Proposed Rules

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This section of the FEDERAL REGISTER contains notices to the public of the proposed issuance of rules and regulations. The purpose of these notices is to give interested persons an opportunity to participate in the rule making prior to the adoption of the final rules.

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 327

Proposed Assessment Rate Adjustment Guidelines for Large and Highly Complex Institutions

AGENCY: Federal Deposit Insurance Corporation (FDIC).

ACTION: Request for comment.

SUMMARY: The FDIC seeks comment on proposed guidelines that would be used to determine how adjustments could be made to the total scores that are used in calculating the deposit insurance assessment rates of large and highly complex insured institutions. Total scores are determined according to the Assessments and Large Bank Pricing approved by the FDIC Board on February 7, 2011.

DATES: Comments must be received on or before May 31, 2011.

ADDRESSES: You may submit comments, identified by "Adjustment Guidelines," by any of the following methods:

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

Instructions: All submissions received must include the agency name and "Adjustment Guidelines" in the heading. All comments received will be posted to the extent practicable and, in some instances, the FDIC may post summaries of categories of comments, with the comments themselves available in the FDIC's reading room. Comments will be posted at *http://www.fdic.gov/regulations/laws/federal/propose.html,* including any personal information provided.

FOR FURTHER INFORMATION CONTACT: Lisa Ryu, Chief, Large Bank Pricing Section, Division of Insurance and Research, (202) 898–3538; Andrew Felton, Acting Chief, Large Bank Pricing Section, Division of Insurance and Research, (202) 898–3823; Mike Anas, Senior Financial Analyst, Division of Insurance and Research, (630) 241–0359 x 8252; and Christopher Bellotto, Counsel, Legal Division, (202) 898–3801, 550 17th Street, NW., Washington, DC 20429.

SUPPLEMENTARY INFORMATION:

I. Background

On February 7, 2011 (76 FR 10672 (Feb. 25, 2011)), the FDIC Board amended its assessment regulations (the Amended Assessment Regulations), by, among other things, adopting a new methodology for determining assessment rates for large institutions.[1] [2] The Amended Assessment Regulations eliminate risk categories for large institutions and combine CAMELS ratings and forward-looking financial measures into one of two scorecards, one for highly-complex institutions and another for all other large institutions.[3] Each of the two scorecards produces two scores—a performance score and a loss severity score—that are combined into a total score, which cannot be greater than 90 or less than 30. The FDIC can adjust a bank's total score up or down by no more than 15 points, but the resulting score cannot be greater than 90 or less than 30. The score is then converted to an initial base assessment rate, which, after application of other possible adjustments, results in a total assessment rate.[4] The total assessment rate is multiplied by the bank's assessment base to calculate the amount of its assessment obligation.

Tables 1 and 2 show the scorecards for large and highly complex institutions, respectively.

TABLE 1—SCORECARD FOR LARGE INSTITUTIONS

Scorecard measures and components	Measure weights (percent)	Component weights (percent)
P Performance Score		
P.1 *Weighted Average CAMELS Rating*	100	*30*
P.2 *Ability to Withstand Asset-Related Stress:*		*50*
Tier 1 Leverage Ratio	10	
Concentration Measure	35	
Core Earnings/Average Quarter-End Total Assets *	20	

[1] Assessments, Large Bank Pricing, 76 FR 10672 (February 25, 2011) (to be codified at 12 CFR 327.9).

[2] A large institution is defined as an insured depository institution: (1) That had assets of $10 billion or more as of December 31, 2006 (unless, by reporting assets of less than $10 billion for four consecutive quarters since then, it has become a small institution); or (2) that had assets of less than $10 billion as of December 31, 2006, but has since had $10 billion or more in total assets for at least four consecutive quarters, whether or not the institution is new.

[3] A "highly complex institution" is defined as: (1) An insured depository institution (excluding a credit card bank) that has had $50 billion or more in total assets for at least four consecutive quarters and that either is controlled by a U.S. parent holding company that has had $500 billion or more in total assets for four consecutive quarters, or is controlled by one or more intermediate U.S. parent holding companies that are controlled by a U.S. holding company that has had $500 billion or more in assets for four consecutive quarters, and (2) a processing bank or trust company. A processing bank or trust company is an insured depository institution whose last three years' non-lending interest income, fiduciary revenues, and investment banking fees, combined, exceed 50 percent of total revenues (and its last three years' fiduciary revenues are non-zero), whose total fiduciary assets total $500 billion or more and whose total assets for at least four consecutive quarters have been $10 billion or more.

[4] These adjustments are the unsecured debt adjustment, the depository institution debt adjustment, and the brokered deposit adjustment.

TABLE 1—SCORECARD FOR LARGE INSTITUTIONS—Continued

Scorecard measures and components	Measure weights (percent)	Component weights (percent)
Credit Quality Measure	35	
P.3 *Ability to Withstand Funding-Related Stress:*		*20*
Core Deposits/Total Liabilities	60	
Balance Sheet Liquidity Ratio	40	
L Loss Severity Score		
L.1 *Loss Severity Measure*		*100*

* Average of five quarter-end total assets (most recent and four prior quarters).

TABLE 2—SCORECARD FOR HIGHLY COMPLEX INSTITUTIONS

Measures and components	Measure weights (percent)	Component weights (percent)
P Performance Score		
P.1 *Weighted Average CAMELS Rating*	100	*30*
P.2 *Ability to Withstand Asset-Related Stress:*		*50*
Tier 1 Leverage Ratio	10	
Concentration Measure	35	
Core Earnings/Average Quarter-End Total Assets	20	
Credit Quality Measure and Market Risk Measure	35	
P.3 *Ability to Withstand Funding-Related Stress:*		*20*
Core Deposits/Total Liabilities	50	
Balance Sheet Liquidity Ratio	30	
Average Short-Term Funding/Average Total Assets	20	
L Loss Severity Score		
L.1 *Loss Severity*		*100*

* Average of five quarter-end total assets (most recent and four prior quarters).

Scorecard measures (other than the weighted average CAMELS rating) are converted to scores between 0 and 100 based on minimum and maximum cutoff values for each measure. A score of 100 reflects the highest risk and a score of 0 reflects the lowest risk. A value reflecting lower risk than the cutoff value receives a score of 0 and a value reflecting higher risk than the cutoff value receives a score of 100. A risk measure value between the minimum and maximum cutoff values converts linearly to a score between 0 and 100, which is rounded to 3 decimal points. The weighted average CAMELS rating is converted to a score between 25 and 100, where 100 reflects the highest risk and 25 reflects the lowest risk.

In most cases, the total score produced by the applicable scorecard will correctly reflect an institution's overall risk relative to other large institutions; however, the scorecard includes assumptions that may not be appropriate for all institutions. Therefore, the FDIC believes that it is important that it have the ability to consider idiosyncratic or other relevant risk factors that are not adequately captured in the scorecards and make appropriate adjustments to an institution's total score. The Amended Assessment Regulations state that, after consultation with an institution's primary Federal regulator, the FDIC may make a limited adjustment to an institution's total score based upon risks that are not adequately captured in the scorecard. The Amended Assessment Regulations provide that no new adjustments will be made until new guidelines have been published for comment and approved by the FDIC's Board of Directors.[5]

The proposed guidelines describe the process the FDIC would follow to determine whether to make an adjustment and to determine the size of any adjustment. This request for comments also outlines the process the FDIC would use when notifying an institution regarding an adjustment.

These proposed guidelines would supersede the large bank pricing adjustment guidelines published by the FDIC on May 14, 2007 (the 2007 Guidelines).[6] The 2007 Guidelines outline the adjustment process for the large bank assessment system then in effect. The Amended Assessment Regulations include scorecards that explicitly incorporate some of the risks that were previously captured primarily through large bank adjustments. The proposed guidelines take these changes into account; however, the processes for communicating with affected institutions and implementing adjustments once determined remain largely unchanged from the 2007 Guidelines, except that the FDIC is now explicitly allowing institutions to request a large bank adjustment.

The FDIC seeks comments on the proposed guidelines and the procedures for making an adjustment to an institution's score. Although the FDIC has in this instance chosen to publish the proposed guidelines and solicit comment from the industry, notice and comment are not required and need not be employed to make future changes to the guidelines.

[5] The Amended Assessment Regulations also require that the FDIC publish aggregate statistics on adjustments each quarter once the guidelines are adopted. 76 FR 10699.

[6] Assessment Rate Adjustment Guidelines for Large Institutions and Insured Foreign Branches in Risk Category I, 72 FR 27122 (May 14, 2007).

II. Overview of Proposed Guidelines on Large Bank Adjustment

The proposed large bank adjustment process would be based on a set of guidelines designed to ensure that the adjustment process is fair and transparent and that any decision to adjust a score is well supported. The following general guidelines would govern the adjustment process, which is described in greater detail below.

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.
- The FDIC would primarily consider two types of information in determining whether to make a large bank adjustment: 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); or 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.
- 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, the use and management of government support programs, 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 in 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 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 meaningful adjustment of the institution's total score (generally, an adjustment of five points or more).

Procedural Guidelines

The processes for communicating with affected institutions and implementing adjustments once determined would remain largely unchanged by this proposal, except that the FDIC would now explicitly allow institutions to request 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, the size of the proposed adjustment or removal, specify when the adjustment or removal would take effect, and provide institutions with up to 60 days to respond.
- The FDIC would re-evaluate the need for total score adjustments on a quarterly basis.
- Institutions could make written request to the FDIC for an adjustment, but must support the request with evidence of a material risk or risk-mitigating factor that is not adequately accounted for in the scorecard.
- An institution could 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 CFR 327.4(c). An institution could similarly request review of or appeal a decision not to apply an adjustment following a request by the institution for an adjustment.

III. The Assessment Rate Adjustment Process

A. Identifying the Need for an Adjustment

The FDIC believes that any adjustment should improve the rank ordering of institutions according to risk. Institutions with similar risk profiles should have similar total scores and corresponding initial assessment rates, and institutions with higher or lower risk profiles should have higher or lower total scores and initial assessment rates, respectively. The FDIC would evaluate scorecard results each quarter to identify institutions with a score that is clearly too high or too low when considered in light of risks or risk-mitigating factors that are inadequately accounted for by the scorecard. Some examples of these types of risks and risk-mitigating factors include considerations for purchased credit impaired (PCI) loans, accounting rule changes such as FAS 166/167, credit underwriting and credit administration practices, collateral and other risk mitigants, including the materiality of guarantees and franchise value. Commenters on the proposed large bank pricing rule published on November 9, 2010 (the Large Bank NPR) [7] suggested that these factors be considered in determining an institution's assessment rate. As discussed in the preamble to the Final Rule on Assessments and Large Bank Pricing approved by the FDIC Board in February 2011, the FDIC stated that it would consider these factors in the large bank assessment rate adjustments.[8]

In addition to considering an institution's relative risk ranking among all large institutions, the FDIC would consider how an institution compares to similar institutions. The comparison would allow the FDIC to account for variations in risk measures that may exist among institutions with differing business models. For purposes of the comparison, the FDIC would, where appropriate, assign an institution to a peer group. The proposed peer groups are:

Processing Banks and Trust Companies: Large institutions whose last three years' non-lending interest income, fiduciary revenues, and investment banking fees, combined, exceed 50 percent of total revenues (and its last three years' fiduciary revenues

[7] 75 FR 72612 (Nov. 24, 2010).

[8] 76 FR 10672 (Feb. 25, 2011).

are non-zero), and whose total fiduciary assets total $500 billion or more.

Residential Mortgage Lenders: Large institutions not described in the peer group above whose mortgage loans plus mortgage-backed securities exceed 50 percent of total assets.

Non-diversified Regional Institutions: Large institutions not described in a peer group above if: credit card plus securitized receivables exceed 50 percent of assets plus securitized receivables; or the sum of residential mortgage loans, credit card loans, and other loans to individuals exceeds 50 percent of assets.

Large Diversified Institutions: Large institutions not described in a peer group above with over $150 billion in assets.

Diversified Regional Institutions: Large institutions not described in a peer group above with less than $150 billion in assets.

An institution can also request that the FDIC make an adjustment to its score by submitting a written request to the FDIC's Director of the Division of Insurance and Research in Washington, DC. Similar to FDIC-initiated adjustments, an institution's request for an adjustment would be considered only if it is supported by evidence of a material risk or risk-mitigating factor that is not adequately accounted for in the scorecard. The FDIC would consider these requests as part of its ongoing effort to identify and adjust scores that require adjustment. An institution-initiated request would not preclude a subsequent request for review (12 CFR 327.4(c)) or appeal pursuant to the assessment appeals process.[9]

B. Determining the Adjustment Amount

Once it determines that an adjustment may be warranted, the FDIC would determine the adjustment amount necessary to bring an institution's total score into better alignment with those of other institutions that pose similar levels of risk. The FDIC would initiate adjustments only when a combination of risk measures and other information suggests either materially higher or lower risk than their total scores indicate, generally resulting in an adjustment of an institution's total score by five points or more. The FDIC believes that the adjustment process should be used to address material idiosyncratic issues in a small number of institutions rather than as a fine-tuning mechanism for a large number of institutions. If the size of the adjustment required to align an institution's total score with institutions of similar risk is not material, no adjustment would be made.

B. Further Analysis and Consultation With Primary Federal Regulator

As under the 2007 Guidelines, before making an adjustment, the FDIC would consult with an institution's primary Federal regulator and state banking supervisor to obtain further information and comment.

C. Advance Notice

Decisions to lower an institution's total score would not be communicated to institutions in advance. Rather, as under the 2007 Guidelines, they would be reflected in the invoices for a given assessment period along with the reasons for the adjustment.

To give an institution an opportunity to respond, the FDIC would give advance notice to an institution when proposing to make an upward adjustment to the institution's total score.[10] Consistent with the 2007 Guidelines, the timing of the notice would correspond approximately to the invoice date for an assessment period. For example, an institution would be notified of a proposed upward adjustment to its assessment rates covering the period April 1 through June 30 by approximately June 15, which is the invoice date for the January 1 through March 31 assessment period.[11]

D. Institution's Opportunity To Respond

Before implementing an upward adjustment to a total score, the FDIC would review the institution's response to the advance notice, along with any subsequent changes to supervisory ratings, scorecard measures, or other relevant risk factors. Similar to the 2007 Guidelines, if the FDIC decided to implement the upward adjustment, it would notify an institution of its decision along with the invoice for the quarter in which the adjustment would become effective.

Extending the example above, if the FDIC notified an institution of a proposed upward adjustment on June 15, the institution would have 60 days from this date to respond to the notification. If, after evaluating the institution's response and updated information for the quarterly assessment period ending June 30, the FDIC decided to proceed with the adjustment, it would communicate this decision to the institution by approximately September 15, which is the invoice date for the April 1 through June 30 assessment period. In this case, the adjusted rate would be reflected in the September 15 invoice.

The time frames and example above also apply to a decision by the FDIC to remove a previously implemented downward adjustment as well as a decision to increase a previously implemented upward adjustment.

E. Duration of the Adjustment

Consistent with the 2007 Guidelines, the adjustment would remain in effect for subsequent assessment periods until the FDIC determined either that the adjustment was no longer warranted or that the magnitude of the adjustment needed to be reduced or increased (subject to the 15-point limitation and the requirement for further advance notification).[12]

F. Requests for Review and Appeals

An institution could 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 CFR 327.4(c). An institution could similarly request review of or appeal a decision not to apply an adjustment following a request by the institution for an adjustment.

IV. Additional Information on the Adjustment Process, Including Examples

As discussed above, the FDIC would primarily consider two types of information in determining whether to make a large bank adjustment: Scorecard measure outliers or information not directly captured in the scorecard, including complementary quantitative risk measures and qualitative risk considerations.

A. Scorecard Measure Outliers

In order to convert each scorecard ratio into a score that ranges between 0 and 100, the Amended Assessment Regulations use minimum and maximum cutoff values that generally correspond to the 10th and 90th percentile values for each ratio based on data for the 2000 to 2009 period. All values less than the 10th percentile or all values greater than the 90th

[9] See Guidelines for Appeals of Deposit Insurance Assessment Determinations, 75 FR 20362 (April 19, 2010).

[10] The institution would also be given advance notice when the FDIC determines to eliminate any downward adjustment to an institution's total score.

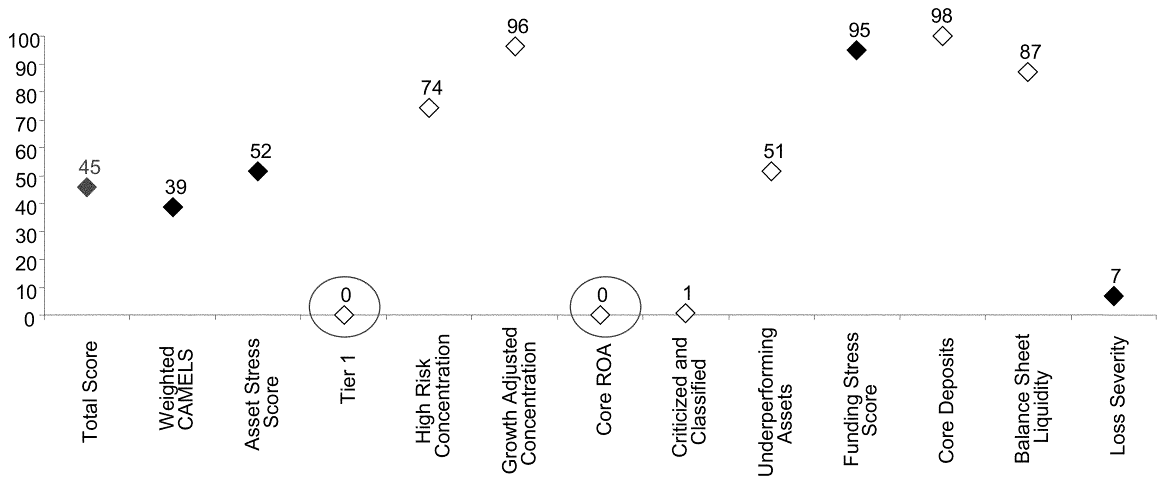
[11] The invoice covering the assessment period January 1 through March 31 in this example would not reflect the upward adjustment.

[12] As noted in the Amended Assessments Regulation, an institution's assessment rate can increase without notice if the institution's supervisory, agency ratings, or financial ratios deteriorate.

percentile are assigned the same score. This process enables the FDIC to compare different ratios in a standardized way and assign statistically-based weights; however, it may mask significant differences in risk among institutions with the minimum or maximum score. The FDIC believes that an institution with one or more scorecard ratios well in excess of the maximum cutoffs or well below the minimum cutoffs may pose significantly greater or lower risk to the deposit insurance fund than its score suggests.

The example below illustrates the analytical process the FDIC would follow in determining to propose a downward adjustment based on scorecard measure outliers. The example is merely illustrative. As shown in Chart 1, Bank A has a total score of 45 and two scorecard measures with a score of 0 (indicating lower risk).

Chart 1
Total and Component Scores for Bank A



Note: Solid diamonds denote either the total score or scorecard component scores; clear diamonds denote scores for the scorecard measures that make up the components.

Since at least one of the scorecard measures has a score of 0, the FDIC would further review whether the ratios underlying these measures materially differ from the cutoff value associated with a score of 0. Materiality would generally be determined by the amount that the underlying ratio differed from the relevant cutoff as a percentage of the overall scoring range (the maximum cutoff minus the minimum cutoff). Table 3 shows that Bank A's Tier 1 Leverage ratio (17 percent) far exceeds the cutoff value associated with a score of 0 (13 percent), with the difference representing 57 percent of the associated scoring range. Based on this additional information and assuming no other mitigating factors, the FDIC could determine that the Bank A's loss absorbing capacity is not fully recognized, particularly when compared with other institutions receiving the same overall score. By contrast, Bank A's Core ROA ratio is much closer to its cutoff values, suggesting that an adjustment based on consideration of those factors may not be justified.

TABLE 3—OUTLIER ANALYSIS FOR BANK A

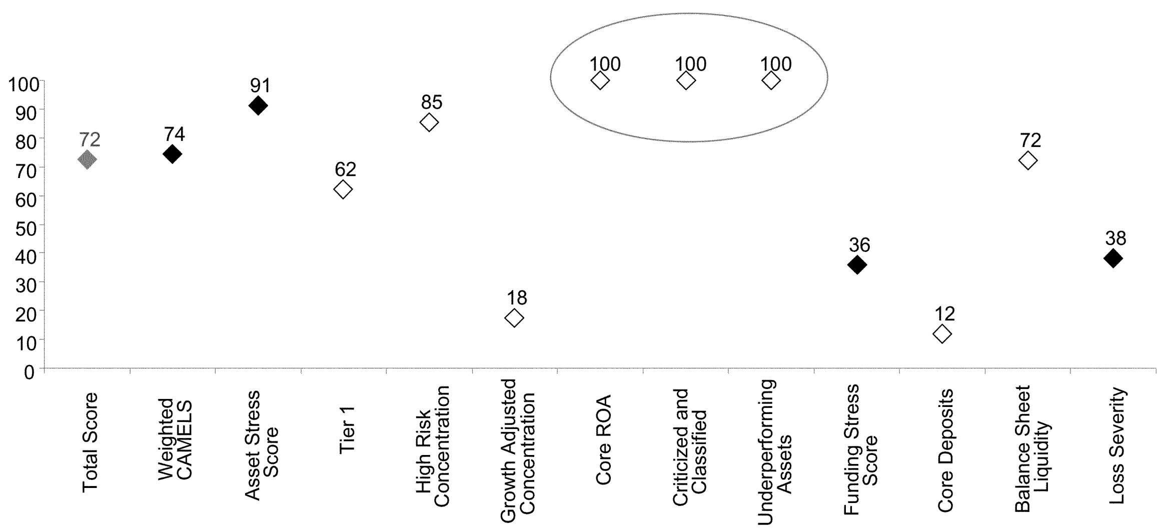
Scorecard measure	Score	Cutoffs		Value (percent)	Outlier amount (value minus cutoff) as percentage of the scoring range (percent)
		Minimum (percent)	Maximum (percent)		
Core ROA	0	0	2	2.08	4
Tier 1 Capital Ratio	0	6	13	17	57

Before initiating an adjustment, however, the FDIC would consider whether Bank A had significant risks that were not captured in the scorecard. If no information on such risks existed, the FDIC would initiate a downward adjustment to Bank A's total score.

The amount of the adjustment would be the amount needed to make the total score consistent with those of banks of comparable overall risk, with particular emphasis on institutions of the same institution type (*e.g.,* diversified regional institutions), as described above. Typically, however, adjustments supported by only one extreme outlier value would be less than the FDIC's potential adjustment authority of 15 points. In the case of multiple outlier values, inconsistent outlier values, or outlier values that are exceptionally beyond the scoring range, an overall analysis of each measure's relative importance may call for higher or lower adjustment amounts. For Bank A, a 5-point adjustment may be most appropriate.

The next example illustrates the analytical process the FDIC would follow in determining to propose an upward adjustment based on scorecard measure outliers. As in the example above, the example is merely illustrative; an institution with less extreme values could also receive an upward adjustment. As shown in Chart 2, Bank B has a total score of 72 and three scorecard measures with a score of 100 (indicating higher risk).

Chart 2
Total and Component Scores for Bank B



Note: Solid diamonds denote either the total score or scorecard component scores; clear diamonds denote scores for the scorecard measures that make up the components.

Since at least one of the scorecard measures has a score of 100, the FDIC would further review whether the ratios underlying these measures materially exceed the cutoff value associated with a score of 100. Table 4 shows that Bank B's Criticized and Classified Items to Tier 1 Capital and Reserves ratio (198 percent) far exceeds the cutoff value associated with a score of 100 (100 percent), with the difference representing 105 percent of the associated scoring range. Based on this additional information and assuming no other mitigating factors, the FDIC could determine that the risk associated with Bank B's ability to withstand asset-related stress and, therefore, its overall risk, may be materially greater than its score suggests, particularly when compared with other institutions receiving the same overall score. By contrast, the Core ROA and Underperforming Assets to Tier 1 Capital and Reserves values are much closer to their respective cutoff values, suggesting that an adjustment based on these factors may not be justified.

TABLE 4—OUTLIER ANALYSIS FOR BANK B

Scorecard measure	Score	Cutoffs		Value (percent)	Outlier amount (value minus cutoff) as percentage of the scoring range (percent)
		Minimum (percent)	Maximum (percent)		
Core ROA	100	0	2	−0.05	−3
Criticized and Classified to Tier 1 Capital & Reserves	100	7	100	198	105
Underperforming Assets to Tier 1 Capital & Reserves	100	2	35	36	3

After considering any risk-mitigating factors, the FDIC would determine the amount of adjustment needed to make the total score consistent with those of banks of comparable overall risk. For Bank B, a 5-point adjustment may be most appropriate.

B. Information Not Directly Captured by the Scorecard

1. Complementary Risk Measures

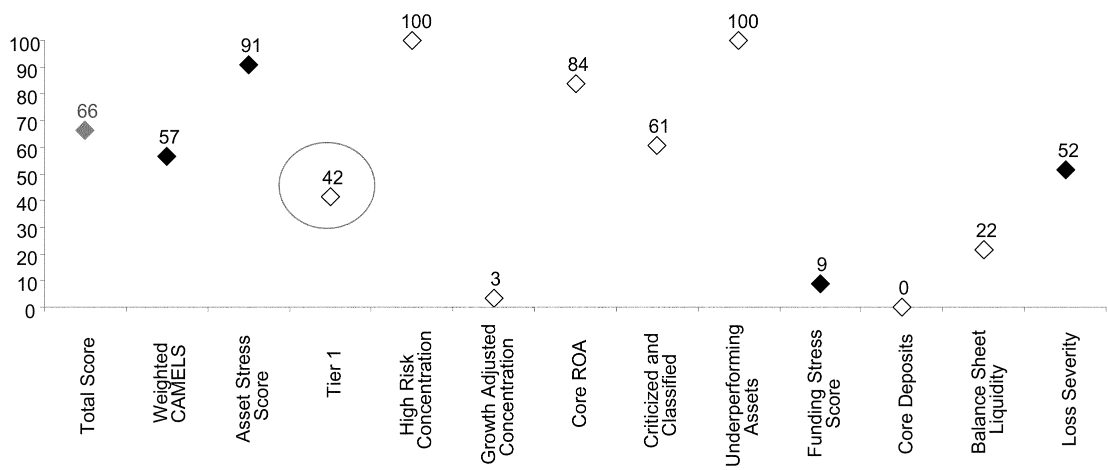
Complementary risk measures are measures that are not included in the scorecard, but that can inform the appropriateness of a given scorecard measure for a particular institution. These measures are readily available for all institutions and include quantitative metrics and market indicators that provide further insights into an institution's ability to withstand financial adversity, and the severity of losses in the event of failure.[13]

Analyzing complementary risk measures would help the FDIC determine whether the assumptions applied to a scorecard measure are appropriate for a particular institution. For example, as detailed in the Amended Assessments Regulation, the scorecard includes a loss severity measure based on the FDIC's loss severity model that applies a standard set of assumptions to all large banks to estimate potential losses to the insurance fund. These assumptions, including liability runoffs and asset recovery rates, are derived from actual bank failures; however, the FDIC recognizes that a large bank may have unique attributes that could have a bearing on the appropriateness of those assumptions. When data or quantitative metrics exist that support materially different runoff assumptions or asset recovery rates for a particular institution, the FDIC may consider an adjustment to the total score, particularly if such information is further supported by qualitative loss severity considerations as discussed below.

The example below illustrates the analytical process the FDIC would follow in determining to propose an upward adjustment based on complementary risk measures. Again, the example is merely illustrative. Chart 3 shows that Bank C has a total score of 66. Some of Bank C's risk measure scores are significantly higher than the total score, while others, including the Tier 1 leverage ratio score (42), are significantly lower.

Chart 3

Total Score and Component Scores for Bank C



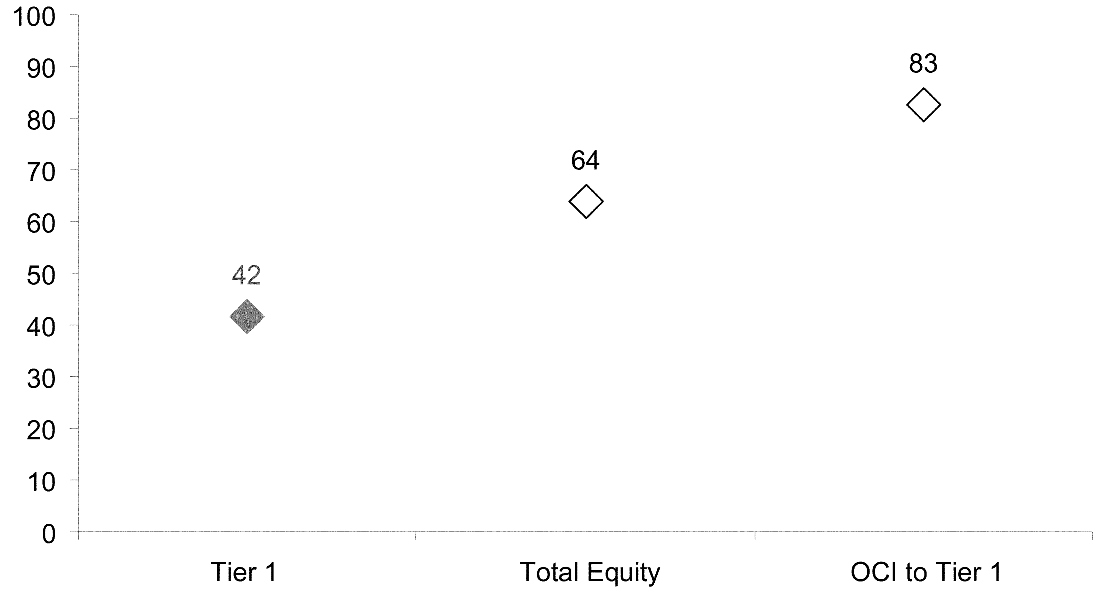
Note: Solid diamonds denote either the total score or scorecard component scores; clear diamonds denote scores for the scorecard measures that make up the components.

After reviewing complementary measures for all financial ratios contained in the scorecard, in the hypothetical example, the complementary measures for Tier 1 leverage ratio showed that the level and quality of capital protection may not be correctly reflected in the Tier 1 leverage ratio score. Chart 4 shows that two other complementary capital measures for Bank C—the total equity ratio and the ratio of other comprehensive income (OCI) to Tier 1 capital—suggest higher risk than the Tier 1 leverage ratio score suggests. Additional review reveals that sizeable unrealized losses in the securities portfolio account for these differences and that Bank C's loss absorbing capacity is potentially overstated by the Tier 1 leverage ratio.

[13] In the context of large institution insurance pricing, loss severity refers to the relative loss, scaled to its current domestic deposits, that an institution poses to the Deposit Insurance Fund in the event of a failure.

Chart 4

Complementary Risk Measures for Capital for Bank C



Note: The solid diamond denotes a scorecard measure; the clear diamonds denote complementary risk measures.

An upward adjustment to Bank C's total score may be appropriate, again assuming that no significant risk mitigants are evident. An adjustment of 5 points would be likely since the underlying level of unrealized losses is extremely high (greater than 25% of Tier 1 capital). While the adjustment in this case would likely be limited to 5 points because the bank's concentration measure and credit quality measure already receive the maximum possible score, in other cases modest unrealized losses could lead to a higher overall adjustment amount, if the concentration and credit quality measures are understated as well.[14]

2. Qualitative Risk Considerations

The FDIC believes that it is important to consider all relevant qualitative risk considerations in determining whether to apply a large bank adjustment. Qualitative information often provides significant insights into institution-specific or idiosyncratic risk factors that cannot be captured in the scorecard. Similar to scorecard outliers and complementary risk measures, the FDIC would use the qualitative information to consider whether potential discrepancies exist between the risk ranking of institutions based on their total score and the relative risk ranking suggested by a combination of risk measures and qualitative risk considerations. Such information includes, but is not limited to, analysis based on information obtained through the supervisory process, such as underwriting practices, interest rate risk exposure and other information obtained through public filings.

Another example of qualitative information that the FDIC would consider is available information pertaining to an institution's ability to withstand adverse events. Sources of this information are varied but may include analyses produced by the institution or supervisory authorities, such as stress test results, capital adequacy assessments, or information detailing the risk characteristics of the institution's lending portfolios and other businesses. Information pertaining to internal stress test results and internal capital adequacy assessment would be used qualitatively to help inform the relative importance of other risk measures, especially concentrations of credit exposures and other material non-lending business activities. As an example, in cases where an institution has a significant concentration of credit risk, results of internal stress tests and internal capital adequacy assessments could obviate FDIC concerns about this risk and therefore provide support for a downward adjustment, or alternatively, provide additional mitigating information to forestall a pending upward adjustment. In some cases, stress testing results may suggest greater risk than would normally be evident through the scorecard methodology alone.

Qualitative risk considerations would also include information that could have a bearing on potential loss severity, and could include, for example, the ease with which the FDIC could make quick deposit insurance determinations and depositor payments, or the availability of sufficient information on qualified financial contracts to allow the FDIC to make timely and correct determinations on these contracts in the event of failure.

In general, qualitative factors would become more important in determining whether to apply an adjustment when an institution has high performance risk

[14] The concentration measure and the credit quality measure are expressed as a percent of Tier 1 capital plus the allowance for loan loss reserves.

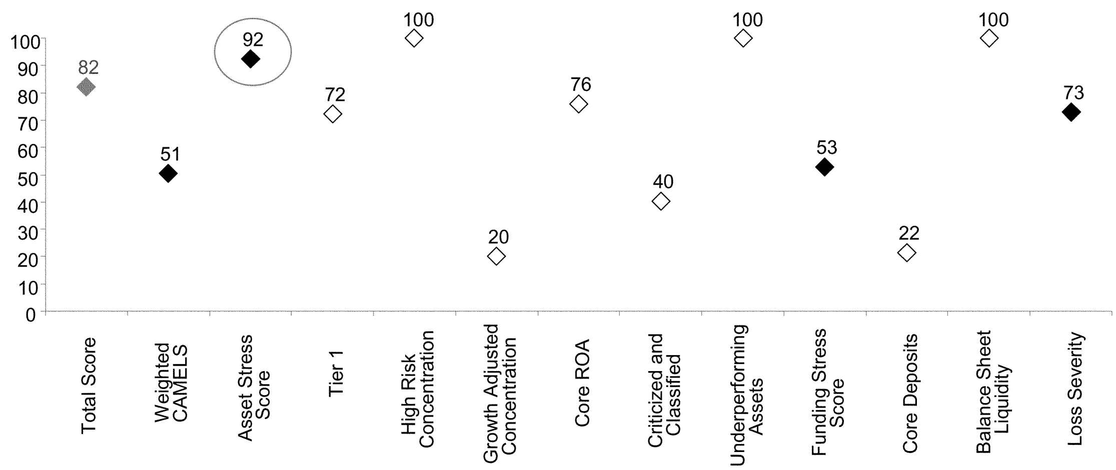
or if the institution has high asset, earnings, or funding concentrations. For example, if a bank is near failure, qualitative loss severity information becomes more important in the adjustment process. Further, if a bank has material concentrations in some asset classes, the quality of underwriting becomes more important in the adjustment process.

Additionally, engaging in certain business lines may warrant further consideration of qualitative factors. For instance, supervisory assessments of operational risk and controls at processing banks are likely to be important regardless of the institution's performance.

The specific example below illustrates the analytical process the FDIC would follow to determine whether to make an adjustment based on qualitative information. Chart 5 shows that Bank D has a high score of 82 that is largely driven by a high score for the ability to withstand asset-related stress component, which is, in turn, largely driven by the higher-risk asset concentration score and the underperforming asset score. The ability to withstand asset-related stress component is heavily weighted in the scorecard (50 percent weight), and, as a result, significant qualitative information that is not considered in the scorecard could lead to an adjustment to the institution's total score.

Chart 5

Total Score and Component Scores for Bank D



Note: Solid diamonds denote either the total score or scorecard component scores; clear diamonds denote scores for the scorecard measures that make up the components.

The FDIC would review qualitative information pertaining to the higher-risk asset concentration measure and the underperforming asset measure for Bank D to determine whether there are one or more important risk mitigants that are not factored into the scorecard. We assume that the further review revealed that, while Bank D has concentrations in non-traditional mortgages, its mortgage portfolio has the following characteristics that suggest lower risk:

a. Most of the loan portfolio is composed of bank-originated residential real estate loans on owner-occupied properties;

b. The portfolio has strong collateral protection (*e.g.,* few or no loans with a high loan-to-value ratio) compared to the rest of the industry;

c. Debt service coverage ratios are favorable (*e.g.,* few or no loans with a high debt-to-income ratio) compared to the institution's peers;

d. The primary Federal regulator notes in its examination report that the institution has strong collection practices and reports no identified risk management deficiencies.

Additionally, these qualitative factors surrounding the bank's real estate portfolio suggest loss rate assumptions applied to Bank D's residential mortgage portfolio may be too severe, resulting in a loss severity score that is too high relative to its risk.

Based on the information above, the bank would be a strong candidate for a 10- to 15-point reduction in total score, primarily since the ability to withstand asset-related stress score and loss severity score do not reflect a number of significant qualitative risk mitigants that suggest lower risk.

V. Request for Comment

The FDIC seeks comment on all aspects of the proposed guidelines for determining how to make potential adjustments to the initial total score of large institutions. In particular, the FDIC seeks comment on:

1. Whether the proposed guidelines governing the adjustment process are appropriate and sufficient to ensure fairness and consistency in deposit insurance pricing determinations. More specifically the FDIC seeks comment on the appropriateness of the following:

a. Reviewing outlier values on scorecard risk measures;

b. Augmenting the analysis of scorecard risk measures with a review of additional complementary and qualitative risk measures;

c. Basing adjustment decisions on considerations of multiple risk indicators;

d. Assessing financial performance risk measures relative to other institutions engaged in similar business activities; and

e. Using additional risk information, including qualitative information, to determine the magnitude of adjustment to an institution's total score that would be necessary to bring its total score into better alignment with institutions with similar risk profiles.

2. Are there additional guidelines that should govern the analytical process to ensure fairness and consistency in deposit insurance pricing determinations?

3. What qualitative information should the FDIC use to best evaluate loss severity?

4. Are the proposed guidelines for controlling the assessment rate adjustment process sufficient to ensure that adjustment decisions are justified, fully supported, and take into account the views of the primary Federal regulator and the institution?

VI. Paperwork Reduction Act

A. Request for Comment on Proposed Information Collection

In accordance with the Paperwork Reduction Act (44 U.S.C. 3501 *et seq.*) the FDIC may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid Office of Management and Budget (OMB) control number. The collection of information contained in this proposed rule is being submitted to OMB for review.

Interested parties may submit written comments to the FDIC concerning the Paperwork Reduction Act (PRA) implications of this proposal. Commenters should refer to "PRA Comments—Adjustment Guidelines" in the subject line. Comments may be submitted by any of the following methods:

- Agency Web site: *http://www.fdic.gov/regulations/laws/federal/propose.html.* Follow instructions for submitting comments on the Agency Web site.
- E-mail: *Comments@FDIC.gov.* Include "PRA Comments—Adjustment Guidelines, 3064–ADXX" in the subject line of the message.
- Mail: Gary A. Kuiper, Counsel, F–1086, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.
- Hand Delivery/Courier: Guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7 a.m. and 5 p.m.

A copy of the comments may also be submitted to the OMB desk officer for the FDIC, Office of Information and Regulatory Affairs, Office of Management and Budget, New Executive Office Building, Washington, DC 20503.

Comment is solicited on:

(1) Whether the proposed collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility;

(2) The accuracy of the agency's estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used;

(3) The quality, utility, and clarity of the information to be collected;

(4) Ways to minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology; e.g., permitting electronic submission of responses; and

(5) Estimates of capital or start-up costs and costs of operation, maintenance, and purchases of services to provide information.

B. Proposed Information Collection

An information collection would occur when a large or highly complex insured depository institution makes a written request that the FDIC make an adjustment to its total score. An institution's request for adjustment would be considered only if it is supported by evidence of a material risk or risk-mitigating factor that is not adequately accounted for in the scorecard.

Respondents: Large and Highly Complex insured depository institutions.

Number of responses: 0–11 per year.

Frequency of response: Occasional.

Average number of hours to prepare a response: 8 hours.

Total annual burden: 0–88 hours.

Dated at Washington, DC, this 12th day of April 2011.

By order of the Board of Directors.

Federal Deposit Insurance Corporation.

Robert E. Feldman,

Executive Secretary.

[FR Doc. 2011–9209 Filed 4–14–11; 8:45 am]

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FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Parts 329 and 330

RIN 3064–AD78

Interest on Deposits; Deposit Insurance Coverage

AGENCY: Federal Deposit Insurance Corporation (FDIC).

ACTION: Notice of proposed rulemaking (NPR) and request for comment.

SUMMARY: Effective July 21, 2011, the statutory prohibition against the payment of interest on demand deposits will be repealed pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (the DFA).[1] In light of this, the FDIC proposes to rescind regulations that have implemented this prohibition with respect to state-chartered nonmember (SNM) banks. Because the regulations include a definition of "interest" that may assist the FDIC in interpreting a recent statutory amendment that provides temporary, unlimited deposit insurance coverage for noninterest-bearing transaction accounts, the FDIC also proposes to retain and move the definition of "interest" into the deposit insurance regulations.

DATES: Comments must be received on or before May 16, 2011.

ADDRESSES: You may submit comments on the notice of proposed rulemaking, identified by RIN number and the words "Interest on Deposits; Deposit Insurance Coverage NPRM," by any of the following methods:

- *Agency Web site: http://www.fdic.gov/regulations/laws/federal/propose.html.* Follow the instructions for submitting comments on the Agency Web site.
- *E-mail: Comments@fdic.gov.* Include the RIN number in the subject line of the message.
- *Mail:* Robert E. Feldman, Executive Secretary, *Attention:* Comments, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.
- *Hand Delivery:* Guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7 a.m. and 5 p.m.
- *Instructions:* All submissions received must include the agency name and RIN for this rulemaking.
- *Public Inspection:* All comments received will be posted without change to *http://www.fdic.gov/regulations/laws/federal/propose.html* including any personal information provided. Paper copies of public comments may be ordered from the Public Information Center by telephone at 1–877–275–3342 or 703–562–2200.

FOR FURTHER INFORMATION CONTACT: Martin Becker, Senior Consumer Affairs Specialist, Division of Consumer and Depositor Protection (703) 254–2233, Mark Mellon, Counsel, Legal Division, (202) 898–3884, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

[1] Public Law 111–203, 124 Stat. 1376.