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LEGAL UPDATES AND NEWS

FDIC Publishes Notice of Proposed Rulemaking on Deposit Insurance Assessments

On November 9, 2010, the Federal Deposit Insurance Corporation ("FDIC") published a notice of a proposed rulemaking under the Dodd-Frank Act to reform the deposit insurance assessment system. The proposal would redefine the assessment base used for calculating deposit insurance assessments. Specifically, the rule would base assessments on an institution's total assets as opposed to total deposits (as has been the case since 1935). The proposal is expected to benefit smaller financial institutions, which rely heavily upon deposits for funding, and shift more of the burden for supporting the insurance fund to larger institutions, which have greater access to non-deposit sources of funding.[1]

Under the proposal, an institution's assessment base will be its average consolidated total assets less its average tangible equity (which is defined as Tier 1 capital). In addition to changing the assessment base, the proposed rule also revises the rate adjustments that can affect an institution's assessment rate. The FDIC charges institutions an amount for deposit insurance equal to their assessment base multiplied by a risk-based assessment rate, which is calculated by using an "initial base assessment rate" ("IBAR") that may be modified through an "unsecured debt adjustment," a "secured liability adjustment," and a "brokered deposit adjustment." As summarized below, the proposal changes these three adjustments and adds a new "depository institution debt" adjustment.

Unsecured Debt Adjustment. Under the FDIC's current assessment system, an institution's assessment rate may be reduced through the unsecured debt adjustment by an amount equal to the institution's long-term unsecured liabilities times 40 basis points divided by the amount of domestic deposits, up to a maximum 5 basis point deduction. Under the proposal, the amount of the reduction in the assessment rate due to the adjustment would be equal to the amount of long-term unsecured liabilities multiplied by the sum of 40 basis points and IBAR, divided by the amount of the new assessment base. The cap on the unsecured debt adjustment will be changed from the current 5 basis points to the lesser of 5 basis points or the institution's IBAR. In addition, the FDIC will alter the definition of "long-term unsecured liabilities" to exclude Tier 1 capital. Overall, these changes are expected to effect an increase in the maximum dollar amount of the unsecured debt adjustment.

Secured Liability Adjustment. Currently, an institution's assessment rate may be increased if its ratio of secured liabilities to domestic deposits is greater than 25%. Under the proposal, there will no longer be a cost advantage for funding with secured liabilities (which, unlike deposits, were

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[1] Concurrently with the issuance of the proposal described in this newsletter, the FDIC issued another proposed rule revising the deposit insurance assessment system for large institutions (i.e., those with $10 billion or more in total assets). The proposal would eliminate risk categories and debt ratings from the assessment calculation for such institutions, and would instead use a "scorecard" that combines the CAMELS rating and certain forward-looking financial measures to assess the risk that the institution poses to the deposit insurance fund, and establish the deposit insurance assessment accordingly.

not assessed for deposit insurance purposes). Therefore, the FDIC has proposed to eliminate the secured liability adjustment with the implementation of the new assessment base.

Brokered Deposit Adjustment. The brokered deposit adjustment applies to institutions in Risk Categories II, III, and IV when their ratio of brokered deposits to domestic deposits exceeds 10%. The adjustment increases an institution's assessment rate by up to 10 basis points, depending on the amount by which its brokered deposits exceed 10% of its domestic deposits. Under the proposal, the FDIC would retain the brokered deposit adjustment, but would scale the adjustment to the new assessment base by incorporating the ratio of domestic deposits to the new assessment base. The cap would remain at 10 basis points.

Depository Institution Debt Adjustment. The FDIC has proposed to establish a new adjustment that would increase the assessment rate of an institution that holds the unsecured debt of another insured depository institution. The rationale for this adjustment is that although the issuance of unsecured debt by an insured depository institution lessens the potential loss to the insurance fund in the event of the institution's failure, when the unsecured debt is held by another insured depository institution, the overall risk to the deposit insurance fund is not reduced. The proposal would apply a 50 basis point adjustment to every dollar of long-term unsecured debt held by an institution when that debt is issued by another insured depository institution, divided by the amount of the institution's new assessment base.

Finally, because the proposal would broaden the assessment base, the FDIC has proposed reducing assessment rates so as not to affect the overall amount of assessment revenue collected by the FDIC.

- For institutions in Risk Category I, the minimum initial base assessment rate would be reduced to 5 basis points (from 7), and the total base assessment rate, after applying adjustments, would be reduced to a range of 2.5 to 9 basis points (from 7 to 24).

- For institutions in Risk Category II, the initial base assessment rate would be reduced to 14 basis points (from 22), and the total base assessment rate, after applying adjustments, would be reduced to a range of 9 to 24 basis points (from 17 to 43).

- For institutions in Risk Category III, the initial base assessment rate would be reduced to 23 basis points (from 32), and the total base assessment rate, after applying adjustments, would be reduced to a range of 18 to 33 basis points (from 27 to 58).

- For institutions in Risk Category IV, the initial base assessment rate would be reduced to 35 basis points (from 45), and the total base assessment rate, after applying adjustments, would be reduced to a range of 30 to 45 basis points (from 40 to 77.5).

The FDIC would retain the ability to adjust these rates, subject to certain restrictions, and it has proposed to decrease assessment rates when the deposit insurance fund reserve ratio meets certain targets.

The FDIC notice is subject to a 45 day comment period. A final rule would take effect for the quarter beginning April 1, 2011, and would be reflected in the invoices for assessments due September 30, 2011.

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