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FDIC Approves Final Rule of Assessments, Dividends, Assessment Base and Large Bank Pricing

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OVERVIEW

On February 7, 2011, the Federal Deposit Insurance Corporation ("FDIC") approved a final rule on Assessments, Dividends, Assessment Base and Large Bank Pricing ("Rule"). The Rule, mandated by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), changes the deposit insurance assessment system from one that is based on domestic deposits to one that is based on average consolidated total assets minus average tangible equity. In addition, the Rule adopts a "scorecard" assessment scheme for larger banks and suspends dividend payments if the Depository Insurance Fund ("DIF") reserve ratio exceeds 1.5 percent but provides for decreasing assessment rates when the DIF reserve ratio reaches certain thresholds. Under the Rule, larger insured depository institutions will likely be forced to pay higher assessments to the DIF than under the old system.

The Rule will take effect for the quarter beginning April 1, 2011, and will be reflected in the invoices for assessments due September 30, 2011. However, because the Dodd-Frank Act requires that several changes be made to the Consolidated Reports of Condition and Income ("Call Report") and the Thrift Financial Report, the effective date is contingent upon these changes being made and may be delayed.

ASSESSMENT BASE

An insured depository institution's assessment is determined by multiplying its assessment rate by its assessment base. Historically, the assessment base has been an insured depository institution's domestic deposits, with some adjustments. As mandated by the Dodd-Frank Act, the Rule changes the assessment base from domestic deposits to an insured depository institution's average consolidated total assets minus average tangible equity during the assessment period.

The Rule requires that insured depository institutions report their average consolidated total assets on a daily basis, using the accounting methodology established for reporting total assets as applied to Line 9 of Schedule RC-K of the Call Report. Tangible equity is defined as Tier 1 capital.[1] The Rule also provides special provisions for the assessment base of custodial banks and bankers' banks. Insured depository institutions with less than $1 billion in consolidated total assets may report average weekly balances instead of daily averages. The averaging period for tangible equity is monthly; however, insured depository institutions with less than $1 billion in consolidated total assets may report tangible equity quarterly.[2]

[1] The FDIC may reconsider the definition of tangible equity once the new Basel III capital definitions have been implemented.
[2] For insured branches of foreign banks, average consolidated total assets are defined as total assets of the branch (including net due from related depository institutions) in accordance with the schedule of assets and liabilities in the Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks, but using the accounting methodology for reporting total assets established in Schedule RC-K of the Call Report. Tangible equity for insured branches of foreign banks is defined, with respect to such branch, as eligible assets (as defined in 12 C.F.R. 347.210) less the book value of liabilities (exclusive of liabilities due to the foreign bank's head office, other branches, agencies, offices, or wholly owned subsidiaries).

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ASSESSMENT RATE ADJUSTMENTS

In February 2009, the FDIC adopted a final rule incorporating three adjustments into the risk-based pricing system: the unsecured debt adjustment, the secured liability adjustment, and the brokered deposit adjustment.[3] The Rule keeps these adjustments, but due to the changes to the deposit insurance assessment base required by the Dodd-Frank Act, it modifies the three adjustments and adds an adjustment for long-term debt held by an insured depository institution where the debt is issued by another insured depository institution.[4]

DIVIDENDS

The Dodd-Frank Act continues the FDIC's authority to declare dividends when the reserve ratio at the end of a calendar year is at least 1.5 percent, but grants the FDIC sole discretion in determining whether to suspend or limit the declaration of payment of dividends (Dodd-Frank Act § 332). The Rule now suspends dividends indefinitely whenever the DIF reserve ratio exceeds 1.5 percent. In lieu of dividends, the Rule adopts progressively lower assessment rate schedules when the reserve ratio exceeds 2 percent and 2.5 percent, respectively. In the discussion of the Rule, the FDIC states that the lower assessment rates serve mainly the same function as dividends in preventing the DIF from becoming unnecessarily large, but provide more stable and predictable effective assessment rates.

ASSESSMENT RATES AND LARGE BANK PRICING

In calculating the assessment rates, the Rule retains the risk category system for small insured depository institutions (*i.e.*, with less than $10 billion in assets), assigning each institution to one of four risk categories based upon the institution's capital evaluation and supervisory evaluation, as defined by the Rule. Depending on the DIF reserve ratio, the total base assessment rates will be as follows:

	Risk Category I	**Risk Category II**	**Risk Category III**	**Risk Category IV**
DIF Reserve Ratio below 1.15 percent	2.5-9 basis points	9-24 basis points	18-33 basis points	30-45 basis points
DIF Reserve Ratio between 1.15 percent and below 2 percent	1.5-7 basis points	7-22 basis points	14-29 basis points	25-40 basis points
DIF Reserve Ratio between 2 percent and below 2.5 percent	1-6 basis points	5-20 basis points	12-27 basis points	23-38 basis points
DIF Reserve Ratio 2.5 percent or higher	0.5-5 basis points	4.5-19 basis points	10-25 basis points	20-35 basis points

[3] 74 FR 9525 (March 4, 2009).
[4] The Dodd-Frank Act mandates the FDIC to conduct a study to evaluate the definitions of brokered deposit and core deposit definitions. Once the study is completed, the FDIC will examine the existing definitions and consider changes, if appropriate.

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For “large institutions” and “highly complex institutions” the Rule eliminates risk categories and the use of long-term debt issuer ratings for calculating risk-based assessment and requires the use of a scorecard method to calculate the respective assessment rates. Insured depository institutions with assets of more than $10 billion are defined as large institutions. A highly complex institution is an insured depository institution with $50 billion or more in total assets that is controlled directly or indirectly by a U.S. parent holding company with $500 billion or more in total assets. The scorecards for both types of institutions produce two scores—a performance score and a loss severity score—that are combined and converted to an initial base assessment rate. The performance score is a weighted average of the scores for three components: the weighted average CAMELS rating score; the ability to withstand asset-related stress score; and the ability to withstand funding-related stress score. The loss severity score measures the relative magnitude of potential loss to the FDIC in the event of the insured depository institution’s failure. The Rule and its appendices contain detailed descriptions of how to measure and calculate the performance score and the loss severity score. Based on these calculations, the total base assessment rates for large institutions and highly complex institutions will be between 2.5 and 45 basis points, and their minimum and maximum will be determined by the DIF reserve ratio at the respective time.

As far as possible, the FDIC will use data that are publicly available to calculate each insured depository institution’s assessment base, and confidential data collected by or provided to the FDIC will remain confidential and protected by the FDIC’s disclosure restrictions set forth in 12 C.F.R. 309.6.

EFFECTS

According to the FDIC press release, the new pricing system for large institutions and highly complex institutions will result in higher assessment rates for banks with high-risk asset concentration, less stable balance sheet liquidity, or potential higher loss severity in the event of a failure. Overall, the FDIC expects that the Rule will not, or only marginally, change the total amount collected from the industry; however, the “amounts that individual institutions pay will be different.” In the discussion of the Rule the FDIC stated that the great majority of insured depository institutions will pay assessments at least 5 percent lower than currently and only 117 insured depository institutions (71 small and 46 large) would pay assessments at least 5 percent higher than they currently do.

NOTE:

- In order to help banks budget for premium under the new assessment system, the FDIC has issued revised assessment calculators that can be found at: http://www.fdic.gov/deposit/insurance/future_calc.html.
- The entire Rule including the appendices can be found at: http://www.fdic.gov/news/board/2011rule1.pdf.
- The FDIC’s press release can be found at: http://www.fdic.gov/news/news/press/2011/pr11028.html.

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