FDIC
Federal Deposit Insurance Corporation
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Division of Insurance and Research

April 7, 2011

MEMORANDUM TO: The Board of Directors

FROM: Arthur J. Murton
Director
Division of Insurance and Research

SUBJECT: Proposed Assessment Rate Adjustment Guidelines for Large and Highly Complex Institutions

Staff recommends that the Board of Directors (FDIC or Board) authorize publication of proposed assessment rate adjustment guidelines for large and highly complex institutions with request for comment.

I. Background

On February 7, 2011, the FDIC Board adopted a new methodology for determining assessment rates for large institutions. The new methodology combines CAMELS ratings and forward-looking financial measures into one of two scorecards, one for highly-complex institutions and another for all other large institutions. Each of the two scorecards produces two scores—a performance score and a loss severity score—that are combined into a total score, which cannot be greater than 90 or less than 30. The score is then converted to an initial base assessment rate. The rule allows the FDIC, after consultation with an institution's primary federal regulator, to make a limited adjustment to an institution's total score based upon risks that are not adequately captured in the scorecard. The rule provides that no adjustments be made under the new methodology until new guidelines governing the adjustment process have been approved by the FDIC's Board of Directors.

The proposed guidelines describe the process staff would follow to determine whether to make an adjustment, to determine the size of any adjustment and how staff would notify an institution of an adjustment.

The proposed guidelines would supersede the large bank pricing adjustment guidelines published on May 15, 2007 (the 2007 Guidelines). The 2007 Guidelines outline the adjustment process for the large bank assessment system then in effect. The scorecards explicitly incorporate some of the risks that were previously captured primarily through large bank adjustments. Accordingly, staff is proposing new guidelines that take these changes into

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account; however, the processes for communicating with affected institutions and implementing adjustments once determined remain largely unchanged from the 2007 Guidelines, except that staff is now proposing to explicitly allow institutions to request an adjustment.

The proposed guidelines request comment on the guidelines and the procedures for making an adjustment to an institution's score.[1]

A summary of the guidelines and process follows.

II. Overview of Proposed Guidelines on Large Bank Adjustment

The proposed large bank adjustment process would be based on a set of guidelines to ensure that the adjustment process is fair and transparent and that any decision to adjust a score is well supported. The following general guidelines would govern the adjustment process. The attached proposed guidelines describe the adjustment process in greater detail and set out several examples.

Analytical Guidelines

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

- The FDIC would primarily consider two types of information in determining whether to make a large bank adjustment: (a) a scorecard ratio or measure that exceeds the maximum cutoff value for a ratio or measure or is less than the minimum cutoff value for a ratio or measure along with the degree to which the ratio or measure differs from the cutoff value (scorecard measure outliers); or (b) information not directly captured in the scorecard, including complementary quantitative risk measures and qualitative risk considerations.

- If an institution has one or more scorecard measure outliers, the FDIC would conduct further analysis to determine whether underlying scorecard ratios are materially higher or lower than the established cutoffs for a given scorecard measure and whether other mitigating or supporting information exists.

- The FDIC would use complementary quantitative risk measures to determine whether a given scorecard measure is an appropriate measure for a particular institution.

- When qualitative risk considerations materially affect the FDIC's view of an institution's probability of failure or loss given failure, these considerations could be the primary factor supporting the adjustment. Qualitative risk considerations include,

[1] Notice and comment are not required, however, and need not be employed to make future changes to the guidelines.

but are not limited to, underwriting practices related to material concentrations, risk management practices, strategic risk, the use and management of government support programs, and factors affecting loss severity.

- Specific risk measures would vary in importance for different types of institutions. In some cases, a single risk factor or indicator may support an adjustment if the factor suggests a significantly higher or lower likelihood of failure, or loss given failure, than the total score reflects.

- To the extent possible in comparing risk measures, the FDIC would consider the performance of similar institutions, taking into account that variations in risk measures exist among institutions with substantially different business models.

- Adjustments would be made only if the comprehensive analysis of an institution's risk, generally based on the two types of information listed above, and the institution's relative risk ranking warrant a meaningful adjustment of the institution's total score (generally, an adjustment of five points or more).

Procedural Guidelines

The processes for communicating with affected institutions and implementing adjustments once determined would remain largely unchanged by this proposal, except that the FDIC would now explicitly allow institutions to request an adjustment.

- The FDIC would consult with an institution's primary federal regulator and appropriate state banking supervisor before making any decision to adjust an institution's total score (and before removing a previously implemented adjustment).

- The FDIC would give institutions advance notice of any decision to make an upward adjustment to a total score, or to remove a previously implemented downward adjustment. The notice would include the reasons for the proposed adjustment or removal, the size of the proposed adjustment or removal, specify when the adjustment or removal would take effect, and provide institutions with up to 60 days to respond.

- The FDIC would re-evaluate the need for total score adjustments on a quarterly basis.

- Institutions could make written request to the FDIC for an adjustment that is supported by evidence of a material risk or risk-mitigating factor that is not adequately accounted for in the scorecard.

- An institution could request review of or appeal an upward adjustment, the magnitude of an upward adjustment, removal of a previously implemented downward adjustment or an increase in a previously implemented upward adjustment pursuant to 12 C.F.R. 327.4(c). An institution could similarly request review of or appeal a decision not to apply an adjustment following a request by the institution for an adjustment.

The Division of Insurance and Research will seek the advice and concurrence of the Office of Complex Financial Institutions (OCFI) for any adjustment it wishes to initiate and will also pursue adjustments based on OCFI recommendations.

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