

[XXXX-XX-X]

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 327

RIN 3064 -

Assessment Dividends

AGENCY: Federal Deposit Insurance Corporation (FDIC).

ACTION: Advance notice of proposed rulemaking (ANPR).

SUMMARY: The FDIC is seeking comments on alternative methods for allocating dividends as part of a permanent final rule to implement the dividend requirements of the Federal Deposit Insurance Reform Act of 2005 (Reform Act) and the Federal Deposit Insurance Reform Conforming Amendments Act of 2005 (Amendments Act). The existing FDIC regulations on assessments dividends will expire on December 31, 2008.

DATE: Comments must be submitted on or before **[insert date 60 days after the FR publication date]**.

ADDRESSES: You may submit comments by any of the following methods:

- Agency Web Site: <http://www.fdic.gov/regulations/laws/federal>. Follow instructions for submitting comments on the Agency Web Site.
- E-mail: Comments@FDIC.gov. Include “ANPR on Assessment Dividends” in the subject line of the message.
- Mail: Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.
- Hand Delivery/Courier: Guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7 a.m. and 5 p.m. (EST).

- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.

Public Inspection: All comments received will be posted without change to <http://www.fdic.gov/regulations/laws/federal> including any personal information provided. Comments may be inspected and photocopied in the FDIC Public Information Center, 3501 North Fairfax Drive, Room E-1002, Arlington, VA 22226, between 9 a.m. and 5 p.m. (EST) on business days. Paper copies of public comments may be ordered from the Public Information Center by telephone at (877) 275-3342 or (703) 562-2200.

FOR FURTHER INFORMATION CONTACT: Munsell W. St. Clair, Senior Policy Analyst, Division of Insurance and Research, (202) 898-8967 or mstclair@fdic.gov; Missy Craig, Senior Program Analyst, Division of Insurance and Research, (202) 898-8724 or mcraig@fdic.gov; or Joseph A. DiNuzzo, Counsel, Legal Division, (202) 898-7349 or jdinuzzo@fdic.gov.

SUPPLEMENTARY INFORMATION:

I. Background

In October 2006, the FDIC issued a temporary final rule to implement the dividend requirements of the Reform Act.¹ At the time, the FDIC stated its intention to initiate a second, more comprehensive notice-and-comment rulemaking on dividends beginning with an advance notice of proposed rulemaking to explore alternative methods for distributing future dividends after the temporary dividend rules expire on December 31, 2008.

¹ 71 FR 61385 (October 18, 2006).

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

Reform Act requirements

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

1. The DIF faces a significant risk of losses over the next year; and
2. It is likely that such losses will be sufficiently high as to justify a finding by the Board that the reserve ratio should temporarily be allowed to grow without requiring dividends when the reserve ratio is between 1.35 and 1.5 percent or exceeds 1.5 percent.⁴

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

³ 12 U.S.C. § 1817(e)(2).

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

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

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

1. The ratio of the assessment base of an insured depository institution (including any predecessor) on December 31, 1996, to the assessment base of all eligible insured depository institutions on that date (the 1996 assessment base ratio);
2. The total amount of assessments paid on or after January 1, 1997, by an insured depository institution (including any predecessor) to the DIF (and any predecessor fund);
3. That portion of assessments paid by an insured depository institution (including any predecessor) that reflects higher levels of risk assumed by the institution; and
4. Such other factors as the Board deems appropriate.

The statute does not define the term “predecessor” (of a depository institution) for purposes of distributing dividends. Predecessor deposit insurance funds are the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF), as those were

the deposit insurance funds that existed after 1996 until their merger into the DIF pursuant to the Reform Act. The merger was effective March 31, 2006.

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

The temporary final rule

The temporary final rule mirrors the dividend provisions of the Reform Act, provides definitions (including the definition of a “predecessor” depository institution) to implement the statute and details how an institution may request the FDIC’s Division of Finance (DOF) to review the FDIC’s determination of the institution’s dividend amount and how an institution may appeal DOF’s response to that request. In the temporary final rule, the FDIC adopted a simple system for allocating any dividends that might be declared during the two-year duration of the regulation. Any dividends awarded before January 1, 2009, will be distributed in proportion to an institution's 1996 assessment base ratio, as determined pursuant to the one-time assessment credit rule.⁷

The sole focus of this ANPR is on the type of assessment dividend allocation method that the FDIC should adopt. Whether and how the FDIC should retain or revise

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

⁶ 71 FR 28804 (May 18, 2006).

⁷ 12 CFR 327.53

the other aspects of the temporary final rule (such as the timetable for determining and paying dividends and institutions' requests for review) will be addressed in the notice of proposed rulemaking that will follow the ANPR.

II. Alternative Methods

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

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

“Older” and “newer” institutions

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

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

Relative dividend shares

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

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

Some of the most important potential differences between the dividend allocation methods are how quickly and under what circumstances the relative dividend share of a newer institution would equal the relative dividend share of an older institution. Equal shares imply that what an institution paid prior to 1997 (using the 1996 assessment base as a proxy) no longer affects its dividend share. Under most variations of the dividend allocation methods, the relative dividend shares of older and newer institutions may never be exactly equal, but they may become approximately equal; that is, over time, for both older and newer institutions, shares of any potential dividend may approximately equal shares of the current aggregate assessment base. For purposes of the analysis in this

ANPR, relative dividends shares will be deemed to be approximately equal (or be said to have *converged*) when the average relative dividend share of the group of institutions that have the highest relative dividend shares as of January 1, 2007, are no more than 15 percent greater (or less) than the average relative dividend shares of newer institutions that initially have no dividend shares.⁹ Under both allocation methods, the average relative dividend share of the group of institutions that would have the highest relative dividend shares as of January 1, 2007, would be 2.2; that is, in this group, on average, an institution's share of any potential dividend would be 2.2 times its share of the current assessment base.

The fund balance method

Description

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

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

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

- A variant on this method would divide only a portion of the December 31, 2006 fund balance among institutions. The remainder of the fund balance would be unallocated.
- Thereafter, from quarter to quarter, fund allocations would grow or shrink depending upon the performance of the fund.
 - Fund losses, FDIC operating expenses and dividends from the fund would diminish an institution's fund allocation, all else equal.
 - Fund gains (for example, from investment income or "ineligible" premium income, which is discussed immediately below) would increase an institution's fund allocation, all else equal.
- In addition, each "eligible" premium would increase an institution's fund allocation, dollar for dollar. An "eligible" premium (which would need to be defined) would be the portion of an institution's premium that would count toward increasing its share of dividends.
 - Possible definitions for an eligible premium include: (1) all premiums charged; (2) premiums charged up to the lowest rate charged a Risk Category I institution; or (3) something in between, for example, premiums charged up to the maximum rate for a Risk Category I institution, in all cases *minus* any credit use.¹⁰ Ineligible premiums would be those paid through the use of credits or those paid in cash at rates in excess of the eligible premium rate.
 - Eligible premiums would include surcharges in a restoration plan.¹¹

¹⁰ However, an eligible premium would never be negative.

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

Risk reduction incentives

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

The treatment of older versus newer institutions

Fund performance and assessment rates. Under the basic form of the fund balance method, in which the entire fund would be allocated among institutions, *low to moderate* fund losses would lead to older institutions retaining a relatively large share of

any dividends for decades, while newer institutions would take decades to obtain a relatively similar share of dividends. In other words, the assessments paid by an institution prior to 1997 (using the 1996 assessment base as a proxy) would affect an institution's potential dividend for a very long time. On the other hand, *large* fund losses would quickly diminish the relative shares of older institutions compared to newer institutions.¹²

Chart 1 illustrates the relative dividend shares of two groups of institutions—those that initially have no dividend shares (the newest group) and those with the highest relative dividend shares (the oldest group)—under a low loss scenario; Chart 2 illustrates the relative dividend shares of these two groups under a high loss scenario similar to the banking crisis of the late 1980s and early 1990s for the third through tenth years, preceded and followed by low losses in earlier and subsequent years. Assuming high fund losses similar to the banking crisis of the late 1980s and early 1990s, the relative dividend share of the newest group could take only 9 years to become approximately equal to that of the oldest group (*i.e.*, the relative dividend shares of each group would be nearly equal to one).

¹² The results in the text, charts and tables that follow: (1) assume that the entire fund balance is allocated among institutions; (2) assume that an eligible premium is a premium paid at the minimum rate applicable to a Risk Category I institution; and (3) are based upon a model that divides all institutions into 1 of 10 unequally sized groups, based on the size of their relative dividend shares as of January 1, 2007. The model assumes that all institutions grow at the same rate. It makes many other assumptions, as well, including levels of assessment rates, investment income, and corporate expenses. These assumptions are set out in more detail in Appendix B.

Chart 1

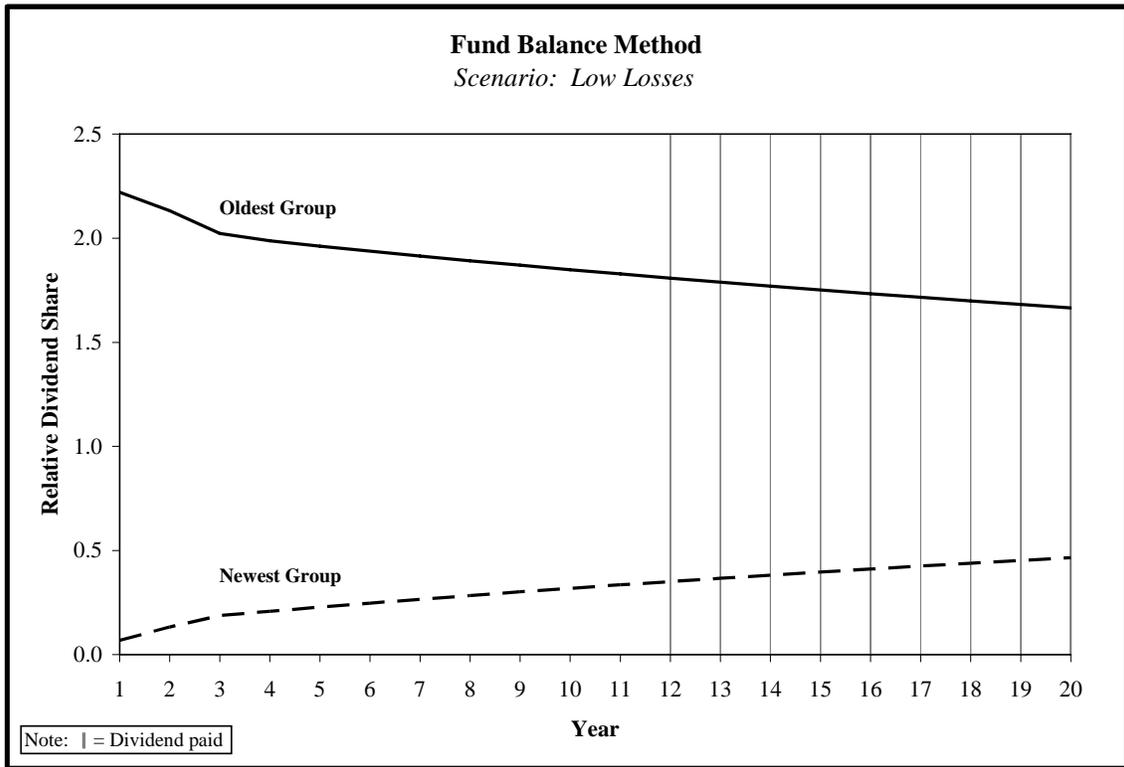
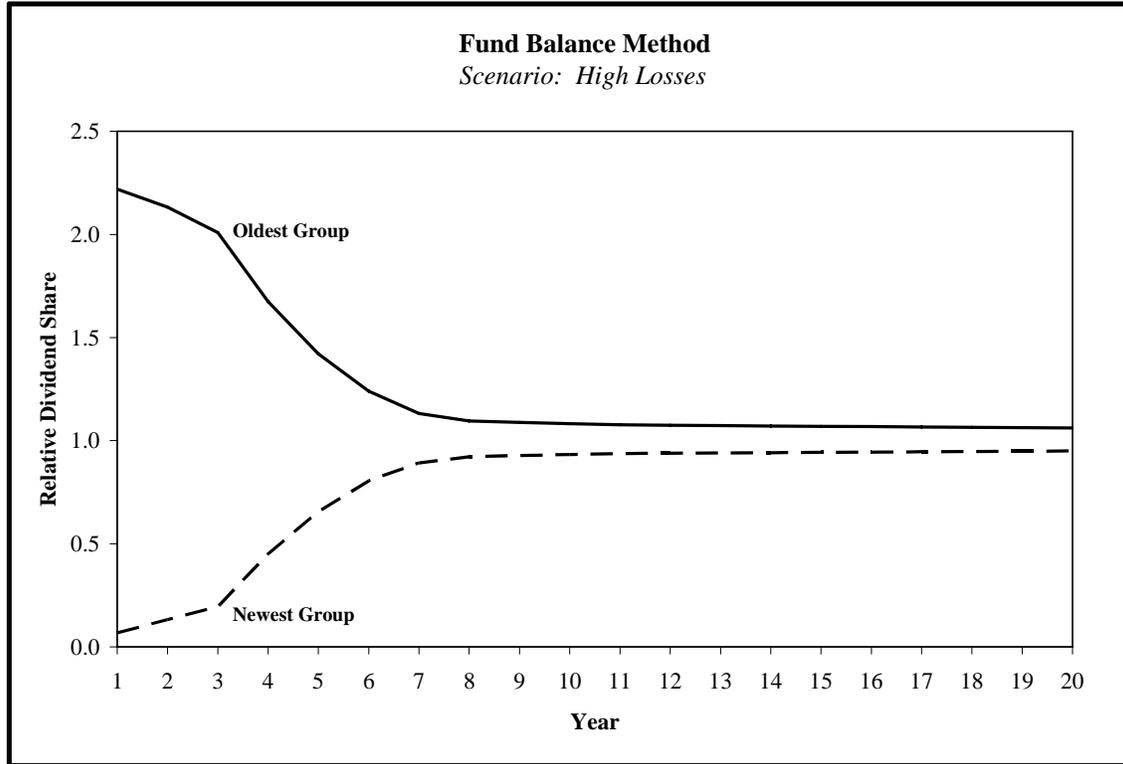


Chart 2



Using the low loss scenario used in Chart 1, Table 1 compares projected dividend share and dividends received for three institutions, each with \$500 million in deposits on December 31, 2006; one initially has no dividend share (or credits) because it is new; one initially has the median relative dividend share of those institutions that have any initial dividend share (or credits); and one initially has a very large relative dividend share because it is in the oldest group shown in the charts above. Table 2 makes the comparison under the high loss scenario used in Chart 2. The institutions are assumed to pay the lowest rate applicable in any period. Like Charts 1 and 2, the dividend share amounts in Tables 1 and 2 illustrate that older institutions will benefit for many years from this method absent a repeat of the banking crisis era.

The low loss scenario in Chart 1 and Table 1 (and in subsequent charts in tables) assumes annual insurance losses that are significantly lower than the average annual

losses for the past 10 years and that the Board would not lower rates below the base assessment rate schedule (2 to 4 basis points for institutions in Risk Category I). In fact, if the Board did lower assessment rates sufficiently below the base rate schedule, the dividends shown in Chart 1 would not occur.

Table 1
Illustration of Fund Balance Method
For Three Institutions Each with \$500 Million in Deposits
Low Loss Scenario

	Year																				
	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
<i>Institution from oldest group</i>																					
Dividend Share (bp)	1.66	1.64	1.58	1.49	1.47	1.45	1.43	1.41	1.40	1.38	1.36	1.35	1.33	1.32	1.31	1.29	1.28	1.27	1.25	1.24	1.23
Dividend Received (\$000)		0	0	0	0	0	0	0	0	0	0	0	35	62	77	87	94	100	104	109	114
<i>Median older institution*</i>																					
Dividend Share (bp)	0.86	0.86	0.84	0.84	0.84	0.83	0.83	0.83	0.83	0.83	0.82	0.82	0.82	0.82	0.82	0.81	0.81	0.81	0.81	0.81	0.81
Dividend Received (\$000)		0	0	0	0	0	0	0	0	0	0	0	21	38	48	55	60	64	67	71	74
<i>Institution from newest group</i>																					
Dividend Share (bp)	0.00	0.05	0.10	0.14	0.15	0.17	0.18	0.20	0.21	0.22	0.24	0.25	0.26	0.27	0.28	0.29	0.30	0.31	0.32	0.33	0.34
Dividend Received (\$000)		0	0	0	0	0	0	0	0	0	0	0	7	13	17	20	22	25	27	29	32

* In this table and all following tables, the median older institution is the institution that has the median initial relative dividend share among institutions that have initial shares greater than zero.

Table 2
Illustration of Fund Balance Method
For Three Institutions Each with \$500 Million in Deposits
High Loss Scenario

	Year																				
	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
<i>Institution from oldest group</i>																					
Dividend Share (bp)	1.66	1.64	1.58	1.47	1.24	1.05	0.92	0.84	0.81	0.81	0.80	0.80	0.80	0.79	0.79	0.79	0.79	0.79	0.79	0.79	0.79
Dividend Received (\$000)		0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
<i>Median older institution</i>																					
Dividend Share (bp)	0.86	0.86	0.84	0.84	0.81	0.78	0.76	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Dividend Received (\$000)		0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
<i>Institution from newest group</i>																					
Dividend Share (bp)	0.00	0.05	0.10	0.14	0.33	0.49	0.60	0.66	0.68	0.69	0.69	0.69	0.69	0.70	0.70	0.70	0.70	0.70	0.70	0.70	0.70
Dividend Received (\$000)		0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0

All else equal, higher assessment rates (whether to cover rapid insured deposit growth or from other causes) would shorten the time to convergence of relative dividend shares of older and newer institutions. However, the effect of higher rates would likely be less marked than the effect of high fund losses similar to those during the banking crisis of the late 1980s and early 1990s.

Institutions chartered in the future. Absent significant insurance fund losses, the fund balance will tend to increase over time. Under the fund balance method, all else equal, the larger the fund grows, the longer it would take an institution chartered in the future to obtain a share of potential dividends that was roughly equal to its share of the assessment base; that is, for its relative dividend share to approximately equal that of older institutions. Thus, an institution chartered 30 years from now could take many decades to obtain a share of potential dividends that was roughly equal to its share of the assessment base.

Simplicity

The fund balance method relies on more data than the payments method described below and is more complex, which may reduce transparency. Both methods of fund allocation discussed in this ANPR are operationally feasible, however.

Remaining decision-making requirements

Both methods require the FDIC to define eligible premiums. Once the definition of an eligible premium is chosen, however, the fund balance method allocates dividends among older and newer institutions automatically, without the need for explicit FDIC decision making about the relative importance to assign the 1996 assessment base

compared to post-1996 eligible premiums.¹³ Only if the FDIC adopted the variant of this method in which something less than the December 31, 2006 fund balance was allocated among older institutions would it make explicit decisions about how to allocate dividends between older and newer institutions.

The payments method

Description

In its basic form, under most probable scenarios, the fund balance method would most likely benefit older institutions. The payments method, on the other hand, offers considerably more options for allocating dividends between older and newer institutions. The payments method could be constructed so as to benefit older institutions for many years, or it could be constructed to accelerate convergence between older and newer institutions.

Under the payments method, unlike the fund balance method, neither fund performance nor dividends paid would affect dividend shares directly. Rather than hinging on its assigned portion of the fund balance, an institution's share of any dividend would depend upon its (and its predecessors') 1996 assessment base (or, equivalently, its 1996 ratio), weighted in some manner, and its quarterly assessments under the new assessment system. Specifically:

- Initially, each institution's dividend share would depend upon its 1996 assessment base compared to all other institutions. For example, initially, each institution's dividend share could equal:

¹³ The FDIC's definition of an "eligible" premium would have some effect on the way the fund balance method allocates dividends between newer and older institutions, considered as a group. The lower the eligible premium rate, the longer older institutions, as a group, would retain a relatively larger share of dividends, all else equal.

1. Its 1996 ratio times the fund balance on December 31, 2006;
2. Its 1996 ratio times the fund balance at some other time; or
3. Its 1996 ratio times insurance fund assessment income over some period of time leading up to December 31, 1996,

in each case as a percentage of the total for all institutions.

- The resulting value assigned to each institution based on its 1996 ratio could either remain unchanged or be assigned a declining weight over time.
- The possible definitions of an eligible (and an ineligible) premium are the same as those under the fund balance method. However, under certain variations of this method discussed below, assessments offset through credit use could increase an institution's dividend share.
- Cumulative eligible premiums paid into the fund since 1996 would add to an institution's share.
- Alternatively, the FDIC could count only eligible premiums paid over some recent period, for example, the most recent 3, 5, 10 or 15 years. In contrast, the fund balance method would necessarily take into account all assessment payments made under the new assessment system.
- Another variation would allow the FDIC to subtract dividends paid to an institution from its eligible premiums.

The Board would explicitly determine the relative importance to assign to each institution's 1996 assessment base and to its eligible premiums paid under the new system. The rate at which the relative importance of eligible premiums paid under the new system increased (and the relative importance of the 1996 assessment base

decreased) could be slow or fast. Alternatively, the FDIC could, at the outset of the system, reserve the right to change the balance in the future.¹⁴

Risk reduction incentives

As under the fund balance method, the degree to which dividend allocation would reinforce the risk incentives of the risk-based premium system would depend upon the FDIC's definition of an eligible premium.

The treatment of older versus newer institutions

Relative weight of the 1996 assessment base. The relative weight to be accorded the 1996 assessment base could have a great influence on how quickly the relative dividend shares of newer and older institutions would converge.

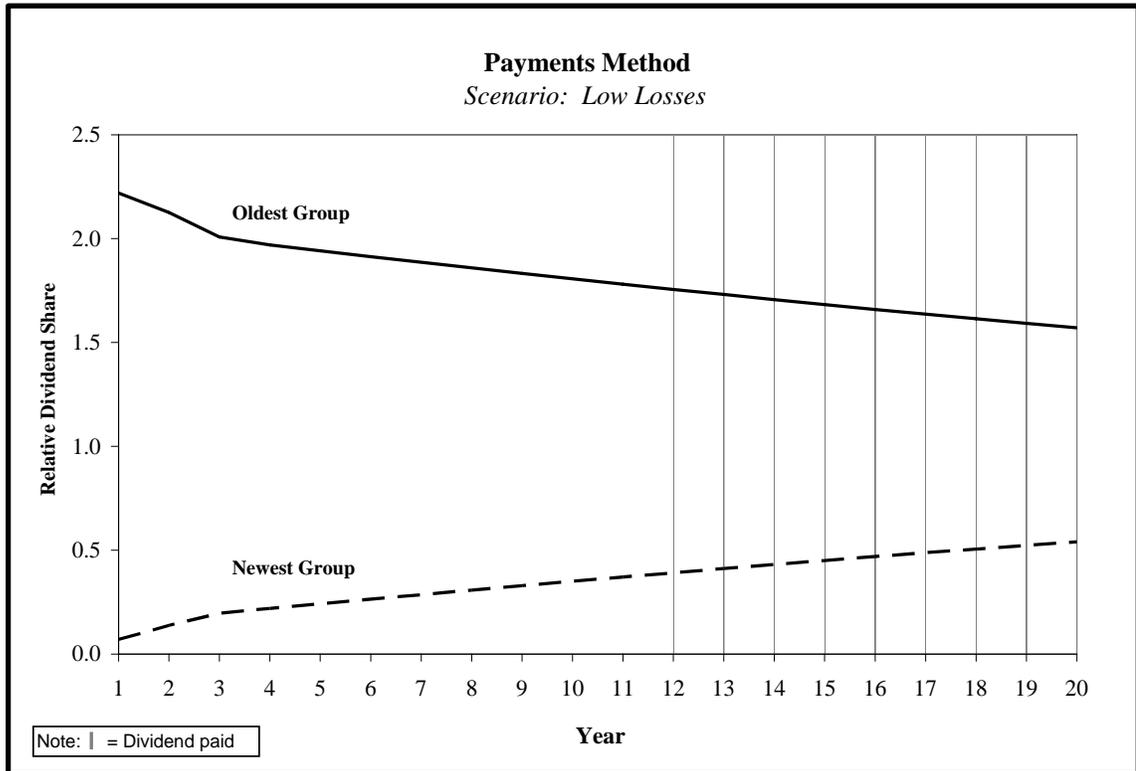
How the payments method would affect the dividend shares of older and newer institutions would depend on the weight that the Board assigned the 1996 assessment base (initially and over time) compared to the weight it assigned eligible premiums paid each year after 1996. Two illustrative variations of the payments method are described below.

Variation 1. The Board could, as under the fund balance method, initially divide the 2006 fund balance based on each institution's share of the December 1996 assessment base. Eligible premiums after 1996 would be added to that amount. As illustrated in Chart 3 and Table 3, this method of implementation would result in older institutions

¹⁴ A simplified version of the payments method would substitute assessment bases as proxies for eligible premiums. Each institution's share of any dividend would depend on its portion of the 1996 assessment base, weighted in some fashion, and its cumulative quarterly assessment bases under the new system. In this version, an institution would automatically have an added incentive to be charged the lowest possible rate, since, given identical assessment bases, an institution paying the lowest assessment rate would increase its dividend share at the same rate as an institution paying the highest assessment rate, all else equal.

retaining relatively large dividend shares for many years—similar to the fund balance method—given low losses. (Compare with Chart 1 and Table 1.)¹⁵

Chart 3



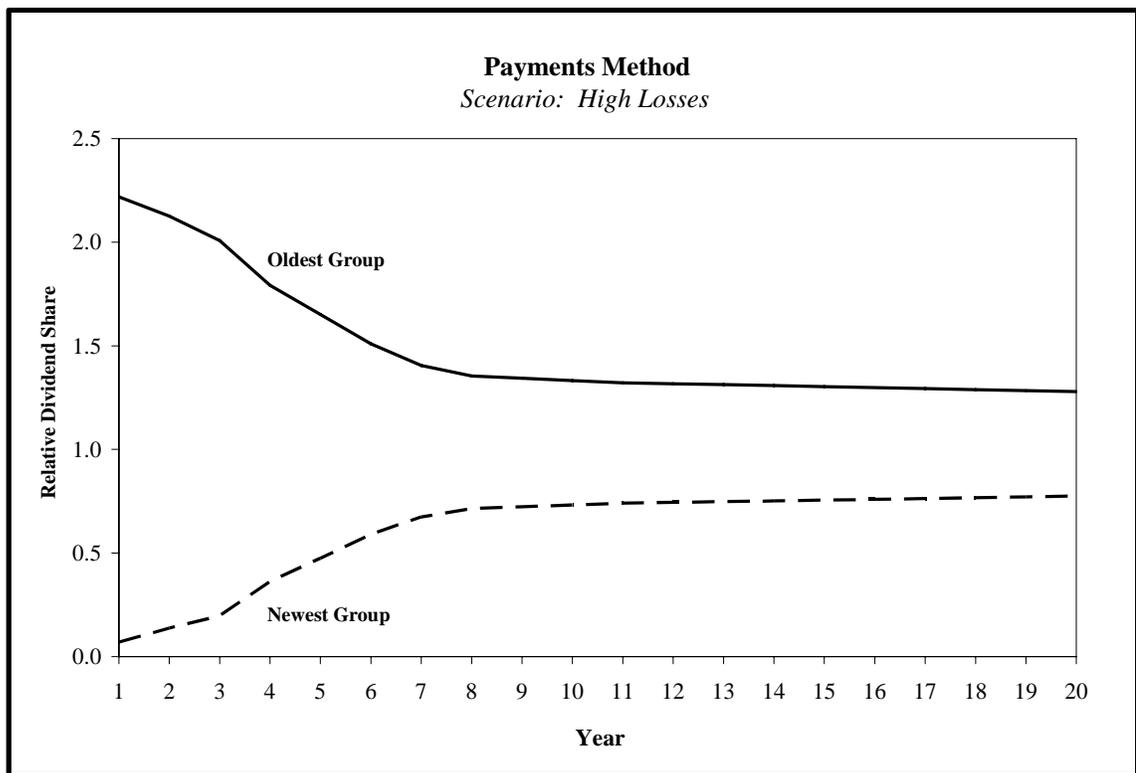
¹⁵ The low loss scenario in Chart 3 and Table 3 again assumes annual insurance losses that are significantly lower than the average annual losses for the past 10 years and that the Board would not lower rates below the base assessment rate schedule (2 to 4 basis points for institutions in Risk Category I). In fact, if the Board did lower assessment rates below the base rate schedule, the dividends shown in Chart 3 and Table 3 would not occur. See also footnote 13.

Table 3
Payments Method
Scenario 2—Low Losses

	Year																				
	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
<i>Institution from oldest group</i>																					
Dividend Share (bp)	1.66	1.64	1.57	1.47	1.45	1.43	1.41	1.39	1.37	1.35	1.33	1.31	1.30	1.28	1.26	1.24	1.22	1.21	1.19	1.18	1.16
Dividend Received (\$000)	0	0	0	0	0	0	0	0	0	0	0	0	34	60	74	84	90	95	99	103	107
<i>Median older institution</i>																					
Dividend Share (bp)	0.86	0.86	0.84	0.84	0.84	0.83	0.83	0.83	0.83	0.82	0.82	0.82	0.81	0.81	0.81	0.81	0.81	0.80	0.80	0.80	0.80
Dividend Received (\$000)	0	0	0	0	0	0	0	0	0	0	0	0	21	38	48	54	59	63	67	70	74
<i>Institution from newest group</i>																					
Dividend Share (bp)	0.00	0.05	0.10	0.15	0.16	0.18	0.20	0.21	0.23	0.24	0.26	0.27	0.29	0.30	0.32	0.33	0.35	0.36	0.37	0.39	0.40
Dividend Received (\$000)	0	0	0	0	0	0	0	0	0	0	0	0	8	14	19	22	25	28	31	34	37

Under the payments method—unlike the fund balance method—fund gains and losses would not *directly* affect an institution’s relative dividend share. However, higher insurance fund losses could lead to higher assessment rates, which would affect relative dividend shares. All else equal, higher assessment rates (either resulting from fund losses or rapid insured deposit growth) would tend to make the relative dividend shares of older and newer institutions converge more quickly. However, as illustrated in Chart 4 and Table 4, the effect of an increase in higher assessment rates on relative dividend shares would not be as large as the direct effect of large insurance losses under the fund balance method. (Compare with Table 2 and Chart 2.)¹⁶

Chart 4



¹⁶ Chart 4 and Table 4 assume that an institution’s dividend share is initially determined by multiplying its 1996 ratio times the fund balance at the end of 2006 and adding eligible premiums over time. See also footnote 13.

Table 4
Payments Method
High Loss Scenario

	Year																				
	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
<i>Institution from oldest group</i>																					
Dividend Share (bp)	1.66	1.64	1.57	1.47	1.32	1.22	1.11	1.04	1.00	0.99	0.98	0.98	0.97	0.97	0.97	0.96	0.96	0.96	0.95	0.95	0.95
Dividend Received (\$000)		0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
<i>Median older institution</i>																					
Dividend Share (bp)	0.86	0.86	0.84	0.84	0.82	0.80	0.79	0.78	0.78	0.77	0.77	0.77	0.77	0.77	0.77	0.77	0.77	0.77	0.77	0.77	0.77
Dividend Received (\$000)		0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
<i>Institution from newest group</i>																					
Dividend Share (bp)	0.00	0.05	0.10	0.15	0.27	0.35	0.44	0.50	0.53	0.54	0.54	0.55	0.55	0.55	0.56	0.56	0.56	0.56	0.57	0.57	0.57
Dividend Received (\$000)		0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0

Variation 2. Another way to implement the payments method would be to consider only premiums paid over some prior period (such as the previous 15 years). When the prior period covered any year before 2007, the years 1997 through 2006 would be skipped, since the great majority of institutions paid no deposit insurance premiums then. Thus, for example, to determine dividend shares at the end of 2009, the method would consider premiums paid from 1985 through 1996 and from 2007 through 2009. Premiums paid during 2007, 2008 and 2009 would include only eligible premiums. However, because the weight accorded the 1996 ratio would effectively decline to zero over time, eligible premiums after 2006 would include eligible premiums offset with credits. An eligible premium paid in 1996 or any earlier year would be calculated as an institution's share of the 1996 assessment base times total deposit insurance fund assessment income in that year.¹⁷

As illustrated in Chart 5 and Table 5, newer and older institutions would have equal relative dividend shares after 15 years.^{18,19,20}

¹⁷ For years prior to 1990, deposit insurance fund assessment income used to produce Chart 5 and Table 5 includes such income for both the FDIC and the Federal Savings and Loan Insurance Corporation.

¹⁸ The low loss scenario in Chart 5 and Table 5 again assumes annual losses that are significantly lower than the average annual losses for the past 10 years and that the Board would not lower rates below the base assessment rate schedule (2 to 4 basis points for institutions in Risk Category I). In fact, if the Board did lower assessment rates below the base rate schedule, the dividends shown in Chart 5 and Table 5 would not occur. See also footnote 13.

¹⁹ If eligible premiums did not include eligible premiums offset with credits, newer institutions would actually have *higher* relative dividend shares than older ones after 15 years (because older institutions would use credits in early years, which would reduce their eligible premiums). Thereafter, however, the dividend shares of older and newer institutions would tend to converge again.

²⁰ A high loss scenario would lead to a more rapid convergence.

Chart 5

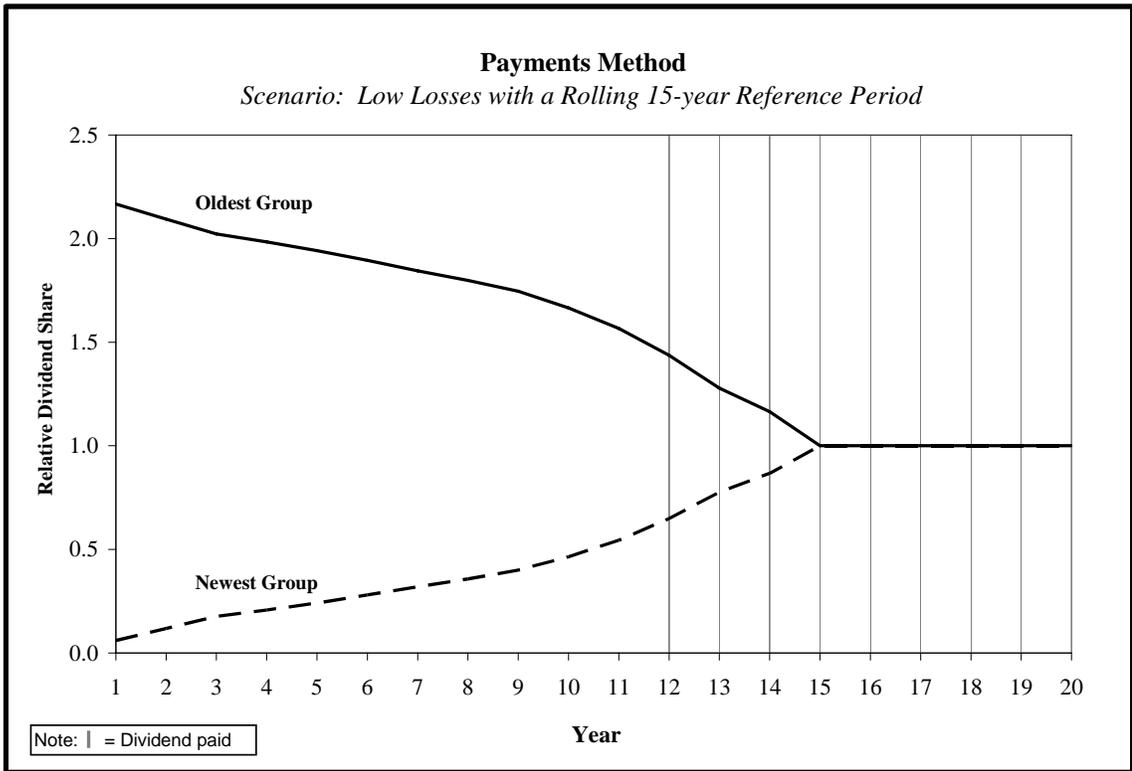


Table 5
Payments Method
Low Loss Scenario with a Rolling 15-Year Reference Period

	Year																				
	0	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
<i>Institution from oldest group</i>																					
Dividend Share (bp)	1.66	1.60	1.55	1.50	1.47	1.44	1.40	1.36	1.33	1.29	1.23	1.16	1.06	0.95	0.86	0.74	0.74	0.74	0.74	0.74	0.74
Dividend Received (\$000)		0	0	0	0	0	0	0	0	0	0	0	28	44	51	50	54	58	62	65	68
<i>Median older institution</i>																					
Dividend Share (bp)	0.86	0.86	0.85	0.84	0.84	0.83	0.83	0.83	0.82	0.82	0.81	0.80	0.78	0.77	0.76	0.74	0.74	0.74	0.74	0.74	0.74
Dividend Received (\$000)		0	0	0	0	0	0	0	0	0	0	0	21	36	45	50	54	58	62	65	68
<i>Institution from newest group</i>																					
Dividend Share (bp)	0.00	0.04	0.09	0.13	0.15	0.18	0.21	0.24	0.26	0.30	0.34	0.40	0.48	0.57	0.64	0.74	0.74	0.74	0.74	0.74	0.74
Dividend Received (\$000)		0	0	0	0	0	0	0	0	0	0	0	13	27	38	50	54	58	62	65	68

The relative dividend shares of older and newer institutions would converge similarly if an institution's dividend share were initially determined by multiplying its 1996 ratio by the fund balance at the end of 2006 and adding eligible premiums over time, where the weight accorded the 1996 ratio diminished linearly and steadily to zero over 15 years (again allowing eligible premiums to include eligible premiums offset with credits). However, institutions chartered in the future would be at a greater disadvantage than if only recent payments (*e.g.*, those made within the previous 15 years) were considered.

In general, the length of time it would take an institution chartered in the future to obtain a share of potential dividends that was roughly equal to its share of the assessment base would depend to a great extent upon the relative weight to be accorded the 1996 ratio. If the 1996 ratio (or 1996 assessment base) were heavily weighted and payments accumulated indefinitely, it could take an institution chartered in the future many years to obtain an equal share of potential dividends. However, if the 1996 ratio received a small weight and only very recent assessments (rather than cumulative payments) were considered, it would take an institution chartered in the future only a short time to obtain an equal share of potential dividends.

Simplicity

The payments method would require less data than the fund balance method and would be relatively easy to administer. If the payments method considered only recent payments (*e.g.*, 3 or 5 years), data needs and record retention requirements for the industry and the FDIC would be particularly simple.²¹

²¹ The simplification of the method in which assessment bases are used as a proxy for actual payments requires only that institutions and the FDIC retain data on assessment bases.

Decision-making

Like the fund balance method, the payments method would require that the FDIC define eligible premiums. Under the payments method the FDIC would have considerably more options regarding the allocation of dividends between older and newer institutions than it would under the fund balance method. The FDIC would decide:

- How much weight to accord the 1996 assessment base compared to premiums paid under the new system;
- Whether that weight should change over time and whether the FDIC should reserve the right to change the weight in the future; and
- Whether all payments under the new system should be considered or only more recent payments.

III. Request for Comments

The FDIC requests comment on all aspects of the fund balance method and the payments method, and on any alternative approach not presented in this ANPR that a commenter chooses to discuss. In particular, the FDIC invites comment on the following:

1. Which method is preferable and why?
2. Is a method not presented in this ANPR preferable? If so, why?
3. Is there a variation or way of implementing any method that is preferable or less preferable? If so, why?
4. How should an eligible premium be defined and why should it be so defined?
5. If the payments method were selected:

- a) Are any of the two illustrative variations more or less preferable?
 - b) Should eligible premiums be considered only over some limited prior period, such as 3, 5 or 10 years?
 - c) Should premiums paid with credits count toward dividend share, as described in the second illustrative variation?
 - d) Should premiums paid over some very recent period (e.g., the previous year) be excluded to avoid creating an incentive for institutions to increase their assessment base and assessments in hope of obtaining a larger dividend?
 - e) Should dividends paid to an institution be subtracted from its eligible premiums?
 - f) How should the 1996 assessment base be taken into account or weighted? How quickly should its relative importance decrease over time? Should the FDIC reserve the right to change its relative importance in the future?
6. Is any method particularly burdensome or not burdensome?
7. Any other aspects of either of the two methods or of a method not presented in this ANPR.

* * *

By order of the Board of Directors.

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

FEDERAL DEPOSIT INSURANCE CORPORATION

Robert E. Feldman,
Executive Secretary

(SEAL)

Appendix A

Definition and Description of the Fund Balance Method

An institution's dividend share would equal the dollar portion of the fund balance assigned to it (its fund allocation) as a percent of the total adjusted fund balance. An institution's dividend share would be defined recursively. Its initial dividend share ($DS_{i,0}$), on January 1, 2007, would be:

$$DS_{i,0} = \frac{a_{i,0}}{F_0} \quad (1)$$

where $a_{i,0}$ is institution i 's fund allocation on January 1, 2007, and F_0 is the fund balance as of December 31, 2006.

For quarters ending after December 31, 2006, adjusted fund balances are used. An adjusted fund balance differs from the actual fund balance by excluding estimated premium income for the quarter. Premiums earned for each quarter would be estimated because they would not be determined for, and collected from, each institution until the following quarter.

An institution's fund allocation at time 0 would be derived from its share of the 1996 aggregate assessment base. Therefore, equation (1) can be restated as:

$$DS_{i_0} = \frac{a_{i,0}}{F_0} = \frac{(f_i)(F_0)}{F_0} = f_i \quad (2)$$

In the equation above, f_i is the share of the 1996 aggregate base for institution i and is calculated as:

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

where ab_{96i} is 1996 assessment base for institution i and $j = I$ through N represents all institutions. Institutions that did not exist on December 31, 1996 or are not successors to institutions in existence then would have 1996 ratios set to zero.

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

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

where $DS_{i,t}$ is institution i 's dividend share at time t , t is the end of the most recent quarter for which the fund balance is available, $a_{i,t}$ is institution i 's fund allocation at time t and F_t is the adjusted fund balance at time t .

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

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

where h_t is an adjustment factor accounting for the growth or shrinkage of the adjusted fund balance (as defined above) from $t-1$ to t after excluding eligible premiums for the quarter ending at time $t-1$ that were collected at time t , r_t is a redistribution factor that redistributes the shares of institutions that failed after time $t-1$ but before time t and $p_{i,t}$ is eligible premiums paid by institution i at time t for the quarter ending at time $t-1$.

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

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

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

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

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

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

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

Definition and Description of the Payments Method

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

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

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

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

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

Appendix B

Model Assumptions

Among other things, the model assumes the following:

1. Investment income in 2007 equals 4.7 percent of the start-of-year fund balance. For each year thereafter, it equals 4.57 percent of that year's starting fund balance. These estimates are based on projections from an investment model that relies on Blue Chip forecasts of the yield curve through 3rd quarter 2008.
2. The initial assessment rate schedule is 3 basis points above the base rate schedule; thus, the initial minimum rate is 5 basis points. Rates fall to base rates the year after the fund reserve ratio reaches or exceeds 1.25 percent. Risk Category I institutions that pay rates between the minimum and maximum rate for the category are assumed to pay 0.6 basis points above the minimum rate, which reflects the current weighted average rate for the group.
3. Any restoration plan is assumed to be a 5 year plan. Surcharges in a restoration plan are estimated using an iterative procedure to account for the effect of credit use. During a restoration plan, an institution may use no more than 3 basis points in credit use.
4. Operating expenses for 2007 are \$988 million and grow at an annual rate of 5 percent thereafter.
5. Insured and domestic deposits are assumed to grow at 5 percent per year.
6. The beginning fund balance at 2007 equals \$50,165 million.
7. Credit use is limited by the 90 percent rule during 2008, 2009, and 2010. (No institution may apply credits to offset more than 90 percent of an assessment for these years.)

8. Institutions are assigned to 1 of 10 credit groups and 1 of 6 assessment rate groups based on December 31, 2006 Call Report and TFR data, CAMELS information, and one-time credits. An institution's credits are determined by its share of the December 31, 1996 assessment base. An institution's credit group is determined by the ratio of its credits to its December 31, 2006 deposits. Because an institution's initial relative dividend share is determined analogously, based upon the ratio of its share of the December 31, 1996 assessment base to its share of the December 31, 2006 deposits, institutions in the same credit group will have similar relative dividend shares. In the tables and charts in the text comparing the relative dividend shares under alternative allocation methods, the "oldest" group refers to the credit group with the most credits relative to their December 31, 2006 deposits, those whose credits are more than 12 basis points of their December 31, 2006 deposits. The initial weighted average of credits-to-deposits for the credit group is 15.6 basis points.
9. High fund losses correspond to the losses incurred by the Bank Insurance Fund from 1987 to 1994, with losses measured relative to total domestic deposits. Low fund losses assume losses are equal to 0.1 basis points of domestic deposits each year.