-borrower’s total monthly housing-related payments and all recurring monthly obligations as a percentage of the borrower's gross monthly income. The monthly total DTI ratio includes the borrower's total monthly housing-related payments (e.g., principal, interest, taxes and insurance, or what is commonly known as "PITI") plus all recurring monthly obligations (e.g., payments on installment or revolving accounts, child support, alimony, etc.) as a percentage of the borrower's gross monthly income. Detailed procedures to calculate this ratio can be found in HUD Handbook 4155.1 (New Version), Mortgage Credit Analysis for Mortgage Insurance, as in effect on December 31, 2010. For credit card and auto loans, an institution should include payments for taxes and insurance to the extent available. In
instances where this information is not readily available, an institution can rely on a “best efforts” basis for obtaining taxes and insurance payment information when calculating the DTI on credit card and auto loans.

Note that the debt and income should be based upon the debt and income of the borrower only and not the debt and income of the household. In situations where there is a co-borrower, the combined income and debt obligations of the borrower and co-borrower can be utilized to determine if the debt-service-to-income ratio meets the subprime threshold.

Q19: Does the debt service-to-income ratio in the subprime loan definition include housing expense such as rent?
A: Yes, the debt service-to-income ratio should include rent.

Q20: For stated income programs such as HARP, is the debt service-to-income (DTI) ratio valid? How should institutions handle loans where the borrower didn’t state income and DTI is shown as zero or is missing?
A: Yes, DTI would be valid for stated income programs such as HARP. Consequently, the DTI provided by the borrower should be used to determine if it meets the criteria of a subprime loan. If a borrower does not state income and DTI is zero or missing, the loan would meet the criteria of debt service to income of 50% or more and those loans would be considered subprime for assessment pricing purposes.

Q21: Does the phrase “subprime loans also include loans identified by an insured depository institution as subprime based upon similar borrower characteristics” allow banks to use credit bureau scores if that is how the bank previously identified subprime loans?
A: Yes. Institutions should include as subprime any loan that meets one or more of the four risk characteristics described in the final rule definition of subprime loans and any loan that meets the criteria included in the institution’s internal methodology for identifying subprime loans.

Q22: One of the criteria for determining subprime loans for deposit insurance pricing purposes is: debt service-to-income ratio of 50 percent or greater, or otherwise limited ability to cover family living expenses after deducting total monthly debt-service requirements from monthly income. What does “limited ability to cover family living expenses” mean?
A: Banks should develop reasonable criteria to determine if this standard is met.
Q23: Should troubled debt restructurings (TDRs) be classified as subprime? Would a TDR that was not classified as subprime prior to the April 1, 2012 transition rule date, be grandfathered as not subprime?

A: If the TDR loan meets any of the criteria for subprime, it should be included as subprime. The FDIC’s intent is that all consumer loans (as defined in the Call Report Instructions under “subprime consumer loans,” which includes loans secured by 1-4 family residential properties, and loans to individuals for household, family, and other personal expenditures) should be evaluated at the time they are restructured to determine if they meet the criteria for subprime. A TDR is considered a refinancing (as noted in Question 3 of the Determination of Higher-Risk Assets section above) and all consumer loans are to be evaluated at the time of origination or refinancing to determine if they meet the criteria for subprime. If an institution was correctly excluding a TDR from subprime prior to the April 1, 2012 transition rule date, the institution could continue to exclude the loan from subprime totals, provided that the loan has not been subsequently refinanced and now meets the Final Rule criteria for subprime.

Q24: Do the criteria for subprime loans also apply to guarantors?

A: The criteria for determining whether a loan is subprime does not include an evaluation of the guarantors.

Non-traditional Mortgage Loans

Q1: Certain loans may be considered nontraditional in the United States, but traditional in other countries that an institution operates in. How should an institution report such loans on the Call Reports or TFRs?

A: All loans on the institution’s balance sheet should be evaluated under the nontraditional mortgage loan criteria detailed in the FDIC’s Final Rule and the Instructions to the Reports of Condition and Income. The “nontraditional” criteria of the country where the loan was originated is not a consideration for pricing purposes.

Q2: Are interest-only business purpose loans secured by 1-4 family residential properties considered nontraditional mortgages?

A: No.

Simultaneous Second Lien Loans

Q1: Are simultaneous second lien loans considered non-traditional mortgage loans?
A: If a simultaneous second lien loan meets the characteristics of a non-traditional mortgage loan as defined in Appendix C of the Final Rule, it should be included in the IDI’s non-traditional mortgage loan total on the Call Report or TFR.

**Closed-End Home Equity Loans**

Q1: Are closed-end home equity loans considered non-traditional mortgage loans?

A: Closed-end home equity loans (not lines of credit) that meet the characteristics of a non-traditional mortgage loan as defined in Appendix C to 12 CFR Part 327 should be included in the IDI’s non-traditional mortgage loan total on the Call Report or TFR.

**Teaser Rates**

Q1: If a loan has an escalating interest rate, how long is the rate considered to be a teaser rate?

A: As long as the current interest rate is a discounted interest rate, the loan is classified as a teaser rate loan. A discounted rate is an effective interest rate at the time of origination or refinance that is less than the rate the bank is willing to accept for an otherwise similar extension of credit with comparable risk.

Q2: Some IDIs offer discounted mortgage rate loans to employees. The loan rates are subject to reset to market rates if an employee leaves the IDI. Would these loans need to be reported as non-traditional mortgage loans?

A: Yes.

Q3: To reduce credit risk and operating overhead (in check processing), many banks incent borrowers to sign up for autodrafts. While on autodraft, the loan’s interest rate is reduced. The rate is increased if the autodraft is cancelled. Would these arrangements be considered teaser rate loans?

A: No, these arrangements would not be considered teaser rate loans.

Q4: In addition to an autodraft discount, an IDI offers a number of other discounts in connection with its mortgage loan programs. For example, the IDI discounts mortgage interest rates (for fixed rate loans) or margins (for variable rate loan products), to certain clients who qualify for preferred benefits and services based on, for example, opening and maintaining certain types of accounts with the bank, or maintaining a certain level of minimum balances across one or more product lines for a certain period, or otherwise. The amount of this “preferred banking” discount available at origination is typically between .25% and .50% below the standard interest rates or margins then available to clients. The underlying agreement discloses both the discounted and undiscounted rates or margins, as applicable, and
that when the client no longer meets the qualification requirements for preferred banking, the discount will be discontinued. Would such an arrangement be considered a teaser rate?

A: No, this type of arrangement would not be considered a teaser rate product.

Top 20 Counterparty Exposure and Largest Counterparty Exposure to Tier 1 Capital and Reserves Definitions

Q1: Is counterparty exposure that is fully guaranteed by the U.S. Government excluded from the counterparty risk definitions?

A: For purposes of the above two definitions, exclude all counterparty exposure to the United States Government and departments or agencies of the United States Government that are unconditionally guaranteed by the full faith and credit of the United States.

Q2: When determining counterparty credit exposure amounts, should institutions use the outstanding amount and undrawn commitments for loans and the mark-to-market amount for derivatives? What about other elements of potential counterparty exposure (e.g., repurchase transactions) which are not calculated on a mark-to-market basis? Are these to be included, and, if so, on what basis should this be done?

A: Institutions should use the outstanding amount and undrawn commitments for loans. Repos are securities financing transactions and counterparty exposure for all securities financing transactions and OTC derivatives should be calculated using either the Internal Models Methodology (IMM), if the institution has received approval to use the IMM, or one of the other methods permitted for measuring EAD in accordance with the appropriate outstanding capital regulations (see below Q&As for more details).

Q3: Does my institution require regulatory approval to use an Internal Models Methodology (IMM) to calculate exposure at default (EAD) for OTC derivatives and/or Securities Financing Transactions (SFTs)?

A: Yes. To adopt IMM to calculate EAD, institutions must receive approval from their primary federal regulator in accordance with the capital regulations issued by each regulator. FDIC supervised institutions would follow the methodology prescribed by Section 32, Appendix D to Part 325 of the FDIC Rules and Regulations for measuring EAD. OCC supervised institutions should follow the methodology prescribed by 12 CFR Part 3, Appendix C, Section 32 and FRB supervised institutions should follow the methodology prescribed by 12 CFR Part 208, appendix F, section 32 (state member banks) and 12 CFR part 225, appendix G, section 32 (bank holding companies) for measuring EAD. If an institution has not received regulatory approval to adopt the IMM, then it may calculate EAD using the current exposure
methodology in accordance with appropriate outstanding capital regulations. As an alternative, institutions without approval to adopt the IMM or institutions not adopting the IMM may report the credit equivalent amount for each counterparty’s derivative exposures as calculated in accordance with Call Report Schedule RC-R item 54.

Q4: My institution does not use an IMM to calculate EAD for SFTs. How should I calculate counterparty exposure for these transactions?

A: If an institution has not received regulatory approval to adopt the IMM, then it must calculate EAD or exposure using one of the other methods permitted in accordance with the appropriate outstanding capital regulations (as noted in the answer above).

Q5: Should my institution include due from accounts, federal funds sold, securities, and credit protection purchased or sold where the counterparty under consideration is a reference entity in the calculation of counterparty exposure?

A: No. For pricing purposes, counterparty exposure only includes gross lending (including unfunded commitments), OTC derivative, and SFT counterparty exposure amounts.

**Criticized and Classified Items**

Q1: Are consumer and retail loans that would be classified under the Uniform Retail Credit Classification and Account Management Policy (Retail Classification Policy) included in criticized and classified items for purposes of the Scorecard?

A: Yes. Criticized and classified items include all on and off balance sheet items (including consumer and retail loans) that meet the characteristics of the IDI’s or the IDI’s primary federal regulator’s definition of Special Mention, Substandard, Doubtful, and Loss.

Q2: Will criticized and classified items information be publicly disclosed or confidential?

A: This information will remain confidential.