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## FEDERAL DEPOSIT INSURANCE CORPORATION

### 12 CFR Part 327

RIN 3064-AE16

#### Assessments

**AGENCY:** Federal Deposit Insurance Corporation (FDIC).

**ACTION:** Final rule.

**SUMMARY:** The FDIC is amending its regulations to revise the ratios and ratio thresholds for capital evaluations used in its risk-based deposit insurance assessment system to conform to the prompt corrective action capital (PCA) ratios and ratio thresholds adopted by the FDIC, the Board of Governors of the Federal Reserve System (Federal Reserve) and the Office of the Comptroller of the Currency (OCC) (collectively, the Federal banking agencies); revise the assessment base calculation for custodial banks to conform to the asset risk weights adopted by the Federal banking agencies; and require all highly complex institutions to measure counterparty exposure for deposit insurance assessment purposes using the Basel III standardized approach credit equivalent amount for derivatives (with modifications for certain cash collateral) and the Basel III standardized approach exposure amount for securities financing transactions—such as repo-style transactions, margin loans and similar transactions—as adopted by the Federal banking agencies.

**DATES:** *Effective date:* January 1, 2015, except for the amendment to § 327.9 (amendatory instruction 5), which is effective January 1, 2018.

*Applicability date:* The incorporation of the supplementary leverage ratio and

corresponding ratio thresholds into the definition of capital evaluations is applicable January 1, 2018.

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#### SUPPLEMENTARY INFORMATION:

##### I. Notice of Proposed Rulemaking and Comments

On July 15, 2014, the FDIC's Board of Directors authorized publication of a notice of proposed rulemaking (NPR) proposing to: (1) Revise the ratios and ratio thresholds for capital evaluations used in its risk-based deposit insurance assessment system to conform to the PCA capital ratios and ratio thresholds adopted by the Federal banking agencies; (2) revise the assessment base calculation for custodial banks to conform to the asset risk weights adopted by the Federal banking agencies; and (3) require all highly complex institutions to measure counterparty exposure for deposit insurance assessment purposes using the Basel III standardized approach credit equivalent amount for derivatives and the Basel III standardized approach exposure amount for securities financing transactions, such as repo-style transactions, margin loans and similar transactions, as adopted by the Federal banking agencies. These changes were proposed in part to accommodate recent changes to the Federal banking agencies' capital rules that are referenced in portions of the FDIC's assessments regulation.

The NPR was published in the **Federal Register** on July 23, 2014.<sup>1</sup> The FDIC sought comment on every aspect of the proposed rule and on alternatives. The FDIC received a total of 4 comment letters. The FDIC also met with one commenter to improve understanding of

the issues raised in the commenter's written comment letter. A summary of the meeting is posted on the FDIC's Web site. Comments are discussed in the relevant sections that follow.

## II. Ratios and Ratio Thresholds Relating to Capital Evaluations

### A. Background

The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA)<sup>2</sup> required that the FDIC establish a risk-based deposit insurance assessment system. To implement this requirement, the FDIC adopted by regulation a system that placed all insured depository institutions (IDIs or banks) into nine risk classifications based on two criteria: Capital evaluations and supervisory ratings.<sup>3</sup> Each bank was assigned one of three capital evaluations based on data reported in its Consolidated Report of Condition and Income (Call Report): Well capitalized, adequately capitalized, or undercapitalized. The capital ratios and ratio thresholds used to determine each capital evaluation were based on the capital ratios and ratio thresholds adopted for PCA purposes by the FDIC, the OCC, the Federal Reserve, and the Office of Thrift Supervision (OTS)—the Federal banking agencies at that time.<sup>4</sup> In 1993, the ratios and ratio thresholds used to determine each capital evaluation for assessment purposes were as shown in Table 1.

<sup>2</sup> 12 U.S.C. 1817(b), Pub. L. 102–242, 105 Stat. 2236 (1991).

<sup>3</sup> The FDIC first published a transitional rule that provided the industry guidance during the period of transition from a uniform rate to a risk-based assessment system. 57 FR 45263 (Oct. 1, 1992). The FDIC established the new risk-based assessment system, which became effective on January 1, 1994, to replace the transitional rule. 58 FR 34357 (June 25, 1993); 12 CFR 327.3 (1993).

<sup>4</sup> This final rule, issued by the FDIC, OCC, Federal Reserve, and OTS, in part, established capital ratios and ratio thresholds for the five capital categories for purposes of the PCA rules: Well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. 57 FR 44866 (Sept. 29, 1992). The risk-based assessment system does not use the two lowest capital categories (significantly undercapitalized and critically undercapitalized) under the PCA rules. For assessment purposes, banks that would be in one of these capital categories are treated as undercapitalized.

<sup>1</sup> 79 FR 42698 (July 23, 2014).

TABLE 1—CAPITAL RATIOS USED TO DETERMINE CAPITAL EVALUATIONS FOR ASSESSMENT PURPOSES

Capital evaluations	Total risk-based ratio (%)	Tier 1 risk-based ratio (%)	Tier 1 leverage ratio (%)
Well Capitalized .....	≥10	≥6	≥5
Adequately Capitalized * .....	≥8	≥4	≥4
Undercapitalized .....	Does not qualify as either Well Capitalized or Adequately Capitalized		

\*An institution is Adequately Capitalized if it is not Well Capitalized, but satisfies each of the listed capital ratio standards for Adequately Capitalized.

In 2007, the nine risk classifications were consolidated into four risk categories, which continued to be based on capital evaluations and supervisory ratings;<sup>5</sup> the capital ratios and the thresholds used to determine capital evaluations remained unchanged.<sup>6</sup>

In 2011, the FDIC adopted a revised assessment system for large banks—generally, those with at least \$10 billion in total assets (Assessments final rule).<sup>7</sup> This system eliminated risk categories for these banks, but PCA capital evaluations continue to be used to determine whether an assessment rate is subject to adjustment for significant amounts of brokered deposits.<sup>8</sup>

The assessment system for small banks, generally those with less than \$10 billion in total assets, continues to use risk categories based on capital evaluations and supervisory ratings; the capital ratios and the thresholds used to determine capital evaluations have remained unchanged.

On September 7, 2013, the FDIC adopted an interim final rule<sup>9</sup> and on April 14, 2014, published a final rule that, in part, revises the definition of regulatory capital.<sup>10</sup> The OCC and the Federal Reserve adopted a final rule in

October 2013 that is substantially identical to the FDIC’s interim final rule and final rule.<sup>11</sup> (The FDIC’s interim final rule and final rule and the OCC and Federal Reserve’s final rule are referred to collectively hereafter as the Basel III capital rules.) The Basel III capital rules revise the thresholds for the tier 1 risk-based capital ratio used to determine a bank’s capital category under the PCA rules (that is, whether the bank is well capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, or critically undercapitalized). The Basel III capital rules also add a new ratio, the common equity tier 1 capital ratio, and new thresholds for that ratio to determine a bank’s capital category under the PCA rules.<sup>12</sup> The new ratio and ratio thresholds will take effect on January 1, 2015.

The Basel III capital rules also adopt changes to the regulatory capital requirements for banking organizations consistent with section 171 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), often referred to as the “Collins Amendment.”<sup>13</sup> Under section 171 of the Dodd-Frank Act, the generally applicable risk-based capital requirements serve as a risk-based capital floor for banking organizations subject to the advanced approaches risk-based capital rules<sup>14</sup> (advanced approaches banks<sup>15</sup>). Under the Basel III

capital rules effective January 1, 2015, the minimum capital requirements as determined by the regulatory capital ratios based on the standardized approach<sup>16</sup> become the “generally applicable” capital requirements under section 171 of the Dodd-Frank Act.

All banks, including advanced approaches banks, must calculate risk-weighted assets under the standardized approach and report these risk-weighted assets, for capital purposes, in Schedule RC–R of the Call Report effective January 1, 2015. Advanced approaches banks also must calculate risk weights using the advanced approaches and report risk-weighted assets in the Risk-Based Capital Reporting for Institutions Subject to the Advanced Capital Adequacy Framework (FFIEC 101). Revisions to the advanced approaches risk-weight calculations became effective January 1, 2014. An advanced approaches bank that has successfully completed the parallel run process<sup>17</sup> must determine whether it meets its minimum risk-based capital requirements by calculating the three risk-based capital ratios using total risk-weighted assets under the general risk-based capital rules and, separately, total risk-weighted assets under the advanced

institution under 12 CFR 324.100(b)(1). In general, an IDI is an advanced approaches bank if it has total consolidated assets of \$250 billion or more, has total consolidated on-balance sheet foreign exposures of \$10 billion or more, or elects to use or is a subsidiary of an IDI, bank holding company, or savings and loan holding company that uses the advanced approaches to calculate risk-weighted assets.

<sup>16</sup>The FDIC’s standardized approach risk-based capital rule is at 12 CFR part 324, subpart D. The standardized-approach risk-based capital rule is supplemented by the FDIC’s market risk rule in 12 CFR part 324, subpart F.

<sup>17</sup>Before determining its risk-weighted assets under advanced approaches, a bank must conduct a satisfactory parallel run. A satisfactory parallel run is a period of no less than four consecutive calendar quarters during which the bank complies with the qualification requirements to the satisfaction of its primary Federal regulator. Following completion of a satisfactory parallel run, a bank must receive approval from its primary Federal regulator to calculate risk-based capital requirements under the advanced approaches. See 12 CFR 324.121 (FDIC); 12 CFR 3.121 (OCC); and 12 CFR 217.121 (Federal Reserve).

<sup>5</sup> The four risk categories are I, II, III, and IV. Banks posing the least risk are assigned to risk category I. 71 FR 69282 (Nov. 30, 2006).

<sup>6</sup> To the extent that the definitions of components of the ratios—such as tier 1 capital, total capital, and risk-weighted assets—have changed over time for PCA purposes, the assessment system has reflected these changes.

<sup>7</sup> 76 FR 10672 (Feb. 25, 2011). The FDIC amended Part 327 in a subsequent final rule by revising some of the definitions used to determine assessment rates for large and highly complex IDIs. 77 FR 66000 (Oct. 31, 2012). The term “Assessments final rule” includes the October 2012 final rule.

<sup>8</sup> In 2009, the FDIC added adjustments to its risk-based pricing methods to improve the way the assessment system differentiates risk among insured institutions. The brokered deposit adjustment (one of the adjustments added in 2009) is applicable only to small institutions in risk categories II, III, and IV, and large institutions that are either less than well capitalized or have a composite CAMELS rating of 3, 4 or 5 (under the Uniform Financial Institution Rating System). The adjustment increases assessment rates for significant amounts of brokered deposits. 74 FR 9525 (Mar. 4, 2009).

<sup>9</sup> 78 FR 55340 (Sept. 10, 2013).

<sup>10</sup> 79 FR 20754 (Apr. 14, 2014).

<sup>11</sup> 78 FR 62018 (Oct. 11, 2013).

<sup>12</sup> 78 FR at 55592 (FDIC) and 78 FR at 62277 and 62283 (OCC and Federal Reserve), codified, in part, at 12 CFR part 324, subpart H (FDIC); 12 CFR part 6 (OCC); and 12 CFR part 208 (Regulation H), subpart D (Federal Reserve).

<sup>13</sup> Pub. L. 111–203, sec. 171, 124 Stat. 1376, 1435 (2010) (codified at 12 U.S.C. 5371).

<sup>14</sup> The FDIC’s advanced approaches rule is at 12 CFR part 324, subpart E. The advanced approaches rule is also supplemented by the FDIC’s risk-based capital requirements for banks subject to significant exposure to market risk (market risk rule) in 12 CFR part 324, subpart F.

<sup>15</sup> As used herein, an advanced approaches bank means an IDI that is an advanced approaches national bank or Federal savings association under 12 CFR 3.100(b)(1), an advanced approaches Board-regulated institution under 12 CFR 217.100(b)(1), or an advanced approaches FDIC-supervised

approaches.<sup>18</sup> The lower ratio for each risk-based capital requirement is the ratio that will be used to determine an advanced approaches bank's compliance with the minimum capital requirements<sup>19</sup> and, beginning on January 1, 2015, for purposes of determining compliance with the new PCA requirements.<sup>20</sup>

For advanced approaches banks, the Basel III capital rules also introduce the supplementary leverage ratio and a threshold for that ratio that advanced approaches banks must meet to be deemed adequately capitalized.<sup>21</sup> (The supplementary leverage ratio as adopted in the Basel III capital rules does not, however, establish a ratio that advanced approaches banks must meet to be deemed well capitalized.) While all advanced approaches banks must calculate and begin reporting the supplementary leverage ratio beginning in the first quarter of 2015, the supplementary leverage ratio does not become effective for PCA purposes until January 1, 2018.<sup>22</sup>

On May 1, 2014, the Federal banking agencies published a final rule (the Enhanced Supplementary Leverage Ratio final rule) that strengthens the supplementary leverage ratio standards for the largest advanced approaches banks.<sup>23</sup> The Enhanced Supplementary Leverage Ratio final rule provides that an IDI that is a subsidiary of a covered bank holding company (BHC) must maintain a supplementary leverage ratio of at least 6 percent to be well capitalized under the Federal banking agencies' PCA framework.<sup>24</sup> On

September 26, 2014, the Federal banking agencies published a second final rule that revises the definition of the denominator of the supplementary leverage ratio (total leverage exposure).<sup>25</sup> Again, all advanced approaches banks must calculate and begin reporting the supplementary leverage ratio beginning in the first quarter of 2015, but the supplementary leverage ratio does not become effective for PCA purposes until January 1, 2018.

#### B. The Final Rule: Capital Evaluations

As proposed, the final rule revises the ratios and ratio thresholds relating to capital evaluations for deposit insurance assessment purposes to conform to the new PCA capital rules. This revision maintains the consistency between capital evaluations for deposit insurance assessment purposes and capital ratios and ratio thresholds for PCA purposes that has existed since the creation of the risk-based assessment system over 20 years ago.

Specifically, the final rule revises the definitions of well capitalized and adequately capitalized for deposit insurance assessment purposes to reflect the threshold changes for the tier 1 risk-based capital ratio, to incorporate the common equity tier 1 capital ratio and its thresholds and, for those banks subject to the supplementary leverage ratio for PCA purposes, to incorporate the supplementary leverage ratio and its thresholds.<sup>26</sup> The definition of undercapitalized remains unchanged. The final rule revises the definitions of well capitalized and adequately capitalized for deposit insurance assessment purposes effective when the

new PCA capital rules become effective. Therefore, some of the revisions for deposit insurance assessment purposes will become effective January 1, 2015 and the remaining revisions will become effective January 1, 2018.

Effective January 1, 2015, for deposit insurance assessment purposes:

1. An institution is well capitalized if it satisfies each of the following capital ratio standards: Total risk-based capital ratio, 10.0 percent or greater; tier 1 risk-based capital ratio, 8.0 percent or greater (as opposed to the current 6.0 percent or greater); leverage ratio, 5.0 percent or greater; and common equity tier 1 capital ratio, 6.5 percent or greater.

2. An institution is adequately capitalized if it is not well capitalized but satisfies each of the following capital ratio standards: Total risk-based capital ratio, 8.0 percent or greater; tier 1 risk-based capital ratio, 6.0 percent or greater (as opposed to the current 4.0 percent or greater); leverage ratio, 4.0 percent or greater; and common equity tier 1 capital ratio, 4.5 percent or greater.

The definition of an undercapitalized institution remains the same: An institution is undercapitalized if it does not qualify as either well capitalized or adequately capitalized.

The final rule makes a technical amendment to Part 327 to replace the terms "Total risk-based ratio," "Tier 1 risk-based ratio," and "Tier 1 leverage ratio," with "total risk-based capital ratio," "tier 1 risk-based capital ratio," and "leverage ratio," respectively, wherever such terms appear.<sup>27</sup>

Table 2 summarizes the ratios and ratio thresholds for determining capital evaluations for deposit insurance assessment purposes, effective January 1, 2015.

<sup>27</sup> The FDIC has identified a slight inconsistency in terminology between the PCA capital rules of parts 324 and 325 and the deposit insurance assessment system of part 327. Currently, the risk-based assessment system under part 327 uses the terms "Total risk-based ratio," "Tier 1 risk-based ratio," and "Tier 1 leverage ratio." The PCA capital rules use the terms "total risk-based capital ratio," "tier 1 risk-based capital ratio," and "leverage ratio" (emphasis added). Despite this minor difference in nomenclature, the underlying calculations for each of these three ratios are the same under parts 324, 325 and 327 of the FDIC regulations.

<sup>18</sup> Currently, the general risk-based capital rules are found at 12 CFR part 325, appendix A (as supplemented by the risk-based capital requirements for banks subject to the market risk rule in appendix C). Effective January 1, 2015, the general risk-based capital rules will be based on the standardized approach for calculating risk-weighted assets under the Basel III capital rules, 12 CFR part 324, subpart D (as supplemented by the risk-based capital requirements for banks subject to the market risk rule in subpart F).

<sup>19</sup> See 12 CFR 324.10(c) (FDIC); 12 CFR 3.10(c) (OCC); and 12 CFR 217.10(c) (Federal Reserve).

<sup>20</sup> See 12 CFR part 324, subpart H.

<sup>21</sup> The supplementary leverage ratio includes many off-balance sheet exposures in its denominator, while the generally applicable leverage ratio does not.

<sup>22</sup> 78 FR at 55592 (FDIC); 78 FR at 62277 (OCC and Federal Reserve).

<sup>23</sup> 79 FR 24528 (May 1, 2014).

<sup>24</sup> 79 FR at 24530. IDI subsidiaries of a "covered BHC" are a subset of IDIs subject to advanced

approaches requirements. A covered BHC is any top-tier U.S. BHC with more than \$700 billion in total consolidated assets or more than \$10 trillion in assets under custody. 79 FR at 24538. The list of "covered BHCs" is consistent with the list of banking organizations that meet the Basel Committee on Banking Supervision (Basel Committee or BCBS) definition of a Global Systemically Important Bank (G-SIB), based on year-end 2011 data, and consistent with the revised list, based on year-end 2012 data. The revised list is available at [http://www.financialstabilityboard.org/publications/r\\_131111.pdf](http://www.financialstabilityboard.org/publications/r_131111.pdf).

<sup>25</sup> 79 FR 57725 (Sept. 26, 2014).

<sup>26</sup> To the extent that the definitions of components of the ratios—such as tier 1 capital, total capital, and risk-weighted assets—change in the future for PCA purposes, the assessment system will automatically incorporate these changes as implemented under the Basel III capital rules.

TABLE 2—CAPITAL RATIOS USED TO DETERMINE CAPITAL EVALUATIONS FOR ASSESSMENT PURPOSES, EFFECTIVE JANUARY 1, 2015

Capital evaluations	Total risk-based capital ratio (%)	Tier 1 risk-based capital ratio (%)	Common equity tier 1 capital ratio (%)	Leverage ratio (%)
Well Capitalized .....	≥10	≥8	≥6.5	≥5
Adequately Capitalized* .....	≥8	≥6	≥4.5	≥4
Undercapitalized .....	Does not qualify as either Well Capitalized or Adequately Capitalized.			

\*An institution is Adequately Capitalized if it is not Well Capitalized, but satisfies each of the listed capital ratio standards for Adequately Capitalized.

Effective January 1, 2018, the final rule adds the supplementary leverage ratio to its capital evaluations for deposit insurance assessment purposes to conform to the PCA capital rules. For assessment purposes, an advanced approaches bank, including an IDI

subsidiary of a covered BHC, must have at least a 3.0 percent supplementary leverage ratio to be adequately capitalized, and an IDI subsidiary of a covered BHC must have at least a 6.0 percent supplementary leverage ratio to be well capitalized.

Table 3 summarizes the ratios and ratio thresholds for determining capital evaluations for deposit insurance assessment purposes, effective January 1, 2018.

TABLE 3—CAPITAL RATIOS USED TO DETERMINE CAPITAL EVALUATIONS FOR ASSESSMENT PURPOSES, EFFECTIVE JANUARY 1, 2018

Capital evaluations	Total risk-based capital ratio (%)	Tier 1 risk-based capital ratio (%)	Common equity tier 1 capital ratio (%)	Leverage ratio (%)	Supplementary leverage ratio (advanced approaches banking organizations) (%)	Supplementary leverage ratio (subsidiary IDIs of covered BHCs) (%)
Well Capitalized .....	≥10	≥8	≥6.5	≥5	Not applicable	≥6
Adequately Capitalized* .....	≥8	≥6	≥4.5	≥4	≥3	≥3
Undercapitalized .....	Does not qualify as either Well Capitalized or Adequately Capitalized.					

\*An institution is Adequately Capitalized if it is not Well Capitalized, but satisfies each of the listed capital ratio standards for Adequately Capitalized.

C. Comments Received

The FDIC sought comments on the proposed ratios and ratio thresholds relating to capital evaluations for deposit insurance assessment purposes. The FDIC received one written comment that supported the proposal to revise the ratios and ratio thresholds for capital evaluations used in the risk-based deposit insurance assessment system to conform to the new PCA capital ratios and ratio thresholds.

In the NPR, the FDIC discussed an alternative that would leave in place the current terminology and capital evaluations for deposit insurance assessment purposes, but the FDIC did not receive any comments on the alternative. In any event, the FDIC believes that the alternative would lead to unnecessary complexity and inconsistency, which could lead to confusion and increase regulatory burden on banks. Therefore, the FDIC will finalize the amendments to Part 327 as proposed.

III. Assessment Base Calculation for Custodial Banks

A. Background

The FDIC charges IDIs an amount for deposit insurance equal to the IDI’s deposit insurance assessment base multiplied by its risk-based assessment rate. The Dodd-Frank Act directed the FDIC to amend its regulatory definition of “assessment base” for purposes of setting assessments for IDIs. Specifically, the Dodd-Frank Act required the FDIC to define the term “assessment base” with respect to a depository institution:

- As an amount equal to—
  - The average consolidated total assets of the insured depository institution during the assessment period; minus
  - The sum of—
    - The average tangible equity of the insured depository institution during the assessment period, and
    - In the case of an insured depository institution that is a custodial bank (as defined by the Corporation, based on

factors including the percentage of total revenues generated by custodial businesses and the level of assets under custody) . . . , an amount that the Corporation determines is necessary to establish assessments consistent with the definition under section 7(b)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1817(b)(1)) for a custodial bank . . . .<sup>28</sup>

In February 2011, the FDIC implemented this requirement in the Assessments final rule.<sup>29</sup> The Assessments final rule defines a custodial bank and specifies the additional amount to be deducted from a custodial bank’s average consolidated total assets for purposes of determining its assessment base. The assessment base deduction for custodial banks is defined as the daily or weekly average (depending upon the way the bank reports its average consolidated total assets) of a specified amount of certain

<sup>28</sup> Pub. L. 111–203, sec. 331(b), 124 Stat. 1538 (codified as amended at 12 U.S.C. 1817(nt)).  
<sup>29</sup> 76 FR at 10706.

low-risk, liquid assets, subject to the limitation that the daily or weekly average value of such assets not exceed the average value of deposits that are classified as transaction accounts and are identified by the bank as being directly linked to a fiduciary or custodial and safekeeping account.

Under the Assessments final rule, a custodial bank may deduct all asset types described in the instructions to lines 34, 35, 36, and 37 of Schedule RC of the Call Report as of December 31, 2010 with a risk weight of 0 percent, regardless of maturity, and 50 percent of those asset types described in the instructions to those same lines with a risk weight of 20 percent, again regardless of maturity.<sup>30</sup> These assets include cash and balances due from depository institutions, securities, federal funds sold, and securities purchased under agreements to resell.

Under the Basel III capital rules, the standardized approach introduces 2 percent and 4 percent risk weights for cleared transactions with Qualified Central Counterparties (QCCPs), as defined in the Basel III capital rules, subject to certain collateral requirements.<sup>31</sup> The lower risk weights reflect the Federal banking agencies' support for "incentives designed to encourage clearing of derivative and repo-style transactions through a CCP [central counterparty] wherever possible in order to promote transparency, multilateral netting, and robust risk-management practices."<sup>32</sup> Nonetheless, the new 2 percent and 4 percent risk weights (being greater than 0) recognize that, while clearing transactions through a CCP significantly reduces counterparty credit risk, the clearing process does not eliminate risk altogether and that some degree of residual risk is retained.

Section 939A of the Dodd-Frank Act requires the removal of any regulatory reference to or requirement of reliance on credit ratings for assessing the credit-worthiness of a security or money market instrument and the substitution of new standards of credit-worthiness.<sup>33</sup> Consequently, the Basel III capital rules remove references to credit ratings for purposes of determining risk weights for risk-based capital calculations, and the

standardized approach introduces a formula-based methodology for calculating risk-weighted assets for many securitization exposures.<sup>34</sup> Risk weights under the standardized approach for certain other assets, including but not limited to exposures to foreign sovereigns, foreign banks, and foreign public sector entities, have also changed.<sup>35</sup>

#### *B. The Final Rule: Assessment Base Calculation*

As proposed in the NPR, the final rule conforms the assessment base deduction for custodial banks to the new standardized approach for risk-weighted assets adopted in the Basel III capital rules. For purposes of the assessment base deduction for custodial banks, the final rule continues to use the generally applicable risk weights (as revised under the standardized approach, effective January 1, 2015), even for advanced approaches banks.

The assessment base deduction for custodial banks will continue to be defined as the daily or weekly average of a certain amount of specified low-risk, liquid assets, subject to the limitation that the daily or weekly average value of these assets cannot exceed the daily or weekly average value of deposits that are classified as transaction accounts and are identified by the bank as being directly linked to a fiduciary or custodial and safekeeping account asset. Subject to this limitation, effective January 1, 2015, the assessment base deduction will be the daily or weekly average of:

1. 100 percent of those asset types described in the instructions to lines 1, 2, and 3 of Schedule RC of the Call Report with a standardized approach risk weight of 0 percent, regardless of maturity; plus

2. 50 percent of those asset types described in the instructions to lines 1, 2, and 3 of Schedule RC of the Call Report, including assets that qualify as securitization exposures, with a standardized approach risk weight greater than 0 and up to and including 20 percent, regardless of maturity.

In general, the assets described in lines 1, 2, and 3 of Schedule RC of the Call Report include cash and balances due from depository institutions, securities (both held-to-maturity and available-for-sale), federal funds sold, and securities purchased under agreements to resell. The inclusion of these asset types in the assessment base

deduction for custodial banks is consistent with the asset types included in the current adjustment.

In response to comments, the final rule differs from the NPR in that it includes in the assessment base deduction for custodial banks those asset types described in lines 1, 2, and 3 of Schedule RC of the Call Report that qualify as securitization exposures (as defined in the Basel III capital rules) and have a standardized risk weight of 20 percent.<sup>36</sup> Under current assessment rules, securitizations with a risk weight of 20 percent are included in the assessment base deduction for custodial banks. After further consideration, the FDIC has concluded that assets of this type appear to be sufficiently low risk (as reflected in the 20 percent risk weight) and sufficiently liquid to allow them to continue to be included in the assessment base deduction. This difference from the NPR conforms the final rule more closely with the current assessment rule.

As proposed, 50 percent of assets described in line 3 of Schedule RC of the Call Report that are assigned a 2 or 4 percent risk weight may be included in the assessment base deduction for custodial banks. In the NPR, the FDIC discussed, as an alternative, including 100 percent of these asset types in the adjustment. The FDIC, however, believes that these assets are not risk-free and thus do not merit a 100 percent inclusion in the assessment base deduction for custodial banks.

Last, the final rule makes a technical amendment to the definition of "custodial bank" by removing any reference to the Call Report date of December 31, 2010, to ensure conformity with the Basel III capital rules.

#### *C. Comments Received*

The FDIC received two written comments on the NPR's proposal regarding the assessment base deduction

<sup>36</sup> Under the Basel III capital rules, a securitization exposure generally includes a credit exposure with more than one underlying exposure where the credit risk associated with the underlying exposures has been separated into at least two tranches reflecting different levels of seniority. Specifically, a securitization exposure is defined as an on- or off-balance sheet credit exposure (including credit-enhancing representations and warranties) that arises from a traditional securitization or a synthetic securitization (including a re-securitization), or an exposure that directly or indirectly references a securitization exposure. See 78 FR at 55482 (FDIC); 78 FR at 62168 (OCC and Federal Reserve). Under the Basel III capital rules' standardized approach, securitized assets of the type described in lines 1, 2, and 3 of Schedule RC of the Call Report cannot have a risk-weight lower than 20 percent. 78 FR at 55515 (FDIC); 78 FR at 62196 (OCC and Federal Reserve).

<sup>30</sup> Risk-weighted assets are generally determined by assigning assets to broad risk-weight categories. The amount of an asset is multiplied by its risk weight (for example, 0 percent or 20 percent) to calculate the risk-weighted asset amount.

<sup>31</sup> See 78 FR at 55502 (FDIC); 78 FR at 62184–85 (OCC and Federal Reserve).

<sup>32</sup> See 78 FR at 55414 (FDIC); 78 FR at 62096 (OCC and Federal Reserve).

<sup>33</sup> See Pub. L. 111–203, sec. 939A, 124 Stat 1887 (codified as amended at 15 U.S.C. 78o–7(nt)).

<sup>34</sup> 78 FR at 55430 (FDIC); 78 FR at 62111 (OCC and Federal Reserve).

<sup>35</sup> See, e.g., 78 FR at 55400–04 (FDIC); 78 FR at 62083–87 (OCC and Federal Reserve).

for custodial banks.<sup>37</sup> Both commenters suggested that the FDIC continue to include low-risk securitization exposures in the assessment base deduction.<sup>38</sup> As discussed above, the FDIC agrees and the change is reflected in the final rule.

In addressing the alternative discussed in the NPR of including 100 percent of cleared transactions with QCCPs in the adjustment, two commenters suggested a different weighting method under which the FDIC would allow custodial banks to deduct 100 percent of a “qualifying asset”<sup>39</sup> minus 2½ times the asset’s Basel III standardized approach risk weight. Under this approach, for example, a custodial bank could deduct 95 percent of a 2 percent risk-weighted qualifying asset from its assessment base and 25 percent of a 30 percent risk-weighted qualifying asset. Commenters argued that this approach would take into account the increased granularity of risk weights under the Basel III standardized approach, where, for example, a securitization could receive a risk weight of 20.5 percent.

In the FDIC’s view, however, this proposal ignores the greater risk reflected in higher risk-weighted assets because it would allow the deduction of assets with risk weights of up to 40 percent. The FDIC has never allowed a deduction from custodial banks’ assessment bases for assets with risk weights greater than 20 percent because the deduction is only intended for low-risk assets.

<sup>37</sup> The comments did not address another alternative discussed in the NPR that would maintain the current assessment base deduction. In any event, the alternative would create unnecessary complexity and inconsistency between the asset risk weights used for capital purposes and for deposit insurance assessment purposes, which would lead to confusion and increase burden.

<sup>38</sup> One commenter also suggested an alternative if the FDIC determined that it is appropriate to fully exclude securitization exposures from the assessment base deduction. Under this alternative, the assessment base deduction for assets with a standardized approach risk weight of 20 percent would increase from 50 percent to 85 percent. The commenter reasoned that assets assigned this risk weight and that are not securitization exposures are characterized by strong credit risk profiles and robust structural liquidity that warrant more favorable treatment.

The FDIC disagrees that assets assigned a 20 percent risk weight are sufficiently low risk and liquid to warrant an 85 percent deduction from the assessment base.

<sup>39</sup> Only one of the commenters used the term “qualifying asset,” but the substance of the other commenter’s suggestion was substantially the same.

#### IV. Calculation of Counterparty Exposures in the Highly Complex Institution Scorecard

##### A. Background

Section 7 of the Federal Deposit Insurance Act (FDI Act) requires the FDIC Board of Directors to adopt a risk-based assessment system based on the probability that the DIF will incur a loss with respect to an institution, the likely amount of any loss to the DIF, and the revenue needs of the DIF.<sup>40</sup> Further, under the FDI Act the FDIC may establish a separate risk-based assessment system for large members of the Deposit Insurance Fund (DIF).<sup>41</sup>

In the Assessments final rule, the FDIC adopted a revised assessment system for large banks—generally, those with at least \$10 billion in total assets. This system, which went into effect in the second quarter of 2011, uses scorecards that combine CAMELS ratings and certain financial measures to assess the risk a large institution poses to the DIF. One scorecard applies to most large institutions and another applies to highly complex institutions, those that are structurally and operationally complex or that pose unique challenges and risks to the DIF in the event of failure.<sup>42</sup>

The scorecards for both large and highly complex institutions use quantitative measures that are useful in predicting a large institution’s long-term performance. Most of the measures used in the highly complex institution scorecard are similar to the measures used in the large bank scorecard. The scorecard for highly complex institutions, however, includes additional measures, such as the ratio of top 20 counterparty exposures to Tier 1 capital and reserves and the ratio of the largest counterparty exposure to Tier 1 capital and reserves (collectively, the counterparty exposure measures). Both ratios are defined in the Assessments final rule.<sup>43</sup>

The Assessments final rule defines counterparty exposure as the sum of exposure at default (EAD) associated

<sup>40</sup> 12 U.S.C. 1817(b)(1)(C).

<sup>41</sup> 12 U.S.C. 1817(b)(1)(D).

<sup>42</sup> A “highly complex institution” is defined as: (1) An IDI (excluding a credit card bank) that has had \$50 billion or more in total assets for at least four consecutive quarters that either is controlled by a U.S. parent holding company that has had \$500 billion or more in total assets for four consecutive quarters, or is controlled by one or more intermediate U.S. parent holding companies that are controlled by a U.S. holding company that has had \$500 billion or more in assets for four consecutive quarters; or (2) a processing bank or trust company. 12 CFR 327.8(g).

<sup>43</sup> 76 FR at 10721; 12 CFR part 327, subpart A, App. A.

with derivatives trading<sup>44</sup> and securities financing transactions (SFTs)<sup>45</sup> and the gross lending exposure (including all unfunded commitments) for each counterparty or borrower at the consolidated entity level.<sup>46</sup> Generally, since June 30, 2011, when highly complex institutions began reporting for scorecard purposes, they have determined and reported their counterparty exposures for assessment purposes using certain methods permitted under the Assessments final rule.<sup>47</sup> The Assessments final rule allows use of an approach based on internal models (the Internal Models Method, or IMM) to calculate counterparty exposures subject to approval by an institution’s primary federal regulator, but until recently no highly complex institution was permitted to use the IMM.

The IMM is one component of the advanced approaches risk-based capital framework. Banking organizations that have received approval to use the advanced approaches do not automatically have approval to use the IMM, which requires a separate approval. Seven of the nine highly complex institutions received approval from their primary federal regulators to use the advanced approaches for regulatory capital beginning in the first quarter of 2014. Of these seven banks, some, but not all, received approval from their primary federal regulators to use the IMM for calculating EAD for counterparty credit risk for derivatives beginning in the second quarter of 2014. Thus, some of the nine banks using the highly complex institution scorecard began calculating their counterparty exposure in the second quarter of 2014 using the IMM, while the others still use non-IMM methods.

Based on assessments data, the adoption of the IMM by itself has caused a significant reduction in measured counterparty exposure amounts and changed the scorecard

<sup>44</sup> Derivatives trading exposures include both over-the-counter (OTC) derivatives and derivative contracts that an IDI has entered into with a CCP.

<sup>45</sup> SFTs include repurchase agreements, reverse repurchase agreements, security lending and borrowing, and margin lending transactions, where the value of the transactions depends on market valuations and the transactions are often subject to margin agreements.

<sup>46</sup> 76 FR at 10721. Counterparty exposure excludes all counterparty exposure to the U.S. government and departments or agencies of the U.S. government that is unconditionally guaranteed by the full faith and credit of the United States.

<sup>47</sup> For example, permitted methods for derivatives exposures have included the credit equivalent amount as calculated under the Federal banking agencies’ general risk-based capital rules and the current exposure method (CEM) under the BCBS Basel II framework.

results in a way that significantly reduces deposit insurance assessments for the banks using the IMM. This significant reduction in assessments does not appear to be driven primarily by a change in risk exposure, but rather by a change in measurement methodology. Moreover, since the second quarter of 2014, the nine banks currently subject to the highly complex institution scorecard have been measuring counterparty risk in different ways.

#### B. The Final Rule: Calculation of Counterparty Exposure

Under the final rule, starting in the first quarter of 2015, exposure to a counterparty is equal to the sum of: Gross loans (including all unfunded commitments); the amount of derivatives exposures reduced by the amount of qualifying cash collateral; and the amount of SFT exposure. Derivatives exposures and SFT exposures are described in more detail below.

Specifically, the counterparty exposure amount associated with derivatives, including OTC derivatives, a cleared transaction that is a derivative contract, or a netting set of derivative contracts,<sup>48</sup> is to be calculated as the credit equivalent amount under the standardized approach without deduction for collateral other than qualifying cash collateral. The credit equivalent amount under the standardized approach is the sum of current credit exposure and potential future exposure; that is, the exposure amount set forth in 12 CFR 324.34(a) (but with no reduction for collateral under 12 CFR 324.34(b)).<sup>49</sup>

The NPR proposed allowing no deduction for collateral from a highly complex institution's counterparty exposure amount associated with derivatives. Two trade groups recommended that the FDIC permit recognition of financial collateral to reduce the counterparty exposure amount associated with derivatives, as permitted under the Basel III standardized approach. The final rule addresses the concerns of these commenters to an extent by allowing

qualifying cash collateral (but not other collateral) to reduce a highly complex institution's derivative exposures in the counterparty exposure measures. To qualify, the cash collateral must be all or part of variation margin and satisfy the conditions that would allow the cash collateral to be excluded from the institution's total leverage exposure for purposes of the supplementary leverage ratio.<sup>50</sup> These conditions are designed to ensure that the cash collateral is in effect a pre-settlement payment on the derivatives contracts.

The counterparty exposure amount associated with SFTs, including SFTs that are cleared transactions, is to be calculated using either the simple approach or the collateral haircut approach contained in 12 CFR 324.37(b) and (c), respectively.

For both derivative and SFT exposures, the amount of counterparty exposure to CCPs must also include the default fund contribution, which is the funds contributed or commitments

made by a clearing member to a CCP's mutualized loss sharing arrangement.<sup>51</sup>

Counterparty exposure continues to exclude all counterparty exposure to the U.S. government and departments or agencies of the U.S. government that is unconditionally guaranteed by the full faith and credit of the United States.

#### C. Comments Received

The FDIC sought comments on the proposed calculation of counterparty exposure measures. The FDIC received a total of three written comments, two from trade groups and one from a bank. In general, the two trade groups contended that the change proposed in the NPR to the counterparty exposure measures is inconsistent with the FDIC's statutory mandate<sup>52</sup> because the proposal does not recognize the risk-mitigating benefits of financial collateral and the minimal risk posed by exposure to CCPs.

As discussed above, in establishing a risk-based assessment system the FDIC is statutorily required to consider a number of factors, including the probability that the DIF will incur a loss with respect to an institution. The FDIC also takes into consideration the likely amount of any such loss and the revenue needs of the DIF. In determining the probability that the DIF will incur a loss, the FDIC takes into consideration the risks attributable to different categories and concentrations of assets and liabilities, both insured and uninsured, contingent and noncontingent, and any other factors the FDIC determines are relevant to assessing such probability.<sup>53</sup> In the case of the counterparty exposure measures, such other factors include the need for a common measurement framework for counterparty exposure and the need to ensure that methodological differences do not determine a bank's exposure relative to its peers.

In this context, the FDIC has taken into account the relative risk-mitigating factors associated with certain financial collateral and the use of CCPs. The FDIC has concluded that it is appropriate to allow qualifying cash collateral to reduce a bank's measured derivatives exposure for purposes of the assessments scorecard, but as discussed in more detail below, does not agree with commenters that other forms of collateral warrant the same recognition.

<sup>50</sup> In general, the conditions are that:

(1) For derivative contracts that are not cleared through a QCCP, the cash collateral received by the recipient counterparty is not segregated (by law, regulation or an agreement with the counterparty);

(2) Variation margin is calculated and transferred on a daily basis based on the mark-to-fair value of the derivative contract;

(3) The variation margin transferred under the derivative contract or the governing rules for a cleared transaction is the full amount that is necessary to fully extinguish the net current credit exposure to the counterparty of the derivative contracts, subject to the threshold and minimum transfer amounts applicable to the counterparty under the terms of the derivative contract or the governing rules for a cleared transaction;

(4) The variation margin is in the form of cash in the same currency as the currency of settlement set forth in the derivative contract, provided that for the purposes of this paragraph, currency of settlement means any currency for settlement specified in the governing qualifying master netting agreement and the credit support annex to the qualifying master netting agreement, or in the governing rules for a cleared transaction;

(5) The derivative contract and the variation margin are governed by a qualifying master netting agreement between the legal entities that are the counterparties to the derivative contract or by the governing rules for a cleared transaction, and the qualifying master netting agreement or the governing rules for a cleared transaction must explicitly stipulate that the counterparties agree to settle any payment obligations on a net basis, taking into account any variation margin received or provided under the contract if a credit event involving either counterparty occurs;

(6) The variation margin is used to reduce the current credit exposure of the derivative contract and not the PFE; and

(7) For the purpose of the calculation of the net-to-gross ratio (NGR), variation margin may not reduce the net current credit exposure or the gross current credit exposure.

The requirements are specified at 12 CFR 324.10(c)(4)(ii)(C)(1)–(7) (FDIC); 12 CFR 3.10(c)(4)(ii)(C)(1)–(7) (OCC); and 12 CFR 217.10(c)(4)(ii)(C)(1)–(7) (Federal Reserve).

<sup>48</sup> A "netting set" is a group of transactions with a single counterparty that are subject to a qualifying master netting agreement or a qualifying cross-product master netting agreement. 12 CFR 324.2.

<sup>49</sup> For multiple OTC derivative contracts subject to a qualifying master netting agreement, however, the exposure amount equals the sum of the net current credit exposure and the adjusted sum of potential future exposure amounts for all OTC derivative contracts subject to the qualifying master netting agreement; that is, the exposure amount set forth in 12 CFR 324.34(a)(2) (but with no reduction for collateral under 12 CFR 324.34(b)).

<sup>51</sup> 12 CFR 324.2 (FDIC); 12 CFR 3.2 (OCC); 12 CFR 217.2 (Federal Reserve).

<sup>52</sup> The two trade groups argued that the FDIC's statutory mandate is "that assessments be based on actual risk to the DIF," and that "assessments [be] based on risk."

<sup>53</sup> 12 U.S.C. 1817(b)(1)(C).

## Financial Collateral

As stated above, two trade groups recommended that financial collateral reduce OTC derivative exposures as permitted when calculating risk-weighted assets under the Basel III standardized approach.<sup>54</sup> The final rule adopts another, more limited, approach, allowing—under certain circumstances—cash variation margin to reduce OTC derivative exposures. The regular and timely exchange of cash variation margin helps to protect both counterparties from the effects of a counterparty default. The conditions under which cash collateral may be used to offset the amount of a derivative contract in the supplementary leverage ratio are intended to ensure that such cash collateral “is, in substance, a form of pre-settlement payment on a derivative contract,”<sup>55</sup> such that that portion of the exposure has essentially been paid. The conditions also ensure that the counterparties calculate their exposures arising from derivative contracts on a daily basis and transfer the net amounts owed, as appropriate, in a timely manner. The approach in the final rule is consistent with the design of the supplementary leverage ratio and with U.S. generally accepted accounting principles (GAAP).<sup>56</sup>

In the FDIC’s view, however, it would be inappropriate to reduce OTC derivatives exposures in the counterparty exposure measures for all types of financial collateral and the final rule allows no reduction for collateral other than qualifying cash collateral. As

<sup>54</sup> The NPR discussed allowing the deduction of collateral in this manner as a possible alternative to the proposal in the NPR.

<sup>55</sup> 79 FR 57725, 57730 (Sept. 26, 2014). The supplementary leverage ratio rule “generally does not permit banking organizations to use collateral to reduce exposures for purposes of calculating total leverage exposure,” but does allow reduction under the circumstances permitted under this final rule.

In the NPR, the FDIC also requested comment on an alternative approach that would require highly complex institutions to use total leverage exposure, as defined in the supplementary leverage ratio, when calculating counterparty exposure measures. The FDIC received two brief comments, one in favor of the alternative approach and one opposed to it. While the FDIC may consider using total leverage exposure, as defined in the supplementary leverage ratio, as a general measure of counterparty exposure in the future, the FDIC is not persuaded that this alternative approach should be adopted wholesale now in lieu of the standardized approach.

<sup>56</sup> As the federal banking regulators noted recently in amending the rules governing the supplementary leverage ratio, “For the purpose of determining the carrying value of derivative contracts, U.S. generally accepted accounting principles (GAAP) provide a banking organization the option to reduce any positive mark-to-fair value of a derivative contract by the amount of any cash collateral received from the counterparty, provided the relevant GAAP criteria for offsetting are met (the GAAP offset option).” 79 FR at 57729.

the Basel Committee noted in adopting the Basel III leverage framework, “Collateral received in connection with derivative contracts does not necessarily reduce the leverage inherent in a bank’s derivatives position, which is generally the case if the settlement exposure arising from the underlying derivative contract is not reduced.”<sup>57</sup>

## Qualifying Central Counterparties (QCCPs)

Two trade groups argued that exposures to QCCPs should be excluded from the counterparty exposure measures. They argued that the capital and prudential requirements applicable to QCCPs ensure that they pose no risk to banks and that, because Congress has encouraged the use of QCCPs, exposures to QCCPs will likely increase and come to dominate the 20 largest total exposure amounts to counterparties while actually reducing risk. One trade group argued that exposures to QCCPs should be excluded from the measures until the full effect of the central clearing requirements are known and the strength of QCCPs is more fully understood.

Counterparty exposures to QCCPs, however, are not risk-free. For example, the Basel Committee notes that despite the benefits that CCPs can bring to OTC derivatives markets, they can concentrate counterparty and operational risks, with a potential for systemic risk.<sup>58</sup> As mentioned above, the counterparty exposure measures are concentration measures intended to assess a highly complex institution’s ability to withstand asset-related stress.<sup>59</sup> Also, as one of the comments implies, QCCPs’ performance in times of stress has not been tested. For these reasons, the final rule continues to include exposures to QCCPs in the counterparty exposure measures. To the extent that derivatives exposures to QCCPs are secured by qualifying cash collateral, however, the amount of exposure for purposes of the counterparty exposure measures will be reduced.

## Affiliates

Two trade groups also argued that exposures to affiliates should be excluded from the counterparty exposure measures on the grounds that

<sup>57</sup> Basel Committee on Banking Supervision. (January 2014). “Basel III leverage ratio framework and disclosure requirements”, available online at <http://www.bis.org/publ/bcb270.pdf>.

<sup>58</sup> Basel Committee on Banking Supervision. (November 2011). “Capitalisation of bank exposures to central counterparties”, available online at <http://www.bis.org/publ/bcb206.pdf>.

<sup>59</sup> 76 FR at 10696.

Section 23A of the Federal Reserve Act and the Federal Reserve’s Regulation W effectively limit a bank’s exposure to an affiliate and impose collateral requirements.<sup>60</sup>

The FDIC disagrees. Limiting exposure to an affiliate, as required by Section 23A and Regulation W, does not eliminate risk, particularly during periods of stress. For this reason, the final rule continues to include exposures to affiliates in the counterparty exposure measures. To the extent that derivatives exposures to affiliates are secured by qualifying cash collateral, however, the amount of exposure for purposes of the counterparty exposure measures will be reduced.

## Non-U.S. Sovereigns

Two trade groups also argued that exposures to non-U.S. sovereigns with high credit quality should be excluded from the counterparty exposure measures. They suggested excluding foreign sovereign exposures where the Basel III capital rules assign a zero risk weight based on either the Organization for Economic Cooperation and Development’s (OECD’s) Country Risk Classification (CRC) or the sovereign’s OECD membership status if no CRC exists, or where the foreign sovereign meets the criteria for obligations that qualify as Level 1 high quality liquid assets under the Liquidity Coverage Ratio rule.

The FDIC again disagrees. Exposures to non-U.S. sovereigns pose risk, particularly during periods of stress. Consequently, the final rule treats these exposures as it does other derivatives exposures. Again, to the extent that derivatives exposures to non-U.S. sovereigns are secured by qualifying cash collateral, the amount of exposure for purposes of the counterparty exposure measures will be reduced.

## IMM

In the NPR, the FDIC requested comment on whether highly complex institutions should be allowed to measure counterparty exposure for assessment purposes using the IMM. Two trade groups made arguments in favor of allowing the use of the IMM. The trade groups argued that the IMM is a better measure of counterparty exposure than is the standardized approach and that the shortcomings of the standardized approach “are well known and have been widely recognized,” citing a Basel Committee paper. Because, in their view, the IMM

<sup>60</sup> 12 U.S.C. 371c; 12 CFR 223.11; 223.12; and 223.14.

is a better risk measure than the standardized approach, the commenters argued that the NPR fails to meet the statutory requirement that the FDIC adopt a risk-based assessment system and that, in conflict with the requirements of the Administrative Procedure Act, the FDIC has failed to justify elimination of the IMM.

The FDIC has considered the issues the commenters raised and does not agree with the commenters. Specifically, the FDIC does not agree that, for assessment purposes, the IMM measures counterparty exposure better than the standardized approach does. In arguing that the IMM is a better measure of counterparty exposure than is the standardized approach, commenters ignore the Basel Committee's observation (noted in the NPR) that the use of internal models has resulted in a material amount of variability between banks, a significant amount of which may be driven by banks' individual modeling choices rather than by distinctions in portfolio risk or risk management practices.<sup>61</sup> Under the IMM, banks may use different assumptions and measurement approaches, resulting in inconsistency. This variability was one of the chief reasons that the NPR rejected the use of the IMM in measuring counterparty exposure for assessment purposes. Partly for this reason, it would be impractical for the FDIC to calibrate and adjust counterparty measures in a way that produces accurate and equitable assessments outcomes.<sup>62</sup>

The commenters also ignore the FDIC's statutory authority to take consistency of risk measurement into account in the risk-based assessment system. As stated above, the FDIC Board of Directors must consider certain enumerated factors when setting a risk-based assessment system, including the probability that the DIF will incur a loss with respect to an institution. In determining the probability that the DIF

<sup>61</sup> 79 FR 42698, 42705 (July 23, 2014). See Basel Committee on Banking Supervision. (January 2013). "Regulatory consistency assessment programme (RCAP)—Analysis of risk-weighted assets for market risk", available online at <http://www.bis.org/publ/bcbs240.htm>; Basel Committee on Banking Supervision. (July 2013). "Regulatory consistency assessment programme (RCAP)—Analysis of risk-weighted assets for credit risk in the banking book," available online at <http://www.bis.org/publ/bcbs256.htm>; and Basel Committee on Banking Supervision. (July 2013). "The regulatory framework: balancing risk sensitivity, simplicity and comparability—discussion paper," available online at <http://www.bis.org/publ/bcbs258.htm>.

<sup>62</sup> In the NPR, the FDIC also discussed but argued against an alternative in which it would recalibrate the conversion of counterparty exposure measures into scores using exposures calculated using the IMM approach.

will incur a loss with respect to an institution, the FDIC may take into account "any other factors the Corporation determines are relevant to assessing such probability."<sup>63</sup> In proposing to use the standardized approach to measure counterparty exposure, the FDIC has taken into account "other factors;" namely, the need for a common measurement framework for counterparty exposure and the need to ensure that methodological differences do not determine a bank's exposure relative to its peers. Consistency in the manner in which highly complex IDIs calculate counterparty exposure is an appropriate and necessary factor in establishing a risk-based assessment system.

More broadly, existing law and regulation do not generally allow the unconstrained use of banks' internal models for regulatory capital purposes, instead providing for the use of a standardized capital floor. Current law recognizes the standardized approach as a valid measure of risk for risk-based capital purposes. Thus, the approach taken in the final rule is consistent in spirit with this aspect of the capital rules.

Two trade groups also argued that adopting the standardized approach for measuring counterparty exposure is premature and that the FDIC should not eliminate the IMM until Federal banking agencies determine whether to adopt the Basel Committee's standardized approach for measuring exposure at default for counterparty credit risk (SA-CCR) for risk-based capital purposes. As the commenters acknowledged, no decision has been made regarding when or how (or whether) the SA-CCR will be adopted in the U.S. for capital purposes. If the Federal banking agencies adopt the SA-CCR for risk-based capital purposes, the FDIC will consider whether changes to the counterparty exposure measures are appropriate. The trade groups' argument, however, amounts to indefinitely allowing the use of vastly different measurement methodologies for calculating counterparty exposure for assessment purposes, with the concomitant inequities in assessment rates, which the FDIC finds unreasonable.

#### Converting Counterparty Exposure Measures to Scores

In the Assessments final rule, the FDIC reserved the right to update the minimum and maximum cutoff values used in each scorecard annually without further rulemaking as long as the

method of selecting cut-off values remained unchanged. Under this reservation, the FDIC can add new data for later years to its analysis and can, from time to time, exclude some earlier years from its analysis.<sup>64</sup>

In the NPR, the FDIC proposed to continue to reserve the right to revise the conversion of the counterparty exposures measures to scores (that is, recalibrate the conversion by updating the minimum and maximum cutoff values) after reviewing data reported for some or all of 2015 without further notice-and-comment rulemaking. Two trade groups objected to this proposal, arguing that the specific recalibration of the counterparty exposure measures proposed in the NPR should be accomplished through notice-and-comment rulemaking. After further consideration, the FDIC has decided that, for the conversion of the counterparty exposure measures to scores only, any revisions will be done through notice-and-comment rulemaking.<sup>65</sup>

#### Cost-Benefit Analysis

One trade group argued that the NPR should not be finalized until the FDIC has conducted a cost-benefit analysis subject to public comment, and that the FDIC would not be able to conduct such a cost-benefit analysis without additional data that will only become available after the first quarter of 2015. For this reason, the commenter suggested foregoing any immediate changes to the counterparty exposure measures until additional data becomes available and can be evaluated.

In developing and reviewing regulations, the FDIC is committed to continually improving the quality of its regulations and policies, minimizing regulatory burdens on the public and the banking industry, and generally to ensuring that its regulations and policies achieve legislative goals effectively and efficiently. The FDIC evaluates benefits and costs of regulations based on available information and the consideration of reasonable and possible alternatives. As part of the notice-and-comment process, the FDIC actively seeks comment on

<sup>64</sup> 76 FR at 10700; see also 77 FR at 66016. 12 CFR part 327, subpart A, App. A.

<sup>65</sup> As currently provided in the FDIC's assessments rules and regulations, the FDIC continues to reserve the general right to update the minimum and maximum cutoff values for all measures in the scorecards without additional notice-and-comment rulemaking. See 12 CFR part 327, subpart A, App. A.

<sup>63</sup> 12 U.S.C. 1817(b)(1)(C)(i)(III).

cost, benefits, and burdens, and carefully considers these comments.<sup>66</sup>

The FDIC has, in fact, evaluated the costs and benefits of requiring that highly complex institutions measure counterparty exposure using the standardized approach in the Basel III capital rules rather than the IMM. For those few banks that are already (or would be) using the IMM to measure counterparty exposure, the final rule is likely to increase these banks' assessment rates compared to rates calculated using the IMM, all else equal. As one trade group noted in its comment letter, albeit in another context, "The credit equivalent amount in the U.S. Basel I-based capital rules, the credit equivalent amount under the Standardized Approach, and the Basel Committee's Basel II current exposure method are all broadly similar." Consequently, in the NPR, the FDIC was able to rely on its data on assessment rates before adoption of the IMM.

Moreover, the FDIC is required by statute to ensure that the DIF reserve ratio reaches at least 1.35 percent of estimated insured deposits by September 30, 2020.<sup>67</sup> The FDIC has already adopted a schedule of lower overall assessment rates that will go into effect automatically when the DIF reserve ratio reaches 1.15 percent.<sup>68</sup> While a few banks will have increased assessment rates under the final rule, these higher rates will reduce the risk that an assessment rate increase for all banks will be needed for the DIF reserve ratio to reach 1.35 percent by the statutory deadline; it will also increase the possibility that the reserve ratio will reach 1.15 percent sooner than otherwise, at which time overall assessment rates will fall.

The FDIC has also tailored its approach to minimize additional reporting burden. Under the final rule, highly complex institutions will calculate their counterparty exposure for deposit insurance assessment purposes using the standardized approach under the Basel III capital rules (modified for cash collateral for derivatives exposures). These banks must determine counterparty exposure using the generally applicable risk-based capital requirements, that is, the standardized approach under the Basel

III capital rules, as required by the Collins Amendment. They must also calculate qualifying cash collateral for derivatives exposures for purposes of the supplementary leverage ratio. Thus, the final rule imposes little, if any, additional reporting burden.

Rather than indefinitely allowing the use of methodologies that would result in inequitable assessments, the final rule takes into account potential burdens, benefits, alternative approaches, and cumulative costs of regulations to make assessments appropriately reflect relative risk.

## V. Effective Date

### A. Ratios and Thresholds Relating to Capital Evaluations

Two effective dates apply to the ratios and ratio thresholds relating to the capital evaluations used in its deposit insurance system: January 1, 2015, for all ratios and ratio thresholds except the supplementary leverage ratio, and January 1, 2018, for the supplementary leverage ratio and ratio threshold. These are the effective dates of the changes to the PCA capital rules.

### B. Assessment Base Calculation for Custodial Banks

The effective date for the assessment base calculation for custodial banks is January 1, 2015.

### C. Calculation of Counterparty Exposures in the Highly Complex Institution Scorecard

The effective date for the calculation of counterparty exposures in the highly complex institution scorecard is January 1, 2015.

## VI. Regulatory Analysis and Procedure

### A. Solicitation of Comments on Use of Plain Language

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

### B. Regulatory Flexibility Act

The FDIC has carefully considered the potential impacts on all banking organizations, including community banking organizations, and has sought to minimize the potential burden of these changes where consistent with applicable law and the agencies' goals.

The Regulatory Flexibility Act (RFA) requires that each Federal agency either

certify that the final rule will not have a significant economic impact on a substantial number of small entities.<sup>69</sup> Certain types of rules, such as rules of particular applicability relating to rates or corporate or financial structures, or practices relating to such rates or structures, are expressly excluded from the definition of "rule" for purposes of the RFA.<sup>70</sup> Nonetheless, the FDIC is voluntarily undertaking a regulatory flexibility analysis.

As of December 31, 2013, of the 6,812 IDIs, there were 5,655 small IDIs as that term is defined for the purposes of the RFA (*i.e.*, institutions with \$550 million or less in total assets). Under the revisions to the ratios and ratio thresholds for capital evaluations in the final rule, five small IDIs (0.09 percent of small IDIs) would have had higher deposit insurance assessments as of the end of December 2013 (assuming that they had not increased their capital in response to the new PCA capital rules). None would have had lower assessments. In the aggregate, these five small IDIs would have been assessed approximately \$1 million more in annual assessments under the final rule. In aggregate, the final rule would have increased small IDIs' assessments by 0.01 percent of all small IDIs' income before taxes.

Four additional IDIs that meet the RFA definition of a small IDI were identified as subsidiaries of custodial banks subject to assessments adjustments. The FDIC estimates that under the final rule, the assessments for these additional small IDIs would not be affected.

The final rule regarding the calculation of counterparty exposures in the highly complex institution scorecard does not affect any small IDIs.

Thus, the final rule does not have a significant economic impact on a substantial number of small entities.

### C. Paperwork Reduction Act

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

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

The FDIC has determined that the final rule does not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, enacted as part of the Omnibus

<sup>66</sup> See FDIC Statement of Policy on the Development and Review of Regulations and Policies, 78 FR 22771, 22772 (Apr. 17, 2013).

<sup>67</sup> See Pub. L. 111–203, sec. 334(d), 124 Stat. 1539 (codified as amended at 12 U.S.C. 1817(nt)). The FDIC is also required to charge banks with \$10 billion or more in assets for the cost of increasing the reserve ratio from 1.15 percent to 1.35 percent. *Id.* at sec. 334(e).

<sup>68</sup> See 12 CFR 327.10.

<sup>69</sup> See 5 U.S.C. 603 and 605.

<sup>70</sup> See 5 U.S.C. 601(2).

Consolidated and Emergency Supplemental Appropriations Act of 1999 (Public Law 105–277, 112 Stat. 2681).

**List of Subjects in 12 CFR Part 327**

Bank deposit insurance, Banks, Savings associations.

For the reasons set forth above, the FDIC amends part 327 as follows:

**PART 327—ASSESSMENTS**

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

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

**Subpart A—[Amended]**

- 2. In subpart A, remove the term “Tier 1 leverage ratio” and add in its place “Leverage ratio” wherever it appears.
- 3. In § 327.5, revise paragraphs (c)(1) and (2) to read as follows:

**§ 327.5 Assessment base.**

\* \* \* \* \*

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

(2) *Assessment base calculation for custodial banks.* A custodial bank shall pay deposit insurance assessments on its assessment base as calculated in paragraph (a) of this section, but the FDIC will exclude from that assessment base the daily or weekly average (depending on how the bank reports its average consolidated total assets) of all asset types described in the instructions to lines 1, 2, and 3 of Schedule RC of the Consolidated Report of Condition and Income with a standardized

approach risk weight of 0 percent, regardless of maturity, plus 50 percent of those asset types described in the instructions to lines 1, 2, and 3 of Schedule RC of the Consolidated Report of Condition and Income, with a standardized approach risk-weight greater than 0 and up to and including 20 percent, regardless of maturity, subject to the limitation that the daily or weekly average (depending on how the bank reports its average consolidated total assets) value of all assets that serve as the basis for a deduction under this section cannot exceed the daily or weekly average value of those deposits that are classified as transaction accounts in the instructions to Schedule RC–E of the Consolidated Report of Condition and Income and that are identified by the institution as being directly linked to a fiduciary or custodial and safekeeping account asset.

\* \* \* \* \*

■ 4. In § 327.9, revise paragraphs (a)(2)(i) and (ii) to read as follows:

**§ 327.9 Assessment pricing methods.**

(a) \* \* \*

(2) \* \* \*

(i) *Well Capitalized.* A Well Capitalized institution is one that satisfies each of the following capital ratio standards: Total risk-based capital ratio, 10.0 percent or greater; tier 1 risk-based capital ratio, 8.0 percent or greater; leverage ratio, 5.0 percent or greater; and common equity tier 1 capital ratio, 6.5 percent or greater.

(ii) *Adequately Capitalized.* An Adequately Capitalized institution is one that does not satisfy the standards of Well Capitalized in paragraph (a)(2)(i) of this section but satisfies each of the following capital ratio standards: Total risk-based capital ratio, 8.0 percent or greater; tier 1 risk-based capital ratio, 6.0 percent or greater; leverage ratio, 4.0 percent or greater; and common equity tier 1 capital ratio, 4.5 percent or greater.

\* \* \* \* \*

■ 5. In § 327.9, effective January 1, 2018, revise paragraphs (a)(2)(i) and (ii) to read as follows:

**§ 327.9 Assessment pricing methods.**

(a) \* \* \*

(2) \* \* \*

(i) *Well Capitalized.* A Well Capitalized institution is one that satisfies each of the following capital ratio standards: Total risk-based capital ratio, 10.0 percent or greater; tier 1 risk-based capital ratio, 8.0 percent or greater; leverage ratio, 5.0 percent or greater; common equity tier 1 capital ratio, 6.5 percent or greater; and, if the institution is an insured depository institution subject to the enhanced supplementary leverage ratio standards under 12 CFR 6.4(c)(1)(iv)(B), 12 CFR 208.43(c)(2)(iv)(B), or 12 CFR 324.403(b)(1)(v), as each may be amended from time to time, a supplementary leverage ratio of 6.0 percent or greater.

(ii) *Adequately Capitalized.* An Adequately Capitalized institution is one that does not satisfy the standards of Well Capitalized in paragraph (a)(2)(i) of this section but satisfies each of the following capital ratio standards: Total risk-based capital ratio, 8.0 percent or greater; tier 1 risk-based capital ratio, 6.0 percent or greater; leverage ratio, 4.0 percent or greater; common equity tier 1 capital ratio, 4.5 percent or greater; and, if the institution is subject to the advanced approaches risk-based capital rules under 12 CFR 6.4(c)(2)(iv)(B), 12 CFR 208.43(c)(2)(iv)(B), or 12 CFR 324.403(b)(2)(vi), as each may be amended from time to time, a supplementary leverage ratio of 3.0 percent or greater.

\* \* \* \* \*

■ 6. In Appendix A to Subpart A, in the table under the section heading, “VI. Description of Scorecard Measures,” revise the descriptions of “(2) Top 20 Counterparty Exposure/Tier 1 Capital and Reserves” and “(3) Largest Counterparty Exposure/Tier 1 Capital and Reserves” under the subheading “Concentration Measure for Highly Complex Institutions” to read as follows:

**Appendix A to Subpart A of Part 327—Method To Derive Pricing Multipliers and Uniform Amount**

\* \* \* \* \*

VI—DESCRIPTION OF SCORECARD MEASURES

Scorecard measures <sup>1</sup>	Description
* * * * *	
(2) Top 20 Counterparty Exposure/ Tier 1 Capital and Reserves.	Sum of the 20 largest total exposure amounts to counterparties divided by Tier 1 capital and reserves. The total exposure amount is equal to the sum of the institution's exposure amounts to one counterparty (or borrower) for derivatives, securities financing transactions (SFTs), and cleared transactions, and its gross lending exposure (including all unfunded commitments) to that counterparty (or borrower). A counterparty includes an entity's own affiliates. Exposures to entities that are affiliates of each other are treated as exposures to one counterparty (or borrower). Counterparty exposure excludes all counterparty exposure to the U.S. government and departments or agencies of the U.S. government that is unconditionally guaranteed by the full faith and credit of the United States. The exposure amount for derivatives, including OTC derivatives, cleared transactions that are derivative contracts, and netting sets of derivative contracts, must be calculated using the methodology set forth in 12 CFR 324.34(a), but without any reduction for collateral other than cash collateral that is all or part of variation margin and that satisfies the requirements of 12 CFR 324.10(c)(4)(ii)(C)(1)–(7). The exposure amount associated with SFTs, including cleared transactions that are SFTs, must be calculated using the standardized approach set forth in 12 CFR 324.37(b) or (c). For both derivatives and SFT exposures, the exposure amount to central counterparties must also include the default fund contribution. <sup>2</sup>
(3) Largest Counterparty Exposure/ Tier 1 Capital and Reserves.	The largest total exposure amount to one counterparty divided by Tier 1 capital and reserves. The total exposure amount is equal to the sum of the institution's exposure amounts to one counterparty (or borrower) for derivatives, SFTs, and cleared transactions, and its gross lending exposure (including all unfunded commitments) to that counterparty (or borrower). A counterparty includes an entity's own affiliates. Exposures to entities that are affiliates of each other are treated as exposures to one counterparty (or borrower). Counterparty exposure excludes all counterparty exposure to the U.S. government and departments or agencies of the U.S. government that is unconditionally guaranteed by the full faith and credit of the United States. The exposure amount for derivatives, including OTC derivatives, cleared transactions that are derivative contracts, and netting sets of derivative contracts, must be calculated using the methodology set forth in 12 CFR 324.34(a), but without any reduction for collateral other than cash collateral that is all or part of variation margin and that satisfies the requirements of 12 CFR 324.10(c)(4)(ii)(C)(1)–(7). The exposure amount associated with SFTs, including cleared transactions that are SFTs, must be calculated using the standardized approach set forth in 12 CFR 324.37(b) or (c). For both derivatives and SFT exposures, the exposure amount to central counterparties must also include the default fund contribution. <sup>2</sup>
* * * * *	

<sup>1</sup> The FDIC retains the flexibility, as part of the risk-based assessment system, without the necessity of additional notice-and-comment rule-making, to update the minimum and maximum cutoff values for all measures used in the scorecard (except for the Top 20 counterparty exposure to Tier 1 capital and reserves ratio and the largest counterparty exposure to Tier 1 capital and reserves ratio). The FDIC will update the minimum and maximum cutoff values for the higher-risk assets to Tier 1 capital and reserves ratio in order to maintain an approximately similar distribution of higher-risk assets to Tier 1 capital and reserves ratio scores as reported prior to April 1, 2013, or to avoid changing the overall amount of assessment revenue collected. 76 FR 10672, 10700 (February 25, 2011). The FDIC will review changes in the distribution of the higher-risk assets to Tier 1 capital and reserves ratio scores and the resulting effect on total assessments and risk differentiation between banks when determining changes to the cutoffs. The FDIC may update the cutoff values for the higher-risk assets to Tier 1 capital and reserves ratio more frequently than annually. The FDIC will provide banks with a minimum one quarter advance notice of changes in the cutoff values for the higher-risk assets to Tier 1 capital and reserves ratio with their quarterly deposit insurance invoice.

<sup>2</sup> SFTs include repurchase agreements, reverse repurchase agreements, security lending and borrowing, and margin lending transactions, where the value of the transactions depends on market valuations and the transactions are often subject to margin agreements. The default fund contribution is the funds contributed or commitments made by a clearing member to a central counterparty's mutualized loss sharing arrangement. The other terms used in this description are as defined in 12 CFR part 324, subparts A and D, unless defined otherwise in 12 CFR part 327.

\* \* \* \* \*

By order of the Board of Directors.  
 Dated at Washington, DC, this 18th day of  
 November, 2014.  
 Federal Deposit Insurance Corporation.  
**Robert E. Feldman,**  
*Executive Secretary.*  
 [FR Doc. 2014-27941 Filed 11-25-14; 8:45 am]  
**BILLING CODE 6714-01-P**

**DEPARTMENT OF TRANSPORTATION**  
**Federal Aviation Administration**  
**14 CFR Part 39**  
**[Docket No. FAA-2014-0191; Directorate**  
**Identifier 2013-NM-256-AD; Amendment**  
**39-18030; AD 2014-23-14]**  
**RIN 2120-AA64**  
**Airworthiness Directives; Bombardier,**  
**Inc. Airplanes**  
**AGENCY:** Federal Aviation  
 Administration (FAA), Department of  
 Transportation (DOT).  
**ACTION:** Final rule.

**SUMMARY:** We are adopting a new  
 airworthiness directive (AD) for certain  
 Bombardier, Inc. Model DHC-8-400  
 series airplanes. This AD was prompted  
 by reports of swing arm assemblies of  
 engine fuel feed ejector pumps  
 detaching from the outlet port of the  
 engine fuel feed ejector pump and  
 partially blocking the engine fuel feed  
 line. This AD requires installing a  
 restrictor into the engine fuel feed line.  
 We are issuing this AD to prevent  
 blocked engine fuel flow and possible  
 engine flameout.  
**DATES:** This AD becomes effective  
 December 31, 2014.  
 The Director of the Federal Register  
 approved the incorporation by reference