consecutive quarters, the FDIC will reclassify the institution as small beginning the following quarter.

(h) *Large Institution.* An insured depository institution with assets of $10 billion or more as of December 31, 2006 (other than an insured branch of a foreign bank) shall be classified as a large institution. If, after December 31, 2006, an institution classified as small under paragraph (g) of this section reports assets of $10 billion or more in its reports of condition for four consecutive quarters, the FDIC will reclassify the institution as large beginning the following quarter.

(i) *Long-Term Debt Issuer Rating.* A long-term debt issuer rating shall mean a current rating of an insured depository institution's long-term debt obligations by Moody's Investor Services, Standard & Poor's, or Fitch Ratings. A long-term debt issuer rating does not include a rating of a company that controls an insured depository institution, or an affiliate or subsidiary of the institution. A current rating shall mean one that has been confirmed or assigned within 12 months before the end of the quarter for which an assessment rate is being determined. If no current rating is available, the institution will be deemed to have no long-term debt issuer rating.

(j) *CAMELS composite and CAMELS component ratings.* The terms *CAMELS composite ratings* and *CAMELS component ratings* shall have the same meaning as in the Uniform Financial Institutions Rating System as published by the Federal Financial Institutions Examination Council.

(k) *ROCA supervisory ratings.* ROCA supervisory ratings rate risk management, operational controls, compliance, and asset quality.

(l) *New depository institution.* A new insured depository institution is a bank or thrift that has not been chartered for at least five years as of the last day of any quarter for which it is being assessed.

(m) *Established depository institution.* An established institution is a bank or thrift that has been chartered for at least five years as of the last day of any quarter for which it is being assessed.

(n) *Risk assignment.* An institution's risk assignment includes assignment to Risk Category I, II, III, or IV, and, within Risk Category I, assignment to an assessment rate or rates.

By order of the Board of Directors.

Dated at Washington, DC, this 2nd day of November, 2006.

Federal Deposit Insurance Corporation.

Robert E. Feldman,

Executive Secretary.

[FR Doc. 06–9267 Filed 11–29–06; 8:45 am]

BILLING CODE 6714–01–P

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 327

RIN 3064–AD09

Assessments

AGENCY: Federal Deposit Insurance Corporation (FDIC).

ACTION: Final rule.

SUMMARY: The Federal Deposit Insurance Reform Act of 2005 requires that the Federal Deposit Insurance Corporation (the FDIC) prescribe final regulations, after notice and opportunity for comment, to provide for deposit insurance assessments under section 7(b) of the Federal Deposit Insurance Act (the FDI Act). In this rulemaking, the FDIC is amending its regulations to create a new risk differentiation system, to establish a new base assessment rate schedule, and to set assessment rates effective January 1, 2007.

DATES: *Effective Date:* January 1, 2007.

FOR FURTHER INFORMATION CONTACT: Munsell W. St. Clair, Senior Policy Analyst, Division of Insurance and Research, (202) 898–8967; or Christopher Bellotto, Counsel, Legal Division, (202) 898–3801.

SUPPLEMENTARY INFORMATION:

I. Background

On February 8, 2006, the President signed the Federal Deposit Insurance Reform Act of 2005 into law; on February 15, 2006, he signed the Federal Deposit Insurance Reform Conforming Amendments Act of 2005 (collectively, the Reform Act).[1] The Reform Act enacts the bulk of the recommendations made by the FDIC in 2001. The Reform Act, among other things, requires that the FDIC, within 270 days, ''prescribe final regulations, after notice and opportunity for comment * * * providing for assessments under section 7(b) of the Federal Deposit Insurance Act, as amended * * *,'' thus giving the FDIC, through its rulemaking authority, the opportunity to better price deposit insurance for risk.[2]

On July 24, 2006, the FDIC published in the **Federal Register**, for a 60-day comment period, a notice of proposed rulemaking providing for deposit insurance assessments (the NPR). 71 FR 41910. The FDIC sought public comment on its proposal and received 707 comment letters, including numerous comments from trade organizations.[3] [4] The comments and the final rule providing for assessments are discussed in later sections.

A. The Current Risk-Differentiation Framework

The Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) required that the FDIC establish a risk-based assessment system. To implement this requirement, the FDIC adopted by regulation a system that places institutions into risk categories[5] based on two criteria: capital levels and supervisory ratings. Three capital groups—well capitalized, adequately capitalized, and undercapitalized, which are numbered 1, 2 and 3, respectively—are based on leverage ratios and risk-based capital ratios for regulatory capital purposes. Three supervisory subgroups, termed A, B, and C, are based upon the FDIC's consideration of evaluations provided by the institution's primary federal regulator and other information the FDIC deems relevant.[6] Subgroup A

[1] Federal Deposit Insurance Reform Act of 2005, Public Law 109–171, 120 Stat. 9; Federal Deposit Insurance Conforming Amendments Act of 2005, Public Law 109–173, 119 Stat. 3601.

[2] Section 2109(a)(5) of the Reform Act. Pursuant to the Section 2109 of the Reform Act, current assessment regulations remain in effect until the effective date of new regulations. Section 2109(a)(5) of the Reform Act requires the FDIC, within 270 days of enactment, to prescribe final regulations, after notice and opportunity for comment, providing for assessments under section 7(b) of the Federal Deposit Insurance Act. Section 2109 also requires the FDIC to prescribe, within 270 days, rules on the designated reserve ratio, changes to deposit insurance coverage, the one-time assessment credit, and dividends. A final rule on deposit insurance coverage was published on September 12, 2006. 71 FR 53547. Final rules on the one-time assessment credit and dividends were published on October 18, 2006. 71 FR 61374; 71 FR 61385. The FDIC is publishing final rulemakings on the designated reserve ratio and on operational changes to part 327 elsewhere in this issue of the **Federal Register**.

[3] The comment period expired on September 22, 2006. The FDIC also received many comments relevant to this rulemaking in response to the other rulemakings discussed in footnote 2. All comments have been considered and are available on the FDIC's Web site, *http://www.fdic.gov/regulations/laws/federal/propose.html.*

[4] The trade associations included the American Bankers Association, the Independent Community Bankers of America, America's Community Bankers, the Clearing House, the Financial Services Roundtable, the New York Bankers Association, the New Jersey League of Community Bankers, the Massachusetts Bankers Association, the Kansas Bankers Association, and the Association for Financial Professionals.

[5] The FDIC's regulations refer to these risk categories as ''assessment risk classifications.''

[6] The term ''primary federal regulator'' is synonymous with the statutory term ''appropriate federal banking agency.'' 12 U.S.C. 1813(q).

consists of financially sound institutions with only a few minor weaknesses; subgroup B consists of institutions that demonstrate weaknesses that, if not corrected, could result in significant deterioration of the institution and increased risk of loss to the insurance fund; and subgroup C consists of institutions that pose a substantial probability of loss to the insurance fund unless effective corrective action is taken. In practice, the subgroup evaluations are generally based on an institution's composite CAMELS rating, a rating assigned by the institution's supervisor at the end of a bank examination, with 1 being the best rating and 5 being the lowest.[7] Generally speaking, institutions with a CAMELS rating of 1 or 2 are put in supervisory subgroup A, those with a CAMELS rating of 3 are put in subgroup B, and those with a CAMELS rating of 4 or 5 are put in subgroup C. Thus, in the current assessment system, the highest-rated (least risky) institutions are assigned to category 1A and the lowest-rated (riskiest) institutions to category 3C. The three capital groups and three supervisory subgroups form a nine-cell matrix for risk-based assessments:

Capital Group	Supervisory Subgroup		
	A	B	C
1. Well Capitalized	1A	1B	1C
2. Adequately Capitalized	2A	2B	2C
3. Undercapitalized	3A	3B	3C

B. Reform Act Provisions

The Federal Deposit Insurance Act, as amended by the Reform Act, continues to require that the assessment system be risk-based and allows the FDIC to define risk broadly. It defines a risk-based system as one based on an institution's probability of causing a loss to the deposit insurance fund due to the composition and concentration of the institution's assets and liabilities, the amount of loss given failure, and revenue needs of the Deposit Insurance Fund (the fund).[8]

At the same time, the Reform Act also restores to the FDIC's Board of Directors the discretion to price deposit insurance according to risk for all insured institutions regardless of the level of the fund reserve ratio.[9]

The Reform Act leaves in place the existing statutory provision allowing the FDIC to ''establish separate risk-based assessment systems for large and small members of the Deposit Insurance Fund.'' [10] Under the Reform Act, however, separate systems are subject to a new requirement that ''[n]o insured depository institution shall be barred from the lowest-risk category solely because of size.'' [11]

II. Summary of the Final Rule

The final rule is set out in detail in ensuing sections, but is briefly summarized here.

The final rule consolidates the existing nine risk categories into four and names them Risk Categories I, II, III and IV. Risk Category I replaces the 1A risk category.

Within Risk Category I, the final rule combines supervisory ratings with other risk measures to differentiate risk. For most institutions, the final rule combines CAMELS component ratings with financial ratios to determine an institution's assessment rate. For large institutions that have long-term debt issuer ratings, the final rule differentiates risk by combining CAMELS component ratings with these ratings. For large institutions within Risk Category I, initial assessment rate determinations may be modified within limits upon review of additional relevant information.

The final rule defines a large institution as an institution that has $10 billion or more in assets. With certain exceptions, beginning in 2010, the final rule treats new institutions (those established for less than five years) in Risk Category I the same, regardless of size, and assesses them at the maximum rate applicable to Risk Category I institutions.

The final rule sets actual rates beginning January 1, 2007, as follows:

	Risk Category				
	I*		II	III	IV
	Minimum	Maximum			
Annual Rates (in basis points)	5	7	10	28	43

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

[7] CAMELS is an acronym for component ratings assigned in a bank examination: Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk. A composite CAMELS rating combines these component ratings, which also range from 1 (best) to 5 (worst).

[8] 12 U.S.C. 1817(b)(1)(A) and (C). The Bank Insurance Fund and Savings Association Insurance Fund were merged into the newly created Deposit Insurance Fund on March 31, 2006.

[9] The Reform Act eliminates the prohibition against charging well-managed and well-capitalized institutions when the deposit insurnace fund is at or above, and is expected to remain at or above, the designated reserve ratio (DRR). This prohibition was included as part of the Deposit Insurance Funds Act of 1996. Public Law 104–208, 110 Stat. 3009, 3009–479. However, while the Reform Act allows the DRR to be set between 1.15 percent and 1.50 percent, it also generally requires dividends of one-half of any amount in the fund in excess of the amount required to maintain the reserve ratio at 1.35 percent when the insurance fund reserve ratio exceeds 1.35 percent at the end of any year. The Board can suspend these dividends under certain circumstances. 12 U.S.C. 1817(e)(2).

[10] 12 U.S.C. 1817(b)(1)(D).

[11] Section 2104(a)(2) of the Reform Act (to be codified at 12 U.S.C. 1817(b)(2)(D)).

These rates are three basis points above the base rate schedule adopted in the final rule:

	Risk Category				
	I*		II	III	IV
	Minimum	Maximum			
Annual Rates (in basis points)	2	4	7	25	40

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

The final rule continues to allow the FDIC Board to adjust rates uniformly from one quarter to the next, except that no single adjustment can exceed three basis points. In addition, cumulative adjustments cannot exceed a maximum of three basis points higher or lower than the base rates without further notice-and-comment rulemaking.

III. General Risk Differentiation Framework

The final rule consolidates the number of assessment risk categories from nine to four. The four new categories will continue to be defined based upon supervisory and capital evaluations, which are both established measures of risk. The consolidation creates four new Risk Categories as shown in Table 1:

Table 1

New Risk Categories

Capital Group	Supervisory Group A	Supervisory Group B	Supervisory Group C
Well Capitalized	I		III
Adequately Capitalized	II		
Undercapitalized	III		IV

Risk Category I contains all well-capitalized institutions in Supervisory Group A (generally those with CAMELS composite ratings of 1 or 2); i.e., those institutions that would be placed in the former 1A category. Risk Category II contains all institutions in Supervisory Groups A and B (generally those with CAMELS composite ratings of 1, 2 or 3), except those in Risk Category I and undercapitalized institutions.[12] Risk Category III contains all undercapitalized institutions in Supervisory Groups A and B, and institutions in Supervisory Group C (generally those with CAMELS composite ratings of 4 or 5) that are not undercapitalized. Risk Category IV contains all undercapitalized institutions in Supervisory Group C; i.e., those institutions that would be placed in the former 3C category.[13]

Comments

No comments disagreed with the proposed reduction in the number of risk categories from nine to four. However, one comment recommended adding subcategories to Risk Category I to provide a warning to institutions that are moving toward Risk Category II if corrective action is not taken and giving an institution that slips from Risk Category I to Risk Category II an opportunity to show quick improvement. The FDIC does not believe that these subcategories are necessary. For an institution in Risk Category I, its assessment rate will provide the same information. The FDIC also does not believe that special treatment should be accorded an institution that slips from Risk Category I, as opposed to other institutions already in Risk Category II.

Some comments argued that, for CAMELS 3, 4 and 5-rated institutions in Risk Categories II and III, some provision for lower premiums should be made for institutions that augment and maintain strong capital, maintain adequate reserves for loan losses and have a plan for recovery approved by the FDIC. The FDIC does not see a need for special provisions for these institutions, as they have other incentives to improve capital and business operations.

IV. Risk Differentiation Within Risk Category I

A. Overview

Risk Category I, as of June 30, 2006, would include approximately 95 percent of all insured institutions. The final rule will further differentiate risk within this category using one of two methods. Both methods share a common feature, namely, the use of CAMELS component ratings. However, each method combines these measures with different sources of information on risk. For small institutions within Risk Category I and for large institutions within Risk Category I that do not have long-term debt issuer ratings, the final rule combines CAMELS component ratings with current financial ratios to determine an institution's assessment rate. For large institutions within Risk Category I that have long-term debt

[12] Under current regulations, bridge banks and institutions for which the FDIC has been appointed or serves as conservator are charged the assessment rate applicable to the 2A category. 12 CFR 327.4(c). The final rule places these institutions in Risk Categoryd I and charges them the minimum rate applicable to that category.

[13] For clarity, the final rule uses the phrase ''Supervisory Group'' to replace ''Supervisory Subground.'' The final rule also designates the capital categories as ''Well Capitalized,'' ''Adequately Capitalized'' and ''Undercapitalilzed,'' rather than Capital Groups 1, 2 and 3. However, the definitions of the Supervisory Groups and Capital Group have not changed in substance.

issuer ratings, the final rule combines CAMELS component ratings with these debt ratings. For all large institutions, initial assessment rates may be modified within limits upon review of additional relevant information.

The risk differentiation methods for institutions in Risk Category I measure levels of risk and result in rank orderings of risk within the category. Within Risk Category I, the final rule assesses those institutions that pose the least risk a minimum assessment rate and those that pose the greatest risk a maximum assessment rate that is two basis points higher than the minimum rate. An institution that poses an intermediate risk within Risk Category I will be charged a rate between the minimum and maximum that will vary by institution. Under the final rule, small changes in an institution's financial ratios, long-term debt issuer ratings or CAMELS component ratings should produce only small changes in assessment rates.

The final rule defines a large institution as an institution that has $10 billion or more in assets and a small institution as an institution that has less than $10 billion in assets. Also, as described below in Section VII, beginning in 2010, with certain exceptions, the final rule treats new institutions in Risk Category I the same, regardless of size, and assesses them at the maximum rate applicable to Risk Category I institutions.

B. Distribution of Assessment Rates

As stated above, within Risk Category I, the final rule results in assessing those institutions that pose the least risk a minimum assessment rate and those that pose the greatest risk a maximum assessment rate that is two basis points higher. An institution that poses an intermediate risk within Risk Category I will be charged a rate between the minimum and maximum that will vary incrementally by institution.

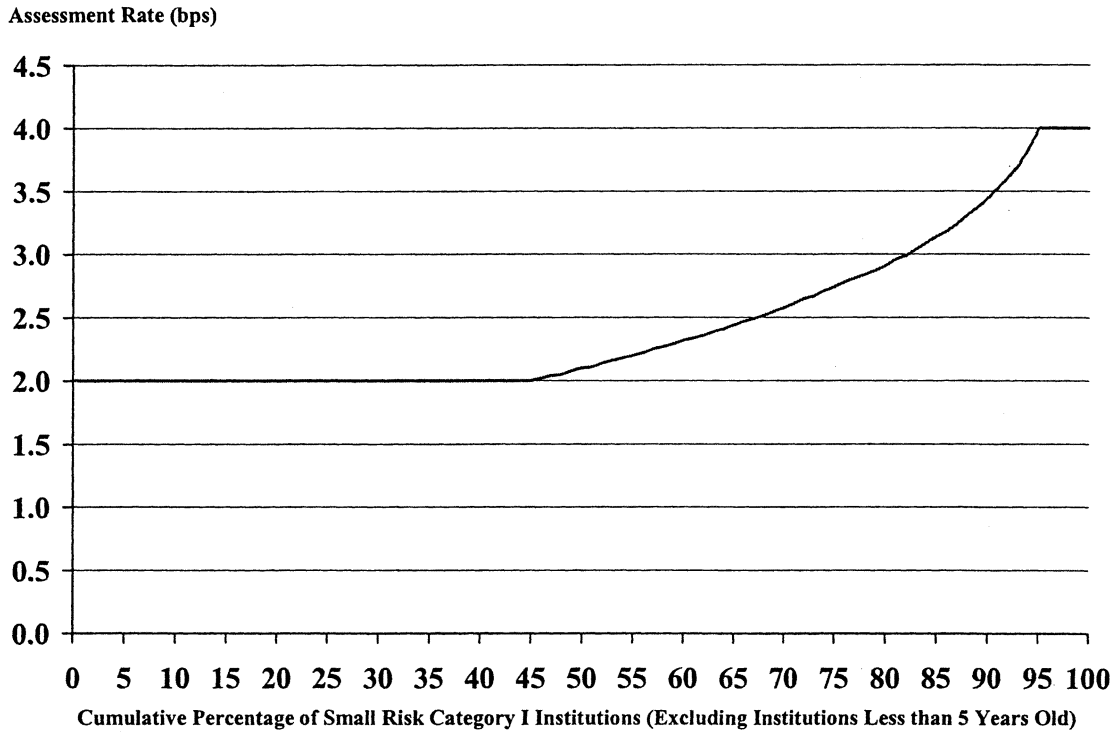
In this regard, the final rule differs from the NPR in its application to large institutions. The NPR had proposed assessing large institutions that posed an intermediate risk within Risk Category I one of four rates between the minimum and maximum based on subcategory assignments. A number of comments expressed concern over the proposed use of assessment rate subcategories and the possibility that large increases (and decreases) in assessment rates could result from relatively small changes in risk. Some of these comments recommended using as few as three assessment rate subcategories, and some comments recommended using incremental pricing, as proposed in the NPR for small institutions. The FDIC has decided to adopt an incremental pricing framework for all institutions so that a small change in risk will produce a small change in assessment rates.

Under the final rule, as of June 30, 2006: (1) Approximately 45 percent of all institutions that would have been in Risk Category I (other than institutions less than 5 years old) would have been charged the minimum assessment rate; and (2) approximately 5 percent of all institutions that would have been in Risk Category I (other than institutions less than 5 years old) would have been charged the maximum assessment rate. In future periods, different percentages of institutions may be charged the minimum and maximum rates.

Chart 1 shows the cumulative distribution of assessment rates based on June 30, 2006 data, using base assessment rates for institutions in Risk Category I. The chart excludes Risk Category I institutions less than 5 years old.

Chart 1

Cumulative Distribution of Assessment Rates Based on June 30, 2006 Data



Comments

Percentages of institutions paying the minimum rate. A comment agreed that charging 45 percent of institutions the minimum rate makes sense given the current health of the banking industry. Several comments (including comments from some trade groups), however, suggested that initially charging 45 percent of institutions the minimum rate was arbitrary or inappropriate. These comments suggested initially charging a larger percentage of institutions the minimum rate, at least in part, because risk in the banking industry is very low at present.

Two comments expressed the view that the decision to place roughly 45 percent of large institutions in the minimum assessment rate subcategory and 5 percent in the maximum assessment rate subcategory was subjective and arbitrary. In one of these comments, it was suggested that large institutions might be restricted from the lowest premium rate by this decision. Several other comments also urged the FDIC to expand the availability of the minimum assessment rate to a larger proportion of large institutions. Some comments argued for the elimination of premiums altogether for the highest-rated large institutions.

The FDIC has found that small institutions with a probability of downgrade to a CAMELS 3 or worse that is equal to or less than the probability of downgrade for the 40th to 50th percentile as of June 30, 2006, had minimal risk of a CAMELS downgrade over time. The remainder of small institutions in the industry had increasing and distinguishable risk of CAMELS downgrades. The FDIC believes it is appropriate to initially assign roughly similar proportions of large and small institutions to the minimum assessment rate to achieve parity. While the initial proportions of large and small institutions being charged the minimum and maximum rates will be similar, the final rule does not fix the proportions for the future. Thus, in future periods, more or less than 45 percent of large (or small) institutions may pay the minimum rate and more or less than 5 percent may pay the maximum rate.

Risk Category I assessment rate spread. Several comments (including comments from trade groups) recommended that the FDIC eliminate or narrow the spread between the minimum and maximum base rates for Risk Category I. Arguments in favor of eliminating or narrowing the spread included:

- The new risk differentiation system is untested and could lead to unintended consequences.
- Improvements in bank risk-management systems, improvements in supervisory evaluations and off-site monitoring, and enhanced supervisory powers enjoyed by the regulators have reduced risk.
- A narrower spread would reduce the adverse effect of changes in subcategories on large banks and the adverse effect of paying the maximum rate on new banks.

Other comments (including comments from some trade groups) recommended increasing the spread between minimum and maximum assessment rates for Risk Category I to 3 basis points. According to these comments, a wider spread would improve risk differentiation and could subject more institutions to incremental rates between the minimum and maximum rates.

The final rule strikes a balance between the arguments for a narrower spread and those for a wider spread. The two basis point spread adopted in the final rule is narrower than the historical loss data would suggest.[14] However, as the comments have noted, the new system is, as yet, untested.

C. CAMELS Ratings

For all institutions in Risk Category I, supervisory ratings will be taken into account in setting assessment rates using a weighted average of an institution's CAMELS components. This weighted average will be created by combining the components as follows:[15]

CAMELS Component	Weight
C	25%
A	20%
M	25%
E	10%
L	10%
S	10%

Comments

Almost every comment that discussed the use of CAMELS ratings to differentiate risk within Risk Category I supported their use. One comment questioned their use and a few comments opposed any differentiation within Risk Category I.

One trade group asserted that the FDIC should use a simple, rather than weighted, average of CAMELS components on the grounds that using financial ratios related to these components effectively weights the components. The trade group noted that capital, for example, is already reflected in an institution's risk category and as a CAMELS component. The trade group also asserted that asset quality is given extra emphasis in the proposed weighting scheme by including several asset quality financial ratios as well as the A rating in the CAMELS component average. With regards to the M component, the trade group asserted that:

Management—the most subjective of all the CAMELS components—must by necessity be involved in all the financial ratios and other examination components. In practice,

[14] See Table 1.6 in Appendix 1 to the NPR, 71 FR 41910.

[15] The FDIC and other bank supervisors do not use a weighting system to determine CAMELS composite ratings. The weights in the table reflect the view of the FDIC regarding the relative importance of each of the CAMELS components for differentiating risk among institutions in Risk Category I for deposit insurance purposes. Different weights might apply if this measure were being used to evaluate risk for deposit insurance purposes for all institutions, including those outside Risk Category I.

therefore, it is unlikely that examiners would rate management higher than the other components. Thus, there is always a bias against a high management rating.

Several comments proposed different weighting schemes for large institutions, such as heavier weights for Liquidity, Capital, and Asset quality.

The final rule retains the weights proposed in the NPR to determine the weighted average CAMELS component rating. These weights reflect the view of the FDIC on the relative importance of each of the CAMELS components in differentiating risk among institutions in Risk Category I for deposit insurance purposes.

D. Financial Ratios

For small institutions and for large institutions without a long-term debt issuer rating, the final rule uses certain financial ratios, in addition to supervisory ratings, to differentiate risk. The final rule differs slightly from the proposal in the NPR with respect to the financial ratios being used and their definitions.

The financial ratios that will be used are:

- The Tier 1 Leverage Ratio;
- Loans past due 30–89 days/gross assets;
- Nonperforming assets/gross assets; [16]
- Net loan charge-offs/gross assets; and
- Net income before taxes/risk-weighted assets.

The Tier 1 Leverage Ratio has the definition used for regulatory capital purposes. Appendix A defines each of the ratios.

Many comments (including comments from several industry trade groups) opposed including time deposits greater than $100,000 in the definition of volatile liabilities for a variety of reasons, including: (1) These deposits are core deposits or should be so considered; and (2) including them would have an effect on attracting municipal deposits. One comment opposed including brokered deposits in the definition of volatile liabilities on the grounds that they are less volatile than many core deposits. One trade group argued that deposits in excess of $100,000 that are insured by excess deposit insurance should not be included in the definition of volatile liabilities.

The final rule eliminates the basis for these concerns by excluding one of the financial ratios proposed in the NPR, the ratio of volatile liabilities to gross assets. The financial data used to compute volatile liabilities reported by thrifts in the Thrift Financial Reports (TFRs) and reported by banks in their Reports of Condition and Income (Call Reports) were not compatible and could not be made compatible without changes in reporting requirements.[17]

The final rule also excludes the portion of loans and leases that is guaranteed by the U.S. Government, including government agencies and government-sponsored agencies, from the computation of loans past due 30–89 days and from the computation of non-performing assets. These types of guaranteed loans are treated as less risky than other loans for risk-based capital purposes. Moreover, the use of past due and nonaccrual loan measures that do not adjust for these guaranteed loans might overstate credit risk and result in assessment rates that are too high for some institutions.

Comments

Almost all comments (including comments from a trade group) on using financial ratios (in addition to CAMELS ratings) to determine assessment rates supported their use. However, some suggested that different financial ratios be used.

In the NPR, the definition of volatile liabilities did not include Federal Home Loan Bank advances, but the FDIC asked for comment on whether it should. The FDIC received 569 comments on this issue. All but one argued that the definition of volatile liabilities should not include Federal Home Loan Bank advances; one argued that the definition should include these advances. The final rule does not include the volatile liability ratio.

A trade group suggested excluding the loans past due 30–89 days to gross assets ratio on the grounds that loan delinquencies are already considered in two CAMELS components, A (Assets) and M (Management). The final rule retains the loans past due 30–89 days to gross assets ratio. Independent of the CAMELS components, this ratio is statistically significant and highly predictive of CAMELS downgrades and institution failures even when it is considered together with the nonperforming ratio.[18]

A trade group commented that the risk weighting formula used to establish risk weighted assets is biased against residential mortgage lenders. It argued that, since they are secured by property liens, all 1–4 family, owner occupied residential mortgage loans with a loan-to-value ratio under 80 percent should be given a risk weighting of zero.

In the final rule, pre-tax earnings are divided by risk-weighted assets rather than by gross assets to avoid penalizing certain types of institutions, including those that hold low-risk and low-yielding assets. The FDIC's analysis shows that institutions specializing in mortgage lending are not charged a higher average assessment rate than other institutions under the final rule. Moreover, Call Reports and TFRs currently do not collect separate data on the loan-to-value ratio for 1–4 family, owner occupied residential mortgage loans; thus, it is not feasible to treat loans with a low loan-to-value ratio differently.

This trade group also requested that the FDIC study how mutual institutions are affected by including earnings in the financial ratios. The FDIC found that, while mutual institutions typically have a lower ratio of pre-tax earnings to risk-weighted assets, they typically have a higher Tier 1 leverage ratio and lower non-performing loan and charge-off ratios than other small institutions in Risk Category I. As a result, mutual institutions are not charged a higher average assessment rate than other institutions under the final rule.

Another trade group advocated averaging financial ratios over a period not less than four quarters, arguing that taking ''a one-quarter snap shot'' can be a misleading indicator of risk, since many financial institutions can experience seasonal variations. By averaging, these seasonalities would be removed.

The final rule uses a four-quarter sum for two of the five financial ratios—the pre-tax earnings and net charge-offs ratios—to reduce volatility related to seasonality. The final rule uses the values of the three other financial ratios as of each quarter-end for several reasons. First, the seasonality of these

[16] The NPR used the phrase ''nonperforming loans'' rather than ''nonperforming assets.'' Because this ratio includes repossessed real estate in the numerator, the FDIC has concluded that the phrase ''nonperforming assets'' would be more accurate. No change in the definition of the ratio is intended by this name change (although, as discussed later, a slight revision to the definition is being made for other reasons).

[17] The largest item in volatile liabilities for the great majority of institutions is time-and-savings deposits greater than $100,000. Institutions that file Call Reports report this figure, but institutions that file TFRs do not report this item separately. Instead, they report all deposits greater than $100,000, including demand deposits. Time-and-savings deposits greater than $100,000 cannot be determined from TFRs.

[18] One comment suggested excluding total loans and lease financing receivables past due 30 to 59 days in the ratio. Call Reports and TFRs currently do not collect separate data on loans and lease financing receivables past due 30 to 59 days; thus, it is not feasible to exclude these past due receivables from the ratio.

financial ratios is more modest. Second, with a quarterly computation of assessment rates, the average assessment rate an institution would be charged throughout the year would roughly equate to the assessment rate calculated with average ratios. Third, averaging financial ratios over time has the disadvantage of blunting the effect of changes in an institution's financial condition that are not related to seasonality; thus, averaging ratios would prevent assessments from fully adjusting to changes in risk.

One trade group supported the FDIC's use of a Tier 1 leverage ratio and suggested that it should be weighted heaviest among the financial ratios considered. However, several comments (including comments from other trade groups) stated that capital should be measured by a risk-adjusted capital ratio rather than the Tier 1 leverage ratio because a risk-adjusted capital ratio is a better measure of capital adequacy.

Several comments stated that the FDIC should not use a Tier 1 leverage ratio to determine assessment rates for large institutions, in particular. One of these comments argued that this ratio is not an accurate measure of risk, effectively penalizes institutions that invest in high quality short-term assets, such as U.S. government securities, and places U.S. banks at a competitive disadvantage with foreign banks. Another comment suggested that larger institutions might tend to be penalized by inclusion of a leverage ratio.

The final rule uses the Tier 1 leverage ratio. The Tier 1 leverage ratio is highly significant in predicting CAMELS downgrades and failures. Using a risk-based capital measure in place of the Tier 1 leverage ratio does not improve predictive accuracy. For the relatively few large Risk Category I institutions that do not have long-term debt issuer ratings, the FDIC's ability to adjust assessment rates based on consideration of other risk information, as discussed below, should ensure that these institutions are treated equitably.

Several comments (including comments from several trade groups) stated that the capital measure should include subordinated debt and stated or implied that subordinated debt should reduce assessment rates because it would reduce loss given failure. Several comments (including comments from some trade groups) argued that the statutes governing the risk-based pricing system require that the FDIC take loss given failure into account when determining assessments and that the proposed system does not do so. Because it does not do so, they argue, the assessment system is actuarially unfair. These issues are discussed in a subsequent section (Section IX).

One commenter explicitly argued that, for large institutions in Risk Category I, only CAMELS components should be used to differentiate risk. However, the comment also implied that only CAMELS components should be used for all Risk Category I institutions, including small institutions. The method adopted in the final rule, which combines financial ratios and supervisory ratings, predicts downgrades better than one without financial ratios. For this reason, the final rule does not adopt the method suggested in the comment.

E. Long-Term Debt Issuer Ratings

For large institutions with long-term debt issuer ratings, the final rule uses these ratings, in addition to supervisory ratings, to differentiate risk. The final rule uses the current long-term debt issuer rating or ratings assigned by the major U.S. rating agencies.[19] Debt issuer ratings of holding companies and other third party debt ratings will not be used in the calculation of an assessment rate, but may be considered along with other information in determining whether adjustments to the resulting assessment rate are appropriate. Possible adjustments to assessment rates are discussed in a subsequent section.

Comments

A number of comments (including comments from some trade groups) supported the use of debt issuer ratings as an objective measure of risk in large institutions and as complementary to supervisory ratings. One trade group urged the FDIC to use ratings issued by any nationally recognized credit rating agency; a rating agency requested that its ratings be used. The rating agency also urged the FDIC to consider agency ratings for both small and large institutions when available.

While there is merit in considering ratings provided by other rating agencies, long-term debt issuer ratings issued by the three major U.S. rating agencies are widely accepted and used by market participants to gauge the relative risk of large financial institutions for many purposes, including the determination of required rates of return on institution-issued debt. They provide market-based views of risk that are complementary to supervisory views.[20] The final rule does not incorporate debt issuer rating information into the pricing methodology used for smaller institutions; however, as described in a subsequent section, institutions with assets between $5 billion and $10 billion may request to be treated as a large institution for pricing purposes.

Other comments (including comments from other trade groups) either urged caution in the use of agency ratings on the grounds of bias in favor of large institutions or argued they should not be used. The FDIC's ability to adjust assessment rates for large institutions, discussed below, should alleviate these concerns.

Several comments urged the FDIC to use holding company debt issuer ratings to determine assessment rates. These comments noted that debt is often issued at the parent level, that holding companies are required to serve as a source of strength to their subsidiary institutions, and that holding company considerations apply to insured subsidiaries due to the cross guarantee liabilities of affiliated institutions.

The long-term debt issuer rating of an insured entity relates directly to the risk in that particular entity. As noted in the NPR, the risk profiles of affiliated institutions within a holding company can differ. Additionally, the value of a cross-guarantee in the future is uncertain because the financial condition of affiliated institutions may, in certain circumstances, weigh against the FDIC's invoking such cross-guarantee provisions.

Nevertheless, it is prudent to consider all available risk information in setting assessment rates. As discussed below, the FDIC will consider additional information, including any holding company debt issuer ratings, in determining whether the assessment rate for any large institution is appropriate.[21]

F. Combining Supervisory Ratings and Financial Ratios

For small institutions within Risk Category I and for large institutions within Risk Category I that do not have long-term debt issuer ratings, the final rule combines supervisory ratings and

[19] That is, Moody's, Standard & Poor's, and Fitch.

[20] The FDIC is aware of the enactment of the Credit Rating Agency Reform Act of 2006, Public Law 109–291. However, this legislation has not yet been implemented. The Act requires the Securities and Exchange Commission to issue final implementing regulations within 270 days of enactment. The FDIC expects to revisit how best to incorporate the ratings of other agencies in the future. Any future revisions would involve notice-and-comment rulemaking.

[21] There are, at present, only a few cases where holding company debt issuer ratings are available and insured entity debt issuer ratings are not. Of these, two cases involve entities owned by non-bank parents. Where both holding company ratings and insured entity debt issuer ratings exist, most insured entity ratings are better (indicating lower risk) than those of the parent company.

financial ratios to determine assessment rates. The financial ratios and the weighted average CAMELS component rating are used to estimate the probability that an institution will be downgraded to CAMELS 3, 4 or 5 at its next examination using data from the end of the years 1984 to 2004.[22] This period covers both periods of stress and strength in the banking industry.[23] The final rule converts the probabilities of downgrade to specific base assessment rates. The analysis and conversion produced the following multipliers for each risk measure:

Risk measures *	Pricing multipliers **
Tier 1 Leverage Ratio	(0.042)
Loans Past Due 30–89 Days/Gross Assets	0.372
Nonperforming Assets/ Gross Assets	0.719
Net Loan Charge-Offs/ Gross Assets	0.841
Net Income before Taxes/ Risk-Weighted Assets	(0.420)
Weighted Average CAMELS Component Rating	0.534

* Ratios are expressed as percentages.

** Multipliers are rounded to three decimal places.

To determine an institution's insurance assessment rate under the base assessment rate schedule, each of these risk measures (that is, each institution's financial ratios and weighted average CAMELS component rating) will be multiplied by the corresponding pricing multipliers. The sum of these products will be added to (or subtracted from) a uniform amount, 1.954.[24] The uniform amount is derived from a statistical analysis.[25] However, no rate within Risk Category I will be less than the minimum assessment rate applicable to the category or higher than the maximum assessment rate applicable to the category. The final rule sets the minimum base assessment rate for Risk Category I at two basis points and the maximum base assessment rate for Risk Category I two basis points higher.

To compute the values of the uniform amount and pricing multipliers shown above, the FDIC chose cutoff values for the predicted probabilities of downgrade such that, as of June 30, 2006: (1) 45 percent of smaller institutions that would have been in Risk Category I (other than institutions less than 5 years old) would have been charged the minimum assessment rate; and (2) 5 percent of smaller institutions that would have been in Risk Category I (other than institutions less than 5 years old) would have been charged the maximum assessment rate.[26] These cutoff values will be used in future periods, which could lead to different percentages of institutions being charged the minimum and maximum rates.

Table 2 gives assessment rates for three institutions with varying characteristics, assuming the pricing multipliers given above, using the base assessment rates for institutions in Risk Category I (which range between a minimum of 2 basis points to a maximum of 4 basis points).[27]

[22] The ''S'' component rating was first assigned in 1997. Because the statistical analysis relies on data from before 1997, the ''S'' component rating was excluded from the analysis. Appendix A describes the statistical analysis.

[23] 2005 data had to be excluded because the analysis is based upon supervisory downgrades within one year and 2006 downgrades have yet to be determined.

[24] Appendix A provides the derivation of the pricing multipliers and the uniform amount to be added to compute an assessment rate. The rate derived will be an annual rate, but will be determined every quarter.

[25] The uniform amount will be the same for all institutions in Risk Category I (other than large institutions that have long-term debt issuer ratings, insured branches of foreign banks and, beginning in 2010, new institutions). In the NPR, the FDIC had proposed that the uniform amount would be adjusted for assessment rates set by the FDIC. The final rule is mathematically equivalent. Rather than adjusting the uniform amount, the final rule simply calculates rates for Risk Category I institutions with respect to the base assessment rates, and adjusts all rates by the same amount to conform to actual rates.

[26] The cutoff value for the minimum assessment rate is a predicted probability of downgrade of approximately 2 percent. The cutoff value for the maximum assessment rate is approximately 14 percent.

[27] These are the base rates for Risk Category I adopted in Section VIII. Under the final rule, actual rates for any year could be as much as 3 basis points higher or lower than the base rates without the necessity of notice-and-comment rulemaking. Beginning in 2007, actual rates will be 3 basis points higher than the base rates.

Table 2

Base Assessment Rates for Three Institutions*

A	B	C	D	E	F	G	H
		Institution 1		Institution 2		Institution 3	
	Pricing Multiplier	Risk Measure Value	Contribution to Assessment Rate	Risk Measure Value	Contribution to Assessment Rate	Risk Measure Value	Contribution to Assessment Rate
Uniform Amount	1.954		1.95		1.95		1.95
Tier 1 Leverage Ratio (%)	(0.042)	9.590	(0.40)	8.570	(0.36)	7.500	(0.32)
Loans Past Due 30-89 Days/Gross Assets (%)	0.372	0.400	0.15	0.600	0.22	1.000	0.37
Nonperforming Assets/Gross Assets (%)	0.719	0.200	0.14	0.400	0.29	1.500	1.08
Net Loan Charge-Offs/Gross Assets (%)	0.841	0.147	0.12	0.079	0.07	0.300	0.25
Net Income before Taxes/Risk-Weighted Assets (%)	(0.420)	2.500	(1.05)	1.951	(0.82)	0.518	(0.22)
Weighted Average CAMELS Component Ratings	0.534	1.200	0.64	1.450	0.77	2.100	1.12
Sum of Contributions			1.56		2.13		4.25
Assessment Rate			2.00		2.13		4.00

* Figures may not multiply or add to totals due to rounding.[28]

The assessment rate for an institution in the table is calculated by multiplying the pricing multipliers (Column B) by the risk measure values (Column C, E or G) to produce each measure's contribution to the assessment rate. The sum of the products (Column D, F or H) plus the uniform amount (the first item in Column D, F and H) yields the total assessment rate. For Institution 1 in the table, this sum actually equals 1.56, but the table reflects the assumed minimum assessment rate of 2 basis points. For Institution 3 in the table, the sum actually equals 4.25, but the table reflects the assumed maximum assessment rate of 4 basis points.

Under the final rule, the FDIC will have the flexibility to update the pricing multipliers and the uniform amount annually, without further notice-and-comment rulemaking. In particular, the FDIC will be able to add data from each new year to its analysis and may, from time to time, exclude some earlier years from its analysis. For example, some time during 2007 the FDIC may include data in the statistical analysis covering the period 1984 to 2005, rather than 1984 to 2004. Because the analysis will continue to use many earlier years' data as well, pricing multiplier changes from year to year should usually be relatively small.

On the other hand, as a result of the annual review and analysis, the FDIC may conclude that additional or alternative financial measures, ratios or other risk factors should be used to determine risk-based assessments or that a new method of differentiating for risk should be used. In any of these events, changes would be made through notice-and-comment rulemaking.

Under the final rule, the financial ratios for any given quarter will be calculated from the report of condition filed by each institution as of the last day of the quarter.[29] In a separate rule, the FDIC has determined that, for purposes of assigning an institution to one of the four risk categories, changes to an institution's supervisory rating will be reflected as of the date that the rating change is transmitted to the institution.[30] This final rule adopts the same rule with respect to CAMELS component rating changes for purposes of determining assessment rates for all institutions in Risk Category I.[31] [32]

Using the transmittal date of a ratings change for assessment purposes represents a change from the method proposed in the NPR. Under the NPR, transmittal dates would only have been used in the absence of an examination start date (for example, for a large institution with continuous on-site supervision). Otherwise, in almost all instances, the examination start date would have been used.

The final rule adopts a suggestion contained in a banking trade group comment and alters the proposed rule for several reasons discussed in more detail in the final rule on operational changes to the assessment system.[33]

The final rule also differs from the NPR for large institutions without long-term debt issuer ratings. The NPR proposed determining assessment rates for these institutions from insurance scores using a weighted average CAMELS rating and a financial ratio factor, with each weighted 50 percent. While the supervisory ratings and financial ratios in the final rule are

[28] The final rule provides that pricing multipliers, the uniform amount, and financial ratios will be rounded to three digits after the decimal point. Resulting assessment rates will be rounded to the nearest one-hundredth (1/100th) of a basis point.

[29] Reports of condition include Reports of Condition and Income and Thrift Financial Reports.

[30] See final rule on Operational Changes to Assessments, published elsewhere in this issue of the **Federal Register**. However, if the FDIC disagrees with the CAMELS composite rating assigned by an institution's primary federal regulator, and assigns a different composite rating, the supervisory change will be effective for assessment purposes as of the date that the FDIC assigned the new rating. Disagreements of this type have been rare.

[31] Pursuant to existing supervisory practice, the FDIC does not assign a different component rating from that assigned by an institution's primary federal regulator, even if the FDIC disagrees with a CAMELS component rating assigned by an institution's primary federal regulator, unless: (1) the disagreement over the component rating also involves a disagreement over a CAMELS composite rating; and (2) the disagreement over the CAMELS composite rating is not a disagreement over whether the CAMELS composite rating should be a 1 or a 2. The FDIC has no plans to alter this practice.

[32] A rating change that is transmitted before this final rule becomes effective (*i.e.*, before January 1, 2007) will be deemed to have been transmitted prior to January 1, 2007.

[33] See final rule on Operational Changes to Assessments, published elsewhere in this issue of the **Federal Register**.

nearly the same as those proposed in the NPR, they are combined differently.[34]

The approach in the final rule is simpler because it uses one consistent method for all institutions other than those with at least $10 billion in assets that have long-term debt issuer ratings.

Comments

Supervisory ratings. Several comments supported the use of supervisory ratings. One comment asserted that supervisory ratings are the only reliable method to differentiate risk among financial institutions. One trade group supported using supervisory ratings as one of the variables used to determine assessment rates as proposed in the NPR and opposed either allowing supervisory ratings to ''be greater than 50 percent of the overall risk score'' or automatically giving supervisory ratings a 50 percent weight for small institutions, which was suggested in the NPR as an alternative method of determining assessment rates. Another trade group urged that ''supervisory ratings should never be weighted more than half of the total weight of both the supervisory ratings and financial ratios.'' Both trade groups urged these limitations because of the perceived subjectivity of supervisory ratings.

The FDIC has decided not to impose a cap on the contribution that supervisory ratings can make to an institution's assessment rate for two reasons. First, the final rule combining supervisory ratings and financial ratios does not use a weighting scheme or a risk score. The final rule uses pricing multipliers, which can be either positive or negative, based on a statistical model that relates financial ratios and component ratings to CAMELS downgrades. The pricing multipliers—including the multiplier for the weighted average CAMELS component rating—are based on the actual historical experience of how well financial ratios and weighted average CAMELS component ratings predict whether an institution will be downgraded to a CAMELS composite rating of 3 or worse at its next examination. Second, a cap on the contribution that supervisory ratings can make to an institution's assessment rate would affect only a small percentage of institutions and the effect would be very small.[35]

Updating pricing multipliers. One trade group agreed that the FDIC should have the flexibility to update the pricing multipliers and the uniform amount annually, without further notice-and-comment rulemaking and that adding additional or alternative financial measures, ratios or other risk factors to determine risk-based assessments or adopting a new method of differentiating for risk should be done through notice-and-comment rulemaking. The final rule is consistent with this comment. No comments disagreed.

Additional comments. One trade group urged that the FDIC avoid having low-risk multi-family loans lead to higher assessment rates to avoid chilling this type of lending. The final rule does not target this kind of lending.

G. Combining Supervisory Ratings With Long-Term Debt Issuer Ratings

For large institutions that have long-term debt issuer ratings, a combination of these ratings and supervisory ratings will determine assessment rates, using equal weighting for each. The base assessment rate will be derived as follows: (1) CAMELS component ratings will be weighted to derive a weighted average CAMELS rating;[36] (2) long-term debt issuer ratings will be converted to numerical values between 1 and 3 using the conversion values in Appendix B;[37] (3) the weighted average CAMELS rating and converted long-term debt issuer rating will be multiplied by a pricing multiplier and the products will be summed; and (4) a uniform amount, which will always be negative, will be added to the result. The resulting base assessment rate will be subject to a minimum and a maximum assessment rate. The pricing multiplier for both the weighted average CAMELS ratings and converted long-term debt issuer rating will be 1.176, and the uniform amount will be −1.882.

The conversion of long-term debt issuer ratings into numerical values in the final rule differs slightly from the conversion proposed in the NPR. Specifically, the final rule assigns the lowest conversion value of ''1'' to the best possible long-term debt issuer rating rather than to double A ratings or better (Aa2 or better for Moody's ratings), and the highest conversion value of ''3'' to triple B or worse ratings (Baa2 or worse for Moody's ratings), rather than to double B plus or worse ratings (Ba1 or worse for Moody's ratings). This revised conversion methodology takes better advantage of the possible range of ratings for large Risk Category I institutions, which are concentrated primarily in the triple B rating range and higher.

Pricing multipliers and the uniform amount for large institutions with debt ratings were derived using cutoff values of the combination of weighted average CAMELS ratings and converted long-term debt issuer ratings (weighted 50 percent each) such that, as of June 30, 2006: (1) Approximately 44 percent of large institutions with long-term debt issuer ratings that would have been in Risk Category I (other than institutions less than 5 years old) would have been charged the minimum assessment rate; and (2) approximately 6 percent of the large institutions with long-term debt issuer ratings that would have been in Risk Category I (other than institutions less than 5 years old) would have been charged the maximum assessment rate.[38] The derivation of pricing multipliers and the uniform amount is described in Appendix 1.

Under the final rule, the base assessment rate for an institution with CAMELS component ratings of ''222111,'' a Moody's long-term debt issuer rating of ''A1,'' and a Standard and Poor's long-term debt issuer rating of ''A'' would be 2.06 basis points. This rate is calculated as follows:

- The weighted average CAMELS rating is computed by multiplying each component rating by its associated weight to produce values of 0.50, 0.40, 0.50, 0.10, 0.10, and 0.10, respectively. The sum of these values, the weighted average CAMELS rating, is 1.70.
- The Moody's and Standard and Poor's long-term debt issuer ratings are converted to numerical values and averaged. The average of the two long-term debt issuer ratings, converted to numerical values of 1.50 and 1.80, respectively, is 1.65.
- The weighted average CAMELS rating and converted long-term debt

[34] The ratio of volatile liabilities to gross assets was included in the proposed rule, but is not included in the final rule. Other minor changes to the ratios have been made. The changes are discussed earlier in the text.

[35] As of June 30, 2006: (1) the contribution of CAMELS component ratings would have exceeded 50 percent of the assessment rate; and (2) assessment rates would have exceeded the minimum rate for less than 1.3 percent of small institutions in Risk Category I (other than institutions less than 5 years old). Most of these institutions, however, would have been charged a rate only slightly above the minimum rate. For a Risk Category I institution being charged the minimum rate, the contribution of the weighted average CAMELS component rating does not increase the institution's assessment rate.

[36] Each component rating will typically, if not always, range from ''1'' to ''3'' for institutions in Risk Category I.

[37] Where more than one long-term debt issuer rating is available, the converted values will be averaged.

[38] As of June 30, 2006, approximately 46 percent of all large institutions that would have been in Risk Category I (other than institutions less than 5 years old) would have been charged the minimum assessment rate and approximately 5 percent of all large institutions that would have been in Risk Category I (other than institutions less than 5 years old) would have been charged the maximum assessment rate.

issuer ratings are multiplied by the pricing multiplier and summed (1.700*1.176 + 1.650*1.176) [39] to produce a value of 3.940. A uniform amount of 1.882 is subtracted from this result to produce a base assessment rate of 2.06 basis points.[40]

The final rule also differs from the NPR in that it does not use financial ratios to determine assessment rates for any large institution that has long-term debt issuer ratings, and does not use varying weights for long-term debt issuer ratings for institutions with between $10 billion and $30 billion in assets. The final rule simplifies the derivation of assessment rates by applying the same weight to weighted average CAMELS component ratings and long-term debt issuer ratings (when they exist) regardless of an institution's size.

Several trade groups commented that the proposed risk differentiation methodology for large banks was too complex, in part because of the varying weights given risk factors for institutions between $10 billion and $30 billion in assets. These comments noted that an institution's assessment rate could change simply because of an increase or decrease in assets even when the institution's risk profile remained unchanged. After considering comments, the FDIC concluded that this simpler approach for all large institutions with debt issuer ratings achieves the objective of differentiating risk in these large institutions without the need to introduce further complexity in the form of varying weights for large institutions in different size categories.

Additional Comments

One trade group expressed concern that dissimilar methods for differentiating risk in large and small institutions could lead to possible inequity among institutions due solely to size. This comment expressed the view that agency and supervisory ratings tend to favor larger institutions, possibly because of diversification considerations.

The FDIC notes that the distribution of current supervisory ratings for large and small institutions does not support this view. Agency debt issuer ratings do take diversification into account, and the FDIC believes that it is appropriate to reflect these considerations in assessment rates. The final rule ensures, as required by statute, that no institution is precluded from the lowest assessment rate solely because of size. This statutory requirement underlies, in part, the FDIC's decision to initially include roughly similar proportions of large and small institutions in Risk Category I that would be charged minimum and maximum assessment rates. As discussed later, the FDIC will have the ability to adjust an institution's assessment rate when this rate is inconsistent with assessment rates of other large institutions with similar risk profiles.

This comment further noted that financial ratios also could be applied to all large institutions. Another trade group argued that the financial ratios should not be phased out in importance as institutions increase in size and should be used for all large institutions. This comment argued that measurements other than the financial ratios that are combined with supervisory ratings might be necessary to assess the off-balance sheet, securitization, trading, and securities processing activities engaged in by large institutions and to serve as a quality control check on long-term debt issuer ratings.

The FDIC believes that consideration of additional risk information (including financial performance and condition measures), discussed below, will be sufficient to ensure that the range of activities engaged in by banking organizations are fully considered and that debt issuer ratings are appropriately considered in assessment rates.

One comment suggested that business diversification should be more explicitly taken into account in determining deposit insurance premiums. This comment also recommended that the FDIC consider lowering or even eliminating premium rates for institutions that adopt the advanced approaches under the Basel II framework or whose actual capital sufficiently exceeds their Basel II required capital, since these institutions will have demonstrated capital levels and risk management practices that virtually eliminate risk to the deposit insurance fund. The FDIC believes that, in most cases, diversification, capital adequacy, and risk management considerations are reflected in supervisory or agency ratings or in financial ratios and the consideration of additional factors (in Appendix C) ensures that they are taken into account in all cases.

One comment argued that the large institution methodology proposed in the NPR was overly subjective because cutoff values to determine the percentage of institutions that would be charged the minimum and maximum rates would be set quarterly by the FDIC. In fact, under the final rule, minimum and maximum assessment rate cutoff values will be established using data as of June 30, 2006. No change will be made to these cutoff values without further notice and opportunity for comment.

H. Additional Provisions Relating to Large Institutions' Assessment Rates in Risk Category I

1. Adjustments to a Large Institution's Assessment Rate

To ensure consistency, fairness, and consideration of all available information, the FDIC will determine, in consultation with the primary federal regulator, whether or not to adjust the assessment rates for large institutions derived from either a combination of long-term debt issuer ratings and supervisory ratings or financial ratios and supervisory ratings (when no long-term debt issuer rating is available). The FDIC will make these determinations by evaluating additional risk information including current financial performance and condition information and trends, current market information, information pertaining to an institution's ability to withstand financial adversity, and information pertaining to severity of losses in the event of failure.

Any adjustments to assessment rates will be limited to 0.50 basis points (higher or lower). Upward adjustments will not take effect without notification to and consideration of responses from both the primary federal regulator and the institution. Downward adjustments will not take effect without notification to and consideration of responses from the primary federal regulator. No rate will be adjusted below the minimum rate for Risk Category I institutions in effect for an assessment period or above the maximum rate for Risk Category I institutions in effect for the period. Rate adjustments in Risk Category I are not meant to (and will not) override supervisory evaluations.[41]

Examples of additional risk factors that will be considered are enumerated in Appendix C. Evaluating this additional risk information on an ongoing basis will help the FDIC ensure that relative levels of risk posed by large

[39] Under the final rule, the pricing multipliers will be rounded to three digits after the decimal point.

[40] Under the final rule, the assessment rates resulting from these calculations will be rounded to the nearest one-hundredth (1/100th) of a basis point.

[41] This rule addresses only adjustments to assessment rates. It does not address the FDIC's role as back-up supervisor involving possible disagreements between the FDIC and the primary federal regulator over CAMELS ratings. Notification and resolution of such disagreements are covered by existing supervisory processes. See also footnote 34.

Risk Category I institutions are consistently represented by resulting assessment rates. Additional information will be evaluated in the following way:

- Current financial performance indicators such as capital levels, profitability measures, and asset quality measures of each large institution will be compared to those of institutions that are ranked similarly in terms of their assessment rates.
- Current market indicators such as subordinated debt spreads and holding company market indicators of each institution will be compared to market indicators of institutions that are ranked similarly in terms of their assessment rates.
- Recent information pertaining to an institution's ability to withstand financial stress will be evaluated by comparing this information to that of institutions ranked similarly in terms of their assessment rates. This information includes the internal risk characteristics of an institution's credit portfolios and other business lines as well as information from internal stress-test models.
- Current loss severity indicators of institutions will be evaluated by comparing this information to that of institutions ranked similarly in terms of their assessment rates. This information includes funding structure considerations such as the extent of priority and subordinated claims, as well as the availability of sufficient information (e.g., information pertaining to the level of insured deposits and qualified financial contracts) to resolve an institution in an orderly and cost-efficient manner.
- Evaluations of financial performance, market information, information pertaining to an institution's ability to withstand financial stress, and loss severity indicators will focus on: first, identifying those institutions that exhibit significantly different risk profiles, as indicated by risk indicators such as those enumerated above, than institutions with similar assessment rates; and second, where inconsistencies between assessment rates and these risk indicators are identified, determining the assessment rate adjustment that would be necessary to bring an institution's assessment rate into better alignment with those of other institutions that pose similar levels or risk.

Some comments (including comments from trade groups) indicated that the FDIC should consider certain information pertaining to losses that might be sustained by the insurance fund in the event of failure. For example, some comments indicated the FDIC should explicitly incorporate information about the relative level of subordinated claims into the determination of assessment rates for large institutions. The FDIC believes the final rule does consider loss given failure by explicitly incorporating consideration of this information into decisions of whether or not to adjust an institution's assessment rate.

In addition to ongoing consultations with the primary federal regulator on whether or not to make assessment rate adjustments, the FDIC will formally notify an institution's primary federal regulator when it decides to recommend an adjustment in assessment rates and will consider the primary federal regulator's response to this notification. The FDIC will also notify an institution in advance when the FDIC intends to increase its assessment rate because of the FDIC's consideration of additional risk information. This notice will include the reasons for the adjustment and when the adjustment will take effect, and provide the institution an opportunity to respond. An institution will, of course, have the right to request a review of any assessment rate that is adjusted in this manner.

After considering an institution's response to the notice, the FDIC will determine whether an adjustment to an institution's assessment rate is warranted, taking into account any revisions to weighted average CAMELS component ratings, long-term debt issuer ratings, and financial ratios, as well as any actions taken by the institution to respond to the FDIC's concerns described in the notice. The FDIC will evaluate the need for the adjustment each subsequent assessment period, until it determines that an adjustment is no longer warranted. The amount of adjustment will in no event be larger than that contained in the initial notice without further notice to, and consideration of responses from, both the primary federal regulator and the institution.

Any downward adjustment in assessment rates will remain in effect for subsequent assessment periods until the FDIC determines that an adjustment is no longer warranted. However, the FDIC will provide advance notice to an institution and its primary federal regulator and give them an opportunity to respond before removing a downward adjustment. Of course, the FDIC may raise an institution's assessment rate without notice if the institution's supervisory or agency ratings or financial ratios (for an institution without long-term debt issuer ratings) deteriorate.

The FDIC acknowledges the need to clarify its processes for making any adjustments to ensure fair treatment and accountability and plans to propose and seek comment on additional guidelines for evaluating whether assessment rate adjustments are warranted and the size of the adjustments. The FDIC will not adjust assessment rates until the guidelines are approved by the FDIC's Board.

2. Timing of Evaluations

Under the final rule, a large institution's risk category will change as of the date the institution is notified of its rating change by its primary federal regulator (or state authority). If the supervisory rating change results in a large institution moving from Risk Category I to Risk Category II, III, or IV, the institution's assessment rate for the portion of the quarter it was in Risk Category I will be based on its assessment rate for the prior quarter. The assessment rate for that portion of the quarter it was in Risk Category II, III, or IV will be based on the assessment rate for these risk categories.

When a large institution is moved from Risk Category II, III, or IV to Risk Category I during a quarter because of a supervisory rating change, the FDIC will determine the associated assessment rate (subject to adjustment as described above) for that portion of the quarter that the institution was in Risk Category I. The assessment rate for that portion of the quarter it was in Risk Category II, III, or IV will be based on the assessment rate for these risk categories.

When an institution remains in Risk Category I during a quarter, but a CAMELS component or long-term debt issuer rating change during the quarter would affect its assessment rate, the FDIC will determine an assessment rate for each portion of the quarter before and after the change. A long-term debt issuer rating change will be effective as of the date the change is announced by the rating agency. Changes in supervisory ratings will be effective as of the date the institution is notified by its primary federal regulator (or state authority).

The timing of changes in assessment rates due to changes in supervisory or long-term debt issuer ratings described above differs only slightly from the proposal in that it uses, in all cases, the date of transmittal of a supervisory rating change by the primary federal regulator to the institution. The reasons

for this change are discussed in a separate rule.[42]

One trade group expressed concern about the possibility of retroactive changes in assessment rates and the prospects for accounting restatements. This comment pointed out that CAMELS rating changes often occur one and even two quarters after the start date of an examination. The use of the transmittal date of examination findings rather than start date of an examination to effect changes in assessment rates should alleviate this concern about retroactive accounting adjustments.

Another comment expressed a similar concern that institutions would not be able to plan for the financial impact of assessment rate changes if they were applied retroactively, either because of a change in supervisory or long-term debt issuer ratings, or because of a decision by the FDIC to adjust an institution's assessment rate. The FDIC believes that the final rule sufficiently addresses this concern since: (1) the transmittal of revised CAMELS ratings or the announcement of revised long-term debt issuer ratings will provide sufficient notice to the institution that a change in assessment rates will occur; and (2) assessment rate changes caused by a decision by the FDIC to adjust an institution's assessment rate will not become effective before the institution is duly notified and has had an opportunity to respond to the proposed change.

Additional Comments

Adjustments to an institution's assessment rates. A number of comments (including several comments from trade groups) questioned the need for the FDIC to incorporate additional information into its pricing decisions for large institutions. Some of the main objections were that:

- Adjustments would override the evaluations of the primary federal regulator;
- The FDIC should not be allowed to unilaterally override CAMELS ratings assigned by the primary federal regulator since they are viewed to have better information than the FDIC about the risks posed by these institutions;
- The need for more timely information is not necessary since many large institutions are supervised on a continuous basis;
- Supervisory ratings incorporate all relevant risk information and therefore consideration of additional information is not necessary;
- The application of the FDIC's discretion over pricing decisions has not been sufficiently described; and
- Many of the additional risk indicators identified in Appendix C of the proposal are vaguely defined and not necessarily aligned with risk.

Several comments specifically criticized the proposal's use of additional stress consideration factors. For example, some comments stated that these factors were not well developed and expressed concern about the possibly conflicting role such information would play in evaluations by the primary federal regulators and the FDIC.

One trade group supported the FDIC's consideration of additional risk information to ensure that assessment rates were consistently assigned, that risk information was incorporated into the assessment rate in a timely manner, and that assessment rates reflected consideration of all relevant risk information.

For the reasons described earlier, the FDIC has decided to retain its ability to adjust assessment rates based upon consideration of additional risk factors.

A number of comments supported providing institutions with prior notification relating to any possible increase in assessment rates. However, many of these comments were made in the context of the proposed risk ''bucket'' or subcategory pricing approach. Given the adoption of an incremental pricing approach for institutions in the incremental pricing range, the FDIC believes advance notice is only needed in two cases based on consideration of additional risk information: (1) Where the FDIC intends to make an upward adjustment to a large institution's assessment rate above that derived from supervisory and long-term debt issuer ratings (or from supervisory ratings and financial ratios); and (2) where it intends to remove a previously made downward adjustment to an institution's assessment rate.

V. Definitions of Large and Small Institutions and Exceptions

Under a companion final rule making operational changes to the FDIC's assessment regulations, a Risk Category I institution will be defined as large if it has $10 billion or more in assets and small if it has assets of less than $10 billion. This determination will initially be made as of December 31, 2006. Thereafter, a small Risk Category I institution will be reclassified as a large institution when it reports assets of $10 billion or more for four consecutive quarters. Similarly, a large Risk Category I institution will be reclassified as a small institution when it reports assets under $10 billion for four consecutive quarters. Any reclassification will remain effective for subsequent quarters, unless an institution reports assets that would change its size category (from large to small or vice versa) for four consecutive quarters.

The definition of large and small institutions for Risk Category I institutions in the final rule is the same as that contained in the proposal. One trade group commented that the $10 billion cutoff point for categorizing institutions as either large or small was appropriate given the tendency of larger institutions to have more available risk information. This same comment indicated that large institutions should be evaluated using more information than current financial ratios and CAMELS component ratings given the types of complex activities engaged in by the largest institutions, such as securitization, derivatives, and trading.

As described in the NPR, the final rule makes an exception to the $10 billion size threshold for Risk Category I institutions with between $5 billion and $10 billion in assets that request treatment as a large institution. The FDIC will grant such requests if it determines that it has sufficient information to evaluate the institution's risk profile adequately under the risk differentiation methods used for large institutions. The absence of long-term debt issuer ratings alone will not preclude the FDIC from granting a request. The assessment rate for an institution without a long-term debt issuer rating would still be derived from supervisory ratings and financial ratios, but would be subject to adjustment. Once a request has been granted, an institution could again request treatment under a different approach after three years, subject to FDIC approval.[43]

As discussed in the NPR, small institutions that are affiliated with large institutions will be evaluated separately under the final rule. Specifically, assessment rates for small institutions will be determined using supervisory ratings and financial ratios, whether or

[42] See final rule on Operational Changes to Assessments, published elsewhere in this issue of the **Federal Register**. If the FDIC disagrees with the CAMELS composite rating assigned by an institution's primary federal regulator, and assigns a different composite rating, the supervisory change will be effective for assessment purposes as of the date that the FDIC assigned the new rating. Disagreements of this type have been rare. See also footnote 34.

[43] In the event that the FDIC grants an institution's request to be treated as a large institution and the institution subsequently reports assets of less than $5 billion for four consecutive quarters, the institution will be assessed as a small institution thereafter.

not these institutions are affiliated with large institutions.

An institution that disagrees with the FDIC's determination that it is small or large may request review of the determination pursuant to 12 CFR 327.4(c).

Comments

One comment supported the proposal to allow institutions with between $5 billion and $10 billion in assets to request treatment as a large institution. This comment noted that the proposal will allow flexibility for small institutions that are transitioning to large institutions and want to be evaluated using long-term debt issuer ratings.

Some comments supported: (1) Assigning the same assessment rate to all affiliated institutions, possibly by strengthening cross guarantees; (2) assigning the assessment rate of the largest institution in a holding company to all institutions in the holding company; or (3) applying the same method of calculating assessment rates to all institutions in a holding company regardless of size to avoid different assessment rate approaches for institutions within the same holding company. The FDIC acknowledges that often each institution in a holding company derives managerial, operational, and financial support from the parent holding company. However, financial condition and operating performance can and does vary among banks within a holding company. Consequently, the FDIC believes it is necessary to evaluate risk at each insured institution individually. Any modifications to current cross guarantee provisions are outside the scope of this proposal.

VI. Risk Differentiation Among Insured Foreign Branches

The final rule for insured foreign branches (insured branches) is substantially similar to the proposed rule. The main difference is the use of incremental pricing for insured branches whose assigned assessment rates fall between the minimum and maximum assessment rates.

Insured branches that are assigned to Risk Category II, III or IV, based on their asset pledge and asset maintenance ratios and supervisory ratings, will be treated in the same manner as other insured institutions in these risk categories. For insured branches that are assigned to Risk Category I, assessment rates will be determined from the supervisory ROCA component ratings assigned to the insured branch.[44] Each of these component ratings will be weighted to produce a weighted average ROCA rating. The weights applied to individual ROCA component ratings will be the same as those contained in the NPR: 35 percent, 25 percent, 25 percent, and 15 percent, respectively. An assessment rate for insured branches will be determined by multiplying the average ROCA rating by a pricing multiplier of 2.353 and adding a uniform amount of −1.882 from this product.[45] The derivation of the pricing multipliers and uniform amount for insured branches is described in Appendix 2.

As with the large institution risk differentiation approach, the FDIC may adjust these assessment rates up or down by 0.50 basis points after consideration of the additional risk factors described in Appendix C. The same process for making adjustments described to large institution rates, including advance notification and consultation with the primary federal regulator, will apply to insured foreign branches.

The FDIC received no comments on the proposed treatment of insured foreign branches.

VII. New Institutions in Risk Category I

Under the final rule, beginning in 2010, new institutions in Risk Category I generally will be assessed at the same rate, which will be the highest rate charged any other institution in this Risk Category. For this purpose, the final rule on operational changes defines a new institution as one that is not an established institution.[46] With three exceptions, beginning in 2010, an established institution, as defined in the final rule on operational changes, will be one that has been chartered as a bank or thrift for at least five years as of the last day of any quarter for which it is being assessed. Before 2010, all Risk Category I institutions will be assessed using either the supervisory ratings and financial ratios method or the supervisory and debt ratings method.

Where an established institution merges or consolidates with a new institution, the surviving or resulting institution will be new unless:

1. The assets of the established institution, as reported in its report of condition for the quarter ending immediately before the merger, exceeded the assets of the new institution, as reported in its report of condition for the quarter ending immediately before the merger; and

2. Substantially all of the management of the established institution continued as management of the resulting or surviving institution.[47] [48]

However, where a new institution merges into an established institution and the merger agreement was entered into on or before July 11, 2006, the final rule contains a grandfather clause under which the surviving institution will be deemed to be an established institution.

This exception to the definition of a new institution represents a change from the proposed rule. The NPR proposed that, when an established institution merged into or consolidated with a new institution, the surviving or resulting institution would be new, but would be allowed to request that the FDIC determine that it was established. The NPR also proposed that, when a new institution merged into an established institution or when an established institution acquired a

[44] ROCA stands for Risk Management, Operational Controls, Compliance, and Asset Quality.

[45] The pricing multiplier and uniform amount for insured branches are computed in the same manner as those used for large Risk Category I institutions with long-term debt issuer ratings. The uniform amount is the same as described under that approach, and the pricing multiplier for weighted average ROCA ratings is simply two times the pricing multiplier used for either weighted average CAMELS ratings or converted long-term debt issuer ratings (*i.e.*, the weighted average ROCA rating is weighted 100 percent).

[46] Empirical studies show that new institutions exhibit a ''life cycle'' pattern and it takes close to a decade after its establishment for a new institution to mature. Despite low profitability and rapid growth, institutions that are three years or newer have, on average, a very low probability of failure—lower than established institutions, perhaps owing to large capital cushions and close supervisory attention. However, after three years, new institutions' failure probability, on average, surpasses that of established institutions. New institutions typically grow more rapidly than established institutions and tend to engage in more high-risk lending activities funded by large deposits. Studies based on data from the 1980s showed that asset quality deteriorated rapidly for many new institutions as a result, and failure probability (conditional upon survival in prior years) reached a peak by the ninth year. Many financial ratios of new institutions generally begin to resemble those of established institutions by about the seventh or eighth year of their operation. See Chiwon Yom, ''Recently Chartered Banks'' Vulnerability to Real Estate Crisis,'' FDIC Banking Review 17 (2005): 1–15 and Robert DeYoung, ''For How Long Are Newly Chartered Banks Financially Fragile?'' Federal Reserve Bank of Chicago Working Paper Series 2000–09.

[47] A surviving or resulting Risk Category I institution that qualifies as an established institution under this exception will have its assessment rate determined using the CAMELS component ratings of the established institution involved in the merger or consolidation until the surviving or resulting institution receives a new supervisory rating.

[48] The resulting institution in a consolidation (as well as the surviving institution in a merger) involving only established institutions will, of course, be deemed to be an established institution.

substantial portion of a new institution's assets or liabilities, and the merger or acquisition agreement was entered into after July 11, 2006 (the date that the FDIC's Board approved the NPR), the FDIC would conduct a review to determine whether the surviving or acquiring institution remained an established institution. The NPR proposed that the FDIC would make determinations based upon factors that included factors similar to the two listed above.

The final rule differs from the NPR in this regard. By specifying the particular circumstances that will allow an institution to be considered established, the final rule will give institutions greater certainty regarding the effects of mergers and consolidations and should reduce the necessity of filing requests for review. The final rule should not result in denying an exception to any institution that would have been considered established under the proposed rule, while still achieving the purpose of the proposed rule.

The second exception was raised in comment letters in response to the FDIC's specific request for comment on its proposed definition of a new institution.[49] This exception will apply to a new institution that is a subsidiary of a holding company with an established institution or that is a subsidiary of an established institution, provided certain criteria are met. Under these circumstances, the institution will be considered established for assessment purposes.[50] Specifically, an institution that would otherwise be new will be considered established if it is a wholly owned subsidiary of:

1. A company that is a ''bank holding company'' under the Bank Holding Company Act of 1956 or a ''savings and loan holding company'' under the Home Owners'' Loan Act, and:

a. At least one ''eligible'' depository institution (as defined in 12 CFR 303.2(r)) that is owned by the holding company has been chartered as a bank or thrift for at least five years as of the date that the otherwise new institution was established; and

b. The holding company has a composite rating of at least ''2'' for bank holding companies or an above average or ''A'' rating for thrift holding companies and at least 75 percent of its depository institution assets are assets of ''eligible'' depository institutions, as defined in 12 CFR 303.2(r);[51] [52] or

2. An ''eligible'' insured depository institution, as defined in 12 CFR 303.2(r), that has been chartered as a bank or thrift for at least five years as of the date that the otherwise new institution was established.

Several comments (including comments from trade groups) argued that, at a minimum, new institutions in a bank holding company should be charged at the same rate as other institutions in the holding company. Arguments for this position included:

- Assessing new institutions at a higher rate will affect a holding company's decision to charter a new institution or to branch; in the context of mergers and acquisitions, the deal structure could be influenced to retain the seasoned banks post-consolidation solely for the purpose of avoiding high assessments, even though a different structure would otherwise be more appropriate.
- The articles referenced by the FDIC in support of assessing all ''new'' institutions at a higher rate did not take into account holding company support or enhancements in supervision.
- Holding companies often have considerable banking experience, so that the institution is not really new. Institutions in a holding company typically share management.

The FDIC is persuaded that a new institution within an established holding company structure does not necessarily pose a higher risk than established institutions, in part because of the banking experience within the holding company, and has created an exception from the new bank definition for these institutions. However, the assessment rate for a new institution subsidiary of an insured depository institution or holding company that qualifies for the exception will not necessarily be the same rate charged an affiliate. As with any established institution in Risk Category I, its assessment rate will be determined based upon the risk it poses.

The third exception was also raised in comment letters in response to the FDIC's specific request for comment on its proposed definition of a new bank.[53] For a credit union that converts to a bank or thrift charter, some comments (including comments from trade groups) urged the FDIC to take into account the period that a credit union has had federal deposit insurance in determining whether it is new or established. As one trade group pointed out:

> These institutions have a seasoned loan portfolio, experienced leaders, and an established business history. They have been carefully screened by their new banking regulator.

The final rule takes into account the period that a credit union has been federally insured as a credit union in determining whether it is new or established.[54]

The final rule also differs from the NPR in its definition of a new institution. Under the NPR, a new institution would have been defined as an institution that had not been chartered as a bank or thrift for at least seven years as of the last day of any quarter for which it was being assessed (subject to the exceptions above).

Several comments (including comments from trade groups) suggested that charging the maximum Risk Category I assessment rate to new institutions for 7 years was too long and

[49] 71 FR 41910.

[50] A Risk Category I institution that has no CAMELS component ratings shall be assessed at one basis point above the minimum rate applicable to Risk Category I institutions until it receives CAMELS component ratings. If an institution has less than $10 billion in assets or has at least $10 billion in assets and no long-term debt issuer rating, once it receives CAMELS component ratings, its assessment rate will be determined under the supervisory ratings and financial ratios method. The assessment rate will be determined by annualizing, where appropriate, financial ratios obtained from the reports of condition that have been filed, until the earlier of the following two events occurs: (1) the institution files four reports of condition; or (2) if it has at least $10 billion in assets, it receives a long-term debt issuer rating.

[51] 12 CFR. 303.2(r) defines an eligible depository institution as one that:

(1) Received an FDIC-assigned composite rating of 1 or 2 under the Uniform Financial Institutions Rating System (UFIRS) as a result of its most recent federal or state examination;

(2) Received a satisfactory or better Community Reinvestment Act (CRA) rating from its primary federal regulator at its most recent examination, if the depository institution is subject to examination under part 345 of this chapter;

(3) Received a compliance rating of 1 or 2 from its primary federal regulator at its most recent examination;

(4) Is well-capitalized as defined in the appropriate capital regulation and guidance of the institution's primary federal regulator; and

(5) Is not subject to a cease and desist order, consent order, prompt corrective action directive, written agreement, memorandum of understanding, or other administrative agreement with its primary federal regulator or chartering authority.

[52] For bank holding companies, RFI ratings replaced BOPEC ratings as of December 2004. For a bank holding company that does not yet have an RFI composite rating, BOPEC ratings will be used.

[53] 71 FR 41910.

[54] Again, a Risk Category I institution that has no CAMELS component ratings shall be assessed at one basis point above the minimum rate applicable to Risk Category I institutions until it receives CAMELS component ratings. If an institution has less than $10 billion in assets or has at least $10 billion in assets and no long-term debt issuer rating, once it receives CAMELS component ratings, its assessment rate will be determined under the supervisory ratings and financial ratios method. The assessment rate will be determined by annualizing, where appropriate, financial ratios obtained from the reports of condition that have been filed, until the earlier of the following two events occurs: (1) The institution files four reports of condition; or (2) if it has at least $10 billion in assets, it receives a long-term debt issuer rating.

favored a shorter period, such as 3 or 5 years (assuming new institutions were assessed separately). One trade group argued that, after three years, an institution's loan portfolio and its operations should be seasoned enough so that the FDIC can assess the risks of the institution based on financial ratios and CAMELS ratings as it does for other institutions. Other arguments for shortening the period that an institution is considered new included:

- Higher failure rates for new institutions occurred in earlier periods, but not in recent periods, partly because supervision has been enhanced.
- The banking industry uses three years as an estimate of banking maturity; banking supervisors use the same period when reviewing new bank applications.

The FDIC's decision to assess new institutions separately from established institutions is based on the difficulty of assessing new institutions' risk with the same risk measures used to assess the risk of established institutions. New institutions undergo rapid changes in the scale and scope of operations for a period of time after being chartered and these changes can make new institutions' financial condition and performance measures volatile. Moreover, new institutions' loan portfolios are unseasoned, and their management is often untested, making it difficult to assess loan quality through standard financial performance measures.

These differences between new and established institutions' financial characteristics could lead to mis-measurement of risk when new institutions are evaluated by the same financial risk measurement model used to evaluate established institutions' risk. More specifically, the FDIC finds that new institution risk is, in general, underestimated by the manner in which supervisory ratings are combined with financial ratios; however, the degree of underestimation of risk declines with bank age.

Under the final rule, all new institutions in Risk Category I will be assessed at the same rate and this rate will be the highest rate charged any other institution in Risk Category I. The FDIC finds that the failure rates of institutions that have been in existence for less than 5 years are greater than those of established institutions that would have historically paid the highest assessment rate in Risk Category I (the riskiest Risk Category I established institutions). Historical failure rates among institutions that have been in existence between 5 and 7 years, however, are somewhat lower than those of the riskiest Risk Category I established institutions. For this reason, for purposes of setting assessment rates, the final rule defines new institutions as those institutions that have been in existence less than 5 years.

Some comments expressed concern that a combination of factors could result in inequitable treatment for new institutions. These factors included the need to initially charge more than the base rates, the lack of credits for most new institutions, and charging the maximum rate to these institutions. The FDIC recognizes that during the transition from the existing system to the new system, this combination of factors could significantly increase assessment rates for new institutions. Consequently, the final rule delays the effective date of the provisions subjecting new Risk Category I institutions to the maximum Risk Category I rate until January 1, 2010.

Before 2010, a Risk Category I institution that has no CAMELS component ratings shall be assessed at one basis point above the minimum rate applicable to Risk Category I institutions until it receives CAMELS component ratings. If an institution has less than $10 billion in assets or has at least $10 billion in assets and no long-term debt issuer rating, once it receives CAMELS component ratings, its assessment rate will be determined under the supervisory ratings and financial ratios method. The assessment rate will be determined by annualizing, where appropriate, financial ratios obtained from the reports of condition that have been filed, until the earlier of the following two events occurs: (1) The institution files four reports of condition; or (2) if it has at least $10 billion in assets, it receives a long-term debt issuer rating.

Additional Comments

No rule for new institutions. Several comments (including comments from trade groups) argued that the FDIC should assess new institutions as other institutions are assessed. Arguments for assessing new institutions as other institutions are assessed included:

- New institutions are scrutinized by examiners more intently and more frequently.
- There is an inherent bias against new institutions in CAMELS ratings.
- Capital is usually higher in new institutions.
- Many new institutions are started by experienced bankers or are spin-offs of established institutions.
- A separate rule for new institutions will undermine public confidence in these institutions.
- A single rate for new institutions does not adequately differentiate risk.
- A new institution has no incentive to reduce its risk because it will not reduce its assessment rate.

The final rule changes the new institution period from seven to five years, but assesses new institutions separately for the reasons described. However, the final rule does delay the effective date of the provisions governing new institutions for three years.

An institution that disagrees with the FDIC's determination that it is new or established may request review of the determination pursuant to 12 CFR 327.4(c).

Mergers. One trade group opposed treating established institutions that merge into or consolidate with new institutions as new on the grounds that such treatment is unreasonable and prejudicial to shareholders. Other comments also took issue, at least implicitly, with the proposed rule regarding mergers and consolidations. A comment from a trade group, however, stated that the FDIC should judge an individual institution based on the specific risk profile that it presents to the deposit insurance fund:

> Generally, a new institution that merges with, acquires or is acquired by an existing depository institution will immediately exhibit certain risk characteristics, such as market penetration, strength of management, amount of capital and experience of the officers and employees of the resulting institution, that will allow the primary federal supervisor of the resulting institution to make a determination whether it most appropriately should be characterized in accordance with the risk profile of the new institution or the established one.

The FDIC has simplified the final rule in response to comments. The final rule allows the FDIC to review the surviving or resulting institution in a merger or consolidation involving both a new and an established institution to determine whether the surviving or resulting institution is new or established based on the criteria previously discussed without, in general, requiring that the institution file a request for review.

VIII. Assessment Rates

A. Rate Schedules

Beginning on January 1, 2007, assessment rates will be as shown in the following table:

	Risk Category				
	I*		II	III	IV
	Minimum	Maximum			
Annual Rates (in basis points)	5	7	10	28	43

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

All institutions in any one risk category, other than Risk Category I, will be charged the same assessment rate. For all institutions in Risk Category I, annual assessment rates will range between 5 and 7 basis points.

The final rule also adopts the base schedule of rates proposed in the NPR: [55]

	Risk Category				
	I*		II	III	IV
	Minimum	Maximum			
Annual Rates (in basis points)	2	4	7	25	40

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

The assessment rates that take effect January 1, 2007, will be uniformly 3 basis points higher than the base rate schedule. Under the present assessment system, the Board has adopted a base assessment schedule where it can uniformly adjust rates up to a maximum of five basis points higher or lower than the base rate schedule without the necessity of further notice-and-comment rulemaking, provided that any single adjustment cannot move rates more than five basis points.[56] In the NPR, the Board indicated its intention to retain the ability to adjust rates up to five basis points without seeking further public comment. Upon considering the comments received on this issue (discussed below), the Board has decided to retain this feature, but limit its ability to adjust rates without seeking further public comment to three basis points. Hence, the final rule allows the Board to adjust rates uniformly up to a maximum of three basis points higher or lower than the base rates without the necessity of further notice-and-comment rulemaking, provided that any single adjustment from one quarter to the next cannot move rates more than three basis points.[57] In the event that the Board uniformly adjusts rates, rates calculated for institutions in Risk Category I in reference to the base assessment rates will be uniformly adjusted by the same amount. Once set by the Board, assessment rates will remain in effect until changed.

Table 3 shows projected reserve ratios assuming different average annual growth rates for insured deposits if the actual rate schedule (as opposed to base rate schedule) adopted in this rule remains in effect through the year in which the reserve ratio first reaches or exceeds the designated reserve ratio (DRR) of 1.25 percent.[58]

[55] With respect to the base schedule of rates, the NPR contains the FDIC's analysis of the statutory factors that must be considered whenever the FDIC's Board of Directors sets rates. These factors include: (1) estimated fund operating expenses; (2) estimated fund case resolution expenses and income; (3) the projected effects of assessments on institution capital and earnings; (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 12 U.S.C § 1817(b)(1)(A) 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)(1)(C).

[56] In addition, no assessment rate may be negative. See 12 CFR 327.9.

[57] And provided, again, that no assessment rate may be negative.

[58] The FDIC is contemporaneously adopting a DRR of 1.25 percent. See final rule on the Designated Reserve Ratio, to be published elsewhere in this issue of the **Federal Register**.

Table 3

Projected Reserve Ratios Assuming Different Growth Rates in Insured Deposits Under the Rate Schedule Adopted in this Rule

Period	Insured Deposit Growth Rate					
	3%	4%	5%	6%	7%	8%
2007	1.22%	1.21%	1.20%	1.19%	1.17%	1.16%
2008	1.27%	1.24%	1.22%	1.20%	1.18%	1.16%
2009		1.31%	1.28%	1.25%	1.22%	1.19%
2010					1.26%	1.22%
2011						1.25%

(1) The year-end 2006 reserve ratio is estimated to be 1.21 percent.
(2) Projections of the components of fund balance growth that result in the reserve ratios shown in this table are provided below.

In summary, the Board bases its decision to adopt this rate schedule on the following:

• The Reform Act gives the Board flexibility to achieve the DRR within a time frame that it believes appropriate, rather than treat the DRR as a ''hard'' annual target. In the Board's view, reaching the DRR within the third year of the new assessment system would be a reasonable goal, which this rate schedule would facilitate, given the FDIC's assumptions regarding insured deposit growth.

• An objective of the Reform Act is to allow the fund to increase under favorable conditions so that it can decline under adverse conditions without sharp increases in assessments. The outlook for economic conditions affecting banks remains generally favorable, industry conditions remain strong, and projected reserve ratios under the rate schedule assume very low insurance losses.

• During the next few years, the rate schedule is likely to prevent the reserve ratio from declining below the 1.15 percent statutory lower bound for the DRR and unlikely to raise the reserve ratio above the 1.35 percent threshold that could trigger the payment of dividends.

• It is reasonable to plan for future annual insured deposit growth in the 4-to-6 percent range, down from higher rates observed last year and estimated for this year. Reaching the DRR within three years under this rate schedule assumes that insured deposit growth will be in this range.

• Assessment credits authorized under the Reform Act will limit assessment revenue in the near term.

• Implementation of the rate schedule is unlikely to have a materially adverse effect on the earnings and capital of insured institutions.

B. Factors Supporting the Rate Schedule

As required by statute, the FDIC's Board of Directors considered the following factors in setting rates:

(i) The estimated operating expenses of the Deposit Insurance Fund.

(ii) The estimated case resolution expenses and income of the Deposit Insurance Fund.

(iii) The projected effects of the payment of assessments on the capital and earnings of insured depository institutions.

(iv) The risk factors and other factors taken into account pursuant to 12 U.S.C section 1817(b)(1) under the risk-based assessment system, including the requirement under 12 U.S.C section 1817(b)(1)(A) to maintain a risk-based system.

(v) Other factors that the Board of Directors determined to be appropriate.[59]

These factors, including those determined by the Board to be appropriate, are discussed in more detail below.

1. Projected Changes to the Fund Balance From Case Resolution Expenses, Operating Expenses, Investment Contributions, and Risk-Based Assessments

Table 4 shows projected changes to the fund balance over the next two years under the rate schedule adopted in this rule. Future changes to the fund balance depend, in turn, on projections and assumptions for insurance losses (case resolution expenses), operating expenses, assessment revenue, and investment contributions. These components of fund balance changes are discussed below.

[59] Section 2104 of the Reform Act (to be codified at 12 U.S.C. 1817(b)(2)(B)). The risk factors referred to in factor (iv) include:

(i) the probability that the Deposit Insurance Fund will incur a loss with respect to the institution, taking into consideration the risks attributable to—

(I) different categories and concentrations of assets;

(II) different categories and concentrations of liabilities, both insured and uninsured, contingent and noncontingent; and

(III) any other factors the Corporation determines are relevant to assessing such probability;

(ii) the likely amount of any such loss; and

(iii) the revenue needs of the Deposit Insurance Fund. 12 U.S.C. 1817(b)(1)(C).

Table 4

Changes to the Fund Balance* under the Adopted Rate Schedule, 2007-2008
($ in millions)**

Period	Beginning Fund Balance	Net Assessment Revenue	Investment Income	Loss Provisions	Operating Expenses	Ending Fund Balance
2007	50,293	617	2,278	71	1,000	52,117
2008	52,117	2,561	2,361	74	1,000	55,965

* The beginning fund balance for 2007 is estimated from the most recent actual fund balance and expected revenue, expenses, and loss provisions through the end of 2006.

** Revenue and loss projections in this table and Table 5 assume that domestic deposits (the assessment base) increase slightly faster than a projected insured deposit growth rate of 5 percent. Alternative deposit growth assumptions would result in relatively small changes in projected fund balances.

a. *Insurance losses and operating expenses.* The rate schedule adopted assumes a continuing trend of very few bank failures and very low insurance losses. Reserve ratio projections based on the rate schedule assume that annual insurance loss provisions beginning in 2007 equal one thousandth of one percent of industry aggregate domestic deposits. This is less than one quarter of the average annual rate over the last 10 years—also a time of few failures and modest insurance losses. Loss provisions in 2007 are projected at $71 million, and rise slightly in proportion to domestic deposit growth.[60]

Banks in general appear to be well positioned to withstand considerable financial stress from unlikely economic shocks.[61] Nonetheless, the possibility remains that insurance losses may be higher than anticipated. Higher losses, in turn, would reduce the likelihood of raising the reserve ratio to the DRR within three years under the rate schedule adopted in this rule. Future assessment rate setting under such conditions would have to weigh several factors, including the desirability of avoiding sharp increases in assessments at a time of industry stress and the need to maintain the fund within the range authorized by the Reform Act.

In Table 3, the reserve ratio projections based on the rate schedule adopted also assume that annual operating expenses remain flat over the next few years, at approximately $1 billion.[62]

b. *Investment contributions.* As shown in Table 4 above, projections of fund balances assume that annual investment contributions beginning in 2007 amount to slightly over 4.5 percent of the fund balance. Investment contributions equal interest income plus (minus) unrealized gains (losses) on available-for-sale securities. The investment yield used in the projections assumes a continuation of recent investment return experience.

The use of expert forecasts for interest rates next year, as detailed in the Blue Chip Financial Forecasts, would yield similar projections for 2007 investment contributions. Since May of this year, short-term Treasury yields have increased slightly as the Federal Reserve raised the target for the federal funds rate to 5.25 percent. Long-term Treasury yields declined by over 35 basis points over the same period, resulting in a modestly inverted yield curve since late July. Low longer-term interest rates reflect historically low and stable long-term inflationary expectations, heightened global demand for low-risk, long-term assets and, potentially, expectations of slower economic growth ahead. The economy is forecast to grow below its long-run average level for the remainder of 2006, and the futures market places little chance of any further federal funds rate increases. Many economic forecasters expect long-term interest rates and the yield curve to remain steady through 2007.

c. *Risk-based assessment revenue and assessment credits.* Table 5 below shows projected gross assessment revenue, assessment credit use, and net assessment revenue for 2007–2008 under the rate schedule adopted in this rule.

[60] The projection for 2007 is very close to the result obtained from the statistical method that has been used to develop estimates of losses to support past semiannual assessment rate schedules. This method estimates likely ranges of insurance losses based on projected changes in the estimated liability for anticipated failures (contingent loss reserve) through December 31, 2007.

[61] Two-year stress event simulations were run based on data through June 30, 2006, affecting institutions specializing in residential mortgages, subprime loans, commercial real estate mortgages, commercial and industrial loans, and consumer loans. The results of each simulation, which were derived from historical stress events, demonstrate that banks are well positioned to withstand a significant degree of financial adversity. In no case did the stress simulation results raise significant concerns for the insurance fund. However, the effects were not evaluated beyond a two-year horizon. Also, the historical experiences underlying the stress scenarios may be less applicable in the future, so conclusions drawn from the stress analyses should be treated with some degree of caution.

[62] Alternatively, if operating expenses increased by 5 percent per year after 2007, the reserve ratio would still be projected to reach the 1.25 percent DRR during, or by year-end, 2009, assuming that insured deposit growth averages between 4 and 6 percent annually.

Table 5

Assessment Revenue and Assessment Credit Use in 2007-2008
Under the Rate Schedule Adopted in this Rule
($ in millions)

Period	Gross Revenue	Credits Used	Net Revenue	Effective Rate (bp)
2007	3,777	3,160	617	0.9
2008	3,978	1,417	2,561	3.4

Projected gross assessment revenue is derived by assigning each insured institution to a Risk Category, and assigning each institution in Risk Category I to the minimum rate, maximum rate, or rate in between, using the most recently available supervisory and debt issuer ratings, and June 30, 2006, financial data. Table 6 shows the distribution of institutions and assessment bases among the Risk Categories using the most recently available data.[63] For purposes of assessment revenue projections, the distribution of assessable deposits among Risk Categories (and within Risk Category I) is assumed to remain constant.

Table 6

Distribution of Institutions and Domestic Deposits Among Risk Categories
($ in millions)*

Risk Category	Number of Institutions	Percent of Total Institutions	Domestic Deposits	Percent of Total Domestic Deposits
I -- Minimum	3,605	41%	4,018,374	62%
I -- Middle	4,300	49%	2,186,515	34%
I -- Maximum	413	5%	129,290	2%
II	416	5%	105,684	2%
III	53	1%	4,312	0%
IV	2	0%	202	0%

*Estimates are based on most recent supervisory and debt issuer ratings, and June 30, 2006, financial data.

Assessment revenue projections reflect the use of assessment credits authorized under the Reform Act and distributed in accordance with the recent final rule adopted for assessment credits.[64] In 2007, most institutions that have credits will apply them to offset either their entire assessment or an amount equal to their total credit, whichever is less. Therefore, as indicated in Table 5 above, the effective rate applicable to the industry next year under this rate schedule is projected to be only 0.9 basis points. The effective rate is projected to rise to 3.4 basis points in 2008 as some institutions exhaust their credits.[65]

2. Projected Insured Deposits

Chart 2 shows levels of insured deposits and corresponding four-quarter growth rates since 1990, including forecasts through 2007. Over the 1990–2005 period, annual growth rates in insured deposits ranged between −2.8 percent and 7.4 percent. After three consecutive annual declines in insured

[63] The table actually reflects domestic deposits rather than assessment bases. However, pursuant to a final rule adopted simultaneously with this final rule, beginning in 2007 the assessment base will equal domestic deposits with minor adjustments. The final rule eliminates the standard amounts deducted from domestic deposits for float. See Final Rule on Operational Changes to Assessments, to be published elsewhere in this issue of the **Federal Register**.

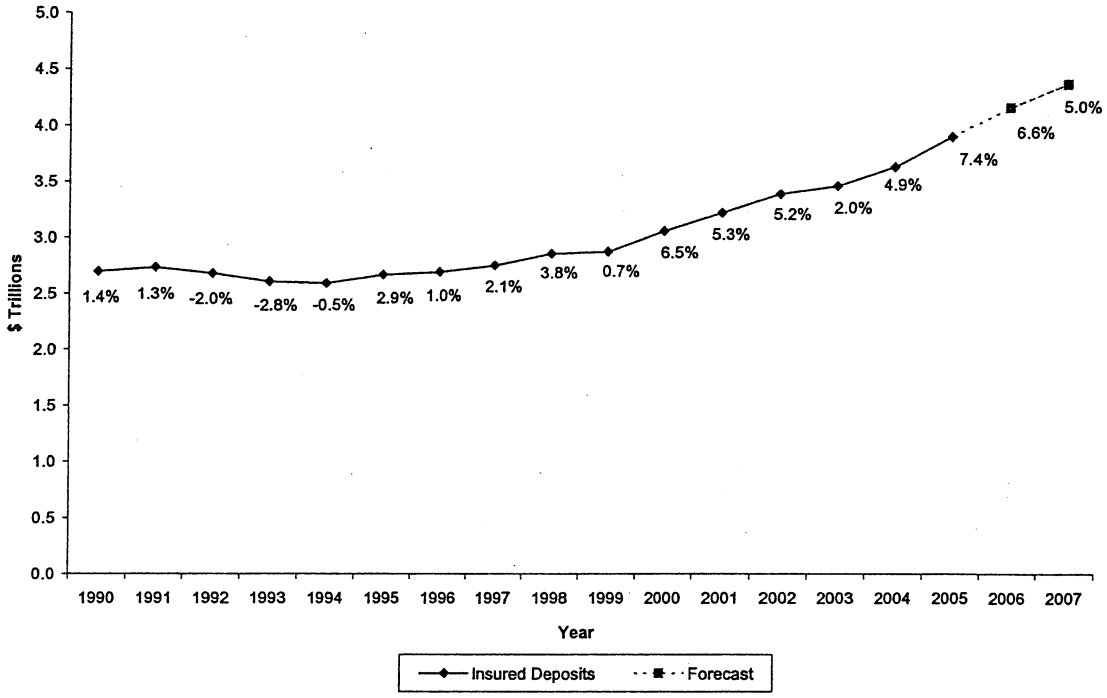
[64] 71 FR 61374 (October 18, 2006).

[65] In 2008, 2009 and 2010, credit use will be capped at 90 percent of an institution's assessment, as required by the Reform Act and implementing regulations.

deposits—from year-end 1991 to year-end 1994—annual growth in insured deposits picked up in the mid-1990s and reached 6.5 percent in 2000. Improved stock market conditions and historically low short-term interest rates helped reduce growth to 2.0 percent in 2003. However, insured deposit growth then climbed to 4.9 percent in 2004 and 7.4 percent in 2005. The high growth in insured deposits may have resulted partly from an increase in short-term interest rates, triggered by a tightening in monetary policy by the Federal Reserve. An increase in short-term interest rates relative to long-term rates makes short-term investment instruments, such as bank deposits, more attractive to investors.

Chart 2

Annual Insured Deposit Growth Rates
(December over December)



Based on the results of a statistical forecast model, insured deposits are predicted to increase by 6.6 percent in 2006 and 5.0 percent in 2007.[66] The projected growth rate in 2007 is approximately the same as the average annual growth rate for the five years ending in 2005.[67]

Beyond 2007, while not relying on a statistical forecast model, the FDIC believes that it is reasonable to plan for average annual insured deposit growth in the 4 percent-to-6 percent range. Table 3 shows that, with an average annual growth rate between 4 percent and 6 percent beginning next year, implementation of a rate schedule 3 basis points above the base rate schedule has a reasonable chance of raising the reserve ratio to the 1.25 percent DRR in the third year (2009) of the new assessment system. That table also indicates that average annual growth of 7 percent or higher would make it unlikely to achieve a reserve ratio of 1.25 percent within three years. Yet, while insured deposits rose by more than 7 percent in 2005, the historical data suggest that it is very unlikely that insured deposits will increase at an average annual rate as high as 7 percent for three consecutive years.[68]

3. Projected Reserve Ratios

Assuming insured deposit growth of 5 percent per year beginning in 2007, projections for year-end 2006 and the first three years under the new rate schedule are as follows:[69]

Table 7

Projected Fund Balances, Insured Deposits, and Reserve Ratios
($ in millions)

Period	Ending Fund Balance	Ending Insured Deposits	Ending Reserve Ratio
2006	50,293	4,148,918	1.21%
2007	52,117	4,356,364	1.20%
2008	55,965	4,574,182	1.22%
2009	61,477	4,802,891	1.28%

The table indicates that the reserve ratio is expected to decline slightly next year as the use of assessment credits prevents the fund balance from rising in pace with insured deposits. However, with two-thirds of credits drawn down by the end of 2007, assessment revenue should accelerate in 2008 and help the fund meet the DRR during 2009.

4. Effect of the Rate Schedule on Capital and Earnings of Insured Institutions

Appendix 3 contains an analysis of the projected effects of the payment of assessments under the actual (as opposed to base) rate schedule adopted in this rule on the capital and earnings of insured depository institutions. In sum, the actual rate schedule is not expected to impair the capital or earnings of insured institutions materially.

5. Other Factors Supporting the Rate Schedule

As permitted by law, the FDIC Board considered other factors in establishing the rate schedule adopted in this rule:

a. *Flexibility to manage the reserve ratio within a range.* While the Reform Act requires the FDIC Board to set a DRR annually, there is no longer a requirement for the reserve ratio to meet the DRR within a particular time frame. The DRR is no longer a statutory ''hard'' target. The Board may choose a time period that it believes appropriate to bring the reserve ratio in line with the DRR and, subject to the range established in the Reform Act, decide how much variation from the DRR would be acceptable.[70]

As of June 30, 2006, the reserve ratio stood at 1.23 percent, and is expected to decline to 1.21 percent by year-end. Returning the fund to the DRR within a 12-month period, as had been required when the DRR was treated as a ''hard'' target, would require charging a minimum rate of 10.5 basis points (assuming insured deposit growth of 5 percent next year, as well as low losses and flat operating expenses). The FDIC does not believe that this steep an increase is advisable or consistent with the Reform Act's objective of providing for greater premium stability. Therefore,

[66] Specifically, the statistical forecast model explains growth in insured deposits as dependent on current and last quarter growth in domestic deposits (both insured and uninsured) as well as on last quarter's growth in insured deposits. The 95 percent confidence interval for the 2006 growth rate is +/−2.6 percent. The range of uncertainty grows beyond 2006 as the forecast horizon lengthens. An alternative forecasting model, which also uses lagged growth in the federal funds rate to explain domestic deposits, resulted in a slightly lower 2007 insured deposit growth rate (4.7 percent).

[67] The forecast does not explicitly account for the effect of the Reform Act provision raising the insurance coverage limit on retirement accounts from $100,000 to $250,000. The increase in coverage became effective on April 1, 2006. There is considerable uncertainty about the provision's effect on aggregate estimated insured deposits and the reserve ratio. Regulatory reporting changes that will help capture the magnitude of any increase in estimated insured deposits took effect in the second quarter of 2006 for Call Report filers and are scheduled to take effect in the fourth quarter of 2006 for TFR filers. Based on the very limited information currently available, staff anticipates that the retirement account coverage limit increase may reduce the reserve ratio by between one-half and one basis point.

[68] Rolling 12-quarter growth rates in insured deposits were calculated beginning with the March 1995 to March 1998 period and ending with the June 2003 to June 2006 period. The mean 12-quarter growth rate over this period was 3.8 percent (annualized), and the largest reported 12-quarter growth rate was 5.7 percent.

[69] These projections also assume that domestic deposits (the assessment base) increase by 5.6 percent in 2007, 5.3 percent in 2008, and 5.2 percent in 2009.

[70] The Reform Act requires the FDIC to establish the DRR within a range of 1.15 percent to 1.50 percent of estimated insured deposits. The Board must establish a restoration plan when the reserve ratio falls below 1.15 percent. The FDIC must also pay dividends when the reserve ratio exceeds 1.35 percent, unless the Board elects to suspend them.

the FDIC is using the flexibility provided in the Reform Act to raise the reserve ratio more gradually and permit a less steep increase in assessment rates.

b. *Increasing the fund when conditions are favorable.* An objective of the Reform Act is to allow the fund to increase under favorable conditions so that it can decline under adverse conditions without sharp increases in assessments. The outlook for economic conditions affecting banks remains favorable. There have been no failures in over two years. Banking industry profits have continued to set records and capital remains strong. Loan performance has been solid and charge-offs are at, or near, 15-year lows. There is little evidence of material adverse conditions currently impairing industry performance.

Nonetheless, it is difficult to predict how long such favorable conditions will last. Areas of concern already visible include the compression in net interest margins, weakening housing markets, and the uncertainty over energy prices, among other risks. In the FDIC's view, it would be prudent not to stretch out too long the time to raise the fund to the 1.25 percent DRR and risk encountering a worsening of industry conditions before the fund is at the desired level.

c. *Ensuring that the fund stays within the range established by Congress.* As Table 3 shows, the rate schedule adopted in this rule is unlikely to cause the reserve ratio to decline below the 1.15 percent lower bound for the range, even in the unlikely event that insured deposit growth averages as much as 8 percent over the next few years. Furthermore, the FDIC Board can act to adjust rates when the reserve ratio achieves the DRR to prevent the fund from growing too large and triggering the requirement to pay dividends.

On the other hand, if the FDIC Board sets rates equal to the base rate schedule, Table 8 below shows that it would be highly unlikely for the fund to reach the 1.25 percent DRR within five years. Furthermore, there would be a significantly greater chance that insured deposit growth would push the fund below the 1.15 percent lower bound.

Table 8

Projected Reserve Ratios Assuming Assessment Rates are Set at the Base Rate Schedule*

Period	Insured Deposit Growth Rate					
	3%	4%	5%	6%	7%	8%
2007	1.21%	1.20%	1.19%	1.18%	1.17%	1.15%
2008	1.21%	1.19%	1.17%	1.15%	1.13%	1.11%
2009	1.22%	1.19%	1.16%	1.13%	1.10%	1.07%
2010	1.24%	1.20%	1.16%	1.12%	1.08%	1.04%
2011	1.27%	1.22%	1.16%	1.12%	1.07%	1.02%

*Note: Assumes the same assumptions for losses, operating expenses, and investment income as the projections based on the rate schedule adopted.

Comments

Overall base rates: Some comments (including a comment from a trade group) noted that the base rates for Risk Categories II, III and IV were not sufficiently high multiples of the average Risk Category I base rate, given the historical costs to the FDIC from failures of institutions in these categories. Thus, ''under the Proposal, a substantial subsidization will remain of the riskier institutions by the safer ones.''

The NPR itself notes that, at least with respect to Risk Category IV, the base rate is substantially lower than the historical analysis would suggest is needed to recover costs from failures. The lower rate is intended to decrease the chance of assessments being so large that they cause these institutions to fail.

When losses due to fraud are taken into account by prorating among all risk categories, the base rates for Categories II and III and for the riskier institutions in Risk Category I are slightly lower than the historical analysis would suggest and the base rates for the less risky institutions in Risk Category I are slightly higher than the historical analysis would suggest.[71] However, the historical analysis can only be a guide to rates. The base rates also take into account the FDIC's estimate of its long-term revenue needs, including the requirement to manage the reserve ratio within a range. In addition, the base rates for institutions in Risk Category I are equal to or lower than the base rate being replaced (four basis points) and the base rates for Risk Categories II, III and IV are, with a single exception, higher than the base rates being replaced.[72] Thus, the new base rates substantially reduce the subsidization of non-Risk Category I institutions by Risk Category I institutions and also substantially reduce the subsidization of higher risk institutions in Risk Category I by lower risk institutions in that category. For these reasons, the FDIC is adopting the proposed base rate schedule unchanged.

Minimum rate. Several comments argued in favor of a lower minimum base rate for institutions in Risk Category I. Suggestions for the minimum base rate included 0, 1 basis point or less, 1 basis point, and 1.25 basis points. Arguments in favor of a lower minimum base rate included:

- The FDIC is not likely to set actual rates below the base rates.
- Institutions in Risk Category I do not present much, if any, risk.
- The FDIC's data does not support charging the least risky institutions 2 basis points.

[71] See Table 1.6 in Appendix 1 to the NPR. 71 FR 41910.

[72] The base rate for institutions in the 2B risk classification was 14 basis points, compared with a base rate for institutions in Risk Category II of 7 basis points.

• Over certain periods in the past, average rates for Risk Category I required to maintain a given reserve ratio have been lower than 2 basis points.

• 2 basis points would unfairly penalize those institutions that could qualify for an assessment of less than 2 basis points under the proposed small institution method.

• The base rates do not take into account loss given default.

As discussed earlier, the historical analysis of costs attributable to each risk category can only be a guide to rates. The base rates take into account the FDIC's estimate of its long-term revenue needs. Moreover, the base rates do not in any sense represent a floor below which rates cannot be set. If these rates prove to generate too much revenue over time, the FDIC's Board can reduce actual rates.

That some institutions appear to qualify for an assessment of less than 2 basis points using the method that combines supervisory ratings with financial ratios is largely an artifact of the statistical method used to estimate an institution's probability of downgrade. Had the FDIC employed the more commonly used logit model rather than an ordinary least squares (OLS) model, this artifact would have nearly disappeared.[73]

The issue of loss given default is discussed in a subsequent section (XI(C)).

Rate adjustments. Several comments (including comments from trade groups) opposed allowing the FDIC to adjust rates from the base rate schedule without further notice-and-comment rulemaking; one suggested that the FDIC be allowed to increase rates above the base rate schedule a maximum of 2 basis points without further notice-and-comment rulemaking. Arguments in support of requiring further notice-and-comment rulemaking included:

• The FDIC is no longer required to raise rates when the reserve ratio falls below the designated reserve ratio; therefore, the FDIC no longer needs to be able to raise rates quickly and drastically.

• If the FDIC must raise rates quickly, it can do so on an expedited basis or on an emergency basis, subject to subsequent notice and comment.

• Notice-and-comment rulemaking will allow banks time to plan for higher rates.

Arguments in support of allowing the FDIC to increase rates above the base rate schedule a maximum of 2 basis points without further notice-and-comment rulemaking included:

• Given historical longer-term insured deposit growth rates, an increase above the base rates of more than 2 basis points is unnecessary.

• An increase above the base rates of more than 2 basis points would affect institutions' earnings and their ability to lend in ways that cannot be justified given the present size of the DIF.

• Limiting the increase in this way should make assessment rates more stable from quarter to quarter.

Congress has granted the FDIC broad authority to establish a risk-based assessment system. 12 U.S.C. 1817(b)(1). Maintaining the ability to adjust rates within limits without notice and comment rulemaking is consistent with our well established practice and will allow the FDIC to act expeditiously to adjust rates in the face of constantly changing conditions, subject to the statutory factors we are required to consider. The NPR gave institutions notice that rates may be significantly higher than the base rates temporarily, partly because of the ongoing trend of high insured deposit growth and partly because the use of one-time credits will limit assessment revenue. For this reason, the final rule continues to allow the FDIC to adjust rates within limits without further notice-and-comment rulemaking. However, in light of the comments, the FDIC has decided to limit its ability to adjust rates without further notice-and-comment rulemaking to three basis points, as discussed above.

One comment opposed making uniform increases from the base rate schedule in determining actual rates and argued that any increase above the base rate schedule that was uniform would not reflect actual risk:

> Any basis point ''surcharge'' should be risk-weighted, so that an institution with a lower risk profile would be charged a lower ''surcharge'' (*e.g.*, 1 basis point or lower), and an institution with a higher risk profile would be charged a higher ''surcharge'' (*e.g.*, 5 basis points).

The FDIC believes that this comment contains a valid point. In the event that revenue needs increase or decrease greatly and variations in risk among institutions suggest non-uniform rate changes, the FDIC will consider whether to increase or decrease the range of assessment rates between risk categories and within Risk Category I. Any such change would only be made pursuant to further rulemaking.

Fraud costs. Two comments argued that the FDIC had failed to take fraud costs into account in the NPR. This is incorrect. Fraud was not excluded from the data used to develop the risk differentiation methods. The risk differentiation methodology was applied to analyze historical costs attributable to the risk categories (and to subsets of Risk Category I). The FDIC conducted this analysis in two steps. In the first step, the FDIC excluded fraud costs because, until fraud is uncovered, an institution engaged in fraud is usually not assigned to the correct risk category. After this step was concluded, the FDIC then distributed these fraud costs pro rata among all risk categories to determine historical costs attributable to the risk categories (and to subsets of Risk Category I). The FDIC used these historical costs to determine and validate base assessment rates.

Currently, fraud cannot be predicted. When it does appear, it can cause the failure of very large institutions. Keystone Bank, which was a relatively large bank, failed as the result of massive fraud. The Bank of Credit and Commerce International and Barings Brothers, Inc., were both very large banks that failed as a result of fraud. Outside of the banking industry, many failures have resulted as the result of fraud.

Actual rates. Many comments dealt with the actual assessment rates to be charged, either explicitly or by implication. Many comments (including comments from trade groups) suggested or implied that the FDIC keep assessment rates low, particularly for institutions in Risk Category I, and build the reserve ratio gradually over a period of years. The reasons cited for keeping assessment rates low included many of the reasons for lowering the base rate schedule for Risk Category I. In addition, other arguments included:

• The Reform Act eliminates the requirement that the reserve ratio reach any particular level within any particular time period.

• There should be a period of transition to allow banks to gradually use up their one-time assessment credits and adjust to paying premiums again under the new risk-based assessment system.

• High rates would be a burden on all institutions and would particularly and unnecessarily burden institutions without one-time credits, harming their competitive position and discouraging the formation of new banks.

• Insured deposit growth rates are not likely to be high over the long term; in

[73] The FDIC chose to use an OLS model for two primary reasons. The two models, logit and OLS, produced very similar risk rankings and the OLS model allowed institutions to easily calculate their potential base assessment rate for given changes in their financial ratios and CAMELS component ratings.

the past 15 years, there has been no 5-year period where annual growth rates much exceeded 5 percent. Given realistic growth rates of 4 to 5 percent, charging high rates will quickly increase the reserve ratio to unnecessarily high levels.

- The banking industry is extremely healthy because of improved risk management policies and procedures in the banking industry, and legislation that has equipped the federal bank regulatory agencies with additional supervisory and enforcement tools and the increased sophistication of the supervisory process.
- The risk of failure for Category I institutions is extremely low, and the risk of loss to the FDIC is even lower.
- Bank customers, particularly corporate customers, actually bear the burden of assessments.

The FDIC has decided on actual rates based upon the analysis described earlier. In sum, the FDIC is using the flexibility afforded under the Reform Act to raise the reserve ratio more gradually than if the 1.25 percent DRR remained a ''hard'' annual target. Nonetheless, consistent with the legislation's objectives, the FDIC believes that rates should currently be set to build up the fund while economic conditions are generally favorable and the industry remains strong. Absent persistent high insured deposit growth, the FDIC expects that future assessment rates should be able to decline toward the base rate schedule once the reserve ratio reaches the DRR. Rates could be set below the base rate schedule if insured deposit growth slows considerably. Finally, the rates adopted in this rule (including rates charged new institutions when the provisions regarding new institutions become effective) remain well below rates that were charged during periods of both economic and industry stress and are not expected to have material adverse effects on established or new institutions.

IX. Comments on Additional Issues

Rapid Growth Premium

Some trade groups proposed imposing an additional premium for institutions (or new institutions) that have rapid deposit growth to offset dilution of the reserve ratio. Other trade groups proposed such a premium for large institutions that have rapid deposit growth.

The FDIC has decided against imposing a specific growth premium, primarily for two reasons. First, Congress has already considered and resolved the issue of rapid growth during the past 10 years, when most institutions have paid nothing for deposit insurance, by awarding a one-time credit to those institutions that helped build the deposit insurance funds before 1996. Second, assessments under the final rule take future growth into account. An institution's assessment equals the product of its assessment rate times its assessment base (which, under a final rule adopted simultaneously with this final rule, will be identical or nearly identical with its domestic deposits). Thus, any growth in domestic deposits will proportionally increase an institution's assessment.[74]

In addition, in the FDIC's view, it is not practicable to define or impose such a premium. One difficult issue with defining an appropriate level of growth as a trigger is that a relatively small dollar increase in deposits at a small institution could represent a significant percentage of growth while a very large increase in deposits at a large institution might result in a small increase in the institution's percentage of growth. Additionally, rapid growth alone may or may not warrant an additional premium. Finally, it would be very difficult—and probably impossible—to specify a rule for triggering a specific growth premium that could not be circumvented by some institutions.

Risk Differentiation

Several comments (including comments from trade groups) asserted that the FDIC cannot accurately differentiate risk amongst Category I institutions (or at least accurately enough for incremental pricing in small banks and/or six sub-categories for large banks) and, therefore, all institutions in Risk Category I should be charged the same assessment rate. These comments argued that subcategories and incremental pricing introduce unnecessary complexities. These comments claim that this additional complexity creates confusion and undermines confidence in the assessment system. One comment added that looking beyond three years when analyzing Category I institutions' risk is unnecessary, since failing institutions would still be placed in a higher risk category well before failure.

The FDIC has found significant differences in risk among institutions in Risk Category I. To illustrate these differences in risk, consider differences in failure rates between CAMELS 1-rated and CAMELS 2-rated institutions that make up Risk Category I. The historical failure rate for CAMELS 2-rated institutions is 2.5 times that of CAMELS 1-rated institutions for both three-and five-year horizons. Moreover, for a two-year horizon, CAMELS 2-rated institutions fail three times more often than do CAMELS 1-rated institutions.

In the FDIC's view, while the analysis that produced the risk differentiation and pricing methodology underlying the final rule is complex, its application is not. Moreover, in general, the simpler a system is, the less able it is to capture differences in risk. The statistical analysis used may be complex, but it produces meaningful distinctions in risk.

One commenter also stated that the proposal makes assessment rates most risk sensitive for those banks that are least likely to fail. The FDIC recognizes that institutions in Risk Category I are less likely to fail than institutions in Risk Categories II, III and IV. These differences are reflected in assessment rates. Base assessment rates for Category IV institutions are 10 to 20 times higher than rates for the riskiest Category I institutions.

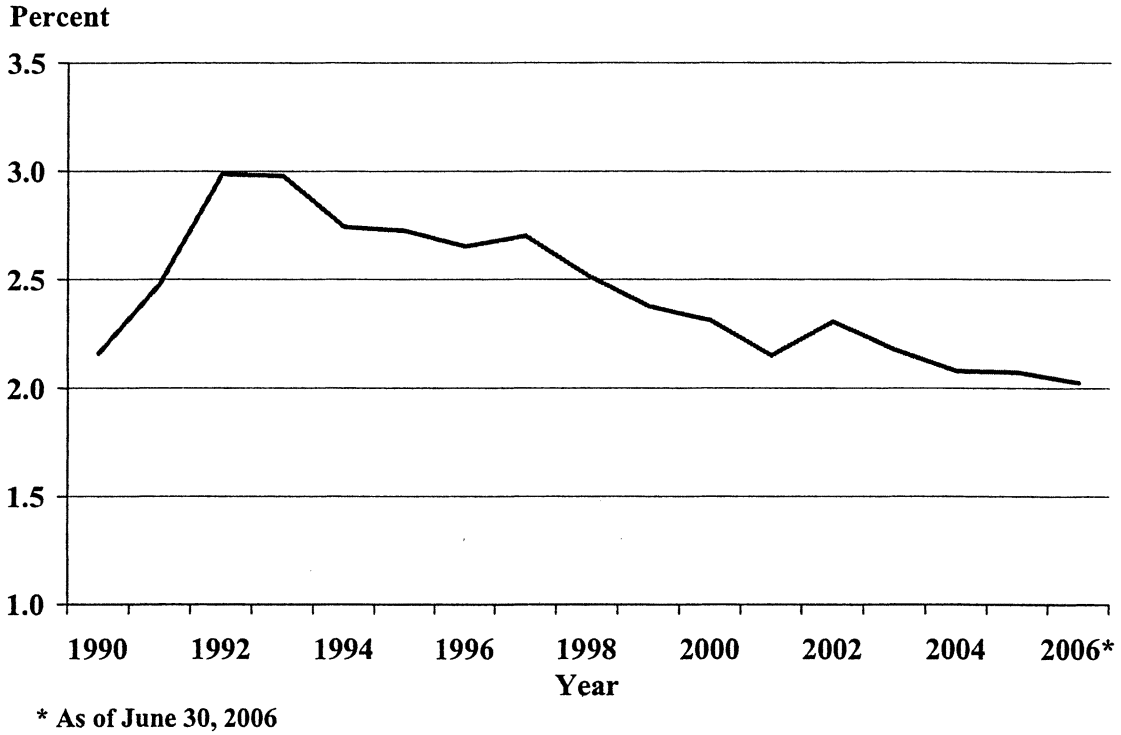
Calibration

One trade group argued that the FDIC's model is not well calibrated to economic cycles because ''the percentage of institutions that would qualify for the floor rate is greater than the 45 percent for every year since 1992, except one.'' The inference apparently intended to be drawn from this argument is that, because the industry is healthier now than it has been for almost all years since 1992, the percentage of institutions that would qualify for the floor rate should be greater now than in the past. However, this argument overlooks two important points. First, the profitability of the banking industry in this decade compared to the 1990s has resulted, in part, from increased risk. From the mid-1990s to the present, earnings did not grow as fast as risk-weighted assets. As shown in Chart 3 below, the median ratio of earnings before taxes to risk-weighted assets has declined steadily since the early 1990s. The risk differentiation methods adopted in the final rule are designed to capture this increased risk. Second, not all institutions are prospering as much as they were in the past. In 2005, the pre-tax return on assets for institutions with under $100 million in assets was 1.29 percent, which was less than in any year between 1992 and 1999.

[74] Of course, only growth in insured deposits can dilute the reserve ratio.

Chart 3

Ratio of Median Earnings before Taxes to Risk-Weighted Assets*



Loss Given Failure

Several comments (including comments from trade groups) stated that the capital measure should include subordinated debt and stated or implied that subordinated debt should reduce assessment rates. For example, one comment recommended that institutions with subordinated liabilities and equity in excess of 25 percent of assets be placed in the minimum assessment rate subcategory. Several comments (including comments from trade groups) argued that the statutes governing the risk-based pricing system require that the FDIC take loss given default into account when determining assessments and that the proposed system fails to do so. This failure, they argue, makes the system actuarially unfair.

The FDIC recognizes that the Federal Deposit Insurance Act requires that the FDIC take the likely amount of any loss from failure into account in the assessment system. The final rule takes loss given failure (and expected loss pricing in general) into account in several ways. For a large institution, the FDIC will consider loss given failure (through the loss severity indicators enumerated in Appendix C) in determining whether to make an adjustment to an institution's assessment rate. The final rule also takes loss given failure into account in the historical analysis that informed the base rate schedule and in each institution's assessment base. However, the FDIC's ability to take loss given failure into account in determining the assessment rate for some institutions, particularly small institutions, is somewhat limited for several reasons.[75] First, Call Reports and TFRs do not provide complete disclosure of several important determinants of loss given failure, such as secured liabilities, loan collateral requirements and the maturity structure of assets and liabilities. Second, as the FDIC explained in the NPR, at present it is not always clear which assumptions regarding loss given failure are most appropriate.[76]

Thus, as the NPR noted, the FDIC is using an alternative to expected loss pricing to differentiate risk and set assessment rates. The FDIC hopes to refine its treatment of loss given failure (and expected loss pricing) in the future. As part of any refinement, the FDIC plans to consider whether, for example, to factor the composition of liabilities into loss given failure.

One comment also argued that the proposed risk differentiation and pricing system is unfair because institutions are assessed on deposits that are not insured, which ''results in institutions with larger-than-average uninsured deposits (as a fraction of total deposits) subsidizing other institutions.'' This argument is inconsistent with studies that show that, as an institution approaches failure, uninsured deposits tend to be replaced by insured deposits and secured liabilities, which increases the FDIC's

[75] Another comment illustrated the loss given failure problem by noting that the FDIC would suffer lower losses, all else equal, at an institution that relied more on non-deposit borrowing relative to one that relied on deposits. However, the FDIC would collect lower assessment revenue from an institution that used non-deposit borrowing, because only deposits are included in the assessment base. In addition, the comment assumes that, between the time the FDIC assesses an institution and the time it fails, the institution's liability structure will not change. As discussed later in the text, this is usually not the case. As an institution approaches failure, insured deposit liabilities and secured liabilities tend to become a larger percentage of an institution's liabilities.

[76] Rosalind L. Bennett, ''Evaluating the Adequacy of the Deposit Insurance Fund: A Credit-Risk Modeling Approach,'' FDIC *Working Paper Series* 2001–02.

loss given failure.[77] Restricting the assessment base in this manner would reduce the assessment system's ability to take into account loss given failure.

Guidance on Disclosure

Some comments expressed concern over potential disclosure of an institution's assessment rate or amount, and changes to that rate or amount, through which third parties could determine an institution's confidential CAMELS component ratings. Concern also was expressed that disclosure of an institution's assessment rate or amount could create funding problems for an institution. Finally, the question was raised whether an institution can disclose its assessment rate because an element of that rate is examination ratings.

Assessment rates remain confidential and cannot be disclosed directly, except to the extent required by law. However, the proposed assessment system, similar to the current system, is based in part on publicly available information. Even under the current system, it is possible to estimate an institution's composite CAMELS rating using publicly available information. Under the proposed system it may be possible to estimate component or composite ratings or assessment rates. The additional information that could be determined under the new assessment system should not materially affect an institution's funding costs compared to the current system.

X. 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. The FDIC invited comments on how to make this proposal easier to understand, but received none.

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 proposal and publish the analysis for comment. See 5 U.S.C. 603, 604, 605. 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. 5 U.S.C. 601. The final rule governs assessments and sets the rates imposed on insured depository institutions for deposit insurance. Consequently, no regulatory flexibility analysis is required. Nonetheless, the FDIC voluntarily undertook a regulatory flexibility analysis to aid the public in commenting upon the small business impact of its proposed rule. The initial regulatory flexibility analysis was published in the **Federal Register** (71 FR 60674) on October 16, 2006. Public comment was invited and the comment period closed on October 26, 2006. The FDIC received no comments on the Initial Regulatory Flexibility Act analysis.

In its analysis, the FDIC used data as of December 31, 2005, and calculated the total assessments that would be collected under the base rate schedule in the final rule. The economic impact on each small institution for RFA purposes (i.e., institutions with assets of $165 million or less) was then calculated as the difference in annual assessments under the base rate schedule compared to the prior rule as a percentage of the institution's annual revenue and annual profits, assuming the same total assessments collected by the FDIC from the banking industry.

Based on the December 2005 data, under the final base rate schedule, for more than 99 percent of small institutions (as defined for RFA purposes), the change in the assessment system would result in assessment changes (up or down) totaling one percent or less of annual revenue.[78] Of the total of 5,362 small institutions for RFA purposes, just 10 would have experienced an increase or decrease equal to 2 percent or greater of their total revenue. These figures do not reflect a significant economic impact on revenues for a substantial number of small insured institutions.

The FDIC performed a similar analysis to determine the impact on profits for small (again, as defined for RFA purposes) institutions. Based on December 2005 data, under the final base rate schedule, 85 percent of the small institutions (as defined for RFA purposes) with reported profits would have experienced an increase or decrease in their annual profits of one percent or less.[79–81] The data indicate that, out of those small institutions, as defined for RFA purposes, with reported profits, just 4 percent would have experienced an increase or decrease in their total profits of 3 percent or greater. Again, these figures do not reflect a significant economic impact on profits for a substantial number of small (as defined for RFA purposes) insured institutions.

The FDIC analyzed the effect of the proposal on these institutions that showed no profit or loss by determining the annual assessment change (either an increase or a decrease) that would result. The analysis showed that 56 percent (224) of the 399 small insured institutions in this category would have experienced a change (increase or decrease) in annual assessments of $5,000 or less. Of the remainder, 3 percent (12) would have experienced assessment changes (increases or decreases) of $20,000 or more.

The final rule makes only minor modifications to the way assessment rates are calculated for small institutions (although the final rule does set assessment rates higher than the base rates). Again assuming that the same assessment revenue would be collected under the old system as under the final rule, these modifications have a minimal effect on almost all small institutions. The effect of the final rule on a small institution's annualized profit and revenue as of June 30, 2006 is nearly identical to the effect shown under the proposal.

The final rule does not directly impose any ''reporting'' or ''recordkeeping'' requirements within the meaning of the Paperwork Reduction Act. The compliance requirements for the final rule do not exceed existing compliance requirements for the present system of FDIC deposit insurance assessments, which, in any event, are governed by separate regulations. The FDIC is unaware of any duplicative, overlapping or conflicting Federal rules. Accordingly, the FDIC certifies that the final rule will not have a significant economic impact on a substantial number of small institutions for purposes of the RFA.

[77] See, *e.g.*, Lawrence G. Goldberg and Sylvia Hudgins, ''Response of Uninsured Depositors to Impending S&L Failures: Evidence of Depositor Discipline,'' *Quarterly Review of Economics and Finance* 36, no. 3 (1996), 311–325; Andrew Davenport and Kathleen McDill, ''The Depositor behind the Discipline: A Micro-Level Case Study of Hamilton Bank,'' *Journal of Financial Services Research* 30: 93–109 (2006).

[78] For about half of the small institutions analyzed, the change reflected an assessment decrease and a revenue increase.

[79–81] For about half of the small institutions analyzed, the change reflected an assessment decrease and a profit increase.

C. Paperwork Reduction Act

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

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

The FDIC has determined that the final 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 (Public Law 105–277, 112 Stat. 2681).

E. Small Business Regulatory Enforcement Fairness Act

The Office of Management and Budget has determined that the final rule is not a ''major rule'' within the meaning of the relevant sections of the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA) (5 U.S.C. 801 *et seq.*). As required by SBREFA, the FDIC will file the appropriate reports with Congress and the Government Accountability Office so that the final rule may be reviewed.

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 hereby amends chapter III of title 12 of the Code of Federal Regulations as follows:

PART 327—ASSESSMENTS

■ 1. The authority citation for part 327 continues to read as follows:

Authority: 12 U.S.C. 1441, 1813, 1815, 1817–1819, 1821; Sec. 2101–2109, Pub. L. 109–171, 120 Stat. 9–21, and Sec. 3, Pub. L. 109–173, 119 Stat. 3605.

■ 2. Revise §§ 327.9 and 327.10 of Subpart A to read as follows:

§ 327.9 Assessment risk categories and pricing methods.

(a) *Risk Categories.* Each insured depository institution shall be assigned to one of the following four Risk Categories based upon the institution's capital evaluation and supervisory evaluation as defined in this section.

(1) *Risk Category I.* All institutions in Supervisory Group A that are Well Capitalized;

(2) *Risk Category II.* All institutions in Supervisory Group A that are Adequately Capitalized, and all institutions in Supervisory Group B that are either Well Capitalized or Adequately Capitalized;

(3) *Risk Category III.* All institutions in Supervisory Groups A and B that are Undercapitalized, and all institutions in Supervisory Group C that are Well Capitalized or Adequately Capitalized; and

(4) *Risk Category IV.* All institutions in Supervisory Group C that are Undercapitalized.

(b) *Capital evaluations.* An institution will receive one of the following three capital evaluations on the basis of data reported in the institution's Consolidated Reports of Condition and Income, Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks, or Thrift Financial Report dated as of March 31 for the assessment period beginning the preceding January 1; dated as of June 30 for the assessment period beginning the preceding April 1; dated as of September 30 for the assessment period beginning the preceding July 1; and dated as of December 31 for the assessment period beginning the preceding October 1.

(1) *Well Capitalized.* (i) Except as provided in paragraph (b)(1)(ii) of this section, a Well Capitalized institution is one that satisfies each of the following capital ratio standards: Total risk-based ratio, 10.0 percent or greater; Tier 1 risk-based ratio, 6.0 percent or greater; and Tier 1 leverage ratio, 5.0 percent or greater.

(ii) For purposes of this section, an insured branch of a foreign bank will be deemed to be Well Capitalized if the insured branch:

(A) Maintains the pledge of assets required under § 347.209 of this chapter; and

(B) Maintains the eligible assets prescribed under § 347.210 of this chapter at 108 percent or more of the average book value of the insured branch's third-party liabilities for the quarter ending on the report date specified in paragraph (b) of this section.

(2) *Adequately Capitalized.* (i) Except as provided in paragraph (b)(2)(ii) of this section, an Adequately Capitalized institution is one that does not satisfy the standards of Well Capitalized under this paragraph but satisfies each of the following capital ratio standards: Total risk-based ratio, 8.0 percent or greater; Tier 1 risk-based ratio, 4.0 percent or greater; and Tier 1 leverage ratio, 4.0 percent or greater.

(ii) For purposes of this section, an insured branch of a foreign bank will be deemed to be Adequately Capitalized if the insured branch:

(A) Maintains the pledge of assets required under § 347.209 of this chapter; and

(B) Maintains the eligible assets prescribed under § 347.210 of this chapter at 106 percent or more of the average book value of the insured branch's third-party liabilities for the quarter ending on the report date specified in paragraph (b) of this section; and

(C) Does not meet the definition of a Well Capitalized insured branch of a foreign bank.

(3) *Undercapitalized.* An undercapitalized institution is one that does not qualify as either Well Capitalized or Adequately Capitalized under paragraphs (b)(1) and (b)(2) of this section.

(c) *Supervisory evaluations.* Each institution will be assigned to one of three Supervisory Groups based on the Corporation's consideration of supervisory evaluations provided by the institution's primary federal regulator. The supervisory evaluations include the results of examination findings by the primary federal regulator, as well as other information that the primary federal regulator determines to be relevant. In addition, the Corporation will take into consideration such other information (such as state examination findings, if appropriate) as it determines to be relevant to the institution's financial condition and the risk posed to the Deposit Insurance Fund. The three Supervisory Groups are:

(1) *Supervisory Group ''A.''* This Supervisory Group consists of financially sound institutions with only a few minor weaknesses;

(2) *Supervisory Group ''B.''* This Supervisory Group consists of institutions that demonstrate weaknesses which, if not corrected, could result in significant deterioration of the institution and increased risk of loss to the Deposit Insurance Fund; and

(3) *Supervisory Group ''C.''* This Supervisory Group consists of institutions that pose a substantial probability of loss to the Deposit Insurance Fund unless effective corrective action is taken.

(d) *Determining Assessment Rates for Risk Category I Institutions.* Subject to paragraphs (d)(4), (6), (7) and (8) of this section, an insured depository institution in Risk Category I, except for a large institution that has at least one long-term debt issuer rating, as defined in § 327.8(i), shall have its assessment rate determined using the supervisory ratings and financial ratios method set forth in paragraph (d)(1) of this section. A large insured depository institution in Risk Category I that has at least one

long-term debt issuer rating shall have its assessment rate determined using the supervisory and debt ratings method set forth in paragraph (d)(2) of this section (subject to paragraphs (d)(4), (6), (7) and (8) of this section). The assessment rate for a large institution whose assessment rate in the prior quarter was determined using the supervisory and debt ratings method, but which no longer has a long-term debt issuer rating, shall be determined using the supervisory ratings and financial ratios method.

(1) *Supervisory ratings and financial ratios method.* Under the supervisory ratings and financial ratios method for Risk Category I institutions, each of five financial ratios and a weighted average of CAMELS component ratings will be multiplied by a corresponding pricing multiplier. The sum of these products will be added to or subtracted from a uniform amount. The resulting sum, subject to adjustment pursuant to paragraph (d)(4) of this section, if appropriate, and adjusted for the actual assessment rates set by the Board under § 327.10, will equal an institution's assessment rate; provided, however, that no institution's assessment rate will be less than the minimum rate in effect for Risk Category I institutions for that quarter nor greater than the maximum rate in effect for Risk Category I institutions for that quarter. The five financial ratios are: Tier 1 Leverage Ratio; Loans past due 30–89 days/gross assets; Nonperforming assets/gross assets; Net loan charge-offs/gross assets; and Net income before taxes/risk-weighted assets. The ratios are defined in Table A.1 of Appendix A to this subpart. The ratios will be determined for an assessment period based upon information contained in an institution's report of condition filed as of the last day of the assessment period as set out in § 327.9(b). The weighted average of CAMELS component ratings is created by multiplying each component by the following percentages and adding the products: Capital adequacy—25%, Asset quality—20%, Management—25%, Earnings—10%, Liquidity—10%, and Sensitivity to market risk—10%. Appendix A to this subpart contains the initial values of the pricing multipliers and uniform amount, describes their derivation, and explains how they will be periodically updated.

(i) *Publication of uniform amount and pricing multipliers.* The FDIC will publish notice in the **Federal Register** whenever a change is made to the uniform amount or the pricing multipliers for the supervisory ratings and financial ratios method.

(ii) *Implementation of CAMELS rating changes*—(A) *Changes between risk categories.* If, during a quarter, a CAMELS rating change occurs that results in an institution whose Risk Category I assessment rate is determined using the supervisory ratings and financial ratios method moving from Risk Category I to Risk Category II, III or IV, the institution's assessment rate for the portion of the quarter that it was in Risk Category I shall be determined using the CAMELS rating in effect before the change, subject to adjustment pursuant to paragraph (d)(4) of this section, if appropriate, and adjusted for the actual assessment rates set by the Board under § 327.10. For the portion of the quarter that the institution was not in Risk Category I, the institution's assessment rate shall be determined under the assessment schedule for the appropriate Risk Category. If, during a quarter, a CAMELS rating change occurs that results in an institution (other than a large institution that has at least one long-term debt issuer rating) moving from Risk Category II, III or IV to Risk Category I, the institution's assessment rate for the portion of the quarter that it was in Risk Category I shall be determined using the supervisory ratings and financial ratios method, subject to adjustment pursuant to paragraph (d)(4) of this section, if appropriate, and adjusted for the actual assessment rates set by the Board under § 327.10. For the portion of the quarter that the institution was not in Risk Category I, the institution's assessment rate shall be determined under the assessment schedule for the appropriate Risk Category.

(B) *Changes within Risk Category I.* If, during a quarter, an institution's CAMELS component ratings change in a way that would change the institution's assessment rate within Risk Category I, the assessment rate for the period before the change shall be determined under the supervisory ratings and financial ratios method using the CAMELS component ratings in effect before the change. Beginning on the date of the CAMELS component ratings change, the assessment rate for the remainder of the quarter shall be determined using the CAMELS component ratings in effect after the change.

(2) *Supervisory and debt ratings method.* A large insured depository institution in Risk Category I that has at least one long-term debt issuer rating shall have its assessment rate determined using the supervisory and debt ratings method (subject to paragraphs (d)(4) through (8) of this section). Its CAMELS component ratings will be weighted to derive a weighted average CAMELS rating using the same weights applied in the supervisory ratings and financial ratios method as set forth under paragraph (d)(1) of this section. Long-term debt issuer ratings will be converted to numerical values between 1 and 3 as provided in Appendix B to this subpart and the converted values will be averaged. The weighted average CAMELS rating and the average of converted long-term debt issuer ratings each will be multiplied by 1.176 (which shall be the pricing multiplier), and the products will be summed. To this result will be added −1.882 (which shall be a uniform amount for all institutions subject to the supervisory and debt ratings method). The resulting sum, subject to adjustment pursuant to paragraph (d)(4) of this section, if appropriate, and adjusted for the actual assessment rates set by the Board pursuant to § 327.10, will equal an institution's assessment rate; provided, however, that no institution's assessment rate will be less than the minimum rate in effect for Risk Category I institutions for that quarter nor greater than the maximum rate in effect for Risk Category I institutions for that quarter.

(3) *Assessment rate for insured branches of foreign banks*—(i) *Insured branches of foreign banks in Risk Category I.* Insured branches of foreign banks in Risk Category I shall be assessed using the weighted average ROCA component rating, as determined under paragraph (d)(3)(ii) of this section.

(ii) *Weighted average ROCA component rating.* The weighted average ROCA component rating shall equal the sum of the products that result from multiplying ROCA component ratings by the following percentages: Risk Management—35%, Operational Controls—25%, Compliance—25%, and Asset Quality—15%. The weighted average ROCA rating will be multiplied by 2.353 (which shall be the pricing multiplier). To this result will be added −1.882 (which shall be a uniform amount for all insured branches of foreign banks). The resulting sum, subject to adjustment pursuant to paragraph (d)(4) of this section and adjusted for assessment rates set by the FDIC pursuant to § 327.10(b), will equal an institution's assessment rate; provided, however, that no institution's assessment rate will be less than the minimum rate in effect for Risk Category I institutions for that quarter nor greater than the maximum rate in effect for Risk Category I institutions for that quarter.

(4) *Adjustments to the initial risk assignment for large banks or insured branches of foreign banks*—(i) *Basis for and size of adjustment.* Within Risk

Category I, large institutions and insured branches of foreign banks are subject to risk assignment adjustment. In determining whether to make an adjustment for a large institution or an insured branch of a foreign bank, the FDIC may consider other relevant information in addition to the factors used to derive the risk assignment under paragraphs (d)(1), (2), or (3) of this section. Relevant information includes financial performance and condition information, other market information, and stress considerations, as described in Appendix C to this subpart. Any such adjustment shall be limited to a change in assessment rate of up to 0.5 basis points higher or lower than the rate determined using the supervisory ratings and financial ratios method, the supervisory and debt ratings method, or the weighted average ROCA component rating method, whichever is applicable.

(ii) *Adjustment subject to maximum and minimum rates.* No rate will be adjusted below the minimum rate or above the maximum rate for Risk Category I institutions in effect for the quarter.

(iii) *Prior notice of adjustments*—(A) *Prior notice of upward adjustment.* Prior to making any upward adjustment to an institution's rate because of considerations of additional risk information, the FDIC will formally notify the institution and its primary federal regulator and provide an opportunity to respond. This notification will include the reasons for the adjustment and when the adjustment will take effect.

(B) *Prior notice of downward adjustment.* Prior to making any downward adjustment to an institution's rate because of considerations of additional risk information, the FDIC will formally notify the institution's primary federal regulator and provide an opportunity to respond.

(iv) *Determination whether to adjust upward; effective period of adjustment.* After considering an institution's and the primary federal regulator's responses to the notice, the FDIC will determine whether the adjustment to an institution's assessment rate is warranted, taking into account any revisions to weighted average CAMELS component ratings, long-term debt issuer ratings, and financial ratios, as well as any actions taken by the institution to address the FDIC's concerns described in the notice. The FDIC will evaluate the need for the adjustment each subsequent assessment period, until it determines that an adjustment is no longer warranted. The amount of adjustment will in no event be larger than that contained in the initial notice without further notice to, and consideration of, responses from the primary federal regulator and the institution.

(v) *Determination whether to adjust downward; effective period of adjustment.* After considering the primary federal regulator's responses to the notice, the FDIC will determine whether the adjustment to an institution's assessment rate is warranted, taking into account any revisions to weighted average CAMELS component ratings, long-term debt issuer ratings, and financial ratios, as well as any actions taken by the institution to address the FDIC's concerns described in the notice. Any downward adjustment in an institution's assessment rate will remain in effect for subsequent assessment periods until the FDIC determines that an adjustment is no longer warranted. Downward adjustments will be made without notification to the institution. However, the FDIC will provide advance notice to an institution and its primary federal regulator and give them an opportunity to respond before removing a downward adjustment.

(vi) *Adjustment without notice.* Notwithstanding the notice provisions set forth above, the FDIC may change an institution's assessment rate without advance notice under this paragraph, if the institution's supervisory or agency ratings or the financial ratios set forth in Appendix A to this subpart (for an institution without long-term debt issuer ratings) deteriorate.

(5) *Implementation of Supervisory and Long-Term Debt Issuer Rating Changes*—(i) *Changes between risk categories.* If, during a quarter, a CAMELS rating change occurs that results in an institution whose Risk Category I assessment rate is determined using the supervisory and debt ratings method or an insured branch of a foreign bank moving from Risk Category I to Risk Category II, III or IV, the institution's assessment rate for the portion of the quarter that it was in Risk Category I shall be based upon its assessment rate for the prior quarter; no new Risk Category I assessment rate will be developed for the quarter in which the institution moved to Risk Category II, III or IV. If, during a quarter, a CAMELS rating change occurs that results in a large institution with a long-term debt issuer rating or an insured branch of a foreign bank moving from Risk Category II, III or IV to Risk Category I, the institution's assessment rate for the portion of the quarter that it was in Risk Category I shall equal the rate determined under paragraphs (d)(2) and (4) or (d)(3) and (4) of this section, as appropriate.

(ii) *Changes within Risk Category I.* If, during a quarter, an institution whose Risk Category I assessment rate is determined using the supervisory and debt ratings method remains in Risk Category I, but a CAMELS component or a long-term debt issuer rating changes that would affect the institution's assessment rate, or if, during a quarter, an insured branch of a foreign bank remains in Risk Category I, but a ROCA component rating changes that would affect the institution's assessment rate, separate assessment rates for the portion(s) of the quarter before and after the change(s) shall be determined under paragraphs (d)(2) and (4) or (d)(3) and (4) of this section, as appropriate.

(6) *Request to be treated as a large institution*—(i) *Procedure.* Any institution in Risk Category I with assets of between $5 billion and $10 billion may request that the FDIC determine its assessment rate as a large institution. The FDIC will grant such a request if it determines that it has sufficient information to do so. The absence of long-term debt issuer ratings alone will not preclude the FDIC from granting a request. The assessment rate for an institution without a long-term debt issuer rating will be derived using the supervisory ratings and financial ratios method, but will be subject to adjustment. Any such request must be made to the FDIC's Division of Insurance and Research. Any approved change will become effective within one year from the date of the request. If an institution whose request has been granted subsequently reports assets of less than $5 billion in its report of condition for four consecutive quarters, the FDIC will consider such institution to be a small institution subject to the supervisory ratings and financial ratios method. An institution that disagrees with the FDIC's determination that it is a large or small institution may request review of that determination pursuant to § 327.4(c).

(ii) *Time limit on subsequent request for alternate method.* An institution whose request to be assessed as a large institution is granted by the FDIC shall not be eligible to request that it be assessed as a small institution for a period of three years from the first quarter in which its approved request to be assessed as a large bank became effective. Any request to be assessed as a small institution must be made to the FDIC's Division of Insurance and Research.

(7) *New and established institutions and exceptions*—(i) *New Risk Category I institutions*—(A) *Rule as of January 1,*

2010. Effective for assessment periods beginning on or after January 1, 2010, a new institution shall be assessed the Risk Category I maximum rate for the relevant assessment period, except as provided in paragraphs (d)(7)(ii)–(viii) of this section.

(B) *Rule prior to January 1, 2010.* Prior to January 1, 2010, a new institution's risk assignment shall be determined under paragraph (d)(1) or (2) of this section, as appropriate. Prior to January 1, 2010, a Risk Category I institution that has no CAMELS component ratings shall be assessed at one basis point above the minimum rate applicable to Risk Category I institutions until it receives CAMELS component ratings. If an institution has less than $10 billion in assets or has at least $10 billion in assets and no long-term debt issuer rating, its assessment rate will be determined under the supervisory ratings and financial ratios method once it receives CAMELS component ratings. The assessment rate will be determined by annualizing, where appropriate, financial ratios obtained from the reports of condition that have been filed, until the earlier of the following two events occurs: the institution files four reports of condition, or, if it has at least $10 billion in assets, it receives a long-term debt issuer rating.

(ii) *Merger or consolidation involving new and established institution(s).* Subject to paragraphs (d)(7)(iii)–(viii) of this section, when an established institution merges into or consolidates with a new institution, the resulting institution is a new institution unless:

(A) The assets of the established institution, as reported in its report of condition for the quarter ending immediately before the merger, exceeded the assets of the new institution, as reported in its report of condition for the quarter ending immediately before the merger; and

(B) Substantially all of the management of the established institution continued as management of the resulting or surviving institution.

(iii) *Consolidation involving established institutions.* When established institutions consolidate into a new institution, the resulting institution is an established institution.

(iv) *Grandfather exception.* If a new institution merges into an established institution, and the merger agreement was entered into on or before July 11, 2006, the resulting institution shall be deemed to be an established institution for purposes of this section.

(v) *Subsidiary exception.* Subject to paragraph (d)(7)(vi) of this section, a new institution will be considered established if it is a wholly owned subsidiary of:

(A) A company that is a bank holding company under the Bank Holding Company Act of 1956 or a savings and loan holding company under the Home Owners' Loan Act, and:

(*1*) At least one eligible depository institution (as defined in 12 CFR 303.2(r)) that is owned by the holding company has been chartered as a bank or savings association for at least five years as of the date that the otherwise new institution was established; and

(*2*) The holding company has a composite rating of at least ''2'' for bank holding companies or an above average or ''A'' rating for savings association holding companies and at least 75 percent of its insured depository institution assets are assets of eligible depository institutions, as defined in 12 CFR 303.2(r); or

(B) An eligible depository institution, as defined in 12 CFR 303.2(r), that has been chartered as a bank or savings association for at least five years as of the date that the otherwise new institution was established.

(vi) *Effect of credit union conversion.* In determining whether an insured depository institution is new or established, as those terms are defined in § 327.8, the FDIC will include any period of time that the institution was a federally insured credit union.

(vii) *CAMELS ratings for the surviving institution in a merger or consolidation.* When an established institution merges with or consolidates into a new institution, if the FDIC determines the resulting institution to be an established institution under paragraph (d)(ii) of this section, its CAMELS ratings will be based upon the established institution's ratings prior to the merger or consolidation until new ratings become available.

(viii) *Rate applicable to institutions subject to subsidiary or credit union exception.* On or after January 1, 2010, if an institution is considered established under paragraph (d)(7)(v) or (vi) of this section, but does not have CAMELS component ratings, it shall be assessed at one basis point above the minimum rate applicable to Risk Category I institutions until it receives CAMELS component ratings. If an institution has less than $10 billion in assets or has at least $10 billion in assets and no long-term debt issuer rating, its assessment rate will be determined under the supervisory ratings and financial ratios method once it receives CAMELS component ratings. The assessment rate will be determined by annualizing, where appropriate, financial ratios obtained from all reports of condition that have been filed, until the earlier of the following two events occurs: the institution files four reports of condition, or, if it has at least $10 billion in assets, it receives a long-term debt issuer rating.

(ix) *Request for review.* An institution that disagrees with the FDIC's determination that it is a new institution may request review of that determination pursuant to § 327.4(c).

(8) *Assessment rates for bridge banks and conservatorships.* Institutions that are bridge banks under 12 U.S.C. 1821(n) and institutions for which the Corporation has been appointed or serves as conservator shall, in all cases, be assessed at the Risk Category I minimum rate.

§ 327.10 Assessment rate schedules.

(a) *Base Assessment Schedule.* The base annual assessment rate for an insured depository institution shall be the rate prescribed in the following schedule:

TABLE 1 TO PARAGRAPH (a)

	Risk Category				
	I*		II	III	IV
	Minimum	Maximum			
Annual Rates (in basis points)	2	4	7	25	40

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

(1) *Risk Category I Base Rate Schedule.* The base annual assessment rates for all institutions in Risk Category I shall range from 2 to 4 basis points.

(2) *Risk Category II, III, and IV Base Rate Schedule.* The base annual

assessment rates for Risk Categories II, III, and IV shall be 7, 25, and 40 basis points respectively.

(3) All institutions in any one risk category, other than Risk Category I, will be charged the same assessment rate.

(b) *Adjusted Rate Schedule.* Beginning on January 1, 2007, the adjusted annual assessment rate for an insured depository institution shall be the rate prescribed in the following schedule:

TABLE 1 TO PARAGRAPH (b)

	Risk Category				
	I*		II	III	IV
	Minimum	Maximum			
Annual Rates (in basis points)	5	7	10	28	43

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

(1) *Risk Category I Adjusted Rate Schedule.* The adjusted annual assessment rates for all institutions in Risk Category I shall range from 5 to 7 basis points.

(2) *Risk Category II, III, and IV Adjusted Rate Schedule.* The adjusted annual assessment rates for Risk Categories II, III, and IV shall be 10, 28, and 43 basis points respectively.

(3) All institutions in any one risk category, other than Risk Category I, will be charged the same assessment rate.

(c) *Rate schedule adjustments and procedures*—(1) *Adjustments.* The Board may increase or decrease the base assessment 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 base assessment schedule. In no case may such adjustments result in an assessment rate that is mathematically less than zero or in a rate schedule that, at any time, is more than 3 basis points above or below the base assessment schedule for the Deposit Insurance Fund, nor may any one such 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 schedule 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.

■ 3–4. Add Appendices A through C to subpart A to read as follows:

Appendix A to Subpart A

Method to Derive Pricing Multipliers and Uniform Amount

I. Introduction

The uniform amount and pricing multipliers are derived from:

- A model (the Statistical Model) that estimates the probability that a Risk Category I institution will be downgraded to a composite CAMELS rating of 3 or worse within one year;
- Minimum and maximum downgrade probability cutoff values, based on data from June 2006, that will determine which small institutions will be charged the minimum and maximum assessment rates in Risk Category I;
- The minimum base assessment rate for Risk Category I, equal to two basis points, and
- The maximum base assessment rate for Risk Category I, which is two basis points higher than the minimum rate.

II. The Statistical Model

The Statistical Model is defined in equation 1a below.

Equation 1a

$$\begin{aligned}\text{Downgrade}(0,1)_{i,t} = {} & \beta_0 + \beta_1(\text{Tier 1 leverage ratio}_{it}) \\ & + \beta_2(\text{Loans past due 30 to 89 days ratio}_{it}) \\ & + \beta_3(\text{Nonperforming asset ratio}_{it}) \\ & + \beta_4(\text{Net loan charge-off ratio}_{it}) \\ & + \beta_5(\text{Net income before taxes ratio}_{it}) \\ & + \beta_6(\text{Weighted average of the C, A, M, E and L component ratings}_{it})\end{aligned}$$

where $\text{Downgrade}(0,1)_{i,t}$ (the dependent variable—the event being explained) is the incidence of downgrade from a composite rating of 1 or 2 to a rating of 3 or worse during an on-site examination for an institution i between 3 and 12 months after time t. Time t is the end of a year within the multi-year period over which the model was estimated (as explained below). The

dependent variable takes a value of 1 if a downgrade occurs and 0 if it does not.

The explanatory variables (regressors) in the model are five financial ratios and a weighted average of the ''C,'' ''A,'' ''M,'' ''E'' and ''L'' component ratings. The five financial ratios included in the model are:

- Tier 1 leverage ratio
- Loans past due 30–89 days/Gross assets
- Nonperforming assets/Gross assets
- Net loan charge-offs/Gross assets
- Net income before taxes/Risk-weighted assets.

The financial ratios and the weighted average of the ''C,'' ''A,'' ''M,'' ''E'' and ''L'' component ratings (collectively, the regressors) are defined in Table A.1. The component rating for sensitivity to market risk (the ''S'' rating) is not available for years prior to 1997. As a result, and as described in Table A.1, the Statistical Model is estimated using a weighted average of five component ratings excluding the ''S'' component. In addition, delinquency and non-accrual data on government guaranteed loans are not available before 1993 for Call Report filers and before the third quarter of 2005 for TFR filers. As a result, and as also described in Table A.1, the Statistical Model is estimated without deducting delinquent or past-due government guaranteed loans from either the loans past due 30–89 days to gross assets ratio or the nonperforming assets to gross assets ratio.

TABLE A.1.—DEFINITIONS OF REGRESSORS

Regressor	*Description*
Tier 1 Leverage Ratio (%)	Tier 1 capital for Prompt Corrective Action (PCA) divided by adjusted average assets based on the definition for prompt corrective action
Loans Past Due 30–89 Days/Gross Assets (%)	Total loans and lease financing receivables past due 30 through 89 days and still accruing interest divided by gross assets (gross assets equal total assets plus allowance for loan and lease financing receivable losses and allocated transfer risk)
Nonperforming Assets/Gross Assets (%)	Sum of total loans and lease financing receivables past due 90 or more days and still accruing interest, total nonaccrual loans and lease financing receivables, and other real estate owned divided by gross assets
Net Loan Charge-Offs/Gross Assets (%)	Total charged-off loans and lease financing receivables debited to the allowance for loan and lease losses less total recoveries credited to the allowance to loan and lease losses for the most recent twelve months divided by gross assets
Net Income before Taxes/Risk-Weighted Assets (%)	Income before income taxes and extraordinary items and other adjustments for the most recent twelve months divided by risk-weighted assets
Weighted Average of C, A, M, E and L Component Ratings	The weighted sum of the ''C,'' ''A,'' ''M,'' ''E'' and ''L'' CAMELS components, with weights of 28 percent each for the ''C'' and ''M'' components, 22 percent for the ''A'' component, and 11 percent each for the ''E'' and ''L'' components. (For the regression, the ''S'' component is omitted.)

The financial ratio regressors used to estimate the downgrade probabilities are obtained from quarterly reports of condition (Reports of Condition and Income and Thrift Financial Reports). The weighted average of the ''C,'' ''A,'' ''M,'' ''E'' and ''L'' component ratings regressor is based on component ratings obtained from the most recent bank examination conducted within 24 months before the date of the report of condition.

The Statistical Model uses ordinary least squares (OLS) regression to estimate downgrade probabilities. The model is estimated with data from a multi-year period (as explained below) for all institutions in Risk Category I, except for institutions established within five years before the date of the report of condition.

The OLS regression estimates coefficients, β_j, for a given regressor j and a constant amount, β_0, as specified in equation 1a. As shown in equation 1b below, these coefficients are multiplied by values of risk measures at time T, which is the date of the report of condition corresponding to the end of the quarter for which the assessment rate is computed. The sum of the products is then added to the constant amount to produce an estimated probability, $d_{i,T}$, that an institution will be downgraded to 3 or worse within 3 to 12 months from time T.

The risk measures are financial ratios as defined in Table A.1, except that the loans past due 30 to 89 days ratio and the nonperforming asset ratio are adjusted to exclude the maximum amount recoverable from the U.S. Government, its agencies or government-sponsored agencies, under guarantee or insurance provisions. Also, the weighted sum of six CAMELS component ratings is used, with weights of 25 percent each for the ''C'' and ''M'' components, 20 percent for the ''A'' component, and 10 percent each for the ''E,'' ''L,'' and ''S'' components.

Equation 1b

$$\begin{aligned} d_{iT} = {} & \beta_0 + \beta_1 \left(\text{Tier 1 leverage ratio}_{iT}\right) \\ & + \beta_2 \left(\text{Loans past due 30 to 89 days ratio}_{iT}\right) \\ & + \beta_3 \left(\text{Nonperforming asset ratio}_{iT}\right) \\ & + \beta_4 \left(\text{Net loan charge-off ratio}_{iT}\right) \\ & + \beta_5 \left(\text{Net income before taxes ratio}_{iT}\right) \\ & + \beta_6 \left(\text{Weighted average of CAMELS component ratings}_{iT}\right) \end{aligned}$$

III. Minimum and maximum downgrade probability cutoff values

The pricing multipliers are also determined by minimum and maximum downgrade probability cutoff values, which will be computed as follows:

- The minimum downgrade probability cutoff value will be the maximum downgrade probability among the forty-five percent of all small insured institutions in Risk Category I (excluding new institutions) with the lowest estimated downgrade probabilities, computed using values of the risk measures as of June 30, 2006.[1] The minimum downgrade probability cutoff value is approximately 2 percent.
- The maximum downgrade probability cutoff value will be the minimum downgrade probability among the five percent of all small insured institutions in Risk Category I (excluding new institutions) with the highest estimated downgrade probabilities, computed using values of the risk measures as of June 30, 2006.[2] The maximum downgrade probability cutoff value is approximately 14 percent.

IV. Derivation of uniform amount and pricing multipliers

The uniform amount and pricing multipliers used to compute the annual base assessment rate in basis points, P_{iT}, for any such institution i at a given time T will be determined from the Statistical Model, the minimum and maximum downgrade probability cutoff values, and minimum and maximum base assessment rates in Risk Category I as follows:

Equation 2

$$P_{iT} = \alpha_0 + \alpha_1 * d_{iT}, \text{ subject to } 2 \le P_{iT} \le 4$$

where α_0 and α_1 are a constant term and a scale factor used to convert d_{iT} (the estimated downgrade probability for institution i at a given time T from the Statistical Model) to an assessment rate, respectively. The numbers 2 and 4 in the restriction to equation 2 are the minimum base assessment rate and maximum base assessment rate, respectively, and they are expressed in basis points.

(P_{iT} is expressed as an annual rate, but the actual rate applied in any quarter will be $\frac{P_{iT}}{4}$.)

Solving equation 2 for minimum and maximum base assessment rates simultaneously, ($2 = \alpha_0 + \alpha_1 * 0.02$ and $4 = \alpha_0 + \alpha_1 * 0.14$), where 0.02 is the minimum downgrade probability cutoff value and 0.14 is the maximum downgrade probability cutoff value, results in values for the constant amount, α_0, and the scale factor, α_1:

Equation 3

$$\alpha_0 = 2 - \frac{2 * 0.02}{(0.14 - 0.02)} = 1.67 \text{ and}$$

Equation 4

$$\alpha_i = \frac{2}{(0.14 - 0.02)} = 16.67$$

Substituting equations 1b, 3 and 4 into equation 2 produces an annual base assessment rate for institution i at time T, P_{iT}, in terms of the uniform amount, the pricing multipliers and the ratios and weighted average CAMELS component rating referred to in 12 CFR 327.9(d)(2)(i):

Equation 5

$$\begin{aligned} P_{iT} = {} & [1.67 + 16.67 * \beta_0] + 16.67 * [\beta_1 (\text{Tier 1 Leverage Ratio}_T)] + \\ & 16.67 * [\beta_2 (\text{Loans past due 30 to 89 days ratio}_T)] + 16.67 * [\beta_3 (\text{Nonperforming asset ratio}_T)] + \\ & 16.67 * [\beta_4 (\text{Net loan charge} - \text{off ratio}_T)] + 16.67 * [\beta_5 (\text{Net income before taxes ratio}_T)] + \\ & 16.67 * [\beta_7 (\text{Weighted average CAMELS component rating}_T)] \end{aligned}$$

again subject to $2 \le P_{iT} \le 4$

where $1.67+16.67*\beta_0$ equals the uniform amount, $16.67*\beta_j$ is a pricing multiplier for the associated risk measure j, and T is the date of the report of condition corresponding to the end of the quarter for which the assessment rate is computed.

V. Updating the Statistical Model, uniform amount, and pricing multipliers

The initial Statistical Model is estimated using year-end financial ratios and the weighted average of the ''C,'' ''A,'' ''M,'' ''E'' and ''L'' component ratings over the 1984 to 2004 period and downgrade data from the 1985 to 2005 period. The FDIC may, from time to time, but no more frequently than annually, re-estimate the Statistical Model with updated data and publish a new formula for determining assessment rates—equation 5—based on updated uniform amounts and pricing multipliers. However, the minimum and maximum downgrade probability cutoff values will not change without additional notice-and-comment rulemaking. The period covered by the analysis will be lengthened by one year each year; however, from time to time, the FDIC may drop some earlier years from its analysis.

Appendix B to Subpart A

NUMERICAL CONVERSION OF LONG-TERM DEBT ISSUER RATINGS

Current long-term debt issuer rating *	Converted value
Standard & Poor's	

[1] As used in this context, a ''new institution'' means an institution that has been chartered as a bank or thrift for less than five years.

[2] As used in this context, a ''new institution'' means an institution that has been chartered as a bank or thrift for less than five years.

NUMERICAL CONVERSION OF LONG-TERM DEBT ISSUER RATINGS—Continued

Current long-term debt issuer rating *	Converted value
AAA	1.00
AA+	1.05
AA	1.15
AA−	1.30
A+	1.50
A	1.80
A−	2.20
BBB+	2.70
BBB or worse	3.00
Moody's	
Aaa	1.00
Aa1	1.05

NUMERICAL CONVERSION OF LONG-TERM DEBT ISSUER RATINGS—Continued

Current long-term debt issuer rating *	Converted value
Aa2	1.15
Aa3	1.30
A1	1.50
A2	1.80
A3	2.20
Baa1	2.70
Baa2 or worse	3.00
Fitch's	
AAA	1.00
AA+	1.05
AA	1.15
AA−	1.30

NUMERICAL CONVERSION OF LONG-TERM DEBT ISSUER RATINGS—Continued

Current long-term debt issuer rating *	Converted value
A+	1.50
A	1.80
A−	2.20
BBB+	2.70
BBB or worse	3.00

* A current rating is defined as one that has been assigned or reviewed in the last 12 months. Stale ratings are not considered.

Appendix C to Subpart A

ADDITIONAL RISK CONSIDERATIONS FOR LARGE RISK CATEGORY I INSTITUTIONS

Information source	Examples of Associated Risk Indicators or Information
Financial Performance and Condition Information	*Capital Measures (Level and Trend)* • Regulatory capital ratios • Capital composition • Dividend payout ratios • Internal capital growth rates relative to asset growth *Profitability Measures (Level and Trend)* • Return on assets and return on risk-adjusted assets • Net interest margins, funding costs and volumes, earning asset yields and volumes • Noninterest revenue sources • Operating expenses • Loan loss provisions relative to problem loans • Historical volatility of various earnings sources *Asset Quality Measures (Level and Trend)* • Loan and securities portfolio composition and volume of higher risk lending activities (e.g., sub-prime lending) • Loan performance measures (past due, nonaccrual, classified and criticized, and renegotiated loans) and portfolio characteristics such as internal loan rating and credit score distributions, internal estimates of default, internal estimates of loss given default, and internal estimates of exposures in the event of default • Loan loss reserve trends • Loan growth and underwriting trends • Off-balance sheet credit exposure measures (unfunded loan commitments, securitization activities, counterparty derivatives exposures) and hedging activities *Liquidity and Funding Measures (Level and Trend)* • Composition of deposit and non-deposit funding sources • Liquid resources relative to short-term obligations, undisbursed credit lines, and contingent liabilities *Interest Rate Risk and Market Risk (Level and Trend)* • Maturity and repricing information on assets and liabilities, interest rate risk analyses • Trading book composition and Value-at-Risk information
Market Information	• Subordinated debt spreads • Credit default swap spreads • Parent's debt issuer ratings and equity price volatility • Market-based measures of default probabilities • Rating agency watch lists • Market analyst reports
Stress Considerations	*Ability to Withstand Stress Conditions* • Internal analyses of portfolio composition and risk concentrations, and vulnerabilities to changing economic and financial conditions • Stress scenario development and analyses • Results of stress tests or scenario analyses that show the degree of vulnerability to adverse economic, industry, market, and liquidity events. Examples include: i. an evaluation of credit portfolio performance under varying stress scenarios ii. an evaluation of non-credit business performance under varying stress scenarios. iii. an analysis of the ability of earnings and capital to absorb losses stemming from unanticipated adverse events • Contingency or emergency funding strategies and analyses • Capital adequacy assessments *Loss Severity Indicators* • Nature of and breadth of an institution's primary business lines and the degree of variability in valuations for firms with similar business lines or similar portfolios • Ability to identify and describe discrete business units within the banking legal entity • Funding structure considerations relating to the order of claims in the event of liquidation (including the extent of subordinated claims and priority claims) • Extent of insured institutions assets held in foreign units • Degree of reliance on affiliates and outsourcing for material mission-critical services, such as management information systems or loan servicing, and products • Availability of sufficient information, such as information on insured deposits and qualified financial contracts, to resolve an institution in an orderly and cost-efficient manner

By order of the Board of Directors.

Dated at Washington, D.C., this 2nd day of November, 2006.

Federal Deposit Insurance Corporation.

Robert E. Feldman,

Executive Secretary.

BILLING CODE 6714–01–P

Note: The following appendices will not appear in the Code of Federal Regulations.

Appendix 1

Uniform Amount and Pricing Multipliers for Large Risk Category I Institutions Where Long-Term Debt Issuer Ratings are Available

This appendix provides technical details of the derivation of the uniform amount and pricing multipliers used to determine annual assessment rates for large Risk Category I institutions that have long-term debt issuer ratings. These values are determined as follows.

Using information as of June 30, 2006 for large Risk Category I institutions with long-term debt issuer ratings, a score is computed by converting the long-term debt issuer rating into a numeric value ranging from 1 to 3, as described in Appendix B, multiplying the weighted average CAMELS rating and the numeric value of the long-term debt issuer rating by 0.50 each, and summing the resulting values. That is, score (S_i) equals:

Equation 1:

$$S_i = 0.50 * Weighted\ Average\ CAMELS\ Component\ Rating_i + 0.50 * Long\text{-}Term\ Debt\ Issuer\ Rating_i$$

The minimum and maximum score cut-off values are then determined based on data as of June 30, 2006 such that approximately 44 percent of large institutions with long-term debt issuer ratings that would have been in Risk Category I (other than institutions less than 5 years old) would have been charged the minimum assessment rate and approximately 6 percent of large institutions with long-term debt issuer ratings that would have been in Risk Category I (other than institutions less than 5 years old) would have been charged the maximum assessment rate.[82] The minimum score cut-off value is 1.65 and the maximum score cut-off value is 2.50.

When the score falls between the minimum and maximum score cut-off values, the assessment rate for an institution i (P_i) is calculated by dividing the difference between the score and the minimum score cut-off value by the difference between the maximum and minimum score cut-off value, multiplying the resulting value by the difference between the maximum assessment rate and the minimum base assessment rate, and adding the result to the minimum assessment rate. The maximum and minimum base assessment rates are 2 basis points and 4 basis points, respectively. That is, the assessment rate equals:

Equation 2:

[82] As used in this context, a "new institution" means an institution that has been chartered as a bank or thrift for less than five years.

$$P_i = 2 + \left(\frac{S_i - 1.65}{0.85} \right) * 2$$

Substituting equation 1 into equation 2 produces the following equation for P_i:

Equation 3:

$$P_i = 1.176 * Weighted\ Average\ CAMELS\ Component\ Rating_i + 1.176 * Long\text{-}Term\ Debt\ Issuer\ Rating_i - 1.882$$

where 1.176 is the pricing multiplier and -1.882 is the uniform amount.

Appendix 2

Uniform Amount and Pricing Multipliers for Insured Foreign Branches

This appendix provides technical details of the derivation of the uniform amount and pricing multipliers used to determine annual assessment rates for insured foreign branches (insured branches). These values are determined as follows.

The score for an insured branch in Risk Category I equals the weighted average ROCA rating as of June 30, 2006. That is, score (S_i) equals:

Equation 1:

$$S_i = Weighted\ Average\ ROCA\ Rating_i$$

As described in Appendix 1, the minimum score cut-off value is 1.65 and the maximum score cut-off is 2.50.

When S_i falls between the minimum and maximum score cut-off values, the assessment rate (P_i) for insured branches is calculated by dividing the difference between the score and the minimum score cut-off value by the difference between the maximum and minimum score cut-off value, multiplying the resulting value by the difference between the maximum assessment rate and the minimum base assessment rate, and adding the result to the minimum assessment rate. That is, the assessment rate equals:

Equation 2:

$$P_i = 2 + \left(\frac{S_i - 1.65}{0.85} \right) * 2$$

Substituting equation 1 into equation 2 produces the following equation for P_i:

Equation 3:

$$P_i = 2.353 * Weighted\ Average\ ROCA\ Rating_i - 1.882$$

where 2.353 is the pricing multiplier and -1.882 is the uniform amount.

Appendix 3

Analysis of the Projected Effects of the Payment of Assessments On the Capital and Earnings of Insured Depository Institutions

This analysis estimates the effect of an increase in the annual deposit insurance assessment rates for all insured institutions on their tangible equity capital and profitability based on the rate schedule adopted in this rule.

While an assessment rate increase would not take effect until 2007, the effect of the new rates is projected using June 2006 reports of condition, and rates are assumed to remain in effect for four quarters.[83] Furthermore, the analysis excludes the effect of any reduction in assessment costs from institutions' use of one-time credits authorized under the Reform Act, in order to evaluate the effect on earnings and capital once the one-time credits have been exhausted. For the majority of institutions, the availability of credits will significantly reduce or completely eliminate any effect of the new rate schedule on earnings and capital in the first year that the schedule is in effect.

While an increase in deposit insurance assessment rates will reduce institutions' profitability and capitalization, the reduction will not necessarily equal the full amount of the assessment increase. Two factors can reduce the effect of increased assessments on institutions' profits and capital. First, a portion of the assessment increase may be transferred to customers in the form of higher borrowing rates, increased service fees and lower deposit interest rates. Since information is not readily available on the extent to

[83] Institution earnings and capital are projected using the same methodology currently used by the FDIC in determining the contingent loss reserve for potential insured institution failures.

which institutions are able to share assessment costs with their customers, this analysis assumes that institutions bear the full after-tax cost of the assessment increase. Second, deposit insurance assessments are a tax-deductible operating expense; therefore, the increase in the assessment expense can be used to lower taxable income. This analysis considers the tax consequences of assessments and estimates the effective after-tax cost of assessments.[84]

Institutions' earnings retention and dividend policies also influence the extent to which increased assessments affect equity levels. If institutions maintain dividend levels, despite an increase in operating costs, equity (retained earnings) will decline by the full amount of the after-tax cost of the assessment. This analysis assumes that institutions' dividend rates remain unchanged from those reported in the June 30, 2006 reports of condition.

The analysis indicates that the effect on institution profitability and capital is very small. Industry tangible equity capital of insured institutions as of June 30, 2006, is approximately $793.4 billion. June 30, 2007 tangible equity capital is projected to equal $806.6 billion if the current assessment rates are maintained.[85] It would be $1.7 billion lower, i.e., $804.9 billion, under the adopted assessment rate schedule. The number of institutions projected to be undercapitalized by June 30, 2007 under the new rate schedule is unchanged from the number based on current assessment rates.[86]

---

[84] The analysis does not incorporate tax-loss carry-back (carry-forward).

[85] Under current assessment rates, approximately 95 percent of insured institutions are charged nothing for deposit insurance.

[86] Undercapitalized institutions are defined as institutions with projected tangible equity capitalization of less than 2 percent by March 31, 2007.

With an increase in assessment rates, the approximately $3.4 billion in additional assessment costs to insured institutions is projected to lead to $1.7 billion less in tangible capital and $0.8 billion less in dividends as of June 30, 2007, compared to amounts if current assessment rates applied. The remaining $0.9 billion in additional assessment costs are projected to be offset by the tax benefit of deducting assessment expenses.

The effect of higher assessments on institution income is measured by the percentage change in income before taxes and extraordinary items, gross of loan loss provisions, due to the assessment rate increase (hereafter, referred to as income). This income measure is used in order to eliminate the potentially transitory effects of loan losses, extraordinary items and taxes on profitability. Institutions' income is projected using June 30, 2006 year-to-date income, adjusted to reflect the increase in operating costs (pre-tax) that might result from the proposed assessment rate increase. The analysis indicates that the proposed increases in assessment rates will reduce institution income moderately.[87] Table 1.1 shows that approximately 76.3 percent of institutions, with 95.1 percent of insured institution assets, are projected to experience a 0 to 5 percent reduction in income. In addition, 12.5 percent of institutions, with 3.3 percent of aggregate assets, are projected to incur a 5 to 10 percent reduction in income.[88]

[87] Because assessments are tax deductible, the after-tax dollar effect on income should be smaller.

[88] In a separate analysis (not presented here), the economic effect of a smaller assessment rate increase – specifically, an increase only to the proposed base rates -- was also analyzed. If assessment rates were to increase to the proposed base rates, projected income for approximately 88 percent of banks would decline by only between 0 to 5 percent.

Table 1.1

Percentage Change in Income
Under the Rate Schedule Adopted in this Rule
(All FDIC-Insured Institutions, $Millions)

Percentage Change	Number	Percent	Assets	Percent
Below -50%	61	0.7	$8,108	0.1
-25% to -50%	86	1.0	29,587	0.3
-15% to -25%	125	1.4	24,119	0.2
-10% to -15%	228	2.6	63,876	0.6
-5% to -10%	1,091	12.4	384,871	3.3
0% to -5%	6,696	76.3	10,958,217	95.1
Missing	491	5.6	54,468	0.5

Notes:
(1) Income refers to income before taxes and extraordinary items, gross of loan loss provisions.
(2) The effects do not take into account the availability of one-time assessment credits in order to determine the effect on income once credits have been used up.
(3) Most banks with results categorized as "Missing" already have negative pre-tax income The percentage change cannot therefore be calculated.
(4) Insured branches of foreign banks were not included in the analysis.

[FR Doc. 06–9204 Filed 11–29–06; 8:45 am]
BILLING CODE 6714–01–C

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 327

RIN 3064–AD02

Deposit Insurance Assessments—Designated Reserve Ratio

AGENCY: Federal Deposit Insurance Corporation.

ACTION: Final rule.

SUMMARY: Under the Federal Deposit Insurance Reform Act of 2005, the Federal Deposit Insurance Corporation (FDIC) must by regulation set the Designated Reserve Ratio (DRR) for the Deposit Insurance Fund (DIF) within a range of 1.15 percent to 1.50 percent. In this rulemaking, the FDIC establishes the DRR for the DIF at 1.25 percent.

DATES: *Effective Date:* January 1, 2007.

FOR FURTHER INFORMATION CONTACT: Munsell St. Clair, Senior Policy Analyst, Division of Insurance and Research, (202) 898–8967; or Christopher Bellotto, Counsel, Legal Division, (202) 898–3801, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

SUPPLEMENTARY INFORMATION:

I. Background

The Federal Deposit Insurance Reform Act of 2005 (the Reform Act) amends section 7(b)(3) of the Federal Deposit Insurance Act (the FDI Act) to eliminate the current fixed designated reserve ratio (DRR) of 1.25 percent.[1] Section 2105 of the Reform Act directs the FDIC Board of Directors (Board) to set and publish annually a DRR for the Deposit Insurance Fund (DIF) within a range of 1.15 percent to 1.50 percent.[2] 12 U.S.C. 1817(b)(3)(A), (B). Under section 2109(a)(1) of the Reform Act, the Board must prescribe final regulations setting the DRR after notice and opportunity for comment not later than 270 days after enactment of the Reform Act.[3]

In setting the DRR for any year, section 2105(a) of the Reform Act, amending section 7(b)(3) of the FDI Act, directs the Board to consider the following factors:

(1) The risk of losses to the DIF in the current and future years, including historic experience and potential and estimated losses from insured depository institutions.

(2) Economic conditions generally affecting insured depository institutions. (In general, the Board should consider allowing the DRR to increase during more favorable economic conditions and decrease during less favorable conditions.)

(3) That sharp swings in assessment rates for insured depository institutions should be prevented.

(4) Other factors as the Board may deem appropriate, consistent with the requirements of the Reform Act.[4] The

[1] Section 2104 of the Reform Act, Public Law 109–171, 120 Stat. 9.

[2] To be codified at 12 U.S.C. 1817(b)(3)(A)(i), (B).

[3] Thereafter, any change to the DRR must be made by regulation after notice and opportunity for comment. Section 2105 of the Reform Act, to be codified at 12 U.S.C. 1817(b)(3)(A) (ii).

[4] To be codified at 12 U.S.C. 1817(b)(3)(C). The Reform Act provides:

(C) FACTORS—In designating a reserve ratio for any year, the Board of Directors shall—

(i) take into account the risk of losses to the Deposit Insurance Fund in such year and future years, including historic experience and potential and estimated losses from insured depository institutions;

(ii) take into account economic conditions generally affecting insured depository institutions so as to allow the designated reserve ratio to increase during more favorable economic conditions and to decrease during less favorable

Continued