Federal Deposit Insurance Corporation
801 17th Street NW, Washington, DC 20429-9990 Division of Insurance and Research

May 22, 2009

MEMORANDUM TO: The Board of Directors

FROM: Arthur J. Murton
Director
Division of Insurance and Research

SUBJECT: Final Rule on Special Assessment

SUMMARY OF RECOMMENDATIONS

Staff recommends that the FDIC authorize publication of the attached Final Rule ("Final Rule") that would:

1. Impose a 5 basis point special assessment on each insured depository institution's assets minus its Tier 1 capital as reported in the report of condition of June 30, 2009;

2. Cap the special assessment at 10 basis points times the institution's assessment base for the second quarter of 2009 risk-based assessment;

3. Allow the FDIC Board of Directors ("Board") to impose additional special assessments of up to 5 basis points on all insured depository institutions based on each institution's assets minus Tier 1 capital for the third and fourth quarters of 2009, if the FDIC estimates that the Deposit Insurance Fund (DIF or the fund) reserve ratio will fall to a level that the Board believes would adversely affect public confidence or to a level that will be close to or below zero;

4. Cap any additional special assessment at 10 basis points times the institution's assessment base for the corresponding quarter's risk-based assessment; and,

5. Terminate authority to impose any additional special assessment under this Final Rule on January 1, 2010.

BACKGROUND

Recent and anticipated failures of FDIC-insured institutions resulting from deterioration in banking and economic conditions have significantly increased losses to the Deposit Insurance Fund (the fund or the DIF). The reserve ratio of the DIF declined from 1.22 percent as of

Concur: ____________________
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General Counsel

December 31, 2007, to 0.40 percent (preliminary) as of December 31, 2008, and is expected to decline further by March 31, 2009. Twenty-five institutions failed in 2008, and the FDIC projects a substantially higher rate of institution failures this year and in the next few years, leading to a further decline in the reserve ratio. (As of May 15, 2009, 33 institutions had failed in 2009.) Because the fund reserve ratio fell below 1.15 percent as of June 30, 2008, and was expected to remain below 1.15 percent, the Federal Deposit Insurance Reform Act of 2005 (the Reform Act) required the FDIC to establish and implement a Restoration Plan that would restore the reserve ratio to at least 1.15 percent within five years, absent extraordinary circumstances.[1]

On October 7, 2008, the FDIC established a Restoration Plan for the DIF.[2] The Restoration Plan called for the FDIC to set assessment rates such that the reserve ratio would return to 1.15 percent within five years. The plan also required the FDIC to update its loss and income projections for the fund and, if needed to ensure that the fund reserve ratio reached 1.15 percent within five years, increase assessment rates. The FDIC amended the Restoration Plan on February 27, 2009, and extended the time within which the reserve ratio must be returned to 1.15 percent from five years to seven years due to extraordinary circumstances.[3] The FDIC also adopted a final rule (the assessments final rule) that, among other things, set quarterly initial base assessment rates at 12 to 45 basis points beginning in the second quarter of 2009.[4] However, given the FDIC's estimated losses from projected institution failures, these assessment rates will not be sufficient to return the fund reserve ratio to 1.15 percent within seven years and are unlikely to prevent the DIF fund balance and reserve ratio from falling to near zero or becoming negative in 2009.

On February 27, 2009, the FDIC, using its statutory authority under section 7(b)(5) of the FDI Act (12 U.S.C. 1817(b)(5)), adopted an interim rule with request for comment imposing a 20 basis point special assessment on June 30, 2009, to be collected on September 30, 2009, at the same time that the regular quarterly risk-based assessments for the second quarter of 2009 are collected.[5] Under the interim rule with request for comment, the assessment base for the special assessment was the same as the assessment base for the second quarter risk-based assessment.

The interim rule with request for comment also provided that, after June 30, 2009, if the reserve ratio of the DIF is estimated to fall to a level that the Board believes would adversely affect public confidence or to a level which shall be close to or below zero at the end of any calendar quarter, the Board, by vote, may impose a special assessment of up to 10 basis points as of the end of any such quarter based on each institution's assessment base calculated pursuant to 12 CFR § 327.5 for the corresponding assessment period.

[1] Section 7(b)(3)(E) of the Federal Deposit Insurance Act, 12 U.S.C. 1817(b)(3)(E).

[2] 74 FR 61598 (October 16, 2008).

[3] 74 FR 9564 (Mar. 4, 2009).

[4] 74 FR 9525 (Mar. 4, 2009).

[5] 74 FR 9338 (Mar. 4, 2009).

THE FINAL RULE

The FDIC received over 14,000 comments on every aspect of the interim rule with request for comment. FDIC staff has reviewed and considered these comments. Staff's recommended Final Rule on the special assessment is attached. The recommended approach differs in several ways from the interim rule with request for comment. These changes include:

1. Reducing the rate used to calculate the special assessment;
2. Changing the base used to calculate the special assessment;
3. Capping the amount of the special assessment;
4. Reducing the rate used to calculate any additional special assessment or assessments that become necessary;
5. Changing the base used to calculate any additional special assessment or assessments that become necessary;
6. Capping the amount of any such additional special assessment; and,
7. Terminating authority to impose any additional special assessment under this Final Rule on January 1, 2010.

Special Assessment

The final rule imposes a 5 basis point special assessment on each institution's assets minus Tier 1 capital as reported on the report of condition as of June 30, 2009, rather than a 20 basis point special assessment on each institution's assessment base for the second quarter 2009 risk-based assessment, as provided in the interim rule with request for comment. The amount of the special assessment for any institution, however, will not exceed 10 basis points times the institution's assessment base for the second quarter 2009 risk-based assessment. The special assessment will be collected on September 30, 2009.

Staff estimates that the total amount collected under the special assessment will approximately equal the amount that would have been collected by imposing approximately a 7 and one-third basis point special assessment on the aggregate industry assessment base for the second quarter 2009 risk-based assessment. For all institutions, the assessment rate in the final rule will result in a smaller assessment than under the interim rule with request for comment.

Staff currently projects approximately $70 billion in losses due to insured depository institution failures over the next five years, the great majority of which are expected to occur in 2009 and 2010. The $70 billion estimate of losses is about $5 billion higher than staff's estimate in February 2009. Staff also currently projects that, without a special assessment, the reserve ratio of the DIF will become negative by the end of 2009.

According to staff's projections, this 5 basis point special assessment, combined with the quarterly risk-based assessment rates adopted by the FDIC in February 2009, should result in maintaining a year-end fund balance and reserve ratio that are positive, albeit close to zero.[6,7] It is important, however, to recognize the inherent uncertainty in these projections. Given the importance of maintaining a positive fund balance and reserve ratio, in staff's view, it is probable that an additional special assessment will be necessary, although the amount and timing of such a special assessment is uncertain.

Therefore, the final rule also provides that, if, after June 30, 2009, the reserve ratio of the DIF is estimated to fall to a level that the Board believes would adversely affect public confidence or to a level which shall be close to or below zero at the end of any calendar quarter, the Board, by vote, may impose an additional special assessment of up to 5 basis points as of the end of any such quarter on all insured depository institutions based on each institution's total assets minus Tier 1 capital as reported on the report of condition for that calendar quarter. Any single additional special assessment will not exceed 10 basis points times the institution's assessment base for the corresponding quarter's risk-based assessment. The interim rule with request for comment had allowed additional special assessments of up to 10 basis points on the assessment base used for quarterly risk-based assessments.

The earliest any such additional special assessment could be imposed under the final rule would be September 30, 2009, with collection on December 30, 2009. Staff recommends that the Board consider whether to impose such an additional special assessment later in 2009.

Staff also recommends that authority to impose any additional special assessment under the final rule terminate January 1, 2010. The FDIC's ability to collect any special assessment imposed prior to January 1, 2010, would not be affected.

FDIC Efforts to Lower the Special Assessment

The FDIC received over 14,000 comment letters, the vast majority of which stated that the proposed 20 basis point special assessment could have a significant adverse effect on the

[6] The Helping Families Save Their Homes Act of 2009, discussed below, extends the temporary deposit insurance coverage limit increase to $250,000 (from the permanent limit of $100,000 for deposits other than retirement accounts) through the end of 2013. The legislation allows the FDIC to factor in the increase in the coverage limit for assessment purposes. Institutions do not currently report the amount of deposits insured above $100,000 (except for retirement accounts). Staff estimates that when institutions begin reporting estimated insured deposits that reflect the higher coverage limit (probably in their September 30, 2009 reports of condition), projected reserve ratios (provided they are positive) will be somewhat lower than they would be using the $100,000 coverage limit. Taking the coverage limit increase into account would not, of course, convert a positive reserve ratio to a negative one.

[7] Also, according to staff's projections, the combination of the 5 basis points special assessment (without any additional special assessments) and regular assessments should return the reserve ratio to 1.15 percent in 2016, one year later than required by the amended Restoration Plan, which requires that the reserve ratio return to 1.15 percent by the end of 2015. It should be noted that the Restoration Plan allows the FDIC the flexibility to adjust assessment rates as needed throughout the plan period to ensure that the fund reserve ratio reaches 1.15 percent within seven years (loss and income projections must be updated at least semiannually).

industry at a very difficult time in the economic and business cycles. A number of letters from smaller institutions and their trade groups noted that the assessment would be particularly hard for community banks to absorb.

Staff recognizes that assessments are a significant expense, particularly during a financial crisis and recession when bank earnings are under pressure. Banks currently face tremendous challenges even without having to pay higher assessments. Assessments reduce the funds that banks can lend in their communities to help revitalize the economy. For that reason, the FDIC has found ways to reduce the size of the special assessment since adopting the interim rule with request for comment. The FDIC recently imposed a surcharge on senior unsecured debt guaranteed under the Temporary Liquidity Guarantee Program (TLGP). Funds collected and anticipated to be collected from this surcharge allow the FDIC to reduce somewhat the size of the special assessment.

The FDIC also requested that Congress increase the FDIC's authority to borrow from Treasury. The size of the special assessment adopted in the interim rule with request for comment reflected the FDIC's need to maintain adequate resources to cover potential unforeseen losses. The FDIC had a thin cushion against unforeseen losses because its $30 billion borrowing authority from Treasury for losses from bank failures had not increased since 1991, although industry assets had more than tripled.

On May 20, 2009, Congress increased the FDIC's authority to borrow from Treasury from $30 billion to $100 billion as a part of the Helping Families Save Their Homes Act of 2009. In addition, this new legislation authorized a temporary increase until December 31, 2010, in the FDIC's borrowing authority above $100 billion (but not to exceed $500 billion) based on a process that would require the concurrence of the FDIC's Board, the Federal Reserve Board, and the Secretary of the Treasury in consultation with the President. Staff believes that this increase in borrowing authority gives the FDIC sufficient cushion against unforeseen bank failures to allow it to reduce the size of the special assessment significantly while continuing to assess at a level that maintains the DIF through industry funding. Although the industry would still pay assessments to cover projected losses and rebuild the fund over time, a lower special assessment would mitigate the pro-cyclical effects of assessments.

Nevertheless, for the reasons given above, staff believes that it is still necessary to impose a special assessment.

Assessment Base

Section 7(b)(5) of the FDI Act, governing special assessments, allows the Corporation to impose one or more special assessments on insured depository institutions in an amount determined by the Corporation for any purpose that the Corporation may deem necessary. One of the FDIC's principal purposes in imposing special assessments under this rule is to prevent the reserve ratio of the fund from declining to zero or below. The statute does not define the assessment base to be used when imposing a special assessment. Thus, the FDIC has authority to define the appropriate assessment base for the special assessment by rulemaking. *Chevron*

USA v. NRDC, 467 U.S. 837, 843 (1984); 12 U.S.C. § 1819 (a) Tenth. Moreover, prior to 1991, section 7(b)(4) of the FDI Act defined a depository institution's assessment base as the institution's liability for deposits as reported on the institution's report of condition, subject to certain statutory adjustments. The Federal Deposit Insurance Corporation Improvement Act of 1991 repealed those provisions and substituted the current risk-based assessment system provisions.[8] No specific definition of the assessment base was put in its place, thus giving the FDIC the discretion to establish the appropriate base against which to charge assessments depending on circumstances.

The interim rule with request for comment based the amount of the special assessment on the assessment base used for the regular quarterly risk-based assessments. In contrast, the final rule bases the special assessment on an institution's total assets less Tier 1 capital. A large number of commenters stated that the special assessment should be based on total assets. After careful consideration, staff has concluded that a departure from the regular risk-based assessment base is appropriate in the current circumstances because it better balances the burden of the special assessment. Staff has excluded Tier 1 capital from the assessment base to ensure that no institution will be penalized for holding large amounts of capital.

The final rule caps any special assessment paid by an institution at 10 basis points of the institution's risk-based assessment base used for the corresponding assessment period. Unless additional special assessments are needed, all institutions will pay considerably less than they would have under the interim rule with request for comment. Even if a second special assessment is needed, no institution will pay more than it would have paid under the interim rule with request for comment.

Credit use

As part of the Restoration Plan, the FDIC has the authority to restrict the use of the one-time assessment credit while the plan is in effect, although an institution may still apply any remaining credit against its assessment to the lesser of its assessment or 3 basis points.[9] The FDIC has decided not to restrict assessment credit use in the Restoration Plan. Staff projects that the amount of the assessment credit remaining at the time that the special assessment is imposed on June 30, 2009, will be very small and that its use will have very little effect on assessment revenue.[10]

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[8] Section 302(a), Pub. L. No. 102-242, 105 Stat. 2236, 2345-48 (Dec. 19, 1991).

[9] Section 7(b)(3)(E)(iv) of the Federal Deposit Insurance Act (12 U.S.C. 1817(b)(3)(E)(iv)). Congress awarded the industry, in aggregate, approximately $4.7 billion in assessment credits in the Federal Deposit Insurance Reform Act of 2005. Almost all of these credits have been used.

[10] For 2009 and 2010, credits may not offset more than 90 percent of an institution's assessment. Section 7(e)(3)(D)(ii) of the Federal Deposit Insurance Act (12 U.S.C. 1817(e)(3)(D)(ii)).

Effect on Capital and Earnings

Staff has analyzed the effect of a 5 basis point special assessment on assets minus Tier 1 capital (not to exceed 10 basis points on an institution's June 30, 2009, assessment base) on the capital and earnings of insured institutions. For this analysis, staff has projected that insured institutions' earnings from April 1, 2009, through March 31, 2010, will equal their earnings from April 1, 2008, through March 31, 2009, a period that included several stressful quarters.[11] Given this projection, for the industry as a whole, the 5 basis point special assessment in 2009 would result in March 31, 2010, equity capital that would be approximately 0.2 percent lower than in the absence of a special assessment. Based on this projection for industry earnings, a 5 basis point special assessment would cause 2 institutions (with $2.9 billion in aggregate assets) whose equity-to-assets ratio would have exceeded 4 percent in the absence of such an assessment to fall below that percentage. Of these institutions, the equity-to-assets ratio of one institution (with $0.2 billion in aggregate assets) would fall below 2 percent.

For profitable institutions, the 5 basis point special assessment would result in pre-tax income for 2009 that would be 5.1 percent lower than if the FDIC did not charge the special assessment. For unprofitable institutions, pre-tax losses would increase by an average of 2.0 percent.

Further Special Assessments

Staff recognizes that there is considerable uncertainty about its projections for losses and insured deposit growth, and, therefore, of future fund reserve ratios. As a result, staff has concluded that the Board should consider the need for any further special assessments periodically beginning later this year when staff can use the most recently available data on fund losses and the fund reserve ratio.

Under the final rule, the Board may, by vote, impose additional special assessments of up to 5 basis points on all insured depository institutions to further ensure that the fund reserve ratio does not decline to a level that could undermine public confidence in federal deposit insurance or to a level which shall be close to or below zero at the end of the third or fourth quarter of 2009. Any such special assessment would be imposed on the last day of a quarter for 2009 (September 30 or December 31) and would be collected approximately three months later at the same time that quarterly risk-based assessments are collected. The earliest possible date as that the Board, by vote, may impose such an additional special assessment is September 30, 2009 (which would be collected December 30, 2009). The final rule reduces the maximum size of any such additional special assessment to 5 basis points from the 10 basis points imposed by the interim rule with request for comment, and also changes the base for calculating this special assessment.

Any additional special assessment also would be based on an institution's total assets minus Tier 1 capital as reported on the report of condition for the quarter ending the date the

[11] Staff excluded goodwill losses and amortization expenses and impairment losses for other intangible assets from earnings during this period, since many of these items were unusual, one-time charges.

special assessment is imposed rather than being based on the institution's assessment base. Thus, for example, a special assessment imposed on December 31, 2009, would be based on total assets minus Tier 1 capital reported for the fourth quarter of 2009 (and would be collected March 30, 2010). Any single additional special assessment would also be capped at 10 basis points of the institution's assessment base used for the corresponding quarter's risk-based assessment. If the FDIC needs to impose an additional special assessment larger than 5 basis points, it would do so by further rulemaking.

Near the end of the third and fourth quarters of 2009, if there is a reasonable possibility that the reserve ratio has declined to a level that could undermine public confidence in federal deposit insurance or to a level which shall be close to or below zero, staff will estimate the reserve ratio for that quarter from available data on, or estimates of, insurance fund assessment income, investment income, operating expenses, other revenue and expenses, and loss provisions (including provisions for anticipated failures). Because no data on estimated insured deposits will be available until after the quarter-end, staff will assume that estimated insured deposits will increase during the quarter at the average quarterly rate over the previous four quarters.

If staff estimates that the reserve ratio will fall to a level that the Board believes would adversely affect public confidence or to a level close to or below zero at the end of the calendar quarter, and the Board decided to impose the special assessment of up to 5 basis points, the FDIC would announce the imposition and rate of the special assessment no later than the last day of the quarter. As soon as practicable after any such announcement, the FDIC would have a notice published in the Federal Register of the imposition of the special assessment.

For example, if staff estimates in late December 2009 that the reserve ratio on December 31, 2009, will fall close to or below zero, and the Board voted to impose a special assessment of up to 5 basis points, the special assessment would be announced no later than December 31. The announcement would state that the special assessment is being imposed on December 31, 2009, the rate of the assessment, and that the assessment would be collected along with the regular quarterly deposit insurance assessment on March 30, 2010. Notice of the special assessment would be published in the Federal Register as soon as practicable.

However, staff would not make its estimates of quarter-end reserve ratios for purposes of any such special assessment, nor would the Board determine whether to impose such a special assessment, until shortly before the end of each quarter, in order to take advantage of the most current data available.

Staff recommends that the authority to impose any additional special assessments under this final rule expire January 1, 2010. The FDIC's ability to collect any special assessments imposed prior to January 1, 2010, would not be affected.

Staff recommends as the FDIC completes the Restoration Plan, the Board review whether the authority granted in this rule to impose additional special assessments remains necessary.

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