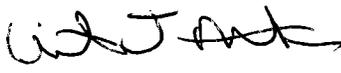




July 21, 2011

MEMORANDUM TO: The Board of Directors

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

SUBJECT: Assessment Rate Adjustment Guidelines for Large and Highly Complex Institutions

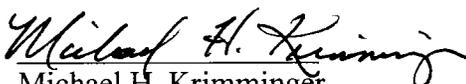
Staff recommends that the Board of Directors (FDIC or Board) approve the attached final guidelines related to the assessment rate adjustment (the large bank adjustment) for large and highly complex institutions. The guidelines describe the process that staff would follow to determine whether to implement a large bank adjustment, the size of the adjustment, and the procedures used to notify an institution of the adjustment.

## I. Background

On February 7, 2011, the FDIC adopted a final rule amending assessment regulations (Amended Assessment Regulations) in light of changes made to the Federal Deposit Insurance Act by the Dodd-Frank Wall Street Reform and Consumer Protection Act. As part of the Amended Assessment Regulations, the FDIC revised the methodology used to determine the assessment rates for large and highly complex institutions to better capture risk at the time the institution assumes the risk, to better differentiate risk among large insured depository institutions during periods of good economic and banking conditions based on how they would fare during periods of stress or economic downturns, and to better take into account the losses that the FDIC may incur if a large insured depository institution fails.

The new methodology combines CAMELS ratings and forward-looking financial measures into one of two scorecards, one for highly-complex institutions and another for all other large institutions. Each of the two scorecards produces two scores—a performance score and a loss severity score—that are combined into a total score. The total score is converted to an institution's initial base assessment rate.

The Amended Assessment Regulations provide that the FDIC, after consultation with an institution's primary federal regulator, may make a limited adjustment to an institution's total score based upon risks that are not adequately captured in the institution's scorecard. The FDIC

Concur:   
Michael H. Krimminger  
General Counsel

promulgated regulations allowing for the adjustment of large institutions' quarterly assessment rates in 2006.<sup>1</sup> The FDIC set forth the procedures for these adjustments in guidelines that were published in 2007 (2007 Guidelines).<sup>2</sup> Although not required, the Amended Assessments Regulations provide that no adjustment will be made under the Amended Assessment Regulations until after revised guidelines are published for comment and approved by the Board. The guidelines were published for notice and comment in April 2011.<sup>3</sup>

The FDIC received eight comments related to the guidelines. The FDIC also received a number of comments related to the scorecard methodology and measures used in the scorecard. The FDIC considered similar comments prior to finalizing the Amended Assessments Regulations and prior to issuing the proposed adjustment guidelines in May. Because the Amended Assessment Regulations are final, and the FDIC has not proposed changing them, suggestions or comments related to the scorecard methodology or the measures used within the scorecard have not been considered in finalizing these adjustment guidelines. Rather, staff has focused on comments related to the guidelines and how they would be used in making a large bank adjustment. These comments are discussed in the relevant section of the attached final guidelines.

The final guidelines would supersede the 2007 Guidelines.<sup>4</sup> Staff notes that, although the proposed guidelines reflect changes made as a result of the Amended Assessment Regulations, the processes for communicating with affected institutions and implementing adjustments remain largely unchanged from the 2007 Guidelines.

## **II. Overview of Proposed Guidelines on Large Bank Adjustment**

The following general principles are intended to ensure that the large bank adjustment process is fair and transparent and that any decision to adjust an institution's total score is well supported. Staff only intends to make material adjustments (an adjustment of at least 5 points) to an institution's total score, which should result in only a limited number of adjustments on a quarterly basis.

### *Analytical Guidelines*

- The FDIC would focus on identifying institutions for which a combination of risk measures and other information suggests either materially higher or lower risk than their total scores indicate. The FDIC would consider all available material information relating to the likelihood of failure or loss severity in the event of failure.

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<sup>1</sup> 71 FR 69282 (Nov. 30, 2006).

<sup>2</sup> 12 CFR 327.9(d)(4) (2011).

<sup>3</sup> 76 Fed. Reg. 21256 (April 15, 2011).

<sup>4</sup> 72 Fed. Reg. 27122 (May 14, 2007).

- The FDIC would primarily consider two types of information in determining whether to make a large bank adjustment: (a) a scorecard ratio or measure that exceeds the maximum cutoff value for a ratio or measure or is less than the minimum cutoff value for a ratio or measure, along with the degree to which the ratio or measure differs from the cutoff value (scorecard measure outliers); and (b) information not directly captured in the scorecard, including complementary quantitative risk measures and qualitative risk considerations.
- If an institution has one or more scorecard measure outliers, the FDIC would conduct further analysis to determine whether underlying scorecard ratios are materially higher or lower than the established cutoffs for a given scorecard measure and whether other mitigating or supporting information exists.
- The FDIC would use complementary quantitative risk measures to determine whether a given scorecard measure is an appropriate measure for a particular institution. Examples of some complementary quantitative risk measures are included in the guidelines.
- When qualitative risk considerations materially affect the FDIC's view of an institution's probability of failure or loss given failure, these considerations could be the primary factor supporting the adjustment. Qualitative risk considerations include, but are not limited to, underwriting practices related to material concentrations, risk management practices, strategic risk, and factors affecting loss severity.
- Specific risk measures would vary in importance for different types of institutions. In some cases, a single risk factor or indicator may support an adjustment if the factor suggests a significantly higher or lower likelihood of failure or loss given failure than the total score reflects.
- To the extent possible when comparing risk measures, the FDIC would consider the performance of similar institutions, taking into account that variations in risk measures exist among institutions with substantially different business models.
- Adjustments to an institution's total score would be made only if the comprehensive analysis of an institution's risk generally based on the two types of information listed above and the institution's relative risk ranking warrant a material adjustment of the institution's total score. For purposes of the proposed guidelines, a material adjustment would be an adjustment of five points or more to an institution's total score.

### *Procedural Guidelines*

The processes for communicating a potential adjustment to affected institutions and implementing adjustments would remain largely unchanged from that used under the 2007

Guidelines, except that the revised guidelines provide for an institution-initiated request for an adjustment.

- The FDIC would consult with an institution's primary federal regulator and appropriate state banking supervisor before making any decision to adjust an institution's total score (and before removing a previously implemented adjustment).
- The FDIC would give institutions advance notice of any decision to make an upward adjustment to a total score, or to remove a previously implemented downward adjustment. The notice would include the reasons for the proposed adjustment or removal and the size of the proposed adjustment or removal would specify when the adjustment or removal would take effect, and would provide institutions with up to 60 days to respond.
- The FDIC would re-evaluate the need for total score adjustments on a quarterly basis.
- An institution may make a written request to the FDIC for an adjustment. Any institution-initiated adjustment must be supported by evidence of a material risk or risk-mitigating factor that is not adequately accounted for in the institution's scorecard. An institution-initiated request should be received by the FDIC no later than 35 days following the end of the quarter for which the institution is requesting the adjustment. An institution-initiated request for adjustment received after this time may be considered for the following quarter.
- An institution may request review of or appeal an upward adjustment, the magnitude of an upward adjustment, removal of a previously implemented downward adjustment or an increase in a previously implemented upward adjustment pursuant to 12 C.F.R. 327.4(c). An institution could similarly request review of or appeal a decision not to apply an adjustment following an institution-initiated request for an adjustment.

The Division of Insurance and Research would seek the advice of the Office of Complex Financial Institutions (OCFI) and the Division of Risk Management Supervision (RMS), depending on which organization is responsible for ongoing supervision of the specific insured depository institution, for any adjustment it wishes to initiate and will also pursue adjustments based on OCFI and RMS recommendations.

The attached guidelines describe the adjustment process in detail and set out examples.

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