FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 327

RIN 3064–AD63

Assessment Dividends, Assessment Rates and Designated Reserve Ratio

AGENCY: Federal Deposit Insurance Corporation (FDIC).

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

SUMMARY: In order to implement a comprehensive, long-range management plan for the Deposit Insurance Fund, the FDIC is proposing to amend its regulations to: implement the dividend provisions in the Dodd-Frank Wall Street Reform and Consumer Protection Act; set assessment rates; and set the designated reserve ratio at 2 percent. The FDIC seeks comment on all aspects of this NPRM.

DATES: Comments must be received on or before November 26, 2010.

ADDRESSES: You may submit comments on the notice of proposed rulemaking, identified by RIN number and the words "Assessments, Dividends and DRR 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. Comments 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 with the comment.

FOR FURTHER INFORMATION CONTACT: Munsell St. Clair, Acting Chief, Fund Analysis and Pricing Section, (202) 898–8967, Christopher Bellotto, Counsel, (202) 898–3801, Donna Saulnier, Deputy Director, Assessment Policy and Operations, (703) 562–6167, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

SUPPLEMENTARY INFORMATION:

I. Background

A. Overview

The FDIC has experienced two banking crises in the years following the Great Depression, one in the late 1980s and early 1990s and the current one. In both of these crises, the balance of the deposit insurance fund (the DIF or the fund) became negative, hitting a low of negative $20.9 billion in December 2009, despite high assessment rates and, in the most recent crisis, other extraordinary measures—including a special assessment—that the FDIC was forced to adopt as losses mounted.

In the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank), Congress revised the statutory authorities governing the FDIC's management of the fund. The FDIC now has the ability to achieve goals for deposit insurance fund management that it has sought to achieve for decades but lacked the tools to accomplish: maintaining a positive fund balance even during a banking crisis and maintaining moderate, steady assessment rates throughout economic and credit cycles.

Among other things, Dodd-Frank: (1) Raises the minimum designated reserve ratio (DRR), which the FDIC must set each year, to 1.35 percent (from the former minimum of 1.15 percent) and removes the upper limit on the DRR (which was formerly capped at 1.5 percent) and therefore on the size of the fund; [1] (2) requires that the fund reserve ratio reach 1.35 percent by September 30, 2020 (rather than 1.15 percent by the end of 2016, as formerly required); [2] (3) requires that, in setting assessments, the FDIC "offset the effect of [requiring that the reserve ratio reach 1.35 percent by September 30, 2020 rather than 1.15 percent by the end of 2016] on insured depository institutions with total consolidated assets of less than $10,000,000,000"; [3] (4) eliminates the requirement that the FDIC provide dividends from the fund when the reserve ratio is between 1.35 percent and 1.5 percent; [4] and (5) continues the FDIC's authority to declare dividends when the reserve ratio at the end of a calendar year is at least 1.5 percent, but grants the FDIC sole discretion in determining whether to suspend or limit the declaration or payment of dividends.[5]

Given these changes, the FDIC considers the present moment optimal for implementing a comprehensive, long-range fund management plan, while the need for a sufficiently large fund and stable premiums is most apparent. Memories of the last two crises will fade and the need for a strong fund will become less apparent. Action now will establish standards for prudent fund management throughout the economic and credit cycle and better position the FDIC to resist future calls to reduce assessment rates or pay larger dividends at the expense of prudent fund management.

The FDIC has developed such a comprehensive, long-range management plan for the DIF. The FDIC sought industry input in developing this plan at a September 24, 2010 roundtable organized by the FDIC. At the roundtable, bank executives and industry trade group representatives uniformly favored steady, predictable assessments and found high assessment rates during crises objectionable.[6] The proposed plan is designed to reduce the pro-cyclicality in the existing system and achieve moderate, steady assessment rates throughout economic and credit cycles while also maintaining a positive fund balance even during a banking crisis, by setting an appropriate target fund size and a strategy for assessment rates and dividends.

The plan covers the near term, governed by the statutory requirement that the fund reserve ratio reach 1.35 percent by 2020, the medium term, when the reserve ratio has recovered to pre-crisis levels, and the long term, when the reserve ratio is sufficiently large that the fund would be able to withstand a crisis similar in magnitude to that of the late 1980s and early 1990s and the current crisis.

Near Term

Pursuant to the comprehensive plan, the FDIC has adopted a new Restoration Plan to ensure that the reserve ratio reaches 1.35 percent by September 30, 2020, as required by statute. The Restoration Plan is based on updated income, loss and reserve ratio projections, which contain lower expected losses for the period 2010 through 2014 than the FDIC's

[1] Public Law 111–203, § 334(a), 124 Stat. 1376, 1539 (to be codified at 12 U.S.C. 1817(b)(3)(B)).

[2] Public Law 111–203, § 334(d), 124 Stat. 1376, 1539 (to be codified at 12 U.S.C. 1817(nt)).

[3] Public Law 111–203, § 334(e), 124 Stat. 1376, 1539 (to be codified at 12 U.S.C. 1817(nt)).

[4] Public Law 111–203, § 332(d), 124 Stat. 1376, 1539 (to be codified at 12 U.S.C. 1817(e)).

[5] Public Law 111–203, § 332, 124 Stat. 1376, 1539 (to be codified at 12 U.S.C. 1817(e)(2)(B)).

[6] The proceedings of the roundtable can be viewed in their entirety at: *http://www.vodium.com/MediapodLibrary/index.asp?library=pn100472_fdic_RoundTable.*

projections in June 2010. Because of the lower expected losses and the additional time provided by Dodd-Frank to meet the minimum (albeit higher) required reserve ratio, the new Restoration Plan foregoes the uniform 3 basis point increase in assessment rates previously scheduled to go into effect on January 1, 2011.[7] The FDIC estimates that the fund reserve ratio will reach 1.15 percent by the fourth quarter of 2018, even without the 3 basis point uniform increase in rates.

Under Dodd-Frank, the FDIC is required to offset the effect on small institutions (those with less than $10 billion in assets) of the statutory requirement that the fund reserve ratio increase from 1.15 percent to 1.35 percent by September 30, 2020. Thus, assessment rates applicable to all insured depository institutions (IDIs) need be set only high enough to reach 1.15 percent; the mechanism for reaching 1.35 percent by the statutory deadline of September 30, 2020, and the manner of offset can be determined separately. Assessing large IDIs for that offset can be done in several ways, consistent with maintaining a risk-based assessment system for all IDIs. The Restoration Plan postpones until 2011 rulemaking regarding the method that will be used to effectuate the offset.

Medium Term

Using historical fund loss and simulated income data from 1950 to the present, the FDIC has undertaken an analysis to determine how high the reserve ratio would have had to have been before the onset of the two crises that occurred during this period to have maintained both a positive fund balance and stable assessment rates throughout the crises. The analysis, which is described in detail below, concludes that a moderate, long-term average industry assessment rate, combined with an appropriate dividend or assessment rate reduction policy, would have been sufficient to have prevented the fund from becoming negative during the crises, though the fund reserve ratio would have had to have exceeded 2 percent before the onset of the crises.

Once the reserve ratio reaches 1.15 percent, the FDIC believes that assessment rates (other than those necessary to effectuate the offset) can be reduced to a moderate level. In this rulemaking, pursuant to its statutory authority to set assessments, the FDIC is proposing a lower assessment rate schedule to take effect when the fund reserve ratio exceeds 1.15 percent.[8]

Long Term

To increase the probability that the fund reserve ratio will reach a level sufficient to withstand a future crisis, the FDIC, based on its authority to suspend or limit dividends, is also proposing to suspend dividends permanently when the fund reserve ratio exceeds 1.5 percent.[9] In lieu of dividends, and pursuant to its authority to set risk-based assessments, the FDIC is proposing to adopt progressively lower assessment rate schedules when the reserve ratio exceeds 2 percent and 2.5 percent. These lower assessment rate schedules would serve much the same function as dividends but would provide more stable and predictable effective assessment rates, an objective that representatives at the September 24, 2010 roundtable organized by the FDIC valued highly.

The FDIC also proposes setting the DRR at 2 percent, which the FDIC views as a long-range goal and the *minimum* level needed to withstand a future crisis of the magnitude of past crises. However, the FDIC's analysis shows that a reserve ratio higher than 2 percent would increase the chance that the fund will remain positive during a future economic and banking downturn similar or more severe than past crises. Thus, the 2 percent DRR should not be viewed as a cap on the fund.

B. Historical Analysis of Loss, Income and Reserve Ratios

For purposes of developing a long-term fund management strategy, the FDIC undertook an analysis to evaluate the tradeoffs between assessment rates and policies that either award dividends or reduce assessment rates by creating a simulated deposit insurance fund covering the years 1950 to 2010.[10] The analysis varied assessment rates and dividends to determine what would have happened to the simulated fund's balance over time.

As a starting point, the analysis sought to determine what constant average nominal assessment rate across the entire 60-year period would have maintained a positive fund balance during both crisis periods, assuming a policy that provided no dividends.[11] The result is a moderate rate of 7.44 basis points, which would have allowed the fund's reserve ratio to reach 2.48 percent (in 1981) before the crisis of the 1980s and early 1990s, and 2.03 percent (in 2006) before the current crisis. (See Charts A and B.) Failure to reach these reserve ratios would have resulted in a negative balance. Assessment rate volatility was by design completely eliminated.

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[7] While the range of reasonably possible losses is large, the FDIC now projects that losses during this period will be $52 billion, down from $60 billion as projected in June.

[8] Under section 7 of the Federal Deposit Insurance Act (FDI Act), the FDIC has authority to set assessments in such amounts as it determines to be necessary or appropriate. In setting assessments, the FDIC must consider certain enumerated factors, including the operating expenses of the DIF, the estimated case resolution expenses and income of the DIF, and the projected effects of assessments on the capital and earnings of IDIs.

[9] 12 U.S.C. 1817(e)(2), as amended by § 332 of the Dodd-Frank Act.

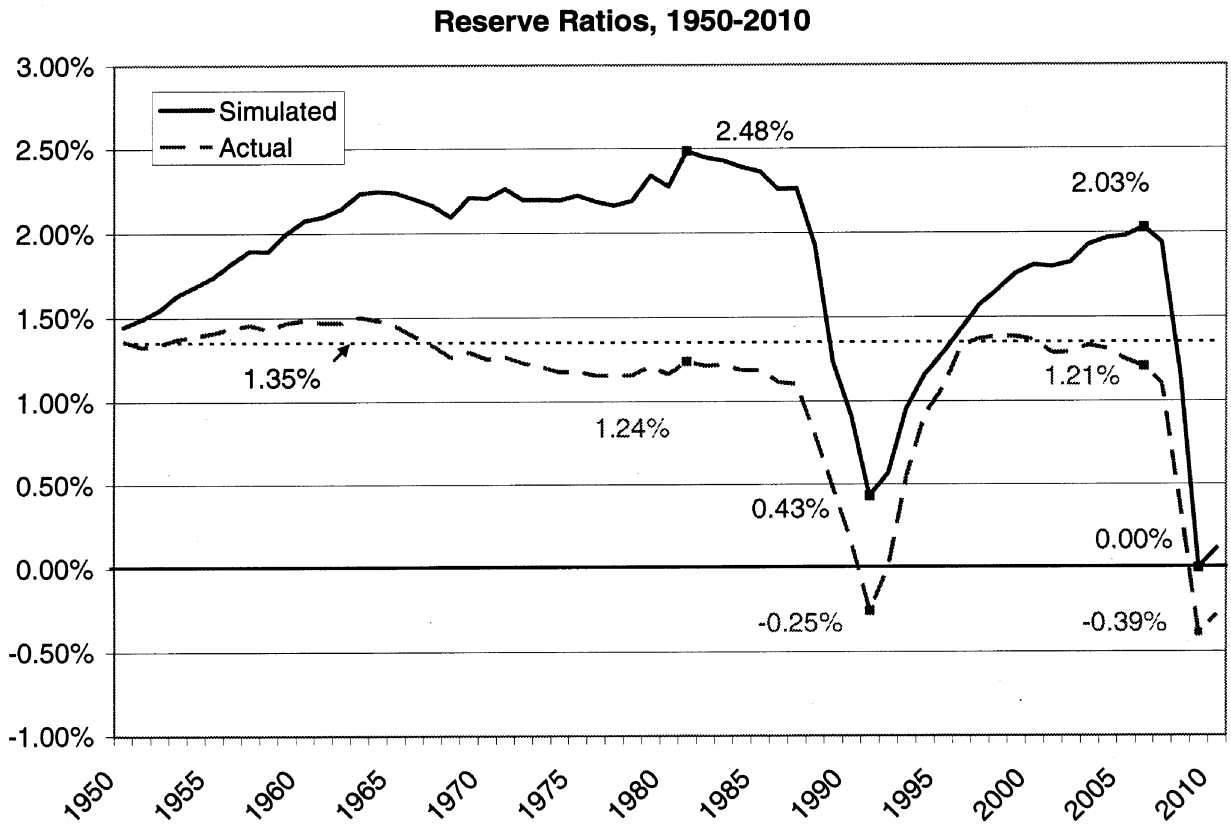
[10] The historical fund analysis uses actual FDIC historical assessment base and fund expense data and historical interest rate data from the Board of Governors of the Federal Reserve System. FDIC historical data are altered in only one respect: For the year 2007, the FDIC coverage level is assumed to be $250,000 because all depositors in failed banks during the current crisis were covered at that level. Projected data from June 30, 2010 to 2040 are based on September 2010 FDIC estimates for losses, expenses and insured deposit and assessment base growth (using adjusted total domestic deposits). Implied forward interest rates (as of September 27, 2010) from Bloomberg are used for the years after 2010. The analysis uses a modeled investment portfolio. After reviewing available historical FDIC portfolio data, a "default" investment portfolio was constructed with the following mix of Treasury securities: 35 percent in 6-month securities; 25 percent in 1-year securities; 25 percent in 3-year securities; and 15 percent in 5-year securities. This portfolio mix is retained unless the FDIC's provision for losses increases for two consecutive years. In that event, all income (proceeds from maturing securities, as well as net assessment and interest income) is invested in 6-month Treasury securities. The modeled portfolio therefore becomes shorter term as anticipated losses rise. When the fund's income exceeds expenses for two years, the fund's investments are returned to the default portfolio mix. The analysis examined fund performance over time using multiple combinations of different assessment rates and dividend policies.

The simulated fund does not include the costs of FSLIC and RTC failures during the 1980s and early 1990s. Their inclusion would have required a much higher reserve ratio to keep the fund balance positive during the late 1980s and early 1990s.

Supplementary material explaining the analysis can be found in the attached Appendix.

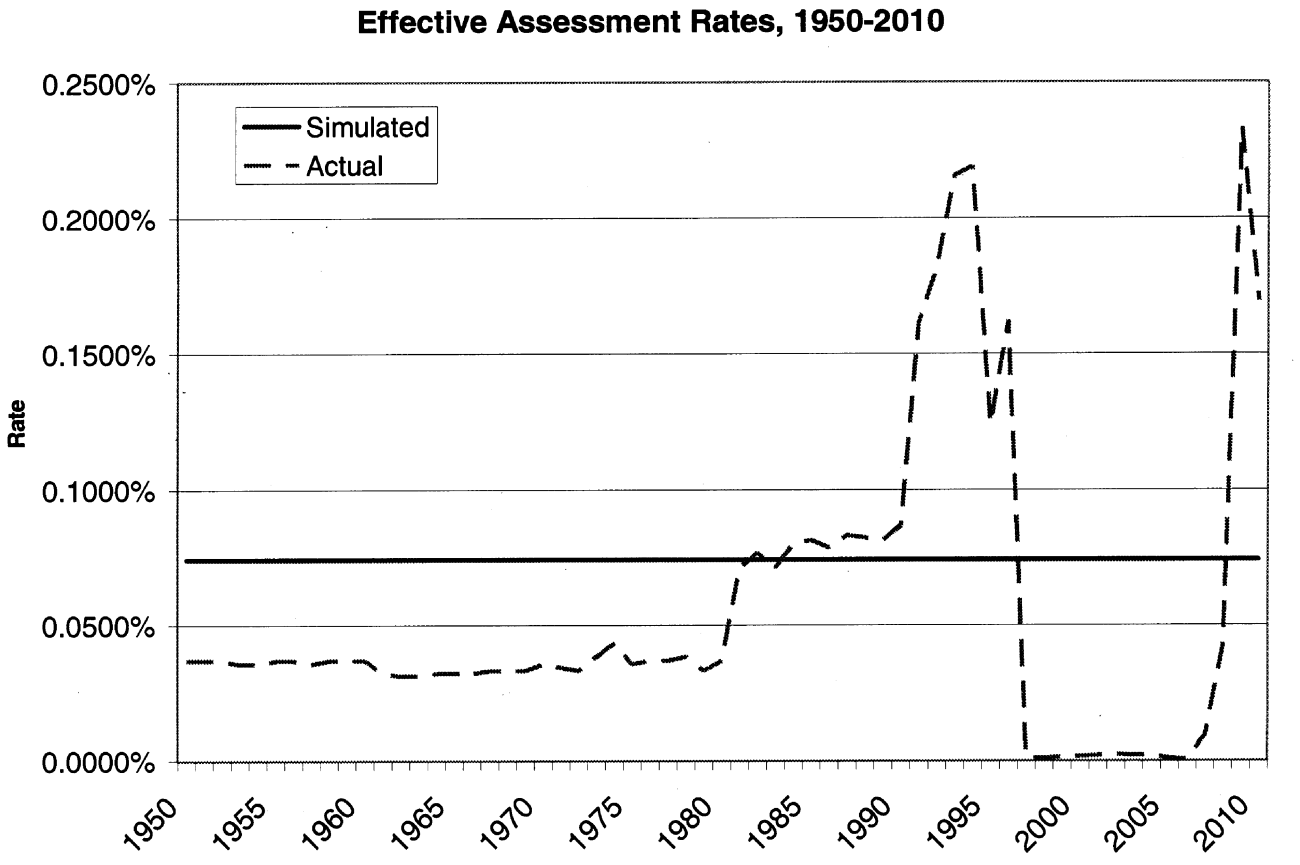
[11] All assessment rates represent an industry-wide average.

Chart A



No dividends, with 7.44 basis point average nominal assessment rate

Chart B

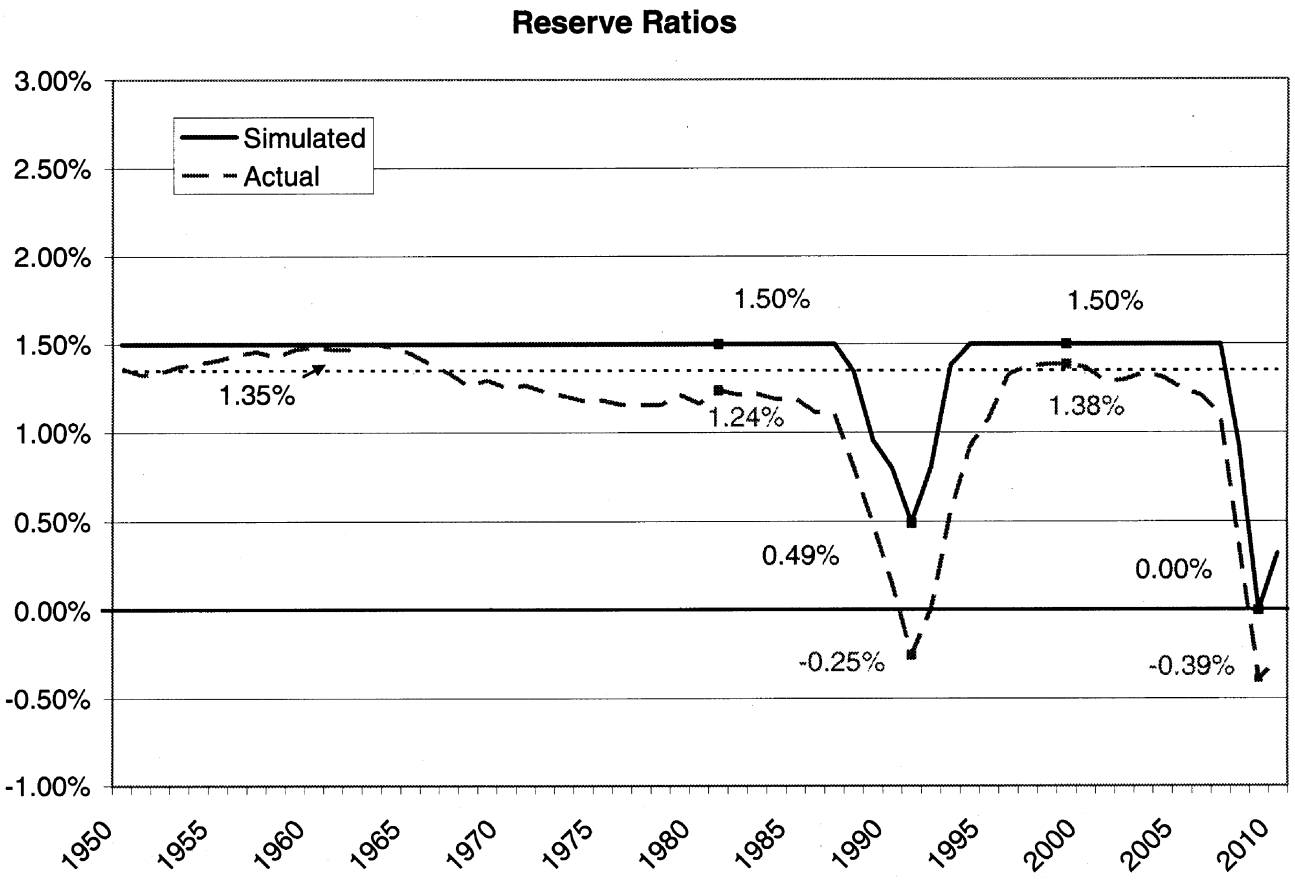


No dividends, with 7.44 basis point average nominal assessment rate

During most years since 1950, however, there has been either a credit or dividend policy provided for by statute (although since 1985 no recurring credits or dividends have been awarded). As amended by Dodd-Frank, the FDI Act continues to authorize the FDIC to dividend 100 percent of the amount in the fund in excess of the amount required to maintain the reserve ratio at 1.5 percent, but provides the FDIC with sole discretion to suspend or limit these dividends. The analysis (given its method and assumptions) sought to evaluate the consequences had the full amount of dividends possible under Dodd-Frank been granted from 1950–2010. (See Charts C and D.) Granting dividends in this way necessitates a constant average nominal assessment rate of 21.96 basis points to maintain a positive fund balance during both periods of crisis. Such a rate is historically very high, and corresponds most closely to the rates charged to recapitalize the fund after a crisis. This policy would have also resulted in substantial premium volatility and pro-cyclical average effective assessment rates.[12] In some years, the effective assessment rate would have been negative.

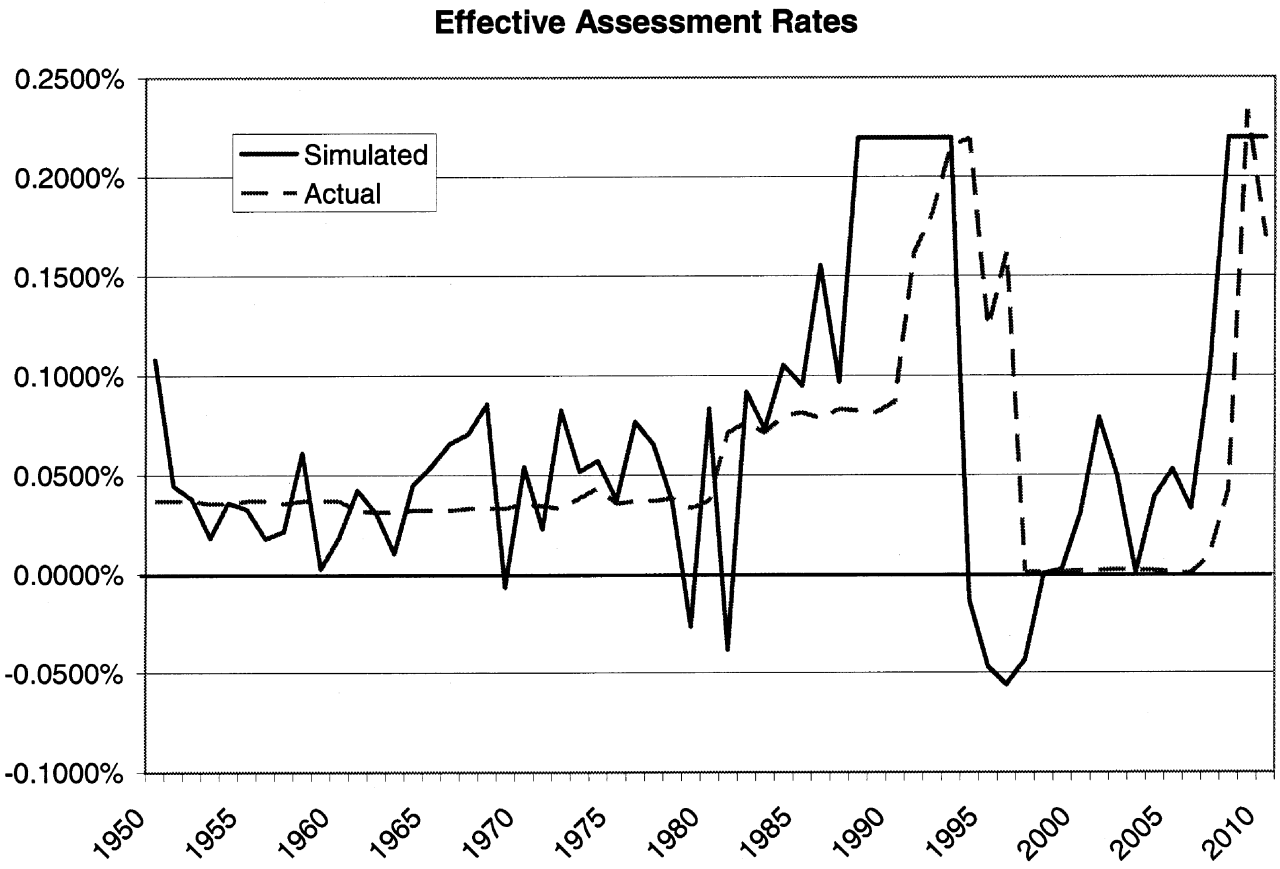
[12] Average effective assessment rates are calculated by subtracting dividends paid from assessments received.

Chart C



Dividends equal to 100 percent of the amount in the fund in excess of the amount required to maintain the reserve ratio at 1.5 percent, with 21.96 basis point average nominal assessment rate

Chart D



Dividends equal to 100 percent of the amount in the fund in excess of the amount required to maintain the reserve ratio at 1.5 percent, with 21.96 basis point average nominal assessment rate

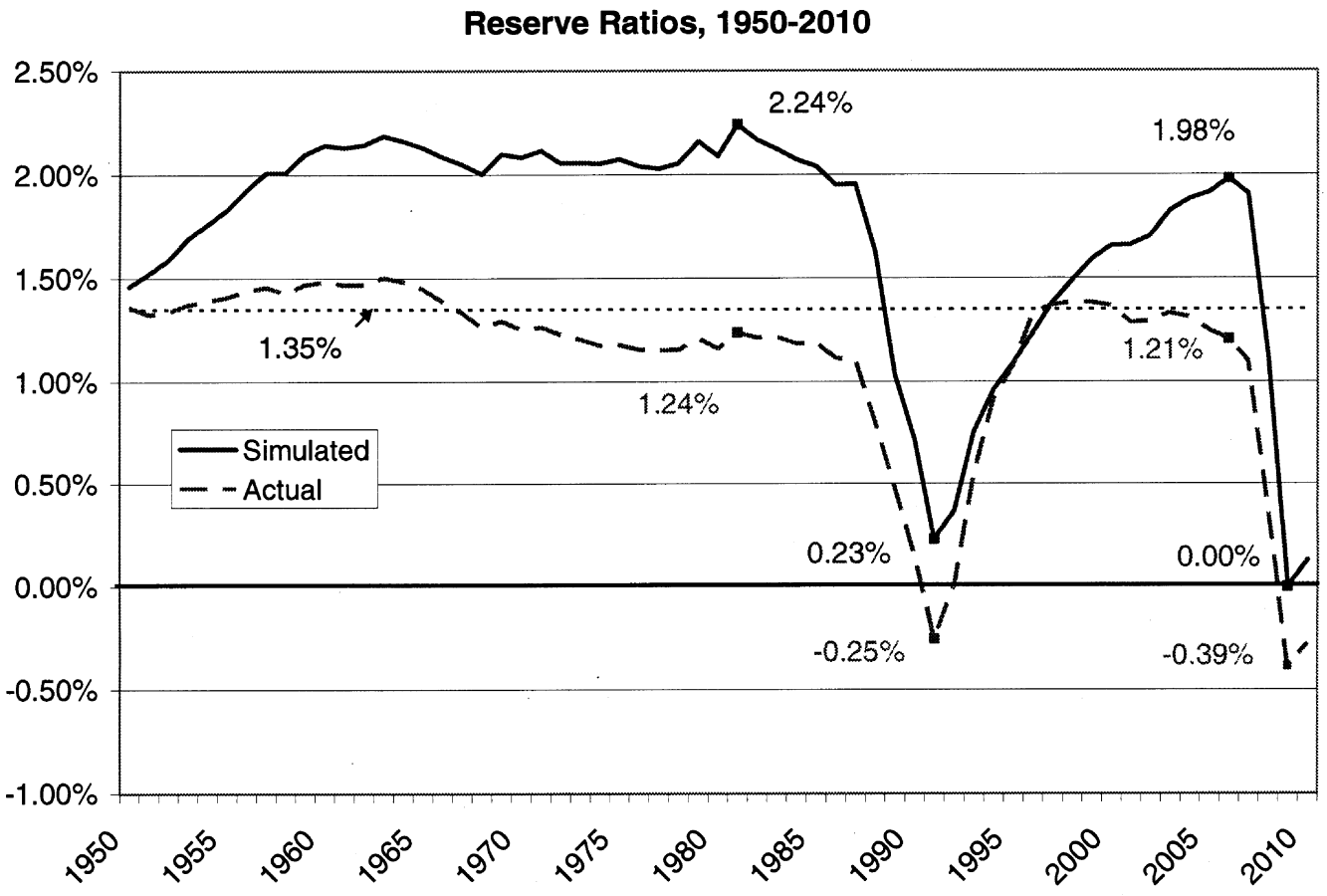
The analysis was therefore extended to examine options that limited dividends or reduced assessment rates in lieu of dividends, in keeping with the broad set of goals for fund management. The analysis examined multiple options with different levels of dividend or assessment rate reduction, and found that many options would still have required relatively high assessment rates. However, the FDIC did identify two options that would achieve the FDIC's goals of maintaining a positive fund balance even during a banking crisis and maintaining moderate, steady assessment rates throughout economic and credit cycles.

One option awards dividends as a percentage of the amount in the fund in excess of the amount required to maintain the reserve ratio at a specified level. The analysis above has already shown that granting dividends equal to 100 percent of the amount in the fund in excess of the amount required to maintain the reserve ratio at 1.5 percent would have required a very high constant average nominal assessment rate of 21.96 basis points. However, granting dividends equal to 25 percent of the amount in the fund in excess of the amount required to maintain the reserve ratio at 2 percent and increasing dividends to 50 percent of the amount in the fund in excess of the amount required to maintain the reserve ratio at 2.5 percent permitted a significantly lower constant average nominal assessment rate to maintain a positive fund balance.

This dividend method, however, introduces a potential problem—the possibility that an IDI could receive a dividend that approaches 100 percent of its assessment. The nearer a dividend comes to 100 percent of an IDI's assessment, the more it introduces moral hazard and reduces or eliminates the FDIC's ability to control and price for risk taking. To avoid this problem, dividends are limited such that no IDI could receive a dividend greater than 50 percent of its annual assessment.

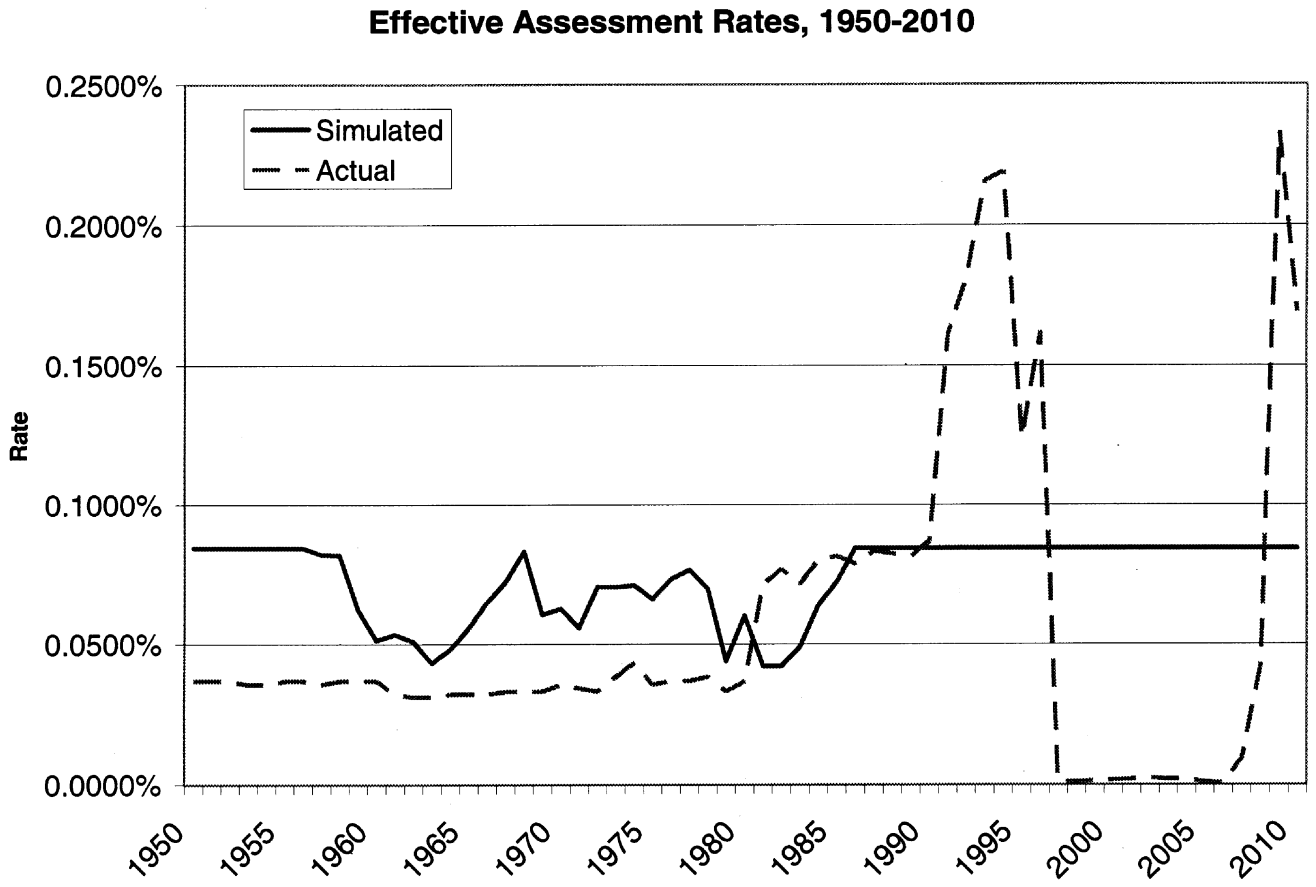
The analysis (reflected in Charts E and F) shows that this option results in a moderate constant nominal assessment rate of 8.45 basis points across the entire 60-year period. The reserve ratios necessary to maintain a positive fund balance are 2.24 percent before the crisis of the 1980s and early 1990s and 1.98 percent before the current crisis. These ratios are, of course, significantly higher than the level that the DRR has been set historically, but should be sufficient to withstand a future crisis similar in depth to those the FDIC has experienced. Pro-cyclicality is limited, but this option generates moderate premium volatility.

Chart E



Dividends equal to 25 percent of the amount in the fund in excess of the amount required to maintain the reserve ratio at 2.0 percent or 50 percent of the amount in the fund in excess of the amount required to maintain the reserve ratio at 2.5 percent, with 8.45 basis point average nominal assessment rate

Chart F

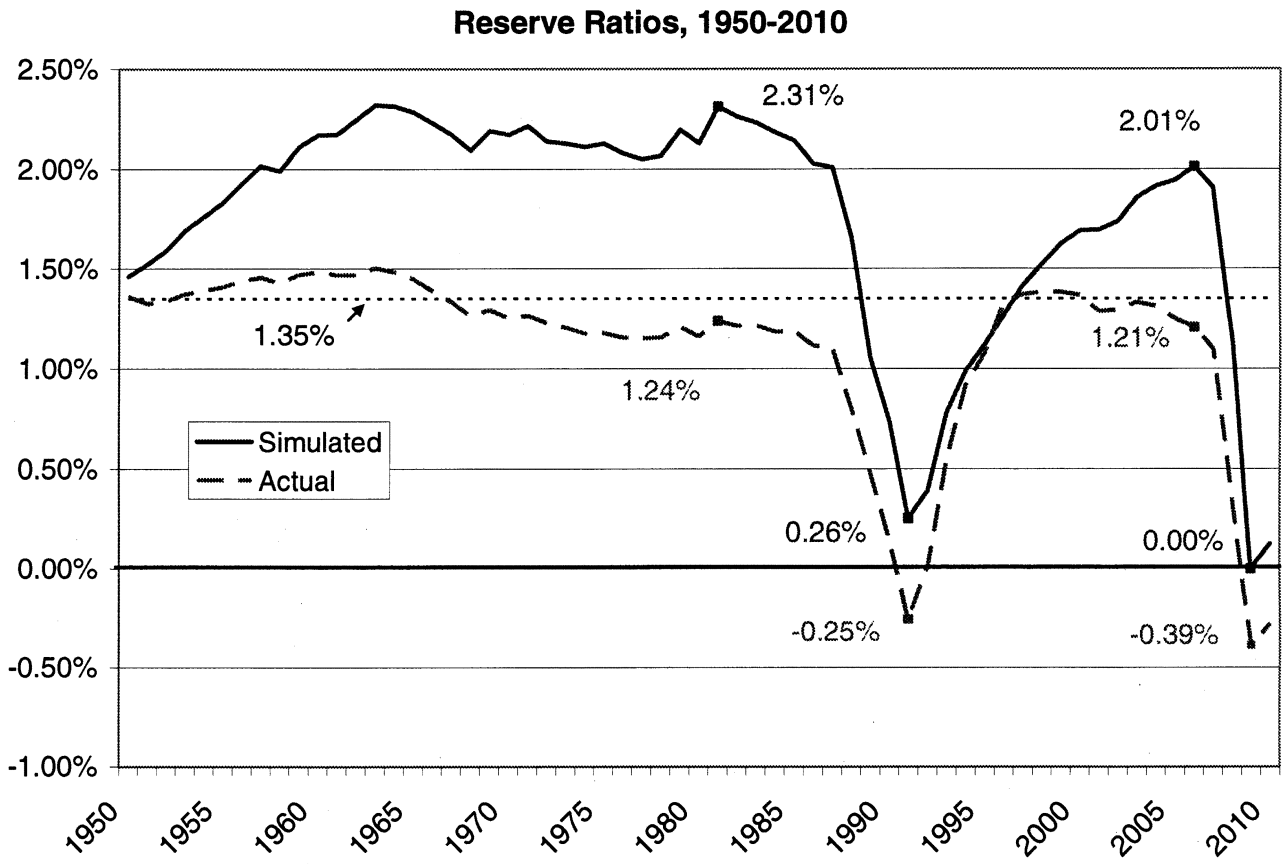


Dividends equal to 25 percent of the amount in the fund in excess of the amount required to maintain the reserve ratio at 2.0 percent or 50 percent of the amount in the fund in excess of the amount required to maintain the reserve ratio at 2.5 percent, with 8.45 basis point average nominal assessment rate

The second option that achieves the FDIC's fund management goals of maintaining a positive fund balance even during a banking crisis and maintaining moderate, steady assessment rates throughout economic and credit cycles would, in lieu of a dividend, reduce the long-term industry average nominal assessment rate by 25 percent when the reserve ratio reached 2 percent, and by 50 percent when the reserve ratio reached 2.5 percent.

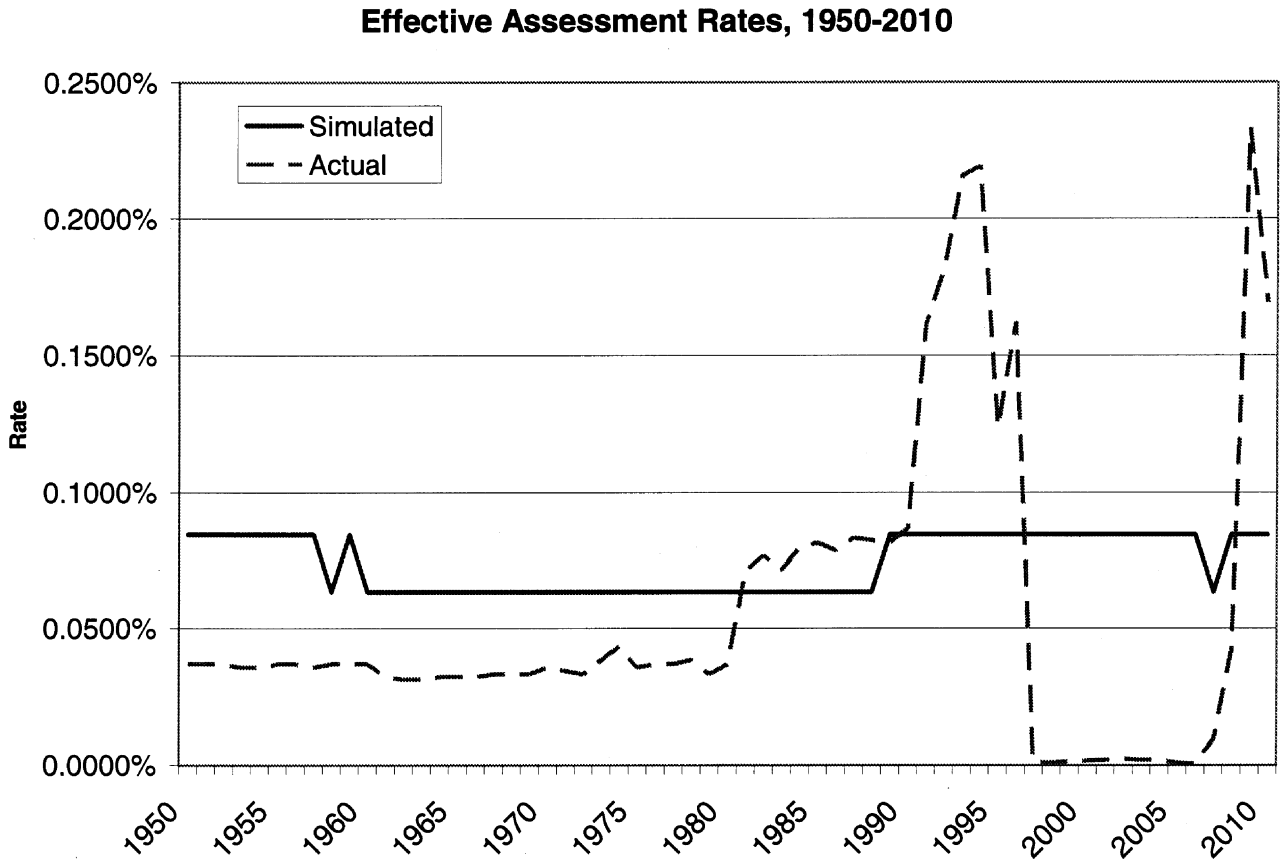
The analysis (reflected in Charts G and H) shows that this option results in a moderate constant nominal assessment rate of 8.47 basis points during the entire 60-year period (except when reduced as the result of the fund exceeding the 2 percent threshold), almost identical to the rate required under the immediately preceding option (limiting dividends). The reserve ratios necessary to maintain a positive fund balance are 2.31 percent before the crisis of the 1980s and early 1990s and 2.01 percent before the current crisis, very similar to the ratios required under the option that would limit dividends. Premium volatility and pro-cyclicality are both successfully minimized, and premium volatility is significantly lower than under the option that would limit dividends.

Chart G



Effective assessment rate reduced by 25 percent when reserve ratio reaches 2 percent and 50 percent when reserve ratio reaches 2.5 percent, with 8.47 basis point average nominal assessment rate

Chart H



Effective assessment rate reduced by 25 percent when reserve ratio reaches 2 percent and 50 percent when reserve ratio reaches 2.5 percent, with 8.47 basis point average nominal assessment rate

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One final concern is whether the fund recovers sufficiently, both in magnitude and in time, to withstand another crisis. Extending the analysis into the future, using estimates based on implied forward interest rates and assuming current FDIC assessment rates and loss projections until the reserve ratio reaches 1.15 percent (approximately the fourth quarter of 2018) and low losses and an 8.47 basis point average nominal assessment rate thereafter, the reserve ratio reaches 2 percent in 2027.[13] This would bring the fund to a level able to withstand past crises in 17 years, approximately the length of time between the depth of the crisis of the late 1980s and early 1990s (in 1991) and the beginning of the current crisis (in 2008).

However, the average rates assumed in the previous paragraph between now and 2018 are much higher than 8.47 basis points, which, if the proposed comprehensive plan is implemented, would be approximately the average rate in effect in the event a future banking crisis causes the fund balance to fall to or near zero. Starting at a reserve ratio of zero, assessment rates of 8.45 to 8.47 basis points (the rates under the option that limits dividends and the one that lowers rates) it would take 25 years for the simulated fund to reach a level of 2 percent. However, allowing the reserve ratio to exceed 2 percent should reduce the chance that the reserve ratio during a crisis would fall all the way to zero.

[13] Because of the offset requirements of Dodd-Frank discussed earlier, the fund reserve ratio is assumed to reach 1.35 percent immediately upon reaching 1.15 percent.

II. The Proposed Rule

A. Dividends

To increase the probability that the fund reserve ratio will reach a level sufficient to withstand a future crisis, the FDIC is proposing to suspend dividends permanently whenever the fund reserve ratio exceeds 1.5 percent. In lieu of dividends, and pursuant to its authority to set risk-based assessments, the FDIC is proposing to adopt progressively lower assessment rate schedules when the reserve ratio exceeds 2 percent and 2.5 percent, as discussed below. These lower assessment rate schedules would serve much the same function as dividends in preventing the DIF from growing unnecessarily large but, as discussed above, would provide more stable and predictable effective assessment rates, a feature that industry representatives

said was very important at the September 24, 2010 roundtable organized by the FDIC.

B. Assessment Rates

Current Assessment Rates

Current initial base assessment rates are set forth in Table 1 below.

TABLE 1—CURRENT INITIAL BASE ASSESSMENT RATES [14]

	Risk Category				
	I*		II	III	IV
	Minimum	Maximum			
Annual Rates (in basis points)	12	16	22	32	45

*Rates for institutions that do not pay the minimum or maximum rate will vary between these rates.

These initial assessment rates are subject to adjustment. An IDI's total base assessment rate can vary from its initial base assessment rate as the result of an unsecured debt adjustment and a secured liability adjustment. The unsecured debt adjustment lowers an IDI's initial base assessment rate using its ratio of long-term unsecured debt (and, for small IDIs, certain amounts of Tier 1 capital) to domestic deposits.[15] The secured liability adjustment increases an IDI's initial base assessment rate if the IDI's ratio of secured liabilities to domestic deposits is greater than 25 percent (the secured liability adjustment).[16] In addition, IDIs in Risk Categories II, III and IV are subject to an adjustment for large levels of brokered deposits (the brokered deposit adjustment).[17]

After applying all possible adjustments, the current minimum and maximum total base assessment rates for each risk category are set out in Table 2 below.

TABLE 2—INITIAL AND TOTAL BASE ASSESSMENT RATES

	Risk Category I	Risk Category II	Risk Category III	Risk Category IV
Initial base assessment rate	12–16	22	32	45
Unsecured debt adjustment	(5)–0	(5)–0	(5)–0	(5)–0
Secured liability adjustment	0–8	0–11	0–16	0–22.5
Brokered deposit adjustment	.....	0–10	0–10	0–10
Total Base Assessment Rate	7–24	17–43	27–58	40–77.5

All amounts for all risk categories are in basis points annually. Total base rates that are not the minimum or maximum rate will vary between these rates.

The FDIC may uniformly adjust the total base rate assessment schedule up or down by up to 3 basis points without further rulemaking.[18]

Proposed Assessment Rates Once the Reserve Ratio Reaches 1.15 Percent

As discussed earlier, under Dodd-Frank, the FDIC is required to offset the effect on small institutions (those with less than $10 billion in assets) of the statutory requirement that the fund reserve ratio increase from 1.15 percent to 1.35 percent by September 30, 2020. Thus, assessment rates applicable to all IDIs need to be set only high enough to reach 1.15 percent. The Restoration Plan postpones until 2011 rulemaking regarding the method that will be used to reach 1.35 percent by the statutory deadline of September 30, 2020, and the manner of offset.

When the reserve ratio reaches 1.15 percent, the FDIC believes that it would be appropriate to lower assessment rates so that the average assessment rate would approximately equal the long-term moderate, steady assessment rate—approximately 8.5 basis points, as discussed above—that would have been needed to maintain a positive fund balance throughout past crises. Based on the FDIC's analysis of weighted average assessment rates paid immediately prior to the current crisis (when the industry was relatively prosperous, and had both good CAMELS ratings and substantial capital), weighted average rates during times of industry prosperity tend to be somewhat less than 1 basis point greater than the minimum rate applicable to Risk Category I.[19] Thus, to achieve

[14] For purposes of determining assessment rates, each IDI is placed into one of four risk categories (Risk Category I, II, III or IV), depending upon supervisory ratings and capital levels. 12 CFR 327.9. Within Risk Category I, there are different assessment systems for large and small IDIs, but the possible range of rates is the same for all IDIs in Risk Category I.

[15] Unsecured debt excludes debt guaranteed by the FDIC under its Temporary Liquidity Guarantee Program.

[16] The initial base assessment rate cannot increase more than 50 percent as a result of the secured liability adjustment.

[17] 12 CFR 327.9(d)(7).

[18] Specifically:

The Board may increase or decrease the total base assessment rate schedule up to a maximum increase of 3 basis points or a fraction thereof or a maximum decrease of 3 basis points or a fraction thereof (after aggregating increases and decreases), as the Board deems necessary. Any such adjustment shall apply uniformly to each rate in the total base assessment rate schedule. In no case may such Board rate adjustments result in a total base assessment rate that is mathematically less than zero or in a total base assessment rate schedule that, at any time, is more than 3 basis points above or below the total base assessment schedule for the Deposit Insurance Fund, nor may any one such Board adjustment constitute an increase or decrease of more than 3 basis points.

12 CFR 327.10(c). On October 19, 2010, the FDIC adopted a new Restoration Plan that foregoes a uniform 3 basis point increase in assessment rates previously scheduled to go into effect on January 1, 2011. Thus, the assessment rates in the current regulation will remain in effect.

[19] The first year in which rates applicable to Risk Category I spanned a range (as opposed to being a single rate) was 2007, when initial assessment rates ranged between 5 and 7 basis points. During that year, weighted average annualized industry assessment rates for the first three quarters varied between 5.41 and 5.44 basis points. (By the end of

approximately an 8.5 basis point average assessment rate during prosperous times, current initial base rates would have to be set 4 basis points lower than current initial base assessment rates. Consequently, pursuant to the FDIC's authority to set assessments, the FDIC proposes that, when the fund reserve ratio first meets or exceeds 1.15 percent, the initial base and total base assessment rates set forth in Table 3 would take effect beginning the next quarter without the necessity of further action by the FDIC's Board. These rates would remain in effect unless and until the reserve ratio met or exceeded 2 percent. The unsecured debt adjustment could not exceed the lesser of 5 basis points or 50 percent of an IDI's initial base assessment rate. The FDIC's Board would retain its current authority to uniformly adjust the total base rate assessment schedule up or down by up to 3 basis points without further rulemaking.

TABLE 3—INITIAL AND TOTAL BASE ASSESSMENT RATES EFFECTIVE FOR THE QUARTER BEGINNING IMMEDIATELY AFTER THE QUARTER IN WHICH THE RESERVE RATIO MEETS OR EXCEEDS 1.15 PERCENT

	Risk Category I	Risk Category II	Risk Category III	Risk Category IV
Initial base assessment rate	8–12	18	28	40
Unsecured debt adjustment*	(5)–0	(5)–0	(5)–0	(5)–0
Secured liability adjustment	0–6	0–9	0–14	0–20
Brokered deposit adjustment	.....	0–10	0–10	0–10
Total Base Assessment Rate	4–18	13–37	23–52	35–70

All amounts for all risk categories are in basis points annually. Total base rates that are not the minimum or maximum rate will vary between these rates.

* The unsecured debt adjustment could not exceed the lesser of 5 basis points or 50 percent of an IDI's initial assessment rate; thus, for example, an IDI with an initial assessment rate of 8 would have a maximum unsecured debt adjustment of 4 basis points and could not have a total base assessment rate lower than 4 basis points.

Proposed Assessment Rates Once the Reserve Ratio Reaches 2.0 Percent

In lieu of dividends, and pursuant to its authority to set assessments, the FDIC proposes that, so long as the fund reserve ratio at the end of the prior quarter meets or exceeds 2 percent, but is less than 2.5 percent, the initial base and total base assessment rates set forth in Table 4 would come into effect without the necessity of further action by the FDIC's Board. If, however, after reaching a reserve ratio of 1.15 percent, the fund reserve ratio subsequently falls below 2 percent at the end of a quarter, the initial base and total base assessment rates set forth in Table 3 would take effect beginning the next quarter without the necessity of further action by the FDIC's Board. However, the assessment rates in Table 4 would not apply to any new depository institutions; these IDIs would remain subject to the assessment rates in Table 3, until they no longer were new depository institutions.[20] Under the proposal, the unsecured debt adjustment could not exceed the lesser of 5 basis points or 50 percent of an IDI's initial base assessment rate. The FDIC's Board would retain its current authority to uniformly adjust the total base rate assessment schedule up or down by up to 3 basis points without further rulemaking.

TABLE 4—INITIAL AND TOTAL BASE ASSESSMENT RATES EFFECTIVE FOR ANY QUARTER WHEN THE RESERVE RATIO FOR THE PRIOR QUARTER MEETS OR EXCEEDS 2 PERCENT (BUT IS LESS THAN 2.5 PERCENT)

	Risk Category I	Risk Category II	Risk Category III	Risk Category IV
Initial base assessment rate	6–10	16	26	38
Unsecured debt adjustment*	(5)–0	(5)–0	(5)–0	(5)–0
Secured liability adjustment	0–5	0–8	0–13	0–19
Brokered deposit adjustment	.....	0–10	0–10	0–10
Total Base Assessment Rate	3–15	11–34	21–49	33–67

All amounts for all risk categories are in basis points annually. Total base rates that are not the minimum or maximum rate will vary between these rates.

* The unsecured debt adjustment could not exceed the lesser of 5 basis points or 50 percent of an IDI's initial assessment rate; thus, for example, an IDI with an initial assessment rate of 6 would have a maximum unsecured debt adjustment of 3 basis points and could not have a total base assessment rate lower than 3 basis points.

Compared to Table 3, the proposed assessment rates in Table 4 should approximately reduce weighted average assessment rates by 25 percent, consistent with the analysis reflected in Chart H above. Based upon the FDIC's

2007, deterioration in the industry became more marked and weighted average rates began increasing.) 0.4 basis points is 20 percent of the 2 basis point difference between the minimum and maximum rates. 20 percent of the 4 basis point difference between the current minimum and maximum rates is 0.8 basis points. Thus, by analogy, in 2007 the current assessment schedule would have produced average assessment rates of about 12.8 basis points.

[20] Subject to exceptions, a new insured depository institution is a bank or savings association that has been federally insured for less than five years as of the last day of any quarter for which it is being assessed. 12 CFR 327.8(m). Under the proposal, other assessment rules related to new depository institutions would generally remain unchanged. For example, subject to the exceptions contained in the regulation, a new institution that is well capitalized would continue to be assessed the Risk Category I maximum initial base assessment rate in Table 3 for the relevant assessment period. 12 CFR 327.9(d)(9). Also, for example, a new institution would not be subject to the unsecured debt adjustment. 12 CFR 327.9(d)(5).

historical simulations, these rates should allow the fund to remain positive during a crisis of the magnitude of the prior two crises without significantly increasing pro-cyclicality or premium volatility.

Proposed Assessment Rates Once the Reserve Ratio Reaches 2.5 Percent

Again in lieu of dividends, and to reduce the low probability of the fund growing unreasonably large, the FDIC, under its authority to set assessments, proposes that the initial base and total base assessment rates set forth in Table 5 would apply if the fund reserve ratio at the end of the prior quarter meets or exceeds 2.5 percent, without the necessity of further action by the FDIC's Board. If, however, after reaching a reserve ratio of 1.15 percent, the fund reserve ratio subsequently falls below 2.5 percent at the end of a quarter, the rates set forth in Tables 3 or 4, whichever is applicable, would take effect beginning the next quarter without the necessity of further action by the FDIC's Board. Again, however, the assessment rates in Table 5 would not apply to any new depository institutions; these IDIs would remain subject to the assessment rates in Table 3, until they no longer were new depository institutions. Under the proposal, the unsecured debt adjustment could not exceed the lesser of 5 basis points or 50 percent of an IDI's initial base assessment rate. The FDIC's Board would retain its current authority to uniformly adjust the total base rate assessment schedule up or down by up to 3 basis points without further rulemaking.

TABLE 5—INITIAL AND TOTAL BASE ASSESSMENT RATES EFFECTIVE FOR ANY QUARTER WHEN THE RESERVE RATIO FOR THE PRIOR QUARTER MEETS OR EXCEEDS 2.5 PERCENT

	Risk Category I	Risk Category II	Risk Category III	Risk Category IV
Initial base assessment rate	4–8	14	24	36
Unsecured debt adjustment*	(4)–0	(5)–0	(5)–0	(5)–0
Secured liability adjustment	0–4	0–7	0–12	0–18
Brokered deposit adjustment	.....	0–10	0–10	0–10
Total Base Assessment Rate	2–12	9–31	19–46	31–64

All amounts for all risk categories are in basis points annually. Total base rates that are not the minimum or maximum rate will vary between these rates.

*The unsecured debt adjustment could not exceed the lesser of 5 basis points or 50 percent of an IDI's initial assessment rate; thus, for example, an IDI with an initial assessment rate of 6 would have a maximum unsecured debt adjustment of 3 basis points and could not have a total base assessment rate lower than 3 basis points.

Compared to Table 3, the proposed assessment rates in Table 5 should approximately reduce weighted average assessment rates by 50 percent, consistent with the analysis reflected in Chart H above and should allow the fund to remain positive during a crisis of the magnitude of the prior two crises without significantly increasing pro-cyclicality or premium volatility.

Capital and Earnings Analysis

The FDIC has analyzed the effect of its proposed rate schedules on the capital and earnings of IDIs.[21] The FDIC anticipates that when the reserve ratio exceeds 1.15 percent, and particularly when it exceeds 2 or 2.5 percent, the industry is likely to be prosperous. Consequently, the FDIC has examined the effect of the proposed lower rates on the industry at the end of 2006, when the industry was prosperous. Reducing average assessment rates by 4 basis points then (the approximate effect of reducing assessment rates from the current rate schedule to the one proposed when the reserve ratio reaches 1.15 percent) would have increased average after-tax income by 1.25 percent and average capital by 0.14 percent. Reducing average assessment rates by an additional 2 basis points (the effect of reducing assessment rates from the proposed rate schedule when the reserve ratio reaches 1.15 percent to the proposed rate schedule when the reserve ratio reaches 2 percent) would have increased average after-tax income by 0.62 percent and average capital by 0.07 percent. Similarly, reducing average assessment rates by an additional 2 basis points (the effect of reducing assessment rates from the proposed rate schedule when the reserve ratio reaches 2 percent to the proposed rate schedule when the reserve ratio reaches 2.5 percent) would have increased average after-tax income by 0.61 percent and average capital by 0.07 percent.

Effect of Upcoming Rulemakings

Dodd-Frank also requires the FDIC to amend its regulations to define an IDI's assessment base (with some possible exceptions) as "the average consolidated total assets of the insured depository institution during the assessment period * * * minus * * * the sum of * * * the average tangible equity of the insured depository institution during the assessment period * * *."[22] This assessment base will be more than 50 percent larger than the current assessment base, at least initially. Before the expiration of the comment period on this proposed rule, the FDIC plans to adopt and publish a notice of proposed rulemaking to define the assessment base. The FDIC anticipates that the notice will also include proposed changes to the risk-based pricing system necessitated by the change in assessment base.

The net effect of this proposal will necessitate that the FDIC also adjust the proposed assessment rates. These adjustments will ensure that the revenue collected under the new assessment system will approximately equal that under the existing assessment system.

For several reasons, however, it is neither possible nor advisable to attempt to make the new assessment system or changes to the assessment rate schedules proposed above perfectly revenue neutral. First, for simplicity, the FDIC prefers, when possible, to use whole numbers when it establishes

[21] In setting assessment rates, the FDIC's Board of Directors is authorized to set assessments for IDIs in such amounts as the Board of Directors may determine to be necessary. 12 U.S.C. 1817(b)(2)(A). In so doing, the Board shall consider: (1) the estimated operating expenses of the DIF; (2) the estimated case resolution expenses and income of the DIF; (3) the projected effects of the payment on the capital and earnings of IDIs; (4) the risk factors and other factors taken into account pursuant to 12 U.S.C.1817(b) (1) under the risk-based assessment system, including the requirement under such paragraph to maintain a risk-based system; and (5) any other factors the Board of Directors may determine to be appropriate. 12 U.S.C. 1817(b)(2)(B). As reflected in the text, the FDIC has taken into account all of these statutory factors.

[22] Public Law 111–203, § 331(b), 124 Stat. 1376, 1538 (to be codified at 12 U.S.C. 1817(nt)).

point assessment rates or the maximum and minimum of an assessment rate range. Second, the FDIC does not presently collect all of the information it needs to determine the exact revenue effect of many of the changes it anticipates proposing. Third, in response to the new assessment base, changes to the adjustments and possible changes to the large IDI assessment system, some IDIs may alter their funding structure and behavior—in ways that are not presently predictable—to minimize assessments.

C. DRR

As discussed above, Dodd-Frank eliminates the previous requirement to set the DRR within a range of 1.15 percent to 1.50 percent, directs the FDIC to set the DRR at a minimum of 1.35 percent (or the comparable percentage of the assessment base as amended by Dodd-Frank) and eliminates the maximum limitation on the DRR.[23] Dodd-Frank retains the requirement that the FDIC set and publish a DRR annually.[24]

While Dodd-Frank retains the requirement that the Board set a DRR annually, it does not direct the FDIC how to use the DRR. In effect, Dodd-Frank permits the FDIC to set the DRR as it sees fit so long as it is set no lower than 1.35 percent. Neither the FDI Act nor the amendments under Dodd-Frank establish a statutory role for the DRR as a trigger, whether for assessment rate determination, recapitalization of the fund, or dividends.

The FDIC sets forth below background information, its analysis of the statutory factors that must be considered in setting the DRR and its proposal to set the DRR for the DIF at 2 percent.[25]

Background

The FDIC must set the DRR in accordance with its analysis of the following statutory factors: Risk of losses to the DIF; economic conditions generally affecting IDIs; preventing sharp swings in assessment rates; and any other factors that the Board may determine to be appropriate and consistent with these three factors.[26] The analysis that follows considers each statutory factor, including one "other factor": maintaining the DIF at a level that can withstand substantial losses. The manner in which the FDIC's Board evaluates the statutory factors may depend on its view of the role of the DRR, which may change over time. Based on current circumstances and historical analysis, the FDIC has identified a role for the DRR as a minimum target for the reserve ratio.

Analysis of Statutory Factors

Risk of Losses to the DIF

During 2009 and 2010, losses to the DIF have been high. As of June 30, 2010, both the fund balance and the reserve ratio continue to be negative after reserving for probable losses from anticipated bank failures. During the current downturn the fund balance has fallen below zero for the second time in the history of the FDIC. The FDIC reported a negative fund balance in the early 1990s during the last banking crisis. The FDIC projects that, over the period 2010 through 2014, the fund could incur approximately $52 billion in failure-resolution costs. The FDIC projects that most of these costs will occur in 2010 and 2011.

In the FDIC's view, the high losses experienced by the DIF during the crisis of the 1980s and early 1990s and during the current economic crisis (and the potential for high risk of loss to the DIF over the course of future economic cycles) suggest that the FDIC should, as a long-range, minimum goal and in conjunction with the proposed dividend and assessment rate policy, set a DRR at a level that would have maintained a zero or greater fund balance during both crises so that the DIF will be better able to handle losses during periods of severe industry stress.

Economic Conditions Affecting FDIC-Insured Institutions

U.S. economic growth, which started in the second half of 2009, remains low. Leading economic indicators have fallen slightly after rising steadily since the spring of 2009. Continued weakness in labor and real estate markets coupled with concern about rising public debt levels have increased uncertainty in the economic outlook and heightened financial market volatility. Consensus forecasts call for the economy to grow at a slower pace in the second half of 2010 compared with the first half of the year, as fiscal stimulus measures wane.

The slow and uncertain pace of economic recovery creates a challenging operating environment for IDIs. Industry-wide loans outstanding continued to fall in the second quarter. As of June 30, there were 829 IDIs on the problem list, representing more than 10 percent of all IDIs. Through October 1, 129 IDIs have failed this year, making this year's total likely to match or exceed the 140 failures that occurred in 2009.

IDIs continue to experience significant credit distress, although loan losses and delinquencies may have peaked. Despite this, the financial performance of IDIs has shown signs of improvement. The industry reported aggregate net income of $26 billion in second quarter 2010, compared to an aggregate net loss of $4.4 billion a year ago. Almost 80 percent of IDIs were profitable in the quarter, and almost two-thirds reported year-over-year earnings growth.

Although these short-term economic conditions can inform the FDIC's decision on setting the DRR, they become less relevant in setting the DRR when, as now, the DIF is negative. In this context, the FDIC believes that the DRR should be viewed in a longer-term perspective. Twice within the past 30 years, serious economic dislocations have resulted in a significant deterioration in the condition of many IDIs and in a consequent large number of IDI failures at high costs to the DIF. In the FDIC's view, the DRR should, therefore, be viewed as a minimum goal needed to achieve a reserve ratio that can withstand these periodic economic downturns and their attendant IDI failures. Taking these longer-term economic realities into account, a prudent and consistent policy would set the DRR at a minimum of 2 percent, since that is the lowest level that would have prevented a negative fund balance at any time since 1950.

Preventing Sharp Swings in Assessment Rates

Current law directs the FDIC to consider preventing sharp swings in assessment rates for IDIs. Setting the DRR at 2 percent as a minimum goal rather than a final target would signal that the FDIC plans for the DIF to grow in good times so that funds are available to handle multiple bank failures in bad times. This plan would help prevent sharp fluctuations in deposit insurance premiums over the course of the business cycle. In particular, it would

[23] Public Law 111–203, § 334(a), 124 Stat. 1376, 1539 (to be codified at 12 U.S.C. 1817(b)(3)(B)).

[24] 12 U.S.C. 1817(b)(3)(A).

[25] The 2 percent DRR is expressed as a percentage of estimated insured deposits.

[26] Specifically, in setting the DRR for any year, the FDIC must consider the following factors:

(1) The risk of losses to the DIF in the current and future years, including historical experience and potential and estimated losses from IDIs.

(2) Economic conditions generally affecting IDIs so as to allow the DRR to increase during more favorable economic conditions and to decrease during less favorable economic conditions, notwithstanding the increased risks of loss that may exist during such less favorable conditions, as the Board determines to be appropriate.

(3) That sharp swings in assessment rates for IDIs should be prevented.

(4) Other factors as the FDIC's Board may deem appropriate, consistent with the requirements of the Reform Act.

12 U.S.C. 1817(b)(3)(B).

help reduce the risk of large rate increases during crises, when IDIs can least afford an increase.

Maintaining the DIF at a Level That Can Withstand Substantial Losses

Setting the DRR as a minimum goal and adopting the proposed dividend and assessment rate policy, which would allow the fund to grow sufficiently large in good times, would increase the likelihood that the DIF would remain positive during bad times. Having adequate funds available when entering a financial crisis would reduce the likelihood that the FDIC would need to increase assessment rates, levy special assessments on the industry or borrow from the U.S. Treasury.

Balancing the Statutory Factors

In the FDIC's view, the best way to balance all of the statutory factors (including the "other factor" identified above of maintaining the DIF at a level that can withstand the substantial losses associated with a financial crisis) is to set the DRR at 2 percent.

IV. Request for Comments

The FDIC requests comments on all aspects of the proposed rule.

V. Regulatory Analysis and Procedure

A. Solicitation of Comments on Use of Plain Language

Section 722 of the Gramm-Leach-Bliley Act, Public Law 106–102, 113 Stat. 1338, 1471 (Nov. 12, 1999), requires the Federal banking agencies to use plain language in all proposed and final rules published after January 1, 2000. We invite your comments on how to make this proposal easier to understand. For example:

- Have we organized the material to suit your needs? If not, how could this material be better organized?
- Are the requirements in the proposed regulation clearly stated? If not, how could the regulation be more clearly stated?
- Does the proposed regulation contain language or jargon that is not clear? If so, which language requires clarification?
- Would a different format (grouping and order of sections, use of headings, paragraphing) make the regulation easier to understand? If so, what changes to the format would make the regulation easier to understand?
- What else could we do to make the regulation easier to understand?

B. Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) requires that each federal agency either certify that a proposed rule would not, if adopted in final form, have a significant economic impact on a substantial number of small entities or prepare an initial regulatory flexibility analysis of the rule and publish the analysis for comment.[27] Certain types of rules, such as rules of particular applicability relating to rates or corporate or financial structures, or practices relating to such rates or structures, are expressly excluded from the definition of "rule" for purposes of the RFA.[28]

As of June 30, 2010, of the 7,830 insured commercial banks and savings associations, there were 4,665 small insured depository institutions as that term is defined for purposes of the RFA (*i.e.,* institutions with $175 million or less in assets).

Among other things, the proposed rule would set the DRR at 2 percent. The FDIC views setting the DRR as having no significant economic impact on a substantial number of small insured depository institutions. However, the FDIC is voluntarily undertaking a regulatory flexibility analysis to aid the public in commenting on the small business impact of the proposed rule. The DRR would have no legal effect on small business entities for purposes of the RFA. The DRR is a minimum target only, and although the Dodd-Frank Act sets a minimum DRR of 1.35 percent of estimated insured deposits, the FDIC has the discretion to set the DRR above that level as it chooses. The DRR does not drive the needs of the Deposit Insurance Fund: the FDIC's total assessment needs are driven by statutory requirements and by the FDIC's aggregate insurance losses, expenses, investment income, and insured deposit growth, among other factors. Neither the FDI Act nor the amendments under Dodd-Frank establish a statutory role for the DRR as a trigger, whether for assessment rate determination, recapitalization of the fund, or dividends. Nor would setting the DRR at 2 percent under the proposed rule alter the distribution of assessments among IDIs. Accordingly, the proposed rule setting the DRR at 2 percent of estimated insured deposits would not have a significant economic effect on small entities for purposes of the RFA.

The remainder of the proposed rule would lower assessment rates when the reserve ratio reaches 1.15 percent, would suspend dividends permanently when the fund reserve ratio exceeds 1.5 percent and, in lieu of dividends, would progressively lower assessment rate schedules when the reserve ratio exceeds 2 percent and 2.5 percent. Dividends are simply an indirect way of lowering assessment rates; the lower assessment rate schedules proposed would serve much the same function as dividends but, as discussed above, would provide more stable and predictable effective assessment rates. This portion of the proposed rule (that is, the portion unrelated to setting the DRR) thus relates to the rates imposed on IDIs for deposit insurance, and to the risk-based assessment system components that measure risk and weigh that risk in determining an IDI's assessment rate. Consequently, a regulatory flexibility analysis is not required for this portion of the proposed rule. Nevertheless, the FDIC is voluntarily undertaking an initial regulatory flexibility analysis of the proposed rule for publication.

Pursuant to section 605(b) of the RFA, the FDIC certifies that the proposed rule would not have a significant economic effect on small entities unless and until the DIF reserve ratio exceeds specific thresholds of 1.15, 1.5, 2, and 2.5 percent. The reserve ratio is unlikely to reach these levels for many years. When it does, the overall effect of the proposed rule will be positive for entities of all sizes. All entities, including small entities, will receive a net benefit as a result of lower assessments paid. The proposed rule should not alter the distribution of the assessment burden between small entities and all others. It is difficult to realistically quantify the benefit at the present time. However, the initial magnitude of the benefit (when the reserve ratio reaches 1.15 percent) is likely to be less than a 2 percent increase in after-tax income and less than a 20 basis point increase in capital.

While each IDI will have the opportunity to request review of new assessments, the proposed rule will rely on information already collected and maintained by the FDIC in the regular course of business. The proposed rule will not directly or indirectly impose any additional reporting, recordkeeping or compliance requirements on IDIs.

C. Paperwork Reduction Act

No collections of information pursuant to the Paperwork Reduction Act (44 U.S.C. Ch. 3501 *et seq.*) are contained in the proposed rule.

[27] *See* 5 U.S.C. 603, 604, 605.

[28] *See* 5 U.S.C. 601.

D. The Treasury and General Government Appropriations Act, 1999—Assessment of Federal Regulations and Policies on Families

The FDIC has determined that the proposed rule will not affect family well-being within the meaning of section 654 of the Treasury and General Government Appropriations Act, enacted as part of the Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999 (Pub. L. 105–277, 112 Stat. 2681).

List of Subjects in 12 CFR Part 327

Bank deposit insurance, Banks, Banking, Savings associations.

For the reasons set forth in the preamble, the FDIC proposes to amend chapter III of title 12 of the Code of Federal Regulations as follows:

PART 327—ASSESSMENTS

1–2. The authority citation for part 327 is revised to read as follows:

Authority: 12 U.S.C. 1441, 1813, 1815, 1817–19, 1821.

3. Revise § 327.4(g) to read as follows:

§ 327.4 Assessment Rates.

* * * * *

(g) *Designated reserve ratio.* The designated reserve ratio for the Deposit Insurance Fund is 2 percent.

4. Revise § 327.9(d)(5)(iii) to read as follows:

§ 327.9 Assessment risk categories and pricing methods.

* * * * *

(d) * * *

(5) * * *

(iii). Limitations—(A) If, after September 30, 2010, the reserve ratio of the DIF has not reached 1.15 percent, the unsecured debt adjustment for any institution shall not exceed five basis points.

(B) Once the reserve ratio of the DIF first reaches 1.15 percent after September 30, 2010, the unsecured debt adjustment for any institution shall not exceed the lesser of five basis points or 50 percent of the institution's initial base assessment rate.

* * * * *

6. Revise section 327.10 to read as follows:

§ 327.10 Assessment rate schedules.

(a) *Assessment rate schedules prior to the reserve ratio of the DIF first reaching 1.15 percent after September 30, 2010—*(1) *Applicability.* The assessment rate schedules in this paragraph (a) will cease to be applicable when the reserve ratio of the DIF first reaches 1.15 percent after September 30, 2010.

(2) *Initial Base Assessment Rate Schedule.* After September 30, 2010, if the reserve ratio of the DIF has not reached 1.15 percent, the initial base assessment rate for an insured depository institution shall be the rate prescribed in the following schedule:

INITIAL BASE ASSESSMENT RATE SCHEDULE IF, AFTER SEPTEMBER 30, 2010, THE RESERVE RATIO HAS NOT REACHED 1.15 PERCENT

	Risk Category				
	I*		II	III	IV
	Minimum	Maximum			
Annual Rates (in basis points)	12	16	22	32	45

*All amounts for all risk categories are in basis points annually. Initial base rates that are not the minimum or maximum rate will vary between these rates.

(i) *Risk Category I Initial Base Assessment Rate Schedule.* The annual initial base assessment rates for all institutions in Risk Category I shall range from 12 to 16 basis points.

(ii) *Risk Category II, III, and IV Initial Base Assessment Rate Schedule.* The annual initial base assessment rates for Risk Categories II, III, and IV shall be 22, 32, and 45 basis points, respectively.

(iii) All institutions in any one risk category, other than Risk Category I, will be charged the same initial base assessment rate, subject to adjustment as appropriate.

(3) *Total Base Assessment Rate Schedule after Adjustments.* After September 30, 2010, if the reserve ratio of the DIF has not reached 1.15 percent, the total base assessment rates after adjustments for an insured depository institution shall be the rate prescribed in the following schedule.

TOTAL BASE ASSESSMENT RATE SCHEDULE (AFTER ADJUSTMENTS)* IF, AFTER SEPTEMBER 30, 2010, THE RESERVE RATIO HAS NOT REACHED 1.15 PERCENT

	Risk Category I	Risk Category II	Risk Category III	Risk Category IV
Initial base assessment rate	12–16	22	32	45
Unsecured debt adjustment	(5)–0	(5)–0	(5)–0	(5)–0
Secured liability adjustment	0–8	0–11	0–16	0–22.5
Brokered deposit adjustment	.....	0–10	0–10	0–10
Total base assessment rate	7–24	17–43	27–58	40–77.5

*All amounts for all risk categories are in basis points annually. Total base rates that are not the minimum or maximum rate will vary between these rates.

(i) *Risk Category I Total Base Assessment Rate Schedule.* The annual total base assessment rates for all institutions in Risk Category I shall range from 7 to 24 basis points.

(ii) *Risk Category II Total Base Assessment Rate Schedule.* The annual total base assessment rates for Risk Category II shall range from 17 to 43 basis points.

(iii) *Risk Category III Total Base Assessment Rate Schedule.* The annual total base assessment rates for Risk Category III shall range from 27 to 58 basis points.

(iv) *Risk Category IV Total Base Assessment Rate Schedule.* The annual total base assessment rates for Risk Category IV shall range from 40 to 77.5 basis points.

(b) *Assessment rate schedules once the DIF reserve ratio first reaches 1.15 percent after September 30, 2010, and the reserve ratio for the immediately prior assessment period is less than 2 percent*—(1) *Initial Base Assessment Rate Schedule.* After September 30, 2010, once the reserve ratio of the DIF first reaches 1.15 percent, and the reserve ratio for the immediately prior assessment period is less than 2 percent, the initial base assessment rate for an insured depository institution shall be the rate prescribed in the following schedule:

INITIAL BASE ASSESSMENT RATE SCHEDULE ONCE THE RESERVE RATIO OF THE DIF REACHES 1.15 PERCENT AFTER SEPTEMBER 30, 2010, AND THE RESERVE RATIO FOR THE IMMEDIATELY PRIOR ASSESSMENT PERIOD IS LESS THAN 2 PERCENT

	Risk Category				
	I*	II	III	IV	
				Minimum	Maximum
Annual Rates (in basis points)	8	12	18	28	40

*All amounts for all risk categories are in basis points annually. Initial base rates that are not the minimum or maximum rate will vary between these rates.

(i) *Risk Category I Initial Base Assessment Rate Schedule.* The annual initial base assessment rates for all institutions in Risk Category I shall range from 8 to 12 basis points.

(ii) *Risk Category II, III, and IV Initial Base Assessment Rate Schedule.* The annual initial base assessment rates for Risk Categories II, III, and IV shall be 18, 28, and 40 basis points, respectively.

(iii) All institutions in any one risk category, other than Risk Category I, will be charged the same initial base assessment rate, subject to adjustment as appropriate. (2) *Total Base Assessment Rate Schedule after Adjustments.* After September 30, 2010, once the reserve ratio of the DIF first reaches 1.15 percent, and the reserve ratio for the immediately prior assessment period is less than 2 percent, the total base assessment rates after adjustments for an insured depository institution shall be the rate prescribed in the following schedule.

TOTAL BASE ASSESSMENT RATE SCHEDULE (AFTER ADJUSTMENTS)* ONCE THE RESERVE RATIO OF THE DIF REACHES 1.15 PERCENT AFTER SEPTEMBER 30, 2010, AND THE RESERVE RATIO FOR THE IMMEDIATELY PRIOR ASSESSMENT PERIOD IS LESS THAN 2 PERCENT

	Risk Category I	Risk Category II	Risk Category III	Risk Category IV
Initial base assessment rate	8–12	18	28	40
Unsecured debt adjustment	(5)–0	(5)–0	(5)–0	(5)–0
Secured liability adjustment	0–6	0–9	0–14	0–20
Brokered deposit adjustment	.....	0–10	0–10	0–10
Total base assessment rate	4–18	13–37	23–52	35–70

*All amounts for all risk categories are in basis points annually. Total base rates that are not the minimum or maximum rate will vary between these rates.

(i) *Risk Category I Total Base Assessment Rate Schedule.* The annual total base assessment rates for institutions in Risk Category I shall range from 4 to 18 basis points.

(ii) *Risk Category II Total Base Assessment Rate Schedule.* The annual total base assessment rates for Risk Category II shall range from 13 to 37 basis points.

(iii) *Risk Category III Total Base Assessment Rate Schedule.* The annual total base assessment rates for Risk Category III shall range from 23 to 52 basis points.

(iv) *Risk Category IV Total Base Assessment Rate Schedule.* The annual total base assessment rates for Risk Category IV shall range from 35 to 70 basis points.

(c) *Assessment rate schedules if the reserve ratio of the DIF for the prior assessment period is equal to or greater than 2 percent and less than 2.5 percent.* (1) *Initial Base Assessment Rate Schedule.* If the reserve ratio of the DIF for the prior assessment period is equal to or greater than 2 percent and less than 2.5 percent, the initial base assessment rate for an insured depository institution, except as provided in paragraph (e) of this section, shall be the rate prescribed in the following schedule:

INITIAL BASE ASSESSMENT RATE SCHEDULE IF RESERVE RATIO FOR PRIOR ASSESSMENT PERIOD IS EQUAL TO OR GREATER THAN 2 PERCENT AND LESS THAN 2.5 PERCENT

	Risk Category				
	I*		II	III	IV
	Minimum	Maximum			
Annual Rates (in basis points)	6	10	16	26	38

* All amounts for all risk categories are in basis points annually. Initial base rates that are not the minimum or maximum rate will vary between these rates.

(i) *Risk Category I Initial Base Assessment Rate Schedule.* The annual initial base assessment rates for all institutions in Risk Category I shall range from 6 to 10 basis points.

(ii) *Risk Category II, III, and IV Initial Base Assessment Rate Schedule.* The annual initial base assessment rates for Risk Categories II, III, and IV shall be 16, 26, and 38 basis points, respectively.

(iii) All institutions in any one risk category, other than Risk Category I, will be charged the same initial base assessment rate, subject to adjustment as appropriate.

(2) *Total Base Assessment Rate Schedule after Adjustments.* If the reserve ratio of the DIF for the prior assessment period is equal to or greater than 2 percent and less than 2.5 percent, the total base assessment rates after adjustments for an insured depository institution, except as provided in paragraph (e) of this section, shall be the rate prescribed in the following schedule.

TOTAL BASE ASSESSMENT RATE SCHEDULE (AFTER ADJUSTMENTS)* IF RESERVE RATIO FOR PRIOR ASSESSMENT PERIOD IS EQUAL TO OR GREATER THAN 2 PERCENT AND LESS THAN 2.5 PERCENT

	Risk Category I	Risk Category II	Risk Category III	Risk Category IV
Initial base assessment rate	6–10	16	26	38
Unsecured debt adjustment	(5)–0	(5)–0	(5)–0	(5)–0
Secured liability adjustment	0–5	0–8	0–13	0–19
Brokered deposit adjustment	.....	0–10	0–10	0–10
Total base assessment rate	3–15	11–34	21–49	33–67

* All amounts for all risk categories are in basis points annually. Total base rates that are not the minimum or maximum rate will vary between these rates.

(i) *Risk Category I Total Base Assessment Rate Schedule.* The annual total base assessment rates for institutions in Risk Category I shall range from 3 to 15 basis points.

(ii) *Risk Category II Total Base Assessment Rate Schedule.* The annual total base assessment rates for Risk Category II shall range from 11 to 34 basis points.

(iii) *Risk Category III Total Base Assessment Rate Schedule.* The annual total base assessment rates for Risk Category III shall range from 21 to 49 basis points.

(iv) *Risk Category IV Total Base Assessment Rate Schedule.* The annual total base assessment rates for Risk Category IV shall range from 33 to 67 basis points.

(d) *Assessment rate schedules if the reserve ratio of the DIF for the prior assessment period is greater than 2.5 percent*—(1) *Initial Base Assessment Rate Schedule.* If the reserve ratio of the DIF for the prior assessment period is greater than 2.5 percent, the initial base assessment rate for an insured depository institution, except as provided in paragraph (e) of this section, shall be the rate prescribed in the following schedule:

INITIAL BASE ASSESSMENT RATE SCHEDULE IF RESERVE RATIO FOR PRIOR ASSESSMENT PERIOD IS GREATER THAN 2.5 PERCENT

	Risk Category				
	I*		II	III	IV
	Minimum	Maximum			
Annual Rates (in basis points)	4	8	14	24	36

* All amounts for all risk categories are in basis points annually. Initial base rates that are not the minimum or maximum rate will vary between these rates.

(i) *Risk Category I Initial Base Assessment Rate Schedule.* The annual initial base assessment rates for all institutions in Risk Category I shall range from 4 to 8 basis points.

(ii) *Risk Category II, III, and IV Initial Base Assessment Rate Schedule.* The annual initial base assessment rates for Risk Categories II, III, and IV shall be 14, 24, and 36 basis points, respectively.

(iii) All institutions in any one risk category, other than Risk Category I, will be charged the same initial base assessment rate, subject to adjustment as appropriate.

(2) *Total Base Assessment Rate Schedule after Adjustments.* If the reserve ratio of the DIF for the prior assessment period is greater than 2.5 percent, the total base assessment rates after adjustments for an insured depository institution, except as provided in paragraph (e) of this section, shall be the rate prescribed in the following schedule.

TOTAL BASE ASSESSMENT RATE SCHEDULE (AFTER ADJUSTMENTS)* IF RESERVE RATIO FOR PRIOR ASSESSMENT PERIOD IS GREATER THAN 2.5 PERCENT

	Risk Category I	Risk Category II	Risk Category III	Risk Category IV
Initial base assessment rate	4–8	14	24	36
Unsecured debt adjustment	(4)–0	(5)–0	(5)–0	(5)–0
Secured liability adjustment	0–4	0–7	0–12	0–18
Brokered deposit adjustment		0–10	0–10	0–10
Total base assessment rate	2–12	9–31	19–46	31–64

* All amounts for all risk categories are in basis points annually. Total base rates that are not the minimum or maximum rate will vary between these rates.

(i) *Risk Category I Total Base Assessment Rate Schedule.* The annual total base assessment rates for institutions in Risk Category I shall range from 2 to 12 basis points.

(ii) *Risk Category II Total Base Assessment Rate Schedule.* The annual total base assessment rates for Risk Category II shall range from 9 to 31 basis points.

(iii) *Risk Category III Total Base Assessment Rate Schedule.* The annual total base assessment rates for Risk Category III shall range from 19 to 46 basis points.

(iv) *Risk Category IV Total Base Assessment Rate Schedule.* The annual total base assessment rates for Risk Category IV shall range from 31 to 64 basis points.

(e) *Assessment Rate Schedules for New Institutions.* New depository institutions, as defined in 327.8(l), shall be subject to the assessment rate schedules as follows:

(1) *Prior to the reserve ratio of the DIF first reaching 1.15 percent after September 30, 2010.* After September 30, 2010, if the reserve ratio of the DIF has not reached 1.15 percent, new institutions shall be subject to the initial and total base assessment rate schedules provided for in subsection (a).

(2) *Assessment rate schedules once the DIF reserve ratio first reaches 1.15 percent after September 30, 2010, and the reserve ratio for the immediately prior assessment period is less than 2 percent.* After September 30, 2010, once the reserve ratio of the DIF first reaches 1.15 percent, and if the reserve ratio for the immediately prior assessment period is less than 2 percent, new institutions shall be subject to the initial and total base assessment rate schedules provided for in subsection (b).

(f) *Total Base Assessment Rate Schedule adjustments and procedures*—(1) *Board Rate Adjustments.* The Board may increase or decrease the total base assessment rate schedule in paragraphs (a) through (d) of this section up to a maximum increase of 3 basis points or a fraction thereof or a maximum decrease of 3 basis points or a fraction thereof (after aggregating increases and decreases), as the Board deems necessary. Any such adjustment shall apply uniformly to each rate in the total base assessment rate schedule. In no case may such Board rate adjustments result in a total base assessment rate that is mathematically less than zero or in a total base assessment rate schedule that, at any time, is more than 3 basis points above or below the total base assessment schedule for the Deposit Insurance Fund in effect pursuant to subsection (b), nor may any one such Board adjustment constitute an increase or decrease of more than 3 basis points.

(2) *Amount of revenue.* In setting assessment rates, the Board shall take into consideration the following:

(i) Estimated operating expenses of the Deposit Insurance Fund;

(ii) Case resolution expenditures and income of the Deposit Insurance Fund;

(iii) The projected effects of assessments on the capital and earnings of the institutions paying assessments to the Deposit Insurance Fund;

(iv) The risk factors and other factors taken into account pursuant to 12 U.S.C. 1817(b)(1); and

(v) Any other factors the Board may deem appropriate.

(3) *Adjustment procedure.* Any adjustment adopted by the Board pursuant to this paragraph will be adopted by rulemaking, except that the Corporation may set assessment rates as necessary to manage the reserve ratio, within set parameters not exceeding cumulatively 3 basis points, pursuant to paragraph (c)(1) of this section, without further rulemaking.

(4) *Announcement.* The Board shall announce the assessment schedules and the amount and basis for any adjustment thereto not later than 30 days before the quarterly certified statement invoice date specified in § 327.3(b) of this part for the first assessment period for which the adjustment shall be effective. Once set, rates will remain in effect until changed by the Board.

§§ 327.51 through 327.54 [Removed]

7. Remove §§ 327.51 through 327.54.

8. Revise § 327.50 to read as follows:

§ 327.50 Dividends.

(a) *Suspension of Dividends.* The Board will suspend dividends permanently whenever the DIF reserve ratio exceeds 1.50 percent at the end of any year.

(b) *Assessment Rate Schedule if DIF Reserve Ratio Exceeds 1.50 Percent.* In lieu of dividends, when the DIF reserve ratio exceeds 1.50 percent, assessment rates shall be determined as set forth in section 327.10, as appropriate.

By order of the Board of Directors.

Dated at Washington, DC, this 19th day of October, 2010.

Federal Deposit Insurance Corporation.

Robert E. Feldman,

Executive Secretary.

The following appendix will not appear in the Code of Federal Regulations.

Appendix

The Appendix provides supplementary details on the method used to generate fund simulations in the FDIC's analysis. It also presents additional comparative examples of simulations using a variety of assessment rate policies that combine different constant nominal assessment rates with different

levels of assessment rate reduction awarded at different reserve ratio thresholds.

Methodology and Assumptions

Data

The simulated fund's assessment base and fund expenses are actual FDIC historical data.[29] For the years 1950 to 1988, data are from the FDIC insurance fund; from 1989 to 2005, data combine the BIF and the SAIF; from 2006 onwards, DIF data are used. FDIC historical data are altered in only one respect: Because all depositors in failed banks during the current crisis were covered up to $250,000, the FDIC deposit insurance coverage level for 2007 is assumed to be $250,000 even though the coverage limit in effect at the time was $100,000. (The Dodd-Frank Act extended the $250,000 coverage limit retroactively to depositors in any IDI for which the FDIC was appointed receiver or conservator on or after January 1, 2008.) Historical interest rate data are from the Board of Governors of the Federal Reserve System. From 2011 to 2040, projections are based on September 2010 FDIC estimates for losses, expenses and insured deposit and assessment base growth (using adjusted total domestic deposits). Implied forward interest rates (as of September 27, 2010) from Bloomberg are used for the years after 2010.

Treatment of Historical Assessment Credits, Special Assessments and FSLIC/RTC Costs

The simulated fund implements neither the assessment credit policies in effect from 1950 to 1984, nor the one-time assessment credit provided under the Deposit Insurance Reform Act of 2005. In addition, the simulated fund's income includes neither the one-time special assessment to recapitalize the SAIF in 1996 nor the one-time special assessment imposed in 2009. The simulated fund does not include as expenses the costs of FSLIC and RTC failures during the 1980s and early 1990s. The inclusion of these costs would require a much higher reserve ratio to keep the fund balance positive during the late 1980s and early 1990s than the analysis shows.

Investment Strategy

No consistent historical data are available describing the FDIC's investment portfolio over time. Moreover, as a simulated fund diverges from the actual fund, the FDIC's actual investment choices become increasingly irrelevant to the simulated fund's likely choices. After reviewing available FDIC data, the method chosen for the analysis was a modeled investment portfolio with the following investment strategy and set of rules for the simulated fund. The fund assumes a "default" portfolio mix of Treasury securities to be maintained under most conditions: 35 Percent in 6-month securities; 25 percent in 1-year securities; 25 percent in 3-year securities; and 15 percent in 5-year securities. This portfolio mix remains fixed unless the FDIC's provision for losses increases for two consecutive years. In that event, all income (proceeds from maturing securities, as well as net assessment and interest income) is invested in 6-month Treasury securities. The simulated fund therefore has an increasingly shorter term bias as anticipated losses from failures rise. When the fund's income exceeds expenses for two years, the fund's investments are returned to the 35–25–25–15 mix.

Assessment Rate, Dividend and Reserve Ratio Variables

Constant nominal industry average assessment rates in the analysis range from 7.44 to 25.88 basis points. The analysis examines two sets of policy options: Percentage reductions in assessment rates, and dividends as a percent of the amount in the fund over a specified reserve ratio. Rate reductions and dividend amounts range from zero to 100 percent. Reserve ratios at which assessment reductions or dividends are first awarded range from 1.5 percent to 2.5 percent.

Additional Comparative Examples

This section provides further detail and examples of the tradeoffs the FDIC examined in seeking an appropriate long-term fund management policy that takes into account the goals of maintaining a positive fund balance even during banking crises, and maintaining low, steady assessment rates throughout economic and credit cycles.[30] The examples below vary assessment rate reductions and the reserve ratio at which reductions are first awarded.

Maintaining Relatively Low Assessment Rates

Table A.1 shows the constant nominal assessment rates that need to be applied to keep the fund from becoming negative during both crises using various levels of assessment rate reduction and reserve ratios at which rates are first reduced.

Table A.1. Nominal Assessment Rates Needed to Maintain Positive Fund Balance

		Reserve Ratio at Which Rates Are First Reduced				
		1.50	1.75	2.00	2.25	2.50
% Reduction in Rates	100	25.88	14.94	9.23	8.03	7.53
	75	17.84	14.15	8.90	7.98	7.49
	50	12.32	11.70	8.73	7.99	7.46
	25	9.22	9.04	8.47	7.75	7.43
	10	8.03	7.97	7.78	7.54	7.41

[29] The assessment base used in this analysis is adjusted total domestic deposits. The Dodd-Frank Act provides that the assessment base be changed to average total consolidated assets minus average tangible equity.

[30] Specifically, the analysis sought to implement an assessment rate policy (a constant nominal rate in combination with assessment rate reductions) that would result in the fund falling to zero in 2009 (the fund's trough during the current crisis). Using assessment rates greater than those identified would cause the simulated fund to grow higher during periods of benign economic conditions and give the fund a capital buffer above zero in 2009.

In general, policies with low reserve ratios at which assessment rate reductions are first awarded and high rate reductions require relatively high nominal assessment rates, and so fail to keep assessment rates relatively low and steady. Policy options with high reserve ratios at which assessment rate reductions are awarded and low rate reductions require the lowest nominal assessment rates.

Reducing Pro-cyclical Assessments

In its analysis, the FDIC sought policies that reduced pro-cyclical assessments, which are assessments that are lower during prosperous times but higher when both IDIs and the fund are stressed by significant losses. Table A.2 compares average effective assessment rates during crisis years with average effective assessment rates during non-crisis years as a measure of how pro-cyclical effective assessment rates are throughout time.[31]

Table A.2. Assessment Rate Multiplier from Non-Crisis to Crisis Years

		Reserve Ratio at Which Rates Are First Reduced				
		1.50	1.75	2.00	2.25	2.50
% Reduction in Rates	100	4.9	2.4	1.2	1.0	0.9
	75	2.6	2.1	1.1	1.0	1.0
	50	1.4	1.3	1.1	1.0	1.0
	25	1.1	1.1	1.0	0.9	1.0
	10	1.0	1.0	1.0	1.0	1.0

Again, policies using low reserve ratios at which assessment reductions begin to be paid and high rate reductions are least desirable and produce greater pro-cyclicality. As a point of reference, the average assessment rates of the actual fund (which has historically had to implement pro-cyclical assessment policies during times of crisis to cover losses and rebuild the fund) more than quadrupled during crisis periods. An appropriate assessment reduction policy should seek relatively small changes in effective assessment rates across both crisis and non-crisis periods.

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[31] Crisis years are defined as 1981–96 (although in terms of bank failures this crisis ended by 1994, the industry had to pay high premiums for an additional two years in order to recapitalize the fund) and 2008–10, while all other years in the sample are non-crisis years: 1950–80 and 1997–2007.