FDIC

Federal Deposit Insurance Corporation
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Financial Institution Letter
FIL-14-2010
April 13, 2010

ASSESSMENTS
Notice of Proposed Rulemaking

Summary: On April 13, 2010, the FDIC Board adopted the attached Notice of Proposed Rulemaking (NPR), which would (1) revise the risk-based assessment system for all large insured depository institutions; and (2) alter the initial and total base assessment rates for all insured depository institutions. The proposed changes would be effective January 1, 2011. Comments on the NPR are due 60 days following publication of the NPR in the *Federal Register*.

Distribution:
All FDIC-Insured Institutions

Suggested Routing:
Chief Executive Officer
President
Chief Financial Officer

Related Topics:
FDIC Regulations Governing the Assessment Process, 12 CFR Part 327

Attachment:
Proposed Rule

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Highlights:

- Risk categories and the use of long-term debt issuer ratings would be eliminated when calculating the initial base assessment rate for large insured depository institutions.
- The proposed assessment system for large institutions would combine CAMELS ratings and certain financial measures into two scorecards—one for most large institutions and another for large institutions that are structurally and operationally complex or that pose unique challenges and risks in case of failure (highly complex institutions).
- Both scorecards would use quantitative measures that are readily available and useful in predicting an institution's long-term performance.
- Similar to the current system, the FDIC would have a limited ability to adjust scores based upon quantitative or qualitative measures not adequately captured in the scorecards.
- Initial and total base assessment rates applicable to all insured depository institutions would be altered effective January 1, 2011.
- Actual total assessment rates will uniformly be set 3 basis points higher than the rates in effect on January 1, 2011, in accordance with the Amended Restoration Plan that the FDIC adopted on September 29, 2009.
- Assessment rate calculators are available to enable insured depository institutions to determine assessment rates under the proposed rule. The calculators are available at: http://wwwdev/deposit/insurance/proposed_calc.html.

ASSESSMENTS
Notice of Proposed Rulemaking

On April 13, 2010, the FDIC Board of Directors (Board) adopted a notice of proposed rulemaking (NPR or proposal) and request for comment that would revise the assessment system applicable to all large insured depository institutions. The NPR would: (1) eliminate risk categories and the use of long-term debt issuer ratings in calculating risk-based assessments for large institutions; (2) use two scorecards —one for most large institutions and another for large institutions that are structurally and operationally complex or that pose unique challenges and risks in the event of failure (highly complex institutions)—to calculate the assessment rates for all large institutions; (3) allow the FDIC to take additional information into account to make limited adjustments to the scores; and (4) use the scorecard to determine the assessment rate for each institution.

The NPR would also alter assessment rates applicable to all insured depository institutions to ensure that the revenue collected under the new assessment system would approximately equal that collected under the existing assessment system and ensure that the lowest rate applicable to small and large institutions would be the same.

On September 29, 2009, the Board adopted a uniform increase in assessment rates effective January 1, 2011. As a result of the Board's earlier action, assessment rates in effect on January 1, 2011, will uniformly increase by 3 basis points.[1]

The following is a summary of the proposal:

The FDIC would revise the method it uses to calculate assessment rates for all large institutions. The new method—a scorecard method—would continue to combine CAMELS ratings and certain forward-looking financial measures to assess the risk an institution poses to the Deposit Insurance Fund. The scorecard would use quantitative measures that are readily available and useful in predicting an institution's long-term performance. Although the methodology used in the scorecard method would be the same for all large institutions, two separate scorecards would be used: one for most large institutions and another for large institutions that are structurally and operationally complex or that pose unique challenges and risks in the case of failure (highly complex institutions).

[1] 74 FR 51062 (Oct. 2, 2010).

Scorecard for Large Institutions (Other than Highly Complex Institutions). A "large institution" would continue to be defined as an insured depository institution with $10 billion or greater in total assets for at least four consecutive quarters. This scorecard would be used for most large institutions and would produce two scores: a performance score and a loss severity score.

Performance Score. A performance score would be calculated to measure an institution's financial performance and its ability to withstand stress. The performance score would include three components: (1) weighted average CAMELS rating; (2) ability to withstand asset-related stress measures; and (3) ability to withstand funding-related stress measures. Each of the components would receive a score, each score would then be weighted and the resulting weighted scores would be summed to arrive at a performance score. The FDIC would have a limited ability to alter an institution's performance score based upon quantitative or qualitative measures not adequately captured in the scorecard.

Weighted Average CAMELS Score. To determine the weighted average CAMELS score, a weighted average of an institution's CAMELS component ratings would first be calculated using the weights for CAMELS components that are applied in the current assessments rule.[2] The weighted average CAMELS rating would be converted to a score that ranges from 25 to 100 that would increase at an increasing rate as the weighted average CAMELS rating increases. The weighted average CAMELS component of the performance score would be assigned a 30 percent weight in calculating an institution's performance score.

Ability to Withstand Asset-Related Stress Score. The ability to withstand asset-related stress component of the performance score would contain measures that are most relevant to assessing an institution's ability to withstand such stress. These measures would include:

- Tier 1 common capital ratio;
- Concentration measure (the higher of the higher-risk concentrations measure or growth-adjusted portfolio concentrations measure);
- Core earnings to average total assets; and
- Credit quality measure (the higher of the criticized and classified items to Tier 1 capital and reserves or underperforming assets to Tier 1 capital and reserves).

[2] 12 CFR 327.9(d)(1) (2009).

The concentration measure score would equal the higher of the two scores that make up the concentration measure. The credit quality score would be based upon the higher of the criticized and classified items ratio score or the underperforming assets ratio score.

The score for each of the four measures would be multiplied by a respective weight and the resulting weighted score would be summed to arrive at an ability to withstand asset-related stress score, which could range from 0 to 100.

The FDIC recognizes that extreme values for some measures should have an additional effect on the final scorecard total. For extreme values of certain measures reflecting particularly high risk, the ability to withstand asset-related stress score could increase through outlier add-ons. Specifically, if an institution's ratio of criticized and classified items to Tier 1 capital and reserves exceeded 100 percent or its ratio of underperforming assets to Tier 1 capital and reserves exceeded 50.2 percent, the ability to withstand asset-related stress score would increase by 30 points. Additionally, if the higher risk concentration measure exceeded 4.8, the ability to withstand asset-related stress score would increase by 30 points. These increases (outlier add-ons) would be determined separately and could increase the total ability to withstand asset-related stress score by 60 points; thus, the total ability to withstand asset-related stress score could be as high as 160 points. This score would be given a weight of 50 percent when calculating an institution's performance score.

Ability to Withstand Funding-Related Stress Score. The ability to withstand funding-related stress component of the performance score would contain three measures most relevant to evaluating an institution's ability to withstand such stress:

- Core deposits to total liabilities ratio;
- Unfunded commitments to total assets ratio; and
- Liquid assets to short-term liabilities (liquidity coverage) ratio.

The ability to withstand funding-related stress component score would be the weighted average of the three funding-related stress measure scores. The total ability to withstand funding-related stress score could range from 0 to 100 and would be assigned a 20 percent weight when calculating an institution's performance score.

Calculation of the Performance Score. The weighted average CAMELS score, the total ability to withstand asset-related stress score, and the total ability to withstand funding-related stress would be multiplied by their respective weights and the result would be summed to arrive at the performance score. The performance score could be adjusted, up or down, by a maximum of 15 points, based upon significant factors that are not adequately captured in the scorecard. (Appendix E to the NPR lists some, but not all, of the criteria that would be considered in this adjustment.) The FDIC would use a process similar to the current large bank adjustment to determine the amount of any adjustment to the performance score.[3] The NPR would cap the total performance score at 100.

Loss Severity Score. The loss severity score would measure the relative magnitude of potential losses to the FDIC in the event of an institution's failure. The loss severity score would be calculated based on two measures that are most relevant to assessing an institution's potential loss severity:

Loss Severity Measure. The loss severity measure would be the ratio of possible losses to the FDIC in the event of an institution's failure to total domestic deposits, averaged over three quarters. A standardized set of assumptions—based on recent failures—regarding liability runoff and the recovery value of asset categories was applied to calculate possible losses to the FDIC. A loss severity measure is used as a part of the current large bank adjustment.[4] The loss severity measure would receive a 50 percent weighting when calculating an institution's loss severity score.

Secured Liabilities to Total Domestic Deposits. The second component of the loss severity score would be the ratio of secured liabilities to total domestic deposits. The FDIC would include such a measure since the greater an institution's secured liabilities relative to total domestic deposits, the greater the FDIC's potential rate of loss in the event of failure. This ratio would also receive a 50 percent risk weighting when calculating an institution's loss severity score.

Calculation of Loss Severity Score. Each of these two measures would be converted to a score between 0 and 100 and equally weighted to calculate a loss severity score. The FDIC could adjust the loss severity score, up or down, a maximum of 15 points, based on other significant risk factors specific to the institution that are not adequately captured in the scorecard. (Appendix E to the NPR lists some, but not all, of the criteria that would be considered in this adjustment.) The total loss severity score could not be less than 0 or more than 100 under the proposal.

Initial Base Assessment Rate. Once the total performance score and total loss severity scores were calculated, these scores would be converted to an initial base assessment rate. Details of the calculation for converting an institution's scores into its initial base assessment rate are provided in the NPR. The initial base assessment rate could

[3] 12 CFR 327.9(d)(4) (2010).

[4] 12 CFR Part 327 Subpart A, Appendix B (2009).

be adjusted as a result of the existing unsecured debt adjustment, secured liability adjustment and brokered deposit adjustment (discussed below).

Scorecard for Highly Complex Institutions. A "highly complex institution" would be defined as: (1) an insured depository institution (excluding a credit card bank) with greater than $50 billion in total assets that is wholly owned by a parent company with more than $500 billion in total assets, or wholly owned by one or more intermediate parent companies that are wholly owned by a holding company with more than $500 billion in assets, or (2) a processing bank and trust company with greater than $10 billion in total assets, provided that the information required to calculate assessment rates as a highly complex institution is readily available to the FDIC. The scorecard for highly complex institutions would include measures tailored to the risks posed by these institutions, but the methodology involved would be the same as used in the scorecard for all other large institutions.

Performance Score. The performance score for highly complex institutions would include four components: (1) weighted average CAMELS rating; (2) ability to withstand asset-related stress measures; (3) ability to withstand funding-related stress measures; and (4) market indicators component.

Weighted Average CAMELS Score. The methodology for calculating the weighted average CAMELS score would be the same as used in the scorecard for other large institutions, but in the case of highly complex institutions, this component of the performance score would be assigned a 20 percent weight.

Ability to Withstand Asset-Related Stress Score. The ability to withstand asset-related stress component of the performance score of highly complex institutions would add one measure to those used in the scorecard for other large institutions: the 10-day 99 percent Value at Risk (VaR). The components of the ability to withstand asset-related stress in highly complex institutions would include:

- Tier 1 common capital ratio;
- Concentration measure (the higher of the higher-risk concentrations measure or growth-adjusted portfolio concentrations measures);
- Core earnings to average total assets;
- Credit quality measure (the higher of the criticized and classified items to Tier 1 capital and reserves or underperforming assets to Tier 1 capital and reserves); and
- 10-day 99 percent VaR to Tier 1 capital.

The ability to withstand asset-related stress in highly complex institutions would be subject to the same outlier-add-ons as other large institutions.

Specifically, if a highly complex institution's ratio of criticized and classified items to Tier 1 capital and reserves exceeded 100 percent or its ratio of underperforming assets to Tier 1 capital and reserves exceeded 50.2 percent, the ability to withstand asset-related stress score would increase by 30 points. Additionally, if the higher risk concentration measure exceeded 4.8, the ability to withstand asset-related stress score would increase by 30 points. These increases (outlier add-ons) would be determined separately and could increase the total ability to withstand asset-related stress score of a highly complex institution by 60 points; thus, the total ability to withstand asset-related stress score could be as high as 160 points. This score would be given a weight of 50 percent when calculating an institution's performance score.

Ability to Withstand Funding-Related Stress Score. The ability to withstand funding-related stress component of the performance score for highly complex institutions would contain four measures most relevant to evaluating a highly complex institution's ability to withstand such stress:

- Core deposits to total liabilities ratio;
- Unfunded commitments to total assets ratio;
- Liquid assets to short-term liabilities (liquidity coverage) ratio; and
- Short-term funding to total assets ratio.

The ability to withstand funding-related stress component score would be the weighted average of these measures. The ability to withstand funding-related stress score could range from 0 to 100 and would be subject to one additional outlier add-on. The ability to withstand funding-related stress component score for highly complex institutions would be adjusted by 30 points if the ratio of short-term funding to total assets exceeded 26.9 percent. Including the outlier add-on, the total score for the ability to withstand funding-related stress for highly complex institution could be as high as 130 points. The total score for the ability to withstand funding-related stress would be assigned a 20 percent weight when calculating a highly complex institution's performance score.

Market Indicator. The market indicator component would be added to the performance scorecard of a highly complex institution and would contain only one measure—the senior bond spread score, and one outlier add-on—the institutions' parent company's tangible common equity (TCE) ratio.

The senior bond spread would be converted to a score of between 0 and 100. This score would be adjusted by up to 30 points if the TCE ratio were less than 4 percent. As a result, including the outlier add-on, the market indicator component score for a highly complex institution could be as high as 130 points. The market indicator score would be assigned a 10 percent weighting in calculating a highly complex institution's performance score.

Calculation of the Performance Score. The weighted average CAMELS score, the total ability to withstand asset-related stress score, the total ability to withstand funding-related stress, and the market indicator component score would be multiplied by their respective weights and the result would be summed to arrive at the performance score. The performance score could be adjusted, up or down, by a maximum of 15 points, based upon significant factors that are not adequately captured in the scorecard. (Appendix E to the NPR lists some, but not all, of the criteria that would be considered in this adjustment.) The FDIC would use a process similar to the current large bank adjustment to determine the amount of any adjustment to the performance score.[5] The total performance score would be capped at 100.

Loss Severity Score. The loss severity score for highly complex institutions would be calculated the same way as it would be calculated for other large institutions. As is the case for other large institutions, the loss severity score could be adjusted, up or down, by a maximum of 15 points, based upon significant factors that are not adequately captured in the scorecard. Again, the FDIC would use a process similar to the current large bank adjustment to determine the amount of any adjustment to the performance score.[6] (Appendix E to the NPR lists some, but not all, of the criteria that would be considered in this adjustment.) The resulting score could not be less than 0 or more than 100.

Initial Base Assessment Rate. The initial base assessment rate for highly complex institutions would be calculated from the total score in the same manner as for other large institutions. As in the case of other large institutions, the initial base assessment rate could be adjusted as a result of the existing unsecured debt adjustment, secured liability adjustment and brokered deposit adjustment (discussed below).

Liability-based Adjustments. The FDIC would continue to allow for adjustments to all large institutions' initial base assessment rate as a result of certain long-term unsecured debt, and secured liabilities.[7] The brokered deposit adjustment provided for under the current assessments rule would continue, but the NPR would extend the adjustment to all large institutions. The brokered deposit adjustment would include all brokered deposits as defined under current regulation, including reciprocal deposits, and brokered deposits that consist of balances swept into an insured institution by another institution.[8] The brokered deposit adjustment would be limited to those institutions whose ratio of brokered deposits to

[5] 12 CFR 327.9(d)(4) (2010).

[6] 12 CFR 327.9(d)(4) (2010).

[7] 12 CFR 327.9(d)(5) (2010) and 12 CFR 327.9(d)(6) (2010).

[8] 12 CFR 327.6 (2010) and 12 CFR 327.8(r) (2010).

domestic deposits is greater than 10 percent; asset growth rates would not affect the adjustment.

Calculation of Total Assessment Rates. The resulting assessment rate after making the liability-based adjustments to an institution's initial base assessment rate would be its total assessment rate. A large institution or highly complex institution's total assessment rate could not be more than 50 percent lower than its initial base assessment rate.

Assessment Rates. The FDIC proposes to establish new initial base assessment rates that would be subject to the liability-based adjustments as described above, effective January 1, 2011. The proposed initial and total base assessment rates for large institutions would be as follows:

Proposed Initial and Total Base Assessment Rates for Large Institutions (including Highly Complex Institutions)

	Large Institutions
Initial base assessment rate………….	10–50
Unsecured debt adjustment………..	–5–0
Secured liability adjustment……….	0–25
Brokered deposit adjustment………	0-10
TOTAL BASE ASSESSMENT RATE	5–85

All amounts are in basis points annually. Total base rates that are not the minimum or maximum rate will vary between these rates. All rates shown would increase 3 basis points on January 1, 2011, pursuant to the FDIC Amended Restoration Plan adopted on September 29, 2009. 74 FR 51062 (Oct. 2, 2009).

The proposed initial and total base assessment rates for small institutions and insured branches of foreign banks would be as follows:

Proposed Initial and Total Base Assessment Rates for Small Institutions and Insured Branches of Foreign Banks

	Risk Category I	Risk Category II	Risk Category III	Risk Category IV
Initial base assessment rate……………….	10–14	22	34	50
Unsecured debt adjustment………..	–5–0	–5–0	–5–0	–5–0
Secured liability adjustment……….	0–7	0–11	0–17	0–25
Brokered deposit adjustment………	…………	0– 10	0–10	0–10
TOTAL BASE ASSESSMENT RATE	5–21	17–43	29–61	45–85

All amounts for all risk categories are in basis points annually. Total base rates that are not the minimum or maximum rate will vary between these rates. All rates shown would increase 3 basis points on January 1, 2011, pursuant to the FDIC Amended Restoration Plan adopted on September 29, 2009. 74 FR 51062 (Oct. 2, 2009).

Assessment rate calculators are available at http://wwwdev/deposit/insurance/proposed_calc.html to assist insured depository institutions in estimating their assessment amounts under the proposal.

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