

## Final FDIC Rule to Change the Large Bank Risk-Based Assessments Scheme

On February 7, the FDIC Board finalized changes in the risk-based premiums scheme for banks with over \$10 billion of assets.<sup>1</sup> The change creates a unique premium scheme for under 100 institutions with banks over \$10 billion. Any bank whose total assets exceed \$10 billion for four consecutive quarters is subject to the large bank risk-based premiums scheme.

The rule abandons the former matrix for determining premiums (which relied on CAMELS ratings, debt issuer ratings and financial ratios) and creates a “Scorecard” system that does not use debt issuer ratings. The old four-bucket system, where rates were set by formula for Risk Category I (“well capitalized,” CAMELS 1&2) and fixed for Categories II-IV will no longer apply. The premium derived from the score is not linear; it rises slowly at first as the score (proxying risk) rises, but then more dramatically as the score continues to rise.

The change goes into effect concurrently with the new assessment base and schedule, in the second quarter of 2011 (payable in September).<sup>2</sup>

The FDIC noted that “[w]hile the rule is overall revenue neutral, it would, in aggregate, increase the share of assessments paid by large institutions, consistent with the express intent of Congress... Many large institutions [will] experience a significant change in their overall assessment.” Based on Sept. 30, 2010, data, the share of overall assessments paid will increase from 70 to 79 percent for banks over \$10 billion and from 48 percent to 57 percent for banks over \$100 billion. For the 110 “large” banks as of that date, 51 will pay more and 59 will pay less due to the changes.

This final rule made some changes from earlier proposals, reflecting some of the issues raised by ABA.<sup>3</sup> Importantly, the Brokered Deposit Adjustment will not apply to banks over \$10 billion that are well-capitalized and CAMELS 1 or 2, consistent with the treatment for smaller banks. Also:

- ◆ The “non-core funding to total liabilities” ratio is eliminated from the Loss Severity Score.
- ◆ The liability run-off rates used in the Loss Severity Score have been revalued.
- ◆ Held-to-maturity and available-for-sale securities will be included at fair value in the “Balance Sheet Liquidity Ratio.”
- ◆ Credit bureau scores will not factor into the pricing model. Instead, institutions’ internal models will determine whether a loan is to be classified as subprime.
- ◆ The definition of leveraged loans excludes those up to \$1 million and removes the total liabilities to assets ratio test.
- ◆ The deduction from the assessment base of a “custodial bank” is expanded to include all assets with 0 percent Basel risk weight and half with 20 percent weighted, and the maturity cutoff is eliminated. (However, the total deduction is limited to deposits classified as transaction accounts, rather than all deposits, linked to custody/fiduciary accounts.)

---

<sup>1</sup> See FDIC, “Assessments, Large Bank Pricing, Final Rule,” 76 *Federal Register* 10672, February 25, 2011, [www.fdic.gov/regulations/laws/federal/2011/11FinalFeb25.pdf](http://www.fdic.gov/regulations/laws/federal/2011/11FinalFeb25.pdf) and the FDIC “Q&A” on the final rule, [www.fdic.gov/deposit/insurance/final\\_rule\\_qanda.pdf](http://www.fdic.gov/deposit/insurance/final_rule_qanda.pdf).

<sup>2</sup> A summary of the assessment base rule is posted to [www.aba.com/aba/documents/fdic/NewAsstBase.pdf](http://www.aba.com/aba/documents/fdic/NewAsstBase.pdf).

<sup>3</sup> See [www.aba.com/members+only/regulatory/gr\\_rbaflargebks\\_dfa2010.htm](http://www.aba.com/members+only/regulatory/gr_rbaflargebks_dfa2010.htm). The second round proposal also made some adjustments suggested by ABA. The system was simplified somewhat, as we suggested. We objected to the excessive amount of subjectivity in the rate-setting scheme and this was limited in the re-proposal – and no adjustment will be made until the objective criteria are proposed for public comment. Core deposits were expanded to include balances up to the \$250,000 insurance limit, as ABA suggested. And the rule will not go into effect until the FDIC assessment base is changed, as ABA requested.

## The Scorecard

The Scorecard has two components: a Performance Score (to measure a bank's financial performance and ability to withstand stress based on CAMELS ratings and other financial measures) and a Loss Severity Score (to measure the FDIC's exposure should the bank fail).

The Loss Severity Score translates into a multiplier for the Performance Score, such that it could increase or decrease the value by as much as 20 percent to determine the Total Score. The Total Score is constrained to be between 30 and 90. The Total Score then translates to a premium rate on a non-linear, sharply-increasing scale.

There will be different Scorecards for: (1) banks with total assets greater than \$10 billion; and (2) "Highly Complex Institutions" where the bank has over \$50 billion in assets and is owned fully by a holding company with over \$500 billion in total assets (6 institutions) or is a processing bank and trust company with over \$10 billion in assets (3 institutions).<sup>4</sup>

### ***Scorecard for Banks Over \$10 billion that are Not "Highly Complex Institutions"***

**Performance Score** – The Performance Score is itself composed of three components:

30% – **CAMELS ratings using the current component weightings**

- The weightings are 25% for C and M, 20% for A, and 10% for E, L and S.

50% – **Ability to Withstand Asset-Related Stress**

5% – Tier 1 leverage ratio

17½% – Concentration – the higher of:

- the sum of C&D loans, higher-risk consumer and C&I loans and securities, and nontraditional mortgage loans to Tier 1 capital and reserves, and
- growth-adjusted portfolio concentrations measure – a complex, weighted growth measure on 7 loan portfolios (first-lien home mortgages and non-agency residential MBS, closed-end junior liens and HELOCs, C&D loans, other CRE loans, C&I loans, credit card loans, other consumer loans)

10% – Core earnings/average quarter-end total assets

- Average of four quarters of merger-adjusted core earnings (net income less extraordinary items and realized securities gains/losses) divided by the end-of-quarter total assets for the last five quarters.

17½% – Credit quality – the higher of:

- Criticized and qualified assets/tier 1 capital + reserves
- Underperforming assets/tier 1 capital + reserves ("Texas ratio")

---

<sup>4</sup> A processing bank and trust company is defined as one whose last three years' non-lending interest income plus fiduciary revenues plus investment banking fees exceed 50 percent of total revenues (and the last 3 years' fiduciary revenues are non-zero).

**20% – Ability to Withstand Funding-Related Stress**

12% – Core deposits/total liabilities

- Core deposits include demand deposits, NOW accounts, MMDA, other savings deposits, and CDs under \$250,000, less insured brokered deposits under \$250,000
- Note that the Brokered Deposits Adjustment still applies

8% – Balance Sheet Liquidity Ratio

- Sum of cash and balances due from depository institutions + federal funds sold and securities purchased under agreements to resell + Treasury, federal agency, and GSEs securities (but not MBS) DIVIDED BY
- Sum of federal funds purchased and repurchase agreements + other borrowings (including from the Federal Home Loan Banks) with a remaining maturity up to a year + 7½ percent of insured domestic deposits + 15 percent of uninsured domestic and foreign deposits

Loss Severity Score – The Loss Severity Score is computed using two measures:

100% – Potential FDIC loss if the bank fails, measured as potential losses/domestic deposits

- Potential losses are calculated using uniform haircuts and recoveries by asset class, and run-off rates for deposits and other liabilities.

**Scorecard for “Highly Complex Institutions”**

The Scorecard for nine “Highly Complex Institutions” is similar to that for other banks over \$10 billion. Calculation of the Loss Severity Score, Total Score and assessment rate based on that score is the same. For the Performance Score, however, some measures are added and some relative weights changed, **as shown in bold below**.

Performance Score for HCIs – The Performance Score is made up of three components:30% – CAMELS rating using the current component weightings (*as above*)

50% – Ability to Withstand Asset-Related Stress

5% – Tier 1 leverage ratio

17½% – Concentration Measure – the higher of:

- the sum of higher risk assets (as above)/Tier 1 capital and reserves,
- **exposure to top-20 counterparties/Tier 1 capital and reserves**, and
- **the largest counterparty exposure/Tier 1 capital and reserves**
- **not growth-adjusted portfolio concentration** (as above).

10% – Core earnings/average quarter-end total assets

17½% – Credit Quality Measure (*as above*) **and Market Risk Measure**

- **The Market Risk Measure uses three factors:**
  - four-quarter trading revenue volatility/Tier 1 capital,
  - market risk capital/Tier 1 capital, and
  - Level 3 trading assets/Tier 1 capital.
    - Level 3 trading assets are those whose fair value cannot be determined using observable measures, such as market prices or models.
- **The weighting between the Credit Quality and Market Risk Measures depends on the Trading Assets Ratio (TAR).**
- TAR = average trading assets/average securities, loans and trading assets

20% – Ability to Withstand Funding-Related Stress:

**10%** – Core deposits/total liabilities

**6%** – Balance Sheet Liquidity Ratio

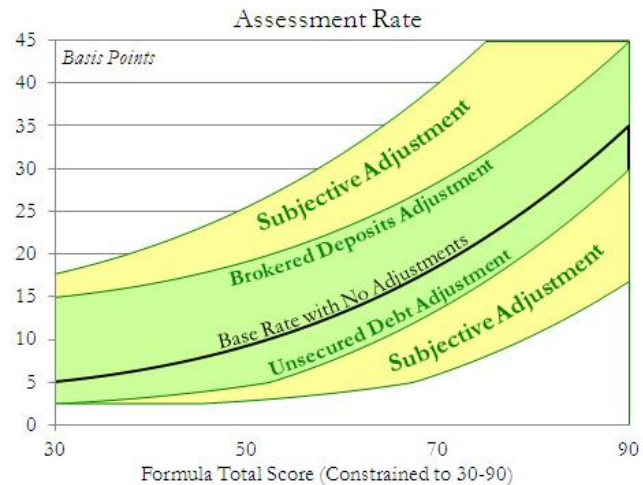
**4%** – **Average short-term funding/average total assets**

- Short-term funding = federal funds purchased and repurchase agreements

### Subjective Adjustments

The FDIC retains discretion to adjust premiums for banks over \$10 billion. However, the adjustments will not be limited to one basis point. Instead, the FDIC can adjust the **Total Score** up or down by up to 15 points. However, the Total Score could not be lowered to less than 30 or raised to over 90.

Since the assessment rate rises at an accelerating rate with the Total Score, these adjustments could raise the rate by over one basis point – much more for banks that receive higher scores. The maximum effect is a 13.1 b.p. swing up or down in the final assessment rate, applicable to banks that would otherwise pay the ceiling assessment rate.



Such adjustments will not be applied until after objective guidelines are formally proposed and commented on this year. Moreover, aggregate statistics on adjustments each quarter will be published in the future – something ABA has long requested.

Notification involving an upward adjustment to a bank’s assessment rate will be made in advance so that the bank has an opportunity to respond or address the FDIC’s rationale.

### Formula Adjustments for Brokered Deposits and Unsecured Liabilities

The rule continues the adjustments (down) for unsecured liabilities and (up) for “excessive” use of brokered deposits – on top of the base assessment rate calculation from the Scorecard. For “large” banks that are not “well capitalized and CAMELS 1&2, use of brokered deposits will trigger higher premiums through the effect on the Performance Score’s “Ability to Withstand Funding-Related Stress” and potentially through the Brokered Deposit Adjustment.<sup>5</sup> The adjustment for secured liabilities is eliminated, since these are part of the new assessment base. Moreover, there is a new “Depository Institution Debt Adjustment” whereby a bank will pay an additional premium equal to 50 basis points on long-term (remaining maturity over a year) unsecured debt issued by another bank (but not bank holding company) in excess of three percent of Tier 1 capital. However, debt guaranteed under the FDIC’s Temporary Liquidity Guarantee Program will not be assessed, since this debt will not decrease FDIC losses should the bank fail.

The FDIC can update the parameters in the Scorecard annually. If the FDIC wants to change the Scorecard components, however, it will use the public proposal and comment process.

<sup>5</sup> As ABA argued strongly, the final rule reverses the proposed application of the Brokered Deposits Adjustment to “well capitalized,” CAMELS 1&2 banks over \$10 billion.