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#### EXEMPTIONS CLAIMED FOR THE SYSTEM:

None.

Federal Communications Commission.

**Marlene H. Dortch,**

*Secretary, Office of the Secretary, Office of Managing Director.*

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## FEDERAL DEPOSIT INSURANCE CORPORATION

### Assessment Rate Adjustment Guidelines for Large and Highly Complex Institutions

**AGENCY:** Federal Deposit Insurance Corporation (FDIC).

**ACTION:** Final guidelines.

**SUMMARY:** The FDIC is adopting guidelines that it will use to determine how adjustments may be made to an institution's total score when calculating the deposit insurance assessment rates of large and highly complex insured institutions. Total scores are determined according to the Final Rule on Assessments and Large Bank Pricing that was approved by the FDIC Board on February 7, 2011 (76 FR 10672 (Feb. 25, 2011)).

**FOR FURTHER INFORMATION CONTACT:** Patrick Mitchell, Acting Chief, Large Bank Pricing Section, Division of Insurance and Research, (202) 898-3943; and Christopher Bellotto, Counsel, Legal Division, (202) 898-3801, 550 17th Street, NW., Washington, DC 20429.

#### SUPPLEMENTARY INFORMATION:

#### I. Dates

These guidelines supersede the assessment rate adjustment guidelines published by the FDIC on May 15, 2007 (the 2007 Guidelines).<sup>1</sup>

#### II. Background

On February 7, 2011, the FDIC Board amended its assessment regulations by, among other things, adopting a new methodology for determining assessment rates for large and highly complex institutions (the Amended Assessment Regulations).<sup>2</sup> The Amended Assessment Regulations eliminated risk categories and combined CAMELS ratings and forward-looking financial measures into one of two scorecards, one for highly-complex institutions and another for all other large institutions.<sup>3</sup> Each of the two scorecards produces two scores—a performance score and a loss severity score—that are combined into a total score.<sup>4</sup>

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

<sup>1</sup> Assessment Rate Adjustment Guidelines for Large Institutions and Insured Foreign Branches in Risk Category I, 72 FR 27122 (May 14, 2007).

<sup>2</sup> Assessments, Large Bank Pricing, 76 FR 10672 (Feb. 25, 2011) (codified at 12 CFR 327.9-10).

<sup>3</sup> 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. 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.

<sup>4</sup> In the context of large institution insurance pricing, the performance score measures a large institution's financial performance and its ability to withstand stress. The loss severity score refers to the relative loss that an institution poses to the Deposit Insurance Fund in the event of a failure.

TABLE 1—SCORECARD FOR LARGE INSTITUTIONS

Scorecard measures and components	Measure weights (percent)	Component weights (percent)
<b>P Performance Score</b>		
P.1 <i>Weighted Average CAMELS Rating</i> .....	100	30
P.2 <i>Ability to Withstand Asset-Related Stress</i> .....		50
Tier 1 Leverage Ratio .....	10	
Concentration Measure .....	35	
Core Earnings/Average Quarter-End Total Assets* .....	20	
Credit Quality Measure .....	35	
P.3 <i>Ability to Withstand Funding-Related Stress</i> .....		20
Core Deposits/Total Liabilities .....	60	
Balance Sheet Liquidity Ratio .....	40	
<b>L Loss Severity Score</b>		
L.1 <i>Loss Severity Measure</i> .....		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)
<b>P Performance Score</b>		
P.1 <i>Weighted Average CAMELS Rating</i> .....	100	30
P.2 <i>Ability to Withstand Asset-Related Stress</i> .....		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 <i>Ability to Withstand Funding-Related Stress</i> .....		20
Core Deposits/Total Liabilities .....	50	
Balance Sheet Liquidity Ratio .....	30	
Average Short-Term Funding/Average Total Assets .....	20	
<b>L Loss Severity Score</b>		
L.1 <i>Loss Severity</i> .....		100

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

In most cases, the total score produced by an institution's scorecard should correctly reflect the institution's overall risk relative to other large institutions; however, the FDIC believes it is important that it have the ability to consider idiosyncratic or other relevant risk factors not reflected in the scorecards. The Amended Assessment Regulations, therefore, allow the FDIC to make a limited adjustment to an institution's total score up or down by no more than 15 points (the large bank adjustment). The resulting score is then converted to an initial base assessment rate, which, after application of other possible adjustments, results in the institution's total assessment rate.<sup>5</sup> The total assessment rate is multiplied by

<sup>5</sup> Adjustments to the initial base assessment rate may include an unsecured debt adjustment, depository institution debt adjustment, and a brokered deposit adjustment.

the institution's assessment base to calculate the amount of its assessment obligation. Adjustments are made to ensure that the total score produced by an institution's scorecard appropriately reflects the institution's overall risk relative to other large institutions.

The FDIC promulgated regulations allowing for the adjustment of large institutions' quarterly assessment rates in 2006.<sup>6</sup> The FDIC set forth the procedures for these adjustments in guidelines that were published in 2007 (2007 Guidelines). The 2007 Guidelines were designed to ensure that the adjustment process was fair and transparent and that any decision to make an adjustment was well supported. The FDIC has exercised its adjustment authority when warranted since that time.

<sup>6</sup> 71 FR 69282 (Nov. 30, 2006).

Following adoption of the Amended Assessment Regulations in February 2011, the FDIC proposed new guidelines that reflect the methodology it now uses to determine assessment rates for large and highly complex institutions. The FDIC sought comment on all aspects of the proposed guidelines.<sup>7</sup> The FDIC received eight comments related to the guidelines, which are described below in the relevant portion of the guidelines.

<sup>7</sup> 76 FR 21256 (April 15, 2011). The Amended Assessment Regulations provided that the FDIC would not make any new large bank adjustments until revised guidelines were published for comment and approved by the FDIC's Board of Directors. Although the FDIC chose in this instance to publish the proposed guidelines and solicit comment, notice and comment are not required and need not be employed to make future changes to the guidelines.

In addition to comments on the Guidelines, the FDIC also received a number of comments related to the scorecard methodology and measures used in the scorecard. The FDIC, however, previously provided two opportunities to comment on the scorecard methodology and all measures through the publication of two notices of proposed rulemaking on the large bank pricing system.<sup>8</sup> The FDIC received a large number of comments on these issues in response to the two notices of proposed rulemaking and carefully considered them before finalizing the Amended Assessment Regulations in February 2011. Since 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, the FDIC has focused on comments related to the guidelines and how the guidelines will apply when making a large bank adjustment.

### III. Overview of the Large Bank Adjustment Guidelines

The following general guidelines will govern the large bank adjustment process.

#### *Analytical Guidelines*

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

- The FDIC will 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 will conduct further analysis to determine whether underlying scorecard ratios are materially higher or

lower than the established cutoffs for the measure and whether other mitigating or supporting information exists.

- The FDIC will use complementary quantitative risk measures to determine whether a 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 may 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, stress test results, interest rate risk exposure, and factors affecting loss severity.

- Specific risk measures may vary in importance for different 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 will 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 will 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 score. For purposes of these guidelines, a material adjustment is an adjustment of five points or more to an institution's total score.

#### *Procedural Guidelines*

The processes for communicating to affected institutions and implementing a large bank adjustment remain largely unchanged from the 2007 Guidelines, except that the revised guidelines provide for an adjustment made as a result of a request by the institution (an institution-initiated adjustment).

- The FDIC will 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 will give institutions advance notice of any decision to make

an upward adjustment, or to remove a previously implemented downward adjustment. The notice will include the reasons for the proposed adjustment or removal, the size of the proposed adjustment or removal, specify when the adjustment or removal will take effect, and provide institutions with up to 60 days to respond.

- The FDIC will re-evaluate the need for an adjustment to an institution's total score on a quarterly basis.

- An institution may make a written request to the FDIC for an adjustment to its total score no later than 35 days following the end of the quarter for which the institution is requesting the adjustment. Such a request must be supported with evidence of a material risk or risk-mitigating factor that is not adequately captured or considered in the scorecard. For example, for the quarter ending March 31, 2012, the request should be received by the FDIC no later than May 5, 2012. Institutions may request an adjustment at any time; however, those well-supported requests received after the deadline may not be considered until the following quarter and the FDIC may require the institution to update the supporting evidence at that time. Further details regarding an institution-initiated request for adjustment are provided below.

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

### IV. The Large Bank Adjustment Process

#### *A. Identifying the Need for an Adjustment*

The FDIC will analyze the results of the large bank methodology under the Amended Assessment Regulations and determine the relative risk ranking of institutions prior to implementing any large bank adjustments. When an institution's total score is consistent with the total score of other institutions with similar risk profiles, the resulting assessment rate of the institutions should be comparable and a large bank adjustment should be unnecessary. When an institution's total score is not consistent with the total scores of other

<sup>8</sup> 75 FR 23516 (May 3, 2011); 75 FR 72612 (Nov. 24, 2010).

institutions with similar risk profiles, the FDIC will consider an adjustment. The FDIC only intends to pursue material adjustments (an adjustment of at least five points) to an institution's total score, which should result in only a limited number of adjustments on a quarterly basis.

Given the implementation of a new assessment system and the collection of new data items, the FDIC does not intend to use its ability to adjust scores precipitously. The FDIC expects to take some time analyzing all institutions' unadjusted scores, the reporting of new data items, and the resulting risk ranking of institutions before making any adjustments. While the FDIC is not precluded from making a large bank adjustment immediately following adoption of these guidelines, the FDIC expects that few, if any, adjustments will be made at that time.

The FDIC will evaluate scorecard results each quarter to identify institutions with a score that is materially too high or too low when considered in light of risks or risk-mitigating factors that are inadequately captured by the institution's scorecard. Examples of the types of risks and risk-mitigating factors include considerations for 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.

The FDIC received several comments regarding risk mitigants considered in the large bank adjustment process. One commenter agreed that the FDIC should retain the ability to adjust an institution's total score based upon risks that are not adequately or fully captured in the scorecard, while another commenter suggested that loss mitigants should be directly factored into the pricing model. Two commenters stated that more detail should be provided regarding consideration of mitigants and the potential impact such mitigants may have on the large bank adjustment process. These same two commenters noted that any adjustment methodology regarding higher risk concentrations should include consideration of an institution's historical risk and loss data. One commenter stated that the FDIC should consider offsetting outliers as a mitigant when considering whether an adjustment is warranted for a different outlier.

Loss mitigants and their effect on individual institutions tend to be idiosyncratic. While the FDIC agrees that it would be ideal for all risk mitigants to be factored into the scorecard model for deposit insurance

assessment purposes, it is impossible in practice to include all potential risk mitigants, particularly mitigants of a qualitative nature, into a quantitative scoring model. For similar reasons, the FDIC is unable to provide precise details of how mitigants will be specifically considered in the adjustment process. The FDIC will consider each institution's risk profile, including consideration of loss mitigants, offsetting outliers, and historical data, when determining the institution's pricing and relative risk ranking among the universe of large institutions. The FDIC believes, however, that historical loss or risk data may be insufficient in isolation to warrant an adjustment given the forward looking nature of the scorecard.

One commenter recommended that the FDIC use the large bank adjustment process to eliminate the effect of FAS 166/167 in the growth-adjusted portfolio concentration measure. As noted in the Amended Assessments Regulation, the FDIC will consider exclusion of the effect of FAS 166/167 through the adjustment process where the FDIC receives sufficient information to make an adjustment and the possible adjustment would have a material effect on an institution's total score.

In addition to considering an institution's relative risk ranking among all large institutions, the FDIC will consider how an institution's total score compares to the total scores of institutions in a peer group. This comparison will allow the FDIC to account for variations in risk measures that exists among institutions with differing business models. For purposes of the comparison, the FDIC will, where appropriate, assign an institution to a peer group. The 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 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 residential mortgage loans, which include home equity lines of credit plus residential mortgage backed securities, exceed 50 percent of total assets.

*Non-diversified Regional Institutions:* Large institutions not described in a peer group above if: (1) Credit card plus securitized receivables exceed the sum of 50 percent of assets plus securitized receivables; or (2) the sum of residential mortgage loans, credit card loans, and

other loans to individuals exceeds 50 percent of assets.

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

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

The FDIC received a comment suggesting that the definition of Residential Mortgage Lenders as a peer group should clarify whether the definition is limited to residential mortgages and whether home-equity lines of credit are included. The FDIC agrees. The definition of has been clarified to include residential mortgages, including home-equity lines of credit and residential mortgage-backed securities.

#### *B. Institution-Initiated Request for a Large Bank Adjustment*

An institution may request a large bank adjustment by submitting a written request to the FDIC no later than 35 days following the end of the quarter for which the institution is requesting the adjustment. Such a request must be supported with evidence of a material risk or risk-mitigating factor that is not adequately captured or considered in the scorecard.<sup>9</sup> Similar to FDIC-initiated adjustments, an institution-initiated request for adjustment will 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 and results in a material change to the total score. Furthermore, the overall risk profile must be materially higher or lower than that produced by the scorecard. The FDIC will consider these requests as part of its ongoing effort to identify and adjust scores so that institutions with similar risk profiles receive similar total scores.

An institution-initiated request for adjustment that is received by the FDIC later than 35 days after the end of the quarter for which the institution is requesting the adjustment may not provide the FDIC with sufficient time to appropriately assess and respond to the request for adjustment; therefore, the FDIC may not be able to consider adjusting an institution's assessment for that quarter if the request is received after this time. Although institutions may request an adjustment at any time, those well-supported requests received

<sup>9</sup> A request for adjustment with supporting evidence should be addressed to Director, Division of Insurance and Research, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

after the deadline may not be considered until the following quarter. In conjunction with the next quarter's consideration, the FDIC may require that the institution update the information supporting the institution-initiated request. The FDIC's determination that an adjustment request was received after the deadline and there was insufficient time to appropriately respond to it may be challenged by the institution in a request for review pursuant to the assessment appeals process (12 CFR 327.4(c)).

For example, a request for adjustment of an institution's third quarter total score with supporting evidence must be received no later than November 4 by the FDIC's Director of the Division of Insurance and Research in Washington, DC. If the request for adjustment is received after November 4, it may not be considered by the FDIC until the fourth quarter and the FDIC may request updated information at that time. Pursuant to 12 CFR 327.4(c), the institution may file a request for review challenging the FDIC's determination to consider the request in the fourth quarter or file a request for review of its third quarter assessment rate once it receives its invoice for the third quarter assessment. An institution that files a request for adjustment more than 35 days after the end of the quarter for which it is requesting an adjustment is not precluded from requesting adjustments for future quarters.

The FDIC received three positive comments regarding the FDIC's willingness to explicitly permit written requests from institutions for a large bank adjustment. One commenter suggested that the FDIC provide the number of challenges to deposit insurance assessment adjustments and rulings for or against such challenges in its quarterly publication of statistics. Another commenter recommended that the FDIC provide a prompt response for any downward adjustment request. Finally, one commenter requested clarification about whether the national or regional office of the FDIC would recommend an adjustment to a large institution's total score, stating that the national office is better suited to consider the entire banking industry when determining outliers for pricing purposes.

As noted in the Amended Assessment Regulations, the FDIC will publish aggregate statistics on adjustments each quarter. The FDIC's Assessment Appeals Committee publishes all appeals and the results of such appeals. In addition, the FDIC will respond promptly to all well-supported requests for a downward

large bank adjustment. As noted previously, a well-supported request (the requests must also be material, as defined above) should be received by the FDIC within 35 days after the end of the quarter for which the adjustment is being requested. Finally, the FDIC will ensure that appropriate staff is involved in the decision-making process relevant to large bank adjustments.

#### *C. Determining the Adjustment Amount*

Once the FDIC determines that an adjustment may be warranted, the FDIC will determine the adjustment necessary to bring an institution's total score into better alignment with those of other institutions that pose similar levels of risk. The FDIC will initiate an adjustment or consider an institution-initiated request for adjustment only when a combination of risk measures and other information suggest either materially higher or lower risk than an institution's total score indicates. The FDIC expects that the adjustment process will be needed for only a relatively small 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 will be made. The FDIC will only initiate adjustments either upward or downward that warrant an adjustment of 5 points or more and adjustments will generally only be made in 5, 10, or 15 point increments.

One commenter stated that the proper size of an adjustment would be subject to differences of opinion. The FDIC agrees that there is subjectivity involved in the large bank adjustment process; however, the FDIC expects that differences of opinion on the appropriate size of the adjustment should be limited. The FDIC will only initiate adjustments or consider reviews for adjustment if the comprehensive analysis of the institution's risk and the institution's relative risk ranking warrant a material adjustment of the institution's total score. To reduce the potential subjectivity regarding the precision of the size of an adjustment, the FDIC has determined that any adjustment will be limited to a minimum of 5 points and generally limited to 5, 10, or 15 point increments. The FDIC believes a minimum 5 point adjustment provides a threshold that clarifies how the FDIC will determine whether an adjustment is material. In addition, the discrete adjustment levels should reduce potential disagreements regarding the appropriate size of any adjustment applied.

#### *D. Further Analysis and Consultation With Primary Federal Regulator*

As under the 2007 Guidelines, the FDIC will 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).

One commenter recommended that any adjustment to an institution's total score should require concurrence by an institution's primary federal regulator, rather than simply consultation. The FDIC disagrees. Large bank adjustments are made only after consideration of the institution's relative risk ranking among the entire large bank universe. Such consideration requires knowledge and data of the total scores for every institution in the large bank universe, which is information that other primary federal regulators do not have. Furthermore, only the FDIC has the legal authority to assess institutions for deposit insurance. Therefore, the FDIC will continue to consult with an institution's primary federal regulator and consider the primary federal regulator's comments prior to making a large bank adjustment, but, ultimately, the decision concerning any adjustment will be made by the FDIC. This process is consistent with the procedure used in the 2007 Guidelines.

#### *E. Advance Notice*

To give an institution an opportunity to respond, the FDIC will give advance notice to an institution when proposing to make an upward adjustment to the institution's total score.<sup>10</sup> Consistent with the 2007 Guidelines, the timing of the notice will correspond approximately to the invoice date for an assessment period. For example, an institution will be notified of a proposed upward adjustment to its assessment rates for 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.<sup>11</sup>

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

<sup>10</sup> The institution will also be given advance notice when the FDIC determines to eliminate any downward adjustment to an institution's total score.

<sup>11</sup> The invoice covering the assessment period January 1 through March 31 in this example would not reflect the upward adjustment.

#### *F. Institution's Opportunity To Respond*

An institution that has been notified of the FDIC's intent to apply an upward adjustment will have 60 days to respond to the notice. Before implementing an upward adjustment, the FDIC will review the institution's response, along with any subsequent changes to supervisory ratings, scorecard measures, or other relevant risk factors. Similar to the 2007 Guidelines, the FDIC will notify the institution of its decision to proceed or not to proceed with the upward adjustment along with the invoice for the quarter in which the adjustment will 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 that 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, the FDIC 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 assessment 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.

#### *G. Duration of the Adjustment*

Consistent with the 2007 Guidelines, the large bank adjustment will remain in

effect for subsequent assessment periods until the FDIC determines either that the adjustment is no longer warranted or that the magnitude of the adjustment needs to be reduced or increased (subject to the 15 point limitation and the requirement for further advance notification).<sup>12</sup>

#### *H. Requests for Review and Appeals*

In making a decision regarding an adjustment, the FDIC will consider all material information available to it, including any information provided by an institution, but ultimately, all decisions concerning adjustments will be made by the FDIC. 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 CFR 327.4(c). An institution may similarly request review of or appeal a decision not to apply an adjustment following an institution-initiated request for an adjustment.

#### **V. Additional Information on the Adjustment Process, Including Examples**

As discussed previously, the FDIC will primarily consider two types of information in determining whether to make a large bank adjustment: scorecard measure outliers and information not

directly captured in the scorecard, including complementary quantitative risk measures and qualitative risk considerations.

#### *A. Scorecard Measure Outliers*

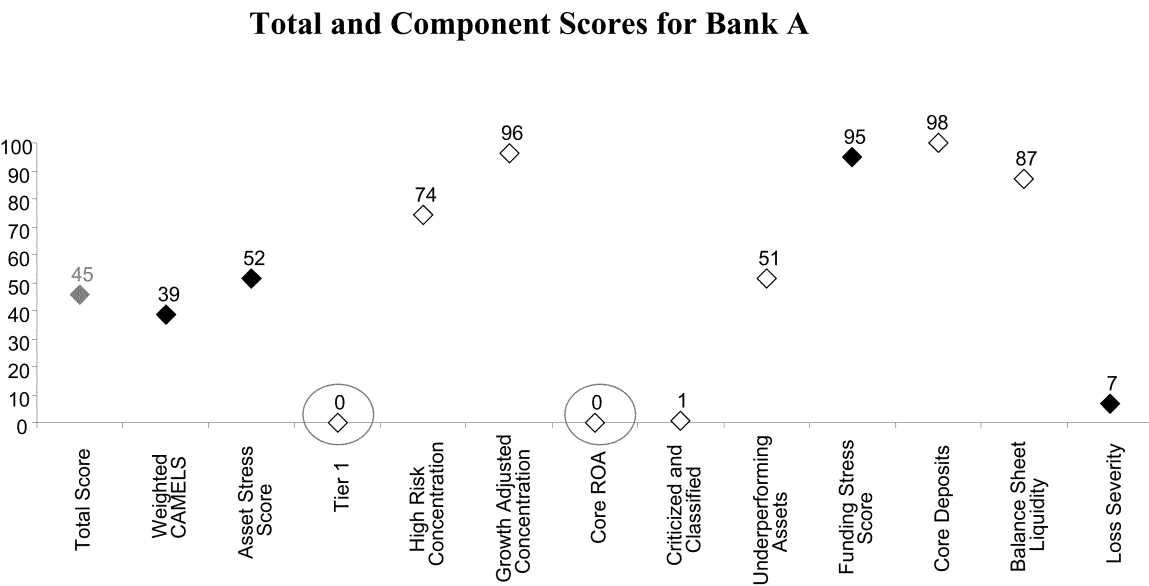
In order to convert each scorecard ratio into a score that ranges between 0 and 100, the Amended Assessment Regulations use minimum and maximum cutoff values that generally correspond to the 10th and 90th percentile values for each ratio based on data for the 2000 to 2009 period. All values less than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

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<sup>12</sup> As noted in the Amended Assessments Regulation, an institution's assessment rate may increase without notice if the institution's supervisory, agency ratings, or financial ratios deteriorate.

Chart 1



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 will generally be determined by the amount that the underlying ratio differs 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 may conclude that 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 Return on Assets (ROA) ratio is much closer to its cutoff values, suggesting that an adjustment based on consideration of this factor may not be justified.

TABLE 3—OUTLIER ANALYSIS FOR BANK A

Scorecard measure	Score	Cutoffs (%)		Value (%)	Outlier amount (value minus cutoff) as percentage of the scoring range
		Minimum	Maximum		
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 to the extent that the FDIC determined that such a downward adjustment warranted at least a 5 point adjustment.

The amount of the adjustment will 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 peer group (e.g., diversified regional institutions), as described above. Typically, however, adjustments supported by only one extreme outlier value will 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 could result in varying adjustment amounts depending on each

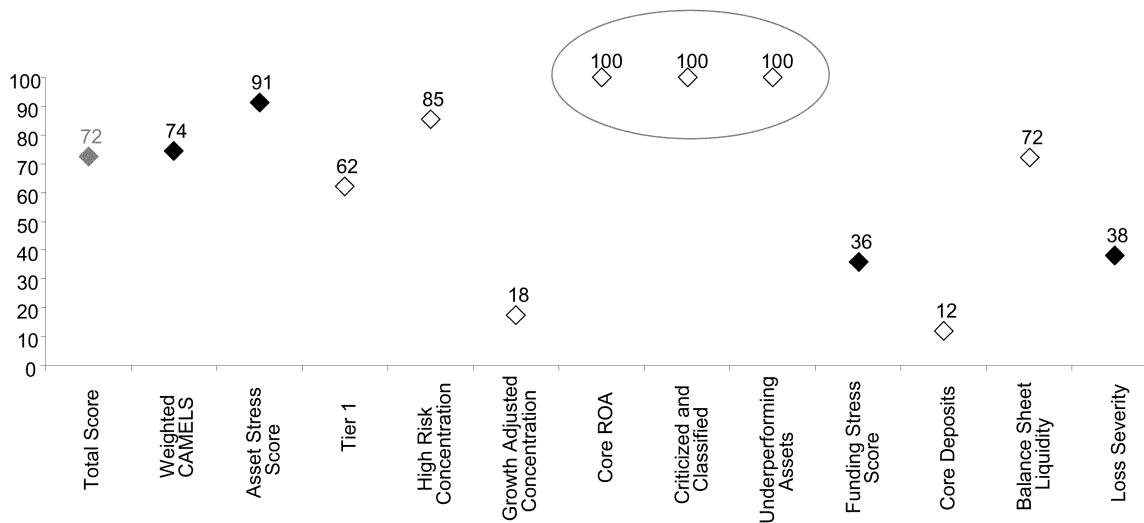
institution’s unique set of circumstances. For Bank A, a 5-point adjustment may be most appropriate.

The next example illustrates the analytical process the FDIC will 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 may 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 may determine that the risk associated with Bank B's ability to withstand asset-related stress and, therefore, its overall risk, is 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 (%)	Outlier amount (value minus cutoff) as percentage of the scoring range
		Minimum	Maximum		
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 will 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 insight into an institution's ability to withstand financial adversity, and the severity of losses in the event of failure.

Analyzing complementary risk measures will 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. The measure 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 the information is further supported by qualitative loss severity considerations as discussed below.

Two commenters suggested that the FDIC provide an exhaustive list of complementary benchmarks or qualitative factors that may be

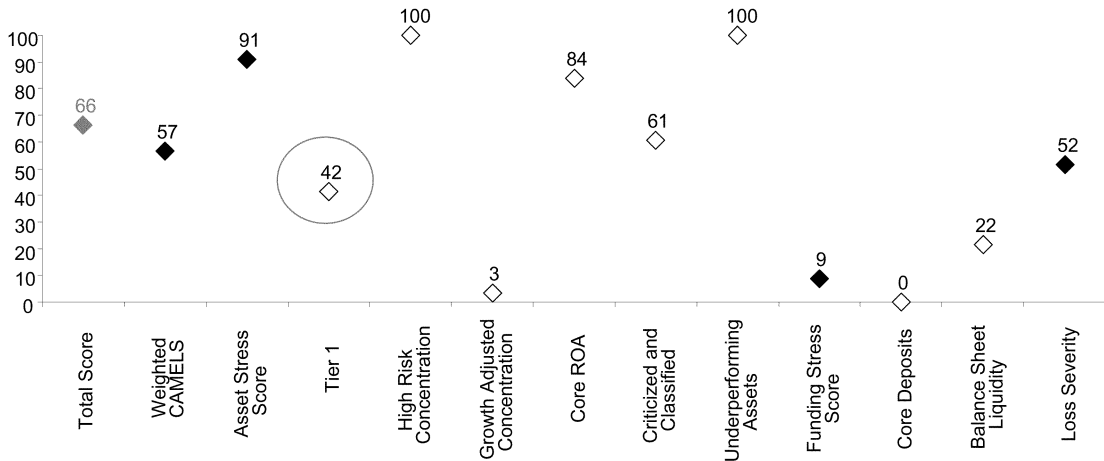
considered during the large bank adjustment process. A few commenters stated that the FDIC has not provided sufficient detail regarding the factors that may trigger a large bank adjustment.

The FDIC agrees that providing an exhaustive list of factors that may be considered in the large bank adjustment process would be ideal, but has concluded that this is not reasonable or practical. The FDIC will consider all factors that may affect an institution's risk profile, including idiosyncratic risks and the dynamic nature of the industry.

The example below illustrates the analytical process the FDIC will follow when determining whether 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.

In this hypothetical, following a review of complementary measures for all financial ratios in the scorecard, the

complementary measures for Tier 1 leverage ratio shows 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

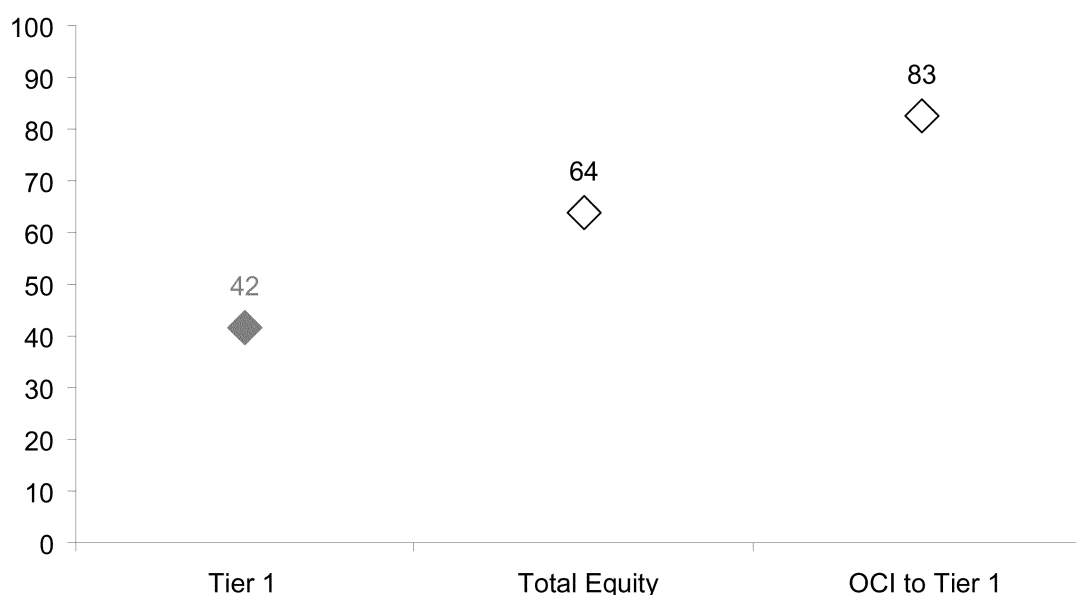
Bank C—the total equity ratio and the ratio of other comprehensive income (OCI) to Tier 1 capital—suggest higher risk than the Tier 1 leverage ratio score

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.

**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 were understated as well.<sup>13</sup>

## 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 are impossible to capture in the scorecard. Similar to scorecard outliers and complementary risk measures, the FDIC will 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, including information gained through the FDIC's special examination authority, such as underwriting practices, interest rate risk exposure and other information obtained through public filings.<sup>14</sup>

Another example of qualitative information that the FDIC will 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 will 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

<sup>13</sup> The concentration measure and the credit quality measure are expressed as a percent of Tier 1 capital plus the allowance for loan loss reserves.

<sup>14</sup> 12 U.S.C. 1820(b)(3); see Interagency Memorandum of Understanding on Special

Examinations dated July 12, 2010. <http://www.fdic.gov/news/news/press/2010/pr10153.html>.

internal capital adequacy assessments could alleviate 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 is normally evident through the scorecard methodology alone.

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

timely manner in the event of the institution's failure.

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

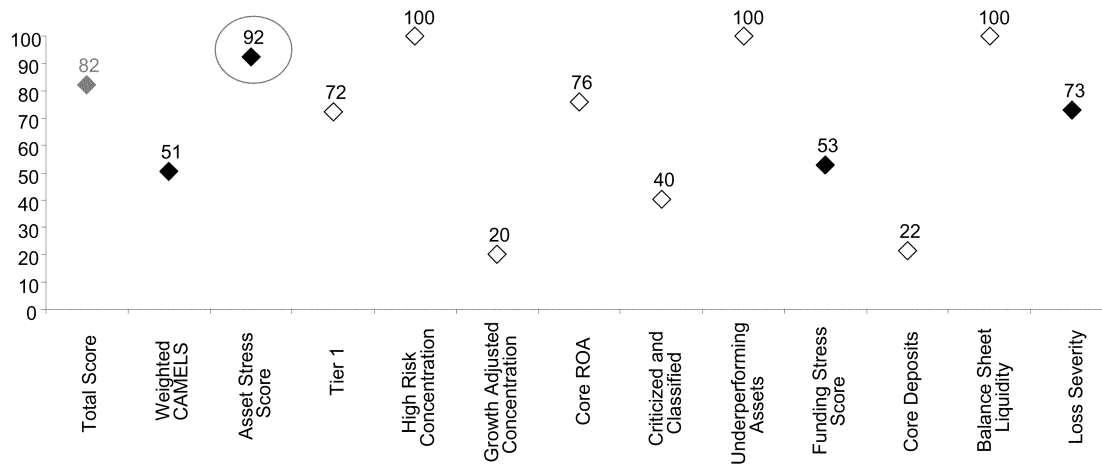
Additionally, engaging in certain business lines may warrant further consideration of qualitative factors. For instance, supervisory assessments of operational risk and controls at processing banks are likely to be

important regardless of the institution's performance.

The specific example below illustrates the analytical process the FDIC will 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. The example assumes that FDIC's 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 that the 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.

## VI. Additional Comments

The FDIC received two comments stating that including Troubled Debt Restructurings (TDR) in the Criticized and Classified items and/or underperforming assets ratios and/or the higher-risk concentration measure is inconsistent with the FDIC's public remarks encouraging institutions to enter into loan modifications. In particular, the commenter cited remarks made in "Supervisory Insights: Regulatory Actions Related to Foreclosure Activities by Large Servicers and Practical Implications for Community Banks." One commenter suggested that the FDIC include in the guidelines a method to adjust institutions' scores that actively demonstrates support for the FDIC's guidance on mortgage loan modifications.

Many loan modifications, such as those to reduce the interest rate for competitive reasons, are not TDRs. However, a loan modification results in a TDR when a creditor for economic or legal reasons related to the borrower's financial difficulties grants a concession to the borrower that the creditor would not otherwise have considered if it were not for the borrower's financial difficulties. Restructured workout loans typically present an elevated level of credit risk as the borrowers are not able to perform according to the original contractual terms. The FDIC is interested in pricing for risk; therefore, TDRs (which display higher risk) are included in certain scorecard ratios.

The FDIC does not believe the definitions and the application of those definitions in the pricing rule for these higher risk assets is inconsistent with the FDIC's guidance to "avoid unnecessary foreclosures and consider mortgage loan modifications or other workouts that are affordable and sustainable." To the extent that TDRs have risk mitigants that materially lower an institution's risk profile relative to that institution's total score, the FDIC would consider those specific mitigants in the adjustment process.

## VII. Effective Date: September 13, 2011

## VIII. Paperwork Reduction Act

In accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*), an agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB

control number. This Notice of Assessment Rate Adjustment Guidelines for Large and Highly Complex Institutions includes a provision allowing large and highly complex institutions to make a written request to the FDIC for an adjustment to an institution's total score. An institution's request for adjustment is 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.

In conjunction with publication of the Proposed Assessment Rate Adjustment Guidelines for Large and Highly Complex Institutions, the FDIC submitted to OMB a request for clearance of the paperwork burden associated with the request for adjustment. That request is still pending. The proposal requested comment on the estimated paperwork burden. One comment addressing the estimated paperwork burden was received; the commenter stated that the number of hours required to prepare an institution-initiated request for adjustment was underestimated. The FDIC agrees that there can be significant variations in the amount of time required to provide a written request for an adjustment and has altered its initial burden estimates accordingly. The revised estimated burden for the application requirement is as follows:

*Title:* "Assessment Rate Adjustment Guidelines for Large and Highly Complex Institutions—Request for Adjustment."

*OMB Number:* 3064-0179.

*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:* 8–80.

*Total Annual Burden:* 0–880 hours.

*Comment Request:* The FDIC has an ongoing interest in public comments on its collections of information, including comments on: (1) Whether this collection of information is necessary for the proper performance of the FDIC's functions, including whether the information has practical utility; (2) the accuracy of the estimates of the burden of the information collection, including the validity of the methodologies and assumptions used; (3) ways to enhance the quality, utility, and clarity of the information to be collected; and (4) ways to minimize the burden of the information collection on respondents, including through the use of automated collection techniques or other forms of information technology. Comments may

be submitted to the FDIC by any of the following methods:

- <http://www.FDIC.gov/regulations/laws/federal/propose.html>.
- *E-mail:* [comments@fdic.gov](mailto:comments@fdic.gov):

Include the name and number of the collection in the subject line of the message.

• *Mail:* Gary Kuiper (202–898–3877), Counsel, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

• *Hand Delivery:* Comments may be hand-delivered to the 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 comment 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, Room 3208, Washington, DC 20503. All comments should refer to the "Assessment Rate Adjustment Guidelines for Large and Highly Complex Institutions—Request for Adjustment." (OMB No. 3064–0179).

By order of the Board of Directors.

Dated at Washington, DC, this 13th day of September, 2011.

Federal Deposit Insurance Corporation.

**Robert E. Feldman,**

*Executive Secretary.*

[FR Doc. 2011–23835 Filed 9–16–11; 8:45 am]

BILLING CODE 6714-01-P

## FEDERAL RESERVE SYSTEM

### Proposed Agency Information Collection Activities; Comment Request

**AGENCY:** Board of Governors of the Federal Reserve System.

**SUMMARY:** On June 15, 1984, the Office of Management and Budget (OMB) delegated to the Board of Governors of the Federal Reserve System (Board) its approval authority under the *Paperwork Reduction Act* (PRA), pursuant to 5 CFR 1320.16, to approve of and assign OMB control numbers to collection of information requests and requirements conducted or sponsored by the Board under conditions set forth in 5 CFR Part 1320 Appendix A.1. Board-approved collections of information are incorporated into the official OMB inventory of currently approved collections of information. Copies of the *Paperwork Reduction Act* Submission, supporting statements and approved collection of information instruments are placed into OMB's public docket files. The Federal Reserve may not conduct or sponsor, and the respondent is not required to respond to, an