Questions and Answers Pertaining to the Final Rule on Assessments, Large Bank Pricing Changes to Definitions of Higher-Risk Assets

For purposes of these Q&As, the term "final rule" refers to the final rule on Assessments, Large Bank Pricing, 77 Fed. Reg. 66000 (Oct. 31, 2012). The terms "large bank" and "highly complex bank" refer, respectively, to a "large institution" and a "highly complex institution," as those terms are used in the final rule.

Higher-Risk Consumer Loans

Portfolio Reassessment

1. Will large and highly complex banks have to reassess their entire consumer loan portfolio to determine which loans meet the higher-risk consumer loan definition for the second quarter of 2013?

   Response: Yes. Large and highly complex banks will be required to reassess their entire consumer loan portfolio so that they can report consumer loans on their Call Reports beginning on June 30, 2013 in accordance with Appendix C to Subpart A to Part 327. No consumer loans will be grandfathered, including loans that were not identified as "subprime" under the February 2011 rule definition. Instead, as of June 30, 2013, large and highly-complex banks will be required to identify the probability of default of all consumer loans in their loan portfolios and report consumer loans with a probability of default of 20 percent or greater as higher-risk consumer loans.

   Securitizations of subprime consumer loans that were reported as subprime consumer loans before April 1, 2013 should continue to be reported as higher risk after April 1, 2013. Banks will need to review all securitizations of consumer loans that are issued on or after April 1, 2013 to determine if these securitizations meet the definition of a higher-risk securitization.

Probability of default (PD) calculations and mapping tables

1. Is a large or highly complex bank permitted to use one mapping table for scores from different or multiple credit bureaus?

   Response: It depends. The rule specifies: "If the current and historical scores were produced by the same vendor using slightly different versions of the same scoring system and equivalent scores represent a similar likelihood of default, then the historical experience could be applied."

   The FDIC recognizes that multiple credit bureaus may be using customized or proprietary versions of the same credit scoring model developed by a single vendor to produce credit scores. If a bank determines that these different versions share the same fundamental methodology, such that the credit risk associated with a particular score is substantially similar across bureaus, then a bank may use the PD mapping from any bureau when evaluating such scores.

2. Is a bank permitted to use one table to map scores from both current and legacy versions of a particular vendor model?

   Response: The rule says "if the current and historical scores were produced by the same vendor using slightly different versions of the same scoring system and equivalent scores represent a similar likelihood of default, then the historical experience could be applied." Thus, a bank may use scores from legacy versions of the same vendor model to develop a mapping table provided that the various legacy versions are substantially similar to each other and various versions would produce a similar likelihood of default.

3. How should the PD be determined if a bank does not have 1,200 observations in each of the 15 PD bands, for example for a product created after April 1, 2013?

   Response: Estimates of PDs must be based on the observed stress period default rate for loans of a similar product type. For a bank to generate its own internal PD mapping, it is required to have 1,200 observations per product type, per credit score band. Consequently, the minimum number of observations a bank must have per product type is 18,000 (1,200 times 15). If a bank does not have this data, it can use either mappings provided by a third party (as long as the mappings conform to the requirements in the final rule) or an alternative methodology. The bank must follow the guidance in the final rule about alternative methodologies and send a written request to: Scott Ciardi, Chief, Large Bank Pricing Section, 550 17th Street NW, Room MB-4002, Washington, DC 20429-0002.

   If a new loan product is similar to an existing product type, the bank may use the score to default rate mappings used for the existing product type. If it is significantly different from existing product types, the bank may use the generic score to default rate mappings provided by credit reporting bureaus for a similar loan product type.

4. With respect to the definition of default for consumer loans, is delinquency (which is one of the criteria used to determine if a loan is in default) to be measured on an Office of Thrift (OTS) or Mortgage Banker's Association (MBA) basis? Per the OTS basis, which is also known as the OTS/FFIEC rule, a loan is delinquent if a monthly payment is not received by the loan's due date in the following month. Per the MBA method, a loan is delinquent if a monthly payment is not received by the end of the day immediately preceding the loan's next due date.

   Response: For the purpose of calculating historical default rates in accordance with the requirements in the final rule, banks may measure delinquency using either the OTS or MBA method.

5. Do banks (or credit bureaus that are preparing mapping tables) need to exclude loans, such as most student loans, that are guaranteed by the U.S. government (and are, therefore, excluded from higher-risk loans) from their default rate calculations to generate the standard PD mapping tables?

   Response: There is nothing in the rule that explicitly requires loans that are guaranteed by the U.S. government to be excluded from the PD mapping tables since guarantees affect the severity of loss but not (strictly speaking) the likelihood of loss. But there is a general requirement that the borrowers in the sample must have credit risk comparable to the loan being evaluated. Therefore, if there was reason to believe that the default behavior of guaranteed loans of a certain type differed materially from the non-guaranteed group, it would be best to exclude the guaranteed loans.

6. Of the requirements for estimating PDs, what is meant by the statement: "The loans should be sampled based on the credit score as of the observation date"?

   Response: Banks should use the credit score on file that the consumer had as of the beginning of the two year performance period (July 2007 to June 2009 or July 2009 to June 2011). Banks should then track the performance (*i.e.*, default or no default) over the two years. For example, the credit score should be as of June or early July of 2007 and June or early July of 2009.

7. When determining a sample of loans to use in estimating PDs, should a bank include loans that were sold within the two two-year performance periods (July 2007 to June 2009 or July 2009 to June 2011)?

   Response: If a loan was sold during the performance period, such that the bank cannot make a determination as to whether the borrower defaulted at any time within the two year period, then it should exclude the loan from the estimation of PDs.

Probability of default reporting table for Call Report purposes

1. Should the balances reported in the PD reporting table by consumer loan category reconcile to those reported on the associated Call Report Schedule RC-C lines?

   Response: It is likely that the PD reporting table for consumer loans will not reconcile to the line items on RC-C because the PD table will not include loans guaranteed by the U.S. government, loans secured by cash, or loans acquired within the prior 6 months. Banks should be allocating items such as payment clearing items, deferred origination costs, and items in process to individual loans for Call Report purposes so that they can accurately file schedule RC-C. Since banks are required to allocate these items to individual loans for schedule RC-C, they should be able to include these amounts in the PD table as well.

   The PD reporting table for consumer loans has not yet been finalized, but is the subject of a PRA notice that was issued by the FDIC, Federal Reserve and OCC in February 2013. The comment period on the proposed table began in late February 2013 and ends April 22, 2013. Comments will be considered when formulating the final format of the table.

2. The PD reporting table separates revolving credit lines secured by 1-4 family residential properties into two lines for first and junior liens. As this table appears to still be in draft form, is there the possibility to combine these two lines?

   Response: Yes. As noted above, the format of the PD table is the subject of a PRA notice and comment period that began in late February 2013 and ends April 22, 2013. Comments will be considered when formulating the final format of the table.

3. Should purchased credit-impaired (PCI) loans that meet the "higher-risk" criteria be reported net of the purchase accounting marks? What if the loans are in pools?

   Response: The loan balance that is reported on Schedule RC-C of the Call Report is the amount that should be reported in the PD reporting table under the applicable PD column for that particular loan. In cases where an entire loan pool is evaluated and a mark (or a discount) is applied to the entire pool to determine the resulting fair value of the pool, the bank must determine the percentage mark (or discount) taken on the entire pool of loans that were evaluated. This percentage mark (or discount) must then be applied to individual loans in the pool for reporting in the PD table. Banks have six months from the date of acquisition to determine the PD of loans acquired on or after April 1, 2013. Loans without a credit score should be reported consistent with the method for reporting unscorable loans outlined in the final rule.

4. Will nontraditional residential mortgage loans be placed into the PD bands or reported as a single number?

   Response: Banks will be required to report the total volume of nontraditional mortgage loans on line item 7 of Schedule RC-O. In addition, in the proposed PD reporting table, banks would be required to segment and report the total volume of nontraditional mortgage loans by PD band. The PD reporting table for consumer loans has not yet been finalized, but is the subject of a PRA notice that was issued by the FDIC, Federal Reserve and OCC in February 2013. The comment period on the proposed table began in late February 2013 and ended April 22, 2013. Comments will be considered when formulating the final format of the table.

Definition of foreign consumer loan

1. What is the definition of a "foreign consumer loan?"

   Response: For purposes of the final rule, a foreign consumer loan is a consumer loan made to a customer whose principal residence address is outside of the United States, Puerto Rico, District of Columbia and any U.S. territories or possessions. If a bank can estimate the PD of a foreign consumer loan following the specifications included in Appendix C of the final rule, it must do so. However, if a bank cannot follow the specifications for estimating a PD in accordance with the final rule, the bank must use the alternative options, also outlined in Appendix C of the final rule.

Definition of "refinance"

1. A refinance of a consumer loan is defined in the rule to include an extension of the legal maturity date by more than six months. Would multiple extensions over time of less than six months each but more than six months in aggregate be considered a refinance?

   The maturity date is defined as the maturity date assigned as of the origination date of the loan or, if the loan has been refinanced, the maturity date assigned as of refinance. Multiple extensions which in aggregate exceed the maturity date by more six months would be considered a refinance.

Higher-Risk C&I Loans and Securities

Grandfathering

1. How should a bank report C&I loans and securities originated before April 1, 2013 on their Call Reports beginning June 30, 2013?

   Response: If a bank decides not to re-evaluate its entire C&I loan and securities portfolio, then, beginning with the June 30, 2013 Call Report, it must continue to report C&I loans originated, refinanced, or purchased before April 1, 2013 as they were reported before the second quarter of 2013. Under these circumstances, the bank will generally not be permitted to stop reporting loans reported through the first quarter 2013 in the RC-O "leveraged" balance that do not meet the new higher-risk definition (even if, for example, the loans would otherwise meet the asset-based lending exclusion, the floor plan lending exclusion, are government guaranteed or are under $5 million in original principal amount).

   If the borrower obtains a new C&I loan or refinances an existing C&I loan on or after April 1, 2013 and at that time the borrower does not meet the criteria to be considered a higher-risk C&I borrower, then C&I loans to that borrower should not be reported as higher-risk. If the borrower obtains a new C&I loan or refinances an existing C&I loan on or after April 1, 2013 and is considered to be a higher-risk borrower at the time the new loan is originated or the existing loan is refinanced, then all C&I loans to that borrower should be reported as higher-risk.

   If, on the other hand, a bank opts to apply the final rule definition of higher-risk C&I loans and securities to all of its C&I loans and securities (including those loans originated, refinanced, or purchased before April 1, 2013), it must also apply the final rule definition of a higher-risk C&I borrower without regard to when a loan is originally made or refinanced (*i.e.*, whether made or refinanced before or after April 1, 2013).

Removing loans from higher-risk category

1. If a borrower is a higher-risk borrower under the definition in the final rule as the result of aggregating all C&I loans to the borrower to reach the $5 million threshold, and, as the result of payments, the aggregate debt owed by the borrower falls below $5 million, may the bank discontinue reporting the loans as a higher-risk C&I loan?

   Response: No. The bank can only discontinue reporting a C&I loan as higher-risk when the loan has been paid off or extinguished (charged off), or at the time a borrower is no longer considered to be a higher-risk C&I borrower. As noted in the final rule, a borrower ceases to be a "higher-risk C&I borrower" only if:

   (a) The borrower no longer has *any* C&I loans owed to the reporting bank that, when originally made, met the purpose and materiality tests described herein;

(b) The borrower has such loans outstanding owed to the reporting bank, but they have all been refinanced more than 5 years after originally being made; or

(c) The reporting bank makes a new C&I loan or refinances an existing C&I loan and the borrower no longer meets the leverage test.

2. For a borrower to cease to be a higher-risk C&I borrower, must the reporting bank refinance the loan that originally qualified the borrower as a higher-risk C&I borrower?

   Response: No. A borrower ceases to be a ‘‘higher-risk C&I borrower’’ if: (1) The borrower no longer has any C&I loans owed to the reporting bank that, when originally made, met the purpose and materiality tests; (2) any such loans outstanding owed by the borrower to the reporting bank have all been refinanced more than five years after originally being made; or (3) the reporting bank makes any new C&I loan (not necessarily a loan that meets the purpose and materiality tests) or refinances any existing C&I loan (again, not necessarily a loan that meets the purpose and materiality tests) and the borrower no longer meets the leverage test. A borrower cannot cease to be a higher-risk borrower except in one of these three ways.

Syndicated loans

1. If a syndicated loan is a higher-risk C&I loan, do all participants report their portion of that loan even if that portion is less than or falls below the $5 million threshold?

   Response: Yes. If the syndicated loan is a higher-risk C&I loan as defined by the final rule, each participating bank must reflect its portion of the syndicated loan as higher-risk, regardless of the size of the loan held by the participant. Assume, for example, a syndicated loan in the original principal amount of $20 million, where the purpose, materiality, and leverage tests are met, making the borrower a higher-risk C&I borrower. Each bank that owns a portion of the syndicated loan will report the dollar amount of the portion it owns as higher-risk, regardless of the size of its portion.

Unfunded commitments

1. Are unconditionally cancellable unfunded commitments included as an unfunded commitment in determining whether a borrower is higher-risk?

   Response: Yes. A “higher-risk C&I borrower” is one that owes a large or highly complex bank on an outstanding loan where the original amount, including funded amounts and the amount of unfunded commitments (whether irrevocable or unconditionally cancellable), is $5 million or more and the purpose, leverage and materiality tests are met. In determining the amount of higher-risk C&I loans to that borrower to report on the Call Report, unfunded commitments (whether irrevocable or unconditionally cancellable) are included. If, however, the commitment is cancelled and no longer exists, the bank should not report the commitment as higher-risk.

2. Can a letter of credit issued to a C&I borrower ever be used to make the borrower a higher-risk C&I borrower and ever be considered a higher-risk C&I loan and security?

Response: No. Letters of credit should not be added to other loans to a borrower to determine whether a borrower meets the original amount test ($5 million). For purposes of the leverage test of the higher-risk C&I loan definition, letters of credit are not considered an unfunded commitment and should not be included in total debt when calculating debt to EBITDA.

Definition of higher-risk borrower

1. If a borrower is considered to be a higher-risk C&I borrower at one bank, does that mean that the borrower is automatically considered a higher-risk borrower at all banks?

   Response: No. A higher-risk C&I borrower is a borrower that ***owes the reporting bank*** on a C&I loan made on or after April 1, 2013, or on a refinanced C&I loan that is refinanced on or after April 1, 2013 if certain conditions are met. Except in the case of a syndicated loan, the definition has been simplified in the final rule so that each bank need only consider C&I loans, refinancings, and commitments that it makes to determine whether a borrower is a higher-risk C&I borrower.

2. Suppose that a large or complex bank acquires bonds issued by a firm where the total value of debt acquired exceeds $5 million, the bond issuance raised the funded debt of the firm by over 20 percent, and the bonds finance a leveraged buyout, such that the firm's debt exceeds the leverage test thresholds. Does the bond itself make the firm a higher-risk C&I borrower and are the bonds "higher-risk securities"?

   Response: No. A higher-risk C&I borrower is defined as a borrower that owes the reporting bank on a C&I loan or obtains a refinanced loan that meets certain specifications. Since bonds are not C&I loans, as defined in the Call Report, debt securities cannot trigger classification of a higher-risk C&I borrower.

   However, if the firm is a higher-risk C&I borrower based on a loan, then all securities issued by the firm, except securities classified as trading book, that are owned by the reporting bank are higher-risk C&I loans and securities.

Definition of refinance

1. Is an existing loan that receives a short term extension of up to 180 days, with no commitment increase or diminution of collateral, considered a refinanced loan?

   Response: Yes. However, the rule states that a refinance would not include a modification of a commercial loan that results in the classification of the loan as a troubled debt restructuring (TDR).

2. Does the term "refinance" include an existing loan at another bank that is refinanced by the reporting bank?

   Response: Yes. A refinanced loan can include refinancing an existing loan at the reporting bank or refinancing any other loan that was originated by another lender. If a bank is refinancing a loan originated by another lender, the October 2012 final rule provides that the new lender must use its best efforts and reasonable due diligence to determine whether the original loan met the purpose and materiality tests.

3. How should a bank determine whether a loan meets the definition of a troubled debt restructuring (TDR) and therefore does not meet the definition of a refinanced loan for purposes of the final rule?

   Response: The final rule states that a refinance of a C&I loan or a consumer loan does not include a modification or series of modifications to a loan that result in the classification of a loan as a TDR, as this term is defined in the glossary of the Call Report instructions, as they may be amended from time to time. Banks should follow the guidance in the glossary of the Call Report instructions when determining whether or not a loan should be considered a TDR for purposes of the higher-risk assets definition in Schedule RC-O.

   Under the instructions, there is a distinction in the way loans within a pool of purchased credit-impaired loans and purchased credit-impaired loans accounted for individually must be evaluated to determine whether they are TDRs. The instructions provide in part:

   > A refinancing or restructuring of a loan within a pool of purchased credit-impaired loans should not result in the removal of the loan from the pool. In addition, a modification of the terms of a loan within a pool of purchased credit-impaired loans is not considered a troubled debt restructuring under the scope exceptions in ASC Subtopic 310-40, Receivables – Troubled Debt Restructurings by Creditors (formerly FASB Statement No. 15, "Accounting by Debtors and Creditors for Troubled Debt Restructurings," as amended). However, a modification of the terms of a purchased credit-impaired loan accounted for individually must be evaluated to determine whether the modification represents a troubled debt restructuring that should be accounted for in accordance with ASC 310-40.

Original Amount

1. Please clarify the meaning of this phrase, "the date of the bank's most recent Call Report" as it appears in the definition of "original amount."

   Response: The phrase means the "as of" date for the bank's Call Report. The phrase appears in more than one place in the definition of "original amount." Thus, for example, for a Call Report that is "as of" September 30, the original amount is the original balance of an open line or loan as of the date of the bank's most recent approval or renewal that occurred closest to (but not after) September 30.

2. How is the "original amount" determined for revolving and non-revolving lines of credit?

   Response: The "original amount" for C&I loans drawn down under lines of credit or loan commitments is the total amount of the line of credit (including funded and unfunded amounts available) or loan commitment on the date of its most recent approval, extension or renewal prior to the date of the most recent Call Report; if, however, the amount currently outstanding on the loan as of the date of the bank's most recent Call Report exceeds this amount, then the original amount of the loan is the amount outstanding as of the date of the bank's most recent Call Report. For all other C&I loans (whether term or non-revolver loans), the "original amount" is the total amount of the loan as of origination or the amount outstanding as of the date of the bank's most recent Call Report, whichever is larger.

To further illustrate, if a $6 million non-revolving line of credit was approved on August 30 and that line remains active as of September 30, then $6 million would be the original amount. If, however, the borrower had exceeded its line of credit as of September 30, then the original amount would be the actual balance outstanding as of September 30 (since that balance is greater than what was originally approved to be extended to the borrower). If, on September 1, the borrower had drawn up the line to $6 million, but, as of September 30, had paid it down to $4.5 million, the original amount would be $4.5 million for purposes of the September 30 Call Report, rather than $6 million, because the borrower could no longer draw on the line.

However, if the loan was a $6 million revolving line of credit and the borrower could still draw up to the full $6 million as of September 30, the original amount would be $6 million for purposes of the September 30 Call Report.

Purpose test for general lines of credit

1. Is a credit line intended as a general liquidity backstop or a multi-purpose credit line that may be used as a borrower sees fit deemed to meet the Purpose Test at origination unless there is a specific covenant against it being used for an acquisition, buyout, or capital distribution that meets the Purpose Test? Or, instead, does the credit line fail to meet the Purpose Test at origination but begin to meet it when there is a draw that satisfies the Purpose Test?

   Response: Multi-purpose lines of credit would not be deemed to meet the purpose test at origination unless the borrower specifically plans to use the line of credit to finance an acquisition, buyout or capital distribution. If the borrower eventually draws on the line of credit for the purpose of financing an acquisition, buyout or capital distribution, the bank would identify this as a purpose loan at the time the line is renewed. If the line meets the purpose test (at origination or renewal), the bank must determine if the borrower meets the other tests outlined in the higher-risk C&I loan definition.

Leverage test

1. When a firm has capitalized a company with both equity and debt (to enhance return and for tax advantages), can the debt be excluded from the leverage test calculation?

   Response: No, even if the debt is deeply subordinated, contains no covenants, no default triggers, and requires payment-in-kind rather than cash interest.

2. For many middle market C&I customers, quarterly financials are not always required. In such cases, would it be acceptable to calculate EBITDA using either: (a) annualized EBITDA based on the most recent interim financials or (b) the most recent fiscal year financials?

   Response: Yes, provided the financial statements used are not more than 12 months old.

3. How should a bank treat a line of credit in the leverage test?

   Response: The leverage test must be calculated by including the debt the borrower is applying for. If the debt the borrower is applying for is a line of credit (on its own or as a part of a lending facility), the reporting bank should also assume that the line is fully drawn when the bank performs its debt to EBITDA calculations, unless the line of credit contains covenants that would, in effect, prevent the borrower's debt to EBITDA ratios from exceeding the leverage test thresholds as defined in Appendix C to Subpart A of Part 327 for a higher-risk C&I borrower. The final rule defines total and senior debt and provides that only funded amounts of lines of credit must be considered debt for purposes of the definition, but this provision refers only to existing debt of the borrower and not to the debt the borrower is applying for.

4. When there are multiple borrowers on a C&I loan but principal or interest payments are expected to be received primarily from one borrower (the "primary borrower"), which financial statements should an institution use when calculating the leverage test?

   Response: The final rule states that the leverage test must be calculated using the consolidated financial statements of the borrower. In the case of multiple borrowers, an institution can use the primary borrower's financial statements to calculate the leverage test. In the case of multiple borrowers who each have joint and several liability for a loan, an institution can use the consolidated financial statements of any one of the borrowers to calculate the leverage test. Moreover, if one such borrower does not meet the criteria for a higher-risk C&I borrower, the loan would not be considered a higher-risk loan. Finally, if a loan is made to a subsidiary whose parent company has unconditionally and irrevocably guaranteed the borrower's debt, the leverage test may be calculated using the consolidated financial statements of the subsidiary or the consolidated financial statements of the parent company.

Materiality test

1. Should floor plan loans be included in the debt considered in the materiality test?

   Response: Yes. If the floor plan loan is the debt the borrower is applying for and it meets the purpose test, the bank must consider the funded and unfunded amount of the floor plan loan and determine whether it equals or exceeds 20 percent of the total funded debt of the borrower. If the floor plan loan exists when the borrower applies for or refinances another C&I loan that meets the purpose test, then, for purposes of the materiality test, only the amount of the floor plan loan that is funded and outstanding should be included in the total funded debt of the borrower (the denominator).

Asset-Based Lending and Dealer Floor Plan Financing Exclusions

1. Could a bank qualify for the asset based lending exclusion if the advance rate on accounts receivable and inventory is 90 percent?

Response: No. The final rule requires that advance rates never exceed 85 percent for the exclusion to apply.

2. Is collateral in Canada considered foreign accounts receivable and therefore ineligible to include as collateral for purposes of the final rule?

   Response: Yes. The final rule states that foreign accounts receivable are ineligible; therefore, accounts receivable from Canada are ineligible.

3. Would foreign accounts receivable that are guaranteed by the Export-Import Bank be eligible to include as collateral for purposes of the asset-based lending exclusion in the final rule?

   Response: Yes. Institutions can include foreign accounts receivable that are guaranteed or insured by the Export-Import Bank as collateral in their borrowing base when determining loan to value for purposes of the asset-based lending exclusion. The maximum amount of foreign accounts receivable that is guaranteed or insured by the Export-Import Bank is the amount that can be included in the borrowing base as collateral. For example, if only 90 percent of the accounts receivable are guaranteed or insured, the bank can only include the 90 percent that is guaranteed or insured as eligible collateral.

4. The automobile floor plan exclusion requires that "each loan advance must be … at no more than 100 percent of (i) dealer invoice plus freight charges (for new vehicles) or (ii) the cost of a used automobile at auction or the wholesale value using the prevailing market guide (*e.g.*, NADA, Black Book, Blue Book). How much is allowed as "freight charges"?

   Response: For new vehicles, banks typically lend 100% of the dealer/manufacturer invoice price, which generally already includes "triple net" charges (*e.g.*, destination charge, hold back, and advertising). In these cases, advances should not exceed the dealer invoice price and additional freight charges should not be added to the dealer invoice price. However, for new vehicle floor plan financing, if triple net charges (including freight charges) are not included in a new vehicle manufacturing invoice, a bank may add the typical triple net fee (which generally amounts to 5 to 7 percent of dealer invoice) in calculating the amount that may be advanced to the borrower consistent with the automobile floor plan exclusion. For used vehicle floor plan financing, the advance rate must not exceed the cost of a used automobile at auction or the wholesale value using the prevailing market guide without addition for freight charges to be consistent with the exclusion.

5. Would a bank be eligible for the automobile dealer floor plan lending exclusion if the bank does not maintain borrowing base certificates to govern advances?

   Response: Yes. To be eligible for the floor plan lending exclusion, the final rule requires that "for automobile floor plan loans, each loan advance must be made against a specific automobile under a borrowing base certificate held as collateral." However, some banks do not use a borrowing base certificate for these loans because they have other controls in place to monitor advances on the loan. For banks that do not use a borrowing base certificate, then, to be eligible for the exclusion, the bank must have a perfected security agreement in place that evidences collateral and the bank must also have a system in place that monitors each loan advance made against specifically identifiable vehicles (*i.e.*., against specific vehicle identification numbers (VINs)). As the dealer sells each vehicle, the bank must ensure that the dealer repays the loan advance against that specific piece of collateral before the bank will release the collateral. The bank must also maintain a listing of each vehicle (including each vehicle's VIN) that it has advanced funds on so that the bank can continuously monitor which vehicles serve as collateral for the loan.

6. Will the floor plan exemption from higher-risk assets for a particular loan apply even though some of the vehicles collateralizing the loan may not always be in the dealer's possession?

   Response: The exemption may apply. The FDIC realizes that not every vehicle will be in the dealer's physical possession because, for example, they are out on test drives, are serving as loaners to service customers, or are being used as demos for dealership personnel. The dealer, however, should be able to document that all of the vehicles held as collateral are owned by the dealer and are accounted for at any given point in time.

7. Can a floor plan loan be eligible for the dealer floor plan exclusion if the bank does not receive borrowing base certificates, accounts receivable and inventory detail, accounts payable detail and covenant compliance certificates?

   Response: Yes. Banks are required to receive borrowing base certificates, accounts receivable and inventory detail, accounts payable detail, and covenant compliance certificates on all asset-based loans to be eligible for the asset-based lending exclusion. However, banks are not necessarily required to receive borrowing base certificates, accounts receivable and inventory detail,* and accounts payable detail on floor plan loans for the floor plan lending exclusion to apply. If the loan agreement for a floor plan loan does not require the receipt of these items, or does not require the receipt of covenant compliance certificates because the loan includes a demand feature instead of covenants, then the bank is not required to receive these documents to be eligible for the floor plan lending exclusion.

   * Regardless of what the loan agreement allows, to be eligible for the floor plan lending exclusion, the bank must maintain a listing of each vehicle or unit of inventory financed through the floor plan loan, the date the inventory was financed, and an identification number.

8. May banks use internally prepared rather than borrower prepared aging reports and still satisfy the final rule's requirements for the floor plan lending exclusion?

   Response: Although the rule states that borrowers must submit floor plan aging reports, aging reports that are developed by the lender are sufficient to satisfy the requirements of the floor plan lending exclusion provided that the records include the following: a listing of each vehicle or unit of inventory financed through the floor plan loan, the date the inventory was financed, and an identification number so that banks may track the length of time it takes to sell a particular unit of inventory. If the information is provided by the dealer-borrower, the bank must also periodically verify the accuracy of the floor plan aging reports via an on-site inspection.

9. A LBP bank cannot use the asset-based lending or floor plan financing exemptions if a supervisor has criticized the management of these programs. Can the FDIC clarify that a bank would be allowed to again use these exemptions as soon as an MRA is cleared?

   Response: A bank cannot use the asset-based lending or floor plan financing exclusions during a period in which an MRA is in place that criticizes the bank's controls or administration of its asset-based or floor plan loan portfolios. Once the MRA is removed (because the bank has corrected the deficiencies that caused the MRA), all loans that meet the requirements of the exclusions, including those made when the MRA was in place, can be excluded from higher-risk C&I loans.

General Questions About Higher-Risk C&I and Consumer Loans

1. If a bank becomes a large bank after April 1, 2013, is the bank expected to review its entire C&I loan portfolio (including loans purchased or originated prior to April 1, 2013) to determine whether the loans are higher-risk?

   Response: Yes. The bank must review its entire C&I loan portfolio. For loans made, refinanced or purchased before April 1, 2013, the bank has three options for identifying and reporting higher-risk C&I loans and securities: (1) the February 2011 final rule definition; (2) the transition guidance (located in the Schedule RC-O Call Report instructions), or (3) the final rule (that is, the October 2012 final rule) definition.

   If the bank elects to use the October 2012 final rule definition of higher-risk C&I loans and securities for any C&I loan originated before April 1, 2013, then the bank must use the October 2012 final rule definition for *all* of its C&I loans, whenever originated, and must apply the final rule definition of a higher-risk C&I borrower without regard to when a loan is originally made (i.e., whether made before or after April 1, 2013).

   Additionally, if a borrower seeking a new C&I loan (or refinancing an existing one) on or after April 1, 2013 meets the October 2012 final rule definition of a higher-risk C&I borrower, then the bank must report all loans to that borrower as higher-risk C&I loans and securities without regard to when the loans were originated or refinanced (*i.e.*, including C&I loans to that borrower that were originated or refinanced prior to April 1, 2013).

2. Does the FDIC provide the list of government agencies for the purpose of determining which loans are guaranteed by the U.S. government and thus may be excluded from higher-risk assets?

   Response: The FDIC does not provide such a list. Lending banks should know whether their loans are guaranteed by the U.S. government. However, a loan guarantee by U.S. government sponsored enterprises, including Fannie Mae, Freddie Mac, the Federal Home Loan Banks, and the Farm Credit System, is *not* grounds for excluding the loan from the definition of higher-risk assets.

Higher-Risk Securitizations

1. How should a bank report higher-risk securitizations issued before April 1, 2013 on their Call Reports beginning June 30, 2013?

   Response: For all securitizations issued before April 1, 2013, banks must either (1) use the definition provided in the February 2011 rule, (2) continue to use the transition guidance in the September 2012 Call Report instructions, or (3) apply the definitions in the final rule to all of its securitizations. If a bank applies the definition of higher-risk C&I loans and securities in the October 2012 final rule to its securitizations, it must also apply the definition of a higher-risk C&I borrower in the final rule to all C&I borrowers without regard to when the loans to those borrowers were originally made or refinanced (*i.e.*, whether made or refinanced before or after April 1, 2013).

2. After April 1, 2013, how should a bank reflect securitizations of nontraditional mortgage (NTM) loans that it was reporting as higher-risk before April 1, 2013?

   Response: Banks should continue to use the transition guidance to report such securitizations as higher-risk after April 1, 2013. The definition of NTM loans has not changed.

3. Are only securitizations purchased after April 1, 2013 required to be evaluated and reported as higher-risk?

   Response: No. For securitizations issued before April 1, 2013, banks must either (1) use the definition provided in the February 2011 rule, (2) continue to use the transition guidance in the September 2012 Call Report instructions, or (3) apply the definitions in the October 2012 final rule to all of its securitizations. If a bank applies the definition of higher-risk C&I loans and securities in the October 2012 final rule to its securitizations, it must also apply the definition of a higher-risk C&I borrower in the final rule to all C&I borrowers without regard to when the loans to those borrowers were originally made or refinanced (i.e., whether made or refinanced before or after April 1, 2013).

   Beginning April 1, 2013, the final rule definitions apply to securitizations issued on or after April 1, 2013.

4. For a securitization issued on or after April 1, 2013, when should a loan under $5 million be considered in determining whether more than 50 percent of the loans backing the securitization meet the definition of a higher-risk C&I loan (which would make the securitization higher risk?

   Response: If the loan is owed by a higher-risk C&I borrower at the time the loan is sold into the securitization trust, the loan is a higher-risk C&I loan, regardless of its original amount, when it was originated or refinanced or the amount outstanding at the time of its sale into the securitization trust. Loans owed by a higher-risk C&I borrower may have paid down to below $5 million at the time they are sold into the securitization trust, but they are still considered higher-risk loans and such loans should be included in determining whether or not more than 50 percent of the loans backing the securitization are higher-risk.

In addition, if the loan is originated before April 1, 2013, and is a higher-risk asset under the transition guidance in the September 2012 Call Report instructions, the loan is also a higher-risk C&I loan.

5. If a C&I loan in a securitization is higher risk, how would the owner of the securitization know if the C&I loan is refinanced and no longer considered higher risk?

   Response: The asset manager of the securitization should have the information on individual loans in the securitization.

6. For purposes of determining whether or not a securitization is a higher-risk securitization, a bank must look to the underlying loans of a securitization to determine if more than 50 percent of the loans backing the securitization meet the definition of a higher-risk C&I loan. How should banks interpret the portion of the definition of a higher-risk C&I borrower that states "a higher-risk C&I borrower is a borrower that owes the reporting bank on a C&I loan"?

   Response: A bank that owns a securitization or that owns a portion of a securitization has an indirect interest in the underlying loans backing the securitization. For purposes of determining whether the loans meet the definition of a higher-risk C&I loan and whether the borrower on a loan is a higher-risk C&I borrower, the underlying loans backing the securitization are deemed to be owed to the reporting bank, i.e., a bank with such an indirect interest. (Otherwise, no C&I securitization would ever be higher-risk.)

7. For purposes of determining whether more than 50 percent of the loans backing the securitization meet the definition of a higher-risk C&I loan, does a bank consider the dollar volume of loans outstanding or the number of loans outstanding?

   Response: If more than 50 percent of the dollar volume of loans outstanding that back the securitization are higher-risk, then the securitization is considered a higher-risk securitization.

Nontraditional Mortgage Loans

1. Is a balloon payment considered to be a deferment such that the loan would be considered a nontraditional mortgage loan?

   Response: No. A balloon payment is not considered a deferment of repayment of principal or interest. Therefore, loans that contain balloon payments are not necessarily considered nontraditional mortgage (NTM) loans for pricing purposes due solely to the fact that they allow for a balloon payment. However, if the loan met the other characteristics of a NTM loan as detailed in the final rule, then the loan would be considered a NTM loan.