October 31, 2006

MEMORANDUM TO: The Board of Directors

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

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Director
Division of Finance

SUBJECT: Final Rule Part 327 - Operational Processes
Governing the Deposit Insurance Assessment System

Recommendation

In May 2006, the FDIC published a notice of proposed rulemaking requesting comment on proposed amendments to 12 CFR 327 to make the deposit insurance assessment system react more quickly and more accurately to changes in institutions' risk profiles and to ameliorate several causes for complaint by insured depository institutions. 71 FR 28790 (May 18, 2006). The comment period was extended for 30 additional days (71 FR 36718 (June 28, 2006)) and expired on August 16, 2006. The FDIC received six comment letters, five from trade groups and one from a depository institution.[1] Four of the commenters generally supported all of the FDIC's proposals; of those four, three suggested modifications to the provisions governing the use of average daily balances in determining assessment bases. Two commenters opposed elimination of the float deductions; three others opposed eliminating the deductions, but only where deposit bases are calculated using quarter-end balances. After considering the comments on the proposed rule, staff recommends that the Board of Directors adopt and authorize publication of the attached final rule in the Federal Register.

The final rule will improve and modernize the FDIC's operational systems for deposit insurance assessments in 12 CFR 327. Under the amendments to 12 CFR sections 327.1 through 327.8 set out in this final rule, deposit insurance assessments will be collected after each quarter ends - which will allow for consideration of more current information than under the prior rule. Ratings changes will become effective when the rating change is transmitted to the institution. Although the FDIC will retain the existing assessment base as applied in practice with only minor modifications, but the computation of institutions' assessment bases will change in the following significant ways: institutions with $1 billion or more in assets will determine their assessment bases using average daily deposit balances; existing smaller institutions will have the option of

[1] The trade organizations were: the American Bankers Association, the Independent Community Bankers of America, the Association for Financial Professionals, the New York Bankers Association, and America's Community Bankers; the depository institution was Capital One Financial Corp.

Concur: ________________________
Douglas H. Jones
Acting General Counsel

using average daily deposits to determine their assessment bases; and the float deductions used to determine the assessment base will be eliminated. In addition, the rules governing assessments of institutions that go out of business will be simpler; newly insured institutions will be assessed for the assessment period in which they become insured; prepayment and double payment options will be eliminated; institutions will have 90 days from each quarterly certified statement invoice to file requests for review of their risk assignment and requests for revision of the computation of their quarterly assessment payment; and the rules governing quarterly certified statement invoices will be adjusted for a quarterly assessment system and for a three-year retention period rather than the former five-year period. The final rule will become effective January 1, 2007.

Background

Prior to passage of the Federal Deposit Insurance Reform Act of 2005 and the Federal Deposit Insurance Reform Conforming Amendments Act of 2005 (collectively, the Reform Act),[2] the FDIC was statutorily required to set assessments semiannually. The FDIC did so by setting assessment rates and assigning institutions to risk classes prior to each semiannual assessment period. The semiannual assessment was collected in two installments, one near the start of the semiannual period and the other three months into the period, so that, in practice, assessment collection was accomplished prospectively every quarter. Provisions in the Reform Act removed longstanding constraints on the deposit insurance assessment system and granted the FDIC discretion to revamp and improve the manner in which assessments are determined and collected from insured depository institutions. These amendments to the FDIC's operational processes governing assessments affect 12 CFR 327.1 through 12 CFR 327.8.[3]

Assessments Collected After Each Quarterly Period

Under the existing system assessments are collected from insured institutions on a semiannual basis in two installments. The first collection is made at the beginning of the semiannual period; the second collection is made in the middle of the semiannual period.[4] Under the final rule, assessments will be collected after the period being insured. The

[2] Federal Deposit Insurance Reform Act of 2005, Public Law 109-171, 120 Stat. 9; Federal Deposit Insurance Conforming Amendments Act of 2005, Public Law 109-173, 119 Stat. 3601.

[3] Section 2109(a)(5) of the Reform Act requires the FDIC, within 270 days of enactment, to prescribe final regulations, after notice and opportunity for comment, providing for assessments under section 7(b) of the Federal Deposit Insurance Act. Section 2109 also requires the FDIC to prescribe, within 270 days, rules on the designated reserve ratio, changes to deposit insurance coverage, the one-time assessment credit, and dividends. A final rule on deposit insurance coverage was published on September 12, 2006. 71 FR 53547. Final rules on the one-time assessment credit and dividends were published on October 18, 2006. 71 FR 61374 and 71 FR 61385. The FDIC will be publishing additional rulemakings on the designated reserve ratio and on risk based assessments simultaneously with this rule.

[4] In December of 1994, the FDIC modified the procedure for collecting deposit insurance assessments, changing from semiannual to quarterly collection.

assessment for each quarter will be due approximately at the end of the following quarter, on the specified payment date.[5] The chart below shows the new assessment process.

Calendar Year Quarter	Date of Capital Evaluation[6]	Assessment Base[6]	Invoice Date	Payment Date
1	March 31, 2007	March 31, 2007	June 15, 2007	June 30, 2007
2	June 30, 2007	June 30, 2007	September 15, 2007	September 30, 2007
3	September 30, 2007	September 30, 2007	December 15, 2007	December 30, 2007
4	December 31, 2007	December 31, 2007	March 15, 2008	March 30, 2008

Collecting quarterly assessments after each assessment period was expressly supported by five commenters and opposed by none. One commenter, a trade group, stated "[t]his should help banks better manage their risk positions and expected premiums during the quarter for which they will be assessed." Similarly, another trade group observed that "banks should be able to predict at the end of each quarter what their assessment will be for that quarter." Staff recommends adoption of the system for quarterly assessment collection after the period being insured to markedly improve the responsiveness and accuracy of the assessment system.

Staff recommends that the final rule take effect January 1, 2007. The last deposit insurance collection under the existing system (made on September 30, 2006, in the middle of the semiannual period before the new system becomes effective) represents payment for insurance coverage through December 31, 2006. The first deposit insurance collection under the new system (made on June 30, 2007, at the end of the second quarter under the new system) will represent payment for insurance coverage from January 1 through March 31, 2007. No deposit insurance assessments will be based upon September 30 or December 31, 2006 reported assessment bases. However, institutions will continue to make the scheduled quarterly Financing Corporation ("FICO") payments on January 2, 2007 (or on the alternate payment date, December 30, 2006) and March 30, 2007, using, respectively, these two reported assessment bases. No changes to the way FICO payments are charged or collected are being made.[7] FICO collections will continue during the transition period to the new assessment system and will not be affected by the

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[5] Adjustments to prior period invoices will continue to be reflected in invoices for later periods.

[6] That is, the date of the Report of Condition on which the assessment base and capital evaluation is determined.

[7] Pursuant to statute and a memorandum of understanding with the Financing Corporation, the FDIC collects FICO assessments from insured depository institutions based upon quarterly report dates. See 12 U.S.C. 1441(f)(2). FICO payments represent funds remitted to FICO to ensure sufficient funding to distribute interest payments for the outstanding FICO obligations.

final rule, except to the extent that the definition and computation of assessment bases has changed. Language has been added to the regulatory text to make this clear (12 CFR 327.3(a)(3)). The date of the assessment base on which FICO payments are based will not change. Any effect on the reserve ratio of transitioning to collecting assessments after each quarterly period will be minimal. Consistent with the concepts of generally accepted accounting principles, the FDIC will recognize assessment revenue in advance of receipt based on a reliable estimate.

Invoices will continue to be presented using FDIC*connect*, and institutions will continue to be required to designate and fund deposit accounts from which the FDIC can make direct debits. Invoices will, as at present, be made available on FDIC*connect* no later than 15 days prior to the payment date. However, the payment dates themselves, in relation to the coverage period, will shift. Collections will be made at or near the end of the following quarter (*i.e.*, June 30, September 30, December 30, and March 30). In this way, the proposed assessment system will synchronize the insurance coverage period with the reporting dates and the institutions' risk assignments.[8]

Under the final rule, the Board will set assessment rates for each risk category no later than 30 days before the date of the invoice for the quarter, which will give the Board the option of setting rates before the beginning of a quarter or after its completion. The final rule will provide the Board with flexibility to set final rates for the first quarter of a year at any time up to May 16 of the that year (30 days before the June 15 invoice date). However, the Board will not necessarily need to continually reconsider or update assessment rates. Once set, rates will remain in effect until changed by the Board. Institutions will have at least 45 days notice of the applicable rates before assessment payments are due.

Ratings Changes Effective When Transmitted

The FDIC proposed that changes to an institution's supervisory rating be reflected as of the date the examination or targeted examination began; if no such date existed, then an institution's supervisory rating would have changed as of the date the institution was notified of its rating change by its primary federal regulator (or state authority). In either case, if the FDIC, after taking into account other information that could affect the rating, did not agree with the classification implied by the examination, then the institution's rating would change as of the date that the FDIC determined that the change in the supervisory rating occurred.

Five commenters supported making ratings changes effective when they occur; no one opposed. One of the supporters, a trade group, suggested that in all cases the change be implemented "when the bank is notified of a change, not the date an examination begins …."

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[8] The existing regulations refer to an institution's "risk classification," that is, one of the nine classifications in the nine-cell matrix, 1A, 2A, and so forth. Under the final rule, an institution's "risk assignment" (see 12 CFR 327.4(a)) includes assignment to Risk Category I, II, III, or IV, and, within Risk Category I, assignment to an assessment rate or rates.

Staff recommends that changes to an institution's supervisory rating be reflected as of the date that the rating change is transmitted to the institution.[9] However, if the FDIC disagrees with the CAMELS composite rating assigned by an institution's primary federal regulator, and assigns a different composite rating, the supervisory change will be effective for assessment purposes as of the date that the FDIC assigns a rating. Disagreements of this type between the FDIC and the other federal regulators have been rare.

Using the transmittal date as the effective date for supervisory changes has a number of benefits. First, additional research after publication of the NPR in May revealed that the federal banking agencies do not all define and record an examination start date the same way.[10] If the start date were used to determine ratings changes for supervisory purposes, similarly situated institutions could be treated differently, simply because they have different primary federal regulators. This result could have been unfair to a large number of institutions. Second, using the start date would have potentially produced ratings changes in many prior quarters, with adjustments to prior assessments paid. By contrast, the final rule should result in far fewer alterations to earlier assessments, allowing greater finality in assessments and enabling institutions to better plan their finances. Several commenters recommended notifying institutions in advance of a ratings change. While the final rule does not provide for advance notification, institutions will receive notice contemporaneously with a change. Third, the final rule is simpler and more uniform than the proposed rule and produces a more cohesive system. The effective date of a ratings change will be defined in the same way for all institutions, large and small. This result comports with the opinions of several commenters who recommended that the risk differentiation and assessment system be made simpler and more cohesive. Fourth, as stated, the trade group specifically recommended that in all cases the effective date for recognition of a change in supervisory rating should be when the bank is notified of a change.[11]

Staff recommends adoption of the final rule, under which supervisory ratings changes would become effective as of the date the institution is notified of its rating change by its primary federal regulator or state authority, assuming that the FDIC, after taking into account other information that could affect the rating, agrees with the assignment implied by the examination, or it would change as of the date that the FDIC determines that the change in the supervisory rating occurs.

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[9] A similar rule will apply for changes in CAMELS component ratings for small and large institutions.

[10] For example, while the Board of Governors of the Federal Reserve System and the Office of Thrift Supervision (OTS) define and record as the start date the date that an examiner arrives at an institution to begin the bulk of examination activity, the Office of the Comptroller of the Currency does not. Rather, for the OCC the start date represents the date that examination activity begins based on an activity plan. This date bears no consistent relation to the date that an examiner arrives at an institution.

[11] The FDIC received no other comments specifically directed to this issue.

Modifications to the Present Assessment Base

At present, an institution's assessment base is principally derived from total domestic deposits. The current definition of the assessment base is detailed in 12 CFR 327.5. Generally, the definition is deposit liabilities as defined by section 3(*l*) of the Federal Deposit Insurance Act (FDI Act) (12 U.S.C. 1813(*l*)) with some adjustments. However, because the total deposits that institutions report in their reports of condition do not coincide with the section 3(*l*) definition, institutions report several adjustments elsewhere in their reports of condition; these adjustments are used to determine the assessment base.

For example, banks are specifically instructed to exclude uninvested trust funds from deposit liabilities as reported on Schedule RC-E of their Reports of Condition and Income (Call Reports). However, these funds are considered deposits as defined by section 3(*l*) and are therefore included in the assessment base. Line item 3 on Schedule RC-O of the Call Report was included to facilitate reporting these funds. For this line item and for the many others, banks simply report the amount of each item that was excluded from the RC-E calculation. Other line items require the restoration of amounts that were netted for reporting purposes on Schedule RC-E. For example, when banks were instructed to file Call Reports in accordance with Generally Accepted Accounting Principles, they were permitted to offset deposit liabilities against assets in certain circumstances. In order to comply with the statutory definition of deposits, lines 12a and 12b were added to Schedule RC-O to recapture those amounts.

The final rule will retain the current assessment base as applied in practice with minor modifications. The reworded definition will operate in concert with a proposed simplification of the associated reporting requirements on insured institutions' reports of condition.[12] The assessment base definition will continue to be deposit liabilities as defined by section 3(*l*) of the FDI Act with enumerated allowable adjustments. These adjustments will include drafts drawn on other depository institutions, that meet the definition of deposits per section 3(*l*) of the FDI Act, but are specifically excluded from the reporting requirements in section 7(a)(4) of the FDI Act (12 U.S.C. 1817(a)(4)). Similarly, although depository institution investment contracts meet the definition of

[12] At present, 26 items are required in the Reports of Condition and Income (Call Reports) to determine a bank's assessment base, and 11 items are required in the Thrift Financial Report (TFRs) to determine a thrift's assessment base. Under the final rule, changes to the way the assessment base is reported should reduce these items to between two and six, depending, in part, on whether an institution reports average daily balances. Essentially, instead of starting with deposits as reported in the report of condition and making adjustments, banks will start with a balance that approximates the statutory definition of deposits. Staff believes that this balance is typically found within most insured institutions' deposit systems. In this way, institutions will be required to track far fewer adjustments. In any case, no additional burden will result for insured institutions since the items required to be reported will remain essentially the same under the new regulatory definition. The changes to reporting requirements should also allow institutions to report daily average deposits more easily, since they will not have to track and average adjustment items separately. As now, the Call Report and TFR instructions will continue to specify the items required to meet the requirements of section 3(*l*) for reporting purposes. Staff has proposed appropriate changes to reports of condition, to become effective March 31, 2007, and is coordinating with the Federal Financial Institutions Examination Council (FFIEC) on the necessary changes to the reports of condition.

deposits as defined by section 3(*l*), they are presently excluded from the assessment base under section 327.5 and will continue to be excluded, as will pass-through reserves. Certain reciprocal bank balances will also be excluded. In addition, hypothecated deposits will be excluded.

Unposted debits will not reduce the assessment base and unposted credits will be excluded from the definition of the assessment base for institutions that report average daily balances because these debits and credits are captured in the next day's deposits (and thus reflected in the averages). For consistency, and because they should not materially affect assessment bases, unposted debits will not reduce the assessment base and unposted credits will also be excluded from the definition of the assessment base for institutions that report quarter-end balances.

The current definition of the assessment base, in 12 CFR 327.5, has been driven by reporting requirements that have evolved over time. These requirements have changed because of the evolving reporting needs of all of the federal regulators. As a result, the FDIC's regulatory definition of the assessment base has required periodic updates when reporting requirements in reports of condition are changed for other purposes.[13] By rewording the definition of the assessment base to deposit liabilities as defined by section 3(*l*) of the FDI Act with allowable exclusions, the FDIC will no longer be required to update its regulation periodically in response to outside factors. Two commenters generally supported the proposed minor modifications to the definition of assessment base; no commenters opposed them. Staff recommends adoption of the final rule.

<u>Average Daily Deposit Balance for Institutions with Assets of $1 Billion or More</u>

Currently, an insured institution's assessment base is computed using quarter-end deposit balances. Most schedules of the Call Report and the TFR are based on quarter-end data, but there are drawbacks to using quarter-end balances for assessment determinations. Under the current system, deposits at quarter-end are used as a proxy for deposits for an entire quarter, but balances on a single day in a quarter may not accurately reflect an institution's typical deposit level. For example, if an institution receives an unusually large deposit at the end of a quarter and holds it only briefly, the institution's assessment base and deposit insurance assessment may increase disproportionately to the amount of deposits it typically holds. A misdirected wire transfer received at the end of a quarter can create a similar result. Using quarter-end balances creates incentives to temporarily reduce deposit levels at the end of a quarter for the sole purpose of avoiding assessments. Institutions of various sizes have raised these issues with the FDIC.

Under the final rule, instead of using quarter-end deposits, certain institutions will use average daily balances over the quarter, which will give a more accurate depiction of an institution's deposits. When combined with other operational changes to the

[13] In fact, the regulatory definition has not kept pace with these reporting changes. In practice, however, the assessment base is calculated as if the regulatory definition had kept pace.

assessment system, the use of average daily balances will provide a more realistic and timely depiction of actual events. The proposal to use average daily balances was supported by all six commenters; however, three of those six suggested that the use of average daily balances be mandatory only for institutions of $1 billion or more in assets rather than $300 million as proposed. For example, one trade group suggested the higher cutoff because "the FDIC and other federal bank regulators use $1 billion in assets as the cutoff in other Call Report requirements and for other regulatory purposes." Similarly, another trade group urged the higher cutoff because "[t]his increase would be consistent with other FDIC regulations and reporting requirements … and would affect only a very small proportion of insured deposits." In addition, a third trade group urged the $1 billion cutoff "to not impose unnecessary paperwork burden on smaller institutions and to be consistent with the $1 billion threshold for other FDIC regulations …." After consideration of these comments, staff recommends that the Board adopt the final rule incorporating the higher cutoff amount.

Institutions do not at present report average daily balances on Call Reports and TFRs. Reporting average assessment bases will therefore necessitate changes to Call Reports and TFRs requiring the approval of the FFIEC and time to implement. Until these changes to the Call Report and TFR are made, institutions will continue to determine assessment bases using quarter-end balances.

Under the final rule, for one year after the necessary changes to the Call Report and TFR have been made, each existing institution will have the option of continuing to use quarter-end balances to determine its assessment base. Thereafter, institutions with $1 billion or more in assets will be required to report average daily balances. To avoid burdening smaller institutions, which might have to modify their accounting and reporting systems, existing institutions with less than $1 billion in assets will have the option of continuing to use quarter-end balances to determine their assessment bases.[14]

If its assessment base is growing, an institution will pay smaller assessments if it reports daily averages rather than quarter-end balances, all else equal. Nevertheless, a smaller institution that elects to report quarter-end balances may continue to do so, so long as its assets, as reported in its Call Report or TFR, do not equal or exceed $1 billion in two consecutive reports. Otherwise, the institution will be required to begin reporting average daily balances for the quarter that begins six months after the end of the quarter in which the institution reported that its assets equaled or exceeded $1 billion for the second consecutive time. An institution with less than $1 billion in assets may switch from reporting quarter-end balances to reporting average daily balances for an upcoming quarter. Any institution, once having begun to report average daily balances, either voluntarily or because required to, may not switch back to reporting quarter-end balances.

Finally, one commenter, a trade group, urged that the $1 billion cutoff apply to newly insured institutions because those institutions "should not be treated differently in

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[14] In those instances where a parent bank or savings association files its Call Report or TFR on a consolidated basis by including a subsidiary bank(s) or savings association(s), the assessment base for all institutions included in the consolidated reporting must be reported separately on an unconsolidated basis so that assessment bases can be determined separately for each institution.

the assessment base calculation" and because "having the option to file using quarter-end balances is important as some banks believe the cost of the more involved General Ledger systems is excessive." Staff believes that systems likely to be in place in newly insured institutions can generate average daily balances and will therefore impose no additional costs in doing so. In addition, this approach will encourage the transition to average daily balances throughout the industry, which will improve the accuracy of institutions' assessment base calculations. Accordingly, under the final rule, any institution that becomes insured after the necessary modifications to the Call Report and TFR have been made will be required to report average daily balances for assessment purposes.

Eliminate the Float Deductions

The largest overall adjustments to the current assessment base are deductions for float, deposits reported as such for assessment purposes that were created by deposits of cash items (checks) for which the institution has not itself received credit or payment. The current float deductions are 16 ⅔ percent for demand deposits and 1 percent for time and savings deposits. Two basic rationales existed for allowing institutions to deduct float. First, without float deductions, institutions would be assessed for balances created by deposits of checks for which they had not actually been paid. Second, crediting an uncollected cash item (a check) to a deposit account can temporarily create double counting in the aggregate assessment base - once at the insured institution that credited the cash item to the deposit account, and again at the payee insured institution on which the cash item is drawn. Deducting float from deposits when calculating the assessment base reduced this double counting.

Before 1960, institutions computed actual float and deducted it from deposits when computing their assessment bases. This proved to be onerous at the time. In 1960, Congress by statute established the standardized float deductions in an effort to simplify and streamline the assessment base calculation. Section 7(b) of the FDI Act defined the deposit insurance assessment base until passage of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), which removed the statutory definition.[15] In the notice of proposed rulemaking, comment was requested on whether to eliminate the float deductions, whether to allow the deduction of actual float, or whether to retain the present standardized float deductions.

All six commenters addressed the float issue. Two opposed elimination of the float deductions. One supported retaining the standard float deductions and "if necessary, modifying them to recognize reduction in float due to technology advances" but opposed requiring banks to deduct actual float. Another urged the adoption of "rules that allow for the deduction of actual float – base assessments on collected balances" and opposed eliminating the standard float deductions because that would "increase the premiums that corporate depositors pay." Three other commenters generally supported elimination of

[15] Since FDICIA, the FDIC's regulations alone defined the assessment base. The current definition, at 12 CFR 327.5, generally tracks the former statutory definition.

the float deductions, but urged retention of the deductions for quarter-end filers, as opposed to institutions reporting average daily balances. A trade group noted that while float has declined, it has not gone away, and without the float deductions for quarter-end filers "the assessment base using quarter-end balances would be greater than appropriate and, therefore, the premium assessed would be higher than appropriate." Two other trade groups suggested revising the current float deductions for quarter-end filers and allowing such institutions to continue their use.

Staff recommends eliminating the float deductions for all institutions on the grounds that, based on available information, the standard float deductions appear to be obsolete. Actual float appears to be small and decreasing as the result of legal, technological and payment systems changes. The basis for the percentages in the standardized deductions chosen by Congress is not clear. However, even if the percentages were a realistic approximation of average bank float when they were selected over 40 years ago, legal, technological and payment systems changes - such as Check 21 - that have accelerated check clearing should have reduced float, everything else being equal, and made the existing standard float deductions obsolete.[16] Consequently, the current standardized float deductions probably do not reflect real float for most institutions. In addition, cash items in the process of collection as a percent of domestic deposits for commercial banks with total assets greater than or equal to $300 million has been decreasing. Over the long term, the ratio of cash items in the process of collection to total domestic deposits has fallen significantly. Cash items in the process of collection can be viewed as a rough approximation of actual float.

Eliminating the float deductions will favor some institutions over others. Institutions with larger percentages of time and savings deposits will see smaller increases in their assessment bases; conversely, those with larger percentages of demand deposits will see greater increases in their assessment bases. However, eliminating the float deductions will only minimally affect the relative distribution of the aggregate assessment base among institutions of different asset sizes and between banks and thrifts (although it will have a greater effect on the assessment bases of some individual institutions). While eliminating the float deductions will increase assessment bases and affect the distribution of the assessment burden among institutions, it should not, in itself, increase assessments. The assessment rates that the Board will set in the new pricing system can take into account the elimination of the float deduction.

[16] Congress enacted P.L. 108-100, Check Clearing for the 21st Century (Check 21), on October 28, 2004. Check 21 allows banks to electronically transfer check images instead of physically transferring paper checks. The Federal Reserve Board, What You Should Know About Your Checks, http://www.federalreserve.gov/pubs/check21/shouldknow.htm (updated Feb. 16, 2005). As a result, the transmission and processing of electronic checks can be done faster than transferring paper checks through the clearing process. A recent Federal Reserve payment survey indicates that, for the first time, bank-to-bank electronic payments have exceeded payments by check. Treasury and Risk Management, Just Another Step Along the Way to a Checkless Economy, www.treasuryandrisk.com, September 2005. With Check 21, the volume of paper checks processed is expected to continue to decline with more payments processed electronically resulting in a smaller float.

Staff recommends against deducting actual float to arrive at the assessment base for a number of reasons. Deducting actual float would require that institutions report actual float; and institutions that determine their assessment base using average daily balances would be required to report average daily float. This would necessitate a new information requirement for float data.[17] Before 1960, institutions computed actual float and deducted it from deposits when computing their assessment bases. Because this proved to be onerous at one time, Congress established the standardized float deductions by statute. Asking institutions again to report actual float could create significant regulatory burden, which staff recommends be avoided.

Finally, staff recommends against retaining the float deductions (or revised or adjusted float deductions) for institutions reporting quarter-end balances, as three commenters urged. It is not clear that reporting quarter-end balances would result in a larger than appropriate assessment than reporting average daily balances, as one commenter suggested. Moreover, allowing standardized deductions for institutions that report quarter-end balances could provide institutions with incentives for retaining the quarter-end balance method. Staff believes that institutions will generally benefit from reporting average daily balances and believes the assessment system should generally be structured to encourage the bulk of institutions with less than $1 billion in assets to opt to use average daily balances in reporting their assessment bases. Staff recommends adoption of the final rule eliminating the float deductions.

Modify the Terminating Transfer Rule.

At present, complex rules apply to terminating transfers[18] to ensure that the assessment of a terminating institution is paid. Determining and collecting assessments after the end of each quarter and using average daily assessment bases make these complex rules largely obsolete. An acquiring institution (or institutions) will remain liable for the quarterly assessment(s) owed by a terminating institution; the assessment base of the terminating institution will be zero for the remainder of the quarter after the terminating transfer.

The terminating transfer provision in the final rule will deal with a few remaining situations. If the terminating institution does not file a report of condition for the quarter

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[17] Despite one commenter's suggestion, the Call Report item "Cash items in process of collection" could not be used to determine the actual float deduction for individual institutions. Because "Cash items in process of collection" contains items other than float, it may overstate actual float. For a few institutions, "Cash items in process of collection," exceeds the institutions' assessment bases. (These institutions' "Cash items" are not included in the approximation of actual float in the text.) Conversely, given the small size of the "Cash items in process of collection" reported by many institutions, this item may understate float at some institutions.

[18] Generally speaking, a *terminating transfer* occurs when an institution assumes another institution's liability for deposits—often through merger or consolidation—when the terminating institution essentially goes out of business. Neither the assumption of liability for deposits from the estate of a failed institution nor a transaction in which the FDIC contributes its own resources in order to induce a surviving institution to assume liabilities of a terminating institution is a terminating transfer.

prior to the quarter in which the terminating transfer occurred, calculation of its quarterly certified statement invoices for those quarters will be based on its assessment base from its most recently filed report of condition. For the quarter before the terminating transfer occurs, the terminating institution's assessment will be determined using its most recent rate; for the quarter in which the terminating transfer occurs, the acquirer's rate will apply, but the calculation will be different depending upon whether the acquiring institution reports its assessment base using average daily balances or quarter-end balances.

Under the final rule, once institutions begin reporting average daily deposits, the average assessment base of the acquiring institution will properly reflect the terminating transfer and will increase after the terminating transfer. When this happens, the terminating institution's assessment for the quarter in which the terminating transfer occurs will be reduced by the percentage of the quarter remaining after the terminating transfer and calculated at the acquirer's rate.

Six commenters generally supported these changes to the terminating transfer rule, and none opposed them.

Under the final rule, an acquiring institution that reports quarter-end balances will have its assessment for the quarter in which the terminating transfer occurred calculated slightly differently from the language in the proposal. Because the acquiring institution is not averaging its assessment base, its assessment for the quarter in which the terminating transfer occurs will be its assessment base (which will include the acquired deposits) calculated at its assessment rate. Thus, for example, an institution that reports quarter-end balances might acquire another institution by merger one month (one-third of the way) into a quarter. Since the acquiring institution's assessment base for that quarter will include the acquired deposits, application of the acquirer's rate to that base will obviate the need to assess the terminating institution separately for that quarter.

Staff recommends adoption of the final rule, including the simpler calculation for acquiring institutions that use quarter-end balances.

Assess Newly Insured Institutions for the Quarter They Become Insured

At present, a newly insured institution is not liable for assessments for the semiannual period in which it becomes insured, but is liable for assessments for the following semiannual period. The institution's assessment base as of the day before the following semiannual period begins is deemed to be its assessment base for the entire semiannual period. These special rules were needed because assessments were based upon assessment bases that an institution reported in the past. Under the existing rules, a newly insured institution reports an assessment base at the end of the quarter in which it becomes insured but that assessment base is not used to calculate its assessment until the following semiannual period. Further, if an institution becomes insured in the second half of a semiannual period, it has no reported assessment base on which to calculate the first installment of its premium for the next semiannual period.

Under the final rules, each quarterly assessment will be based upon the assessment base that an institution reports at the end of that quarter. Since a newly insured institution will have reported an assessment base for the quarter in which it becomes insured, its assessment base will be computed (using average daily balances) in the same manner as all other institutions. Three commenters generally supported elimination of the special rules for newly insured institutions, and none opposed it. Staff recommends adoption of the final rule.

Allow 90 Days Each Quarter to File a Request for Review or Request for Revision

The current deadline for an institution to request a review of its assessment risk classification is 90 days from the invoice date for the first quarterly installment of a semiannual period. Under the final rule, each quarterly assessment will be separately computed. Consequently, the final rule will provide institutions with 90 days from the date of each quarterly certified statement invoice to file a request for review from its risk assignment. Institutions will also have 90 days from the date of any subsequent invoice that adjusted the assessment of an earlier assessment period to request a review. The final rule clarifies that institutions with between $5 billion and $10 billion in assets may request review if the FDIC denies their request to be assessed as a large bank; in addition, institutions may request review of an FDIC determination that they are a new institution.[19]

A parallel amendment will allow requests for revision of an institution's quarterly assessment payment computation to be filed within 90 days of the quarterly assessment invoice for which revision is requested (rather than the present 60 days). Three commenters generally supported these changes to the rules; none opposed them. Staff recommends adoption of the final rule.

Conforming Changes to Certified Statement Rules

The Reform Act eliminated the requirement that the deposit insurance assessment system be semiannual and provided a new three-year statute of limitations for assessments. Accordingly, staff has revised the provisions of 12 CFR 327.2 to clarify that the certified statement is the quarterly certified statement invoice and to provide for the retention of the quarterly certified statement invoice by insured institutions for three years, rather than five years under the prior law. Three commenters generally supported these changes; none opposed them. Staff recommends adoption of the final rule, to take effect January 1, 2007.

Eliminate the Prepayment and Double Payment Options

When the present assessment system was proposed more than 10 years ago, the original quarterly dates for payment of assessments were: March 30; June 30; September 30; and December 30. The FDIC recognized that the December 1995 collection date could present a one-time problem for institutions using cash-basis accounting, since these

[19] 12 CFR 327.9(d)(5), (7). *See* the FDIC's concurrent rulemaking regarding risk based assessments.

institutions would, in effect, be paying assessments for five quarters in 1995. The FDIC believed that few institutions would be adversely affected. Soon after the new system was adopted, however, the FDIC began to receive information that more institutions than had originally been identified would be adversely affected by the December collection date. As a result, the FDIC amended the regulation in 1995 to move the collection date to January 2, but allowed institutions to elect to pay on December 30, thus establishing the prepayment date. Staff recommends adoption of the final rule eliminating this option.

With implementation of the new assessment system, a transition period will be created in which institutions will not be subject to collection of deposit insurance assessments after the September 30, 2006 payment date until June 30, 2007. Consequently, reestablishing the original December 30 payment date should have no adverse consequences for institutions that use cash-basis accounting. No institution would make more than four insurance payments in calendar year 2006; those using the December 30, 2005 payment date would make only three payments in 2006. All institutions would make four payments annually thereafter. This change will keep all assessment payments within each calendar year.[20]

In addition, insured institutions presently have the regulatory option of making double payments on any payment date except January 2. Staff also recommends adoption of the final rule eliminating the double payment option. This option originated in the 1995 amendment, when the payment date was modified from December 30, 1995 to January 2, 1996. The double payment option was adopted to provide cash basis institutions the opportunity to pay the full amount of their semiannual assessment premium on December 30 so as to have the complete benefit of this modification. The transition period from September 30, 2006 to June 30, 2007 and four payments annually beginning in 2007 should eliminate the need for the double payment option, since the FDIC will no longer be charging semiannual premiums.

The final rule also makes clear that scheduled quarterly FICO payments will be collected from all institutions on January 2, 2007, and March 30, 2007, based upon, respectively, their September 30, 2006 and December 31, 2006 reported assessment bases (section 327.3(a)(3)). Institutions that elect to do so, however, will still be able to make prepayment of their first quarter 2007 FICO payment on December 30, 2006, as provided for under the existing rules at 12 CFR 327.3(c)(3). Institutions that do not choose this prepayment option will make their first quarter 2007 FICO payment on January 2, 2007, as the final rule will provide.

Staff recommends adoption of the final rule eliminating the prepayment and double payment options and providing for FICO payments during the 2007 transition period, to become effective January 1, 2007.

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[20] The allowance for payment on the following business day - should January 2 fall on a non-business day - is eliminated as well.

Conclusion

Staff recommends adoption of the final rule to improve and modernize the FDIC's operational systems for deposit insurance assessments in 12 CFR 327 to make the deposit insurance assessment system react more quickly and more accurately to changes in institutions' risk profiles. Deposit insurance assessments will be collected after each quarter ends - which will allow for consideration of more current supervisory information. Ratings changes will become effective when transmitted to the institution. The FDIC will retain the existing assessment base as applied in practice with only minor modifications, but institutions with $1 billion or more in assets will determine their assessment bases using average daily deposit balances; smaller institutions with have the option of using average daily deposits to determine their assessment bases; and the float deduction used to determine the assessment base will be eliminated. In addition, the rules governing assessments of institutions that go out of business will be simpler; newly insured institutions will be assessed for the assessment period they become insured; prepayment and double payment options will be eliminated; institutions will have 90 days from each quarterly certified statement invoice to file requests for review of their risk assignment and requests for revision of the computation of their quarterly assessment payment; the rules governing quarterly certified statement invoices will be adjusted for a quarterly assessment system and for a three-year retention period rather than the former five-year period.

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RESOLUTION

WHEREAS, section 2109(a)(5) of the Federal Deposit Insurance Reform Act of 2005 (the Reform Act) directs the Board of Directors (Board) of the FDIC to prescribe regulations, after notice and opportunity for comment, providing for assessments under section 7(b) of the Federal Deposit Insurance Act, as amended by the Reform Act; and

NOW, THEREFORE, BE IT RESOLVED, that the Board hereby authorizes publication in the Federal Register of the attached final rule through which part 327 would be amended to provide for assessments as required by the Reform Act and the FDI Act.

BE IT FURTHER RESOLVED, that the Board hereby delegates authority to the Executive Secretary, or his designee, and the General Counsel, or his designee, to make technical, nonsubstantive, or conforming changes to the attached final rule and to take such other actions and issue such other documents incident and related to the foregoing as they deem necessary or appropriate to fulfill the Board's objective in connection with this matter.