Federal Deposit Insurance Corporation
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Division of Insurance and Research

November 2, 2010

MEMORANDUM TO: The Board of Directors

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

SUBJECT: Notice of Proposed Rulemaking on Risk-Based Assessment System for Large Insured Depository Institutions

SUMMARY OF RECOMMENDATIONS

Staff recommends that the FDIC Board of Directors (FDIC or Board) authorize publication of the attached Notice of Proposed Rulemaking on Risk-Based Assessment System for Large Insured Depository Institutions (NPR or proposal) with a 45 day comment period that would revise the assessment system applicable to large insured depository institutions (IDIs) to:

- Eliminate risk categories and the use of long-term debt issuer ratings for large IDIs;
- Combine CAMELS ratings and forward-looking financial measures into two scorecards—one for most large IDIs and another for large IDIs that are structurally and operationally complex or that pose unique challenges and risks in case of failure (Highly Complex IDIs);
- Retain the ability to take additional information into account and make a limited adjustment to an IDI's total score; and
- Use the scorecard to determine assessment rates.

I. Background

On April 13, 2010, the Board adopted a notice of proposed rulemaking with request for comment (the April NPR) to revise the assessment system applicable to large IDIs to better capture risk at the time an IDI assumes the risk, to better differentiate IDIs during periods of good economic and banking conditions based on how they would fare during periods of stress

Concur: _____
Richard J. Osterman, Jr.
Acting General Counsel

or economic downturns, and to better take into account the losses that the FDIC may incur if an IDI fails.[1] The FDIC sought comments on every aspect of the April NPR, and specifically requested comment on several issues. The FDIC received 18 written comments on the April NPR. Most commenters to the proposal requested that the FDIC delay implementation of the rulemaking until the effects of then pending comprehensive financial regulation bills were known.

Congress adopted comprehensive financial regulation in the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) that includes a provision directing the FDIC to amend its regulatory definition of "assessment base" for purposes of setting assessments for IDIs. As a result of Dodd-Frank, an IDI's assessment base will be calculated using its average consolidated total assets less its average tangible equity during the assessment period.[2] Staff believes that the recent statutory change to the assessment base constitutes a substantial revision to the deposit assessment system and, under the FDI Act, such changes must be made after notice and opportunity to comment.[3] Accordingly, staff recommends that the Board issue a separate notice of proposed rulemaking with request for comment on the new assessment base and proposed assessment rate schedule (the Assessment Base NPR). Largely as a result of Dodd-Frank and the Assessment Base NPR, staff recommends that the Board issue a second proposal with request for comment on large bank assessments, taking into account the comments received on the April NPR. Staff recommends that this proposal be published concurrently with the Assessment Base NPR.

II. Overview of the Large Bank Pricing Proposal

Staff proposes that the assessment system applicable to large IDIs be revised to better reflect risk at the time an IDI assumes the risk, to better differentiate IDIs during periods of good economic and banking conditions based on how they would fare during periods of stress or economic downturns, and to better take into account the losses that the FDIC may incur if such an IDI fails.

Staff continues to recommend that the Board eliminate risk categories for large IDIs to allow the FDIC to draw finer distinctions among large IDIs based upon the risk they pose. Staff proposes that CAMELS ratings and certain financial measures be combined into two scorecards—one for most large IDIs and another for large IDIs that are structurally and operationally complex or that pose unique challenges and risk in the case of failure (highly complex IDIs). Each scorecard assesses certain risk measures to produce two scores—a performance score and a loss severity score—that are ultimately combined and converted to an initial assessment rate.

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[1] 75 Fed. Reg. 23516 (May 3, 2010).

[2] Pub. L. No. 111-203, §331(b), 124 Stat. 1376, 1539 (to be codified at 12 USC 1817(b)). Dodd-Frank substitutes the new assessment base for the current assessment base, which is closely related to domestic deposits. 12 CFR 327.5 (2010).

[3] 12 U.S.C. 1817(b)(1)(F).

Staff has carefully reconsidered the risk measures that are used in the scorecards in light of the statutory changes made by Dodd-Frank, proposals made by the Basel Committee, and the comments received in response to the April NPR. Staff proposes to include the Tier 1 leverage ratio as a risk measure rather than the Tier 1 common ratio proposed in the April NPR so that capital would be defined consistently throughout the deposit insurance assessment rules to mean regulatory capital, whether it is for the calculating the risk-based assessment rate or for the defining the assessment base.

Staff has also made simplifying revisions to the scorecards. These revisions do not materially reduce the scorecard's ability to differentiate IDIs' risk profiles. These revisions include refining some risk measurements, eliminating the outlier add-ons, and allowing for an adjustment of up to 15 points higher or lower than the total score, rather than allowing for an adjustment of both the performance score and loss severity score as was proposed in April. Staff took these steps partly in response to comments received expressing concerns about the complexity of the proposal.[4] Staff recognizes that the scorecard and some risk measures in the scorecard continue to be somewhat complex; however, this complexity simply reflects the complexity of large IDIs. Staff believes that further reducing the complexity would lead to considerably less accuracy in predicting risk.

The attached proposal includes quantitative measures that are readily available and useful in predicting a large IDI's long-term performance.[5, 6]

Staff believes that since the risk measures used in the scorecards focus on long-term risk, they should mitigate the pro-cyclicality of the current system. IDIs that pose higher risk over the long term would pay higher assessments when they assume these risks—rather than paying large assessment rates when conditions deteriorate. Consequently, the proposed scorecard system should provide incentives for IDIs to avoid excessive risk during economic expansions.

As shown in Chart 1, over the 2005 to 2008 period, the proposed measures were useful in predicting the performance of large IDIs in 2009. The chart contrasts the predictive values of the proposed measures with weighted-average CAMELS component ratings and risk measures included in the existing financial ratios method. The proposed measures predict the proper rank ordering of risk for large IDIs as of the end of 2009 (based on a consensus view of staff analysts) significantly better than do the other two risk measures and, thus, better than the current system

[4] Commenters to the April NPR argued that the "all or nothing" additions of the outlier add-ons were overly punitive and introduced a cliff effect. While staff continues to believe that extreme values for certain risk measures make an IDI more vulnerable to stress, staff recognizes that IDIs with such extreme values can be better addressed on a bank-by-bank basis using the large bank adjustment.

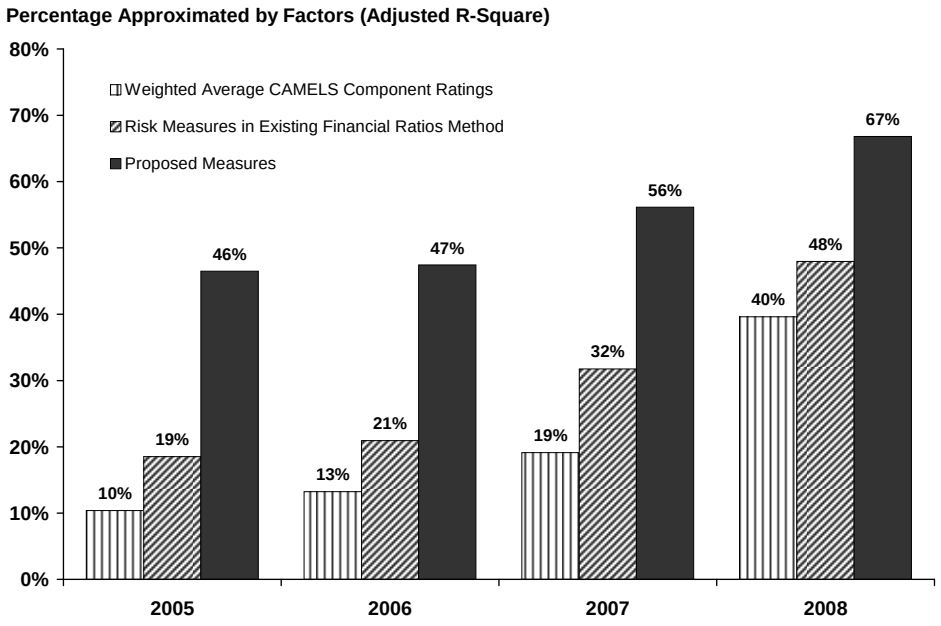
[5] Most of the data are publicly available, but data elements to compute four scorecard measures—higher-risk assets, top 20 counterparty exposures, the largest counterparty exposure and criticized/classified items— are gathered during the examination process. Staff proposes that IDIs provide these data elements as confidential in the Consolidated Reports of Condition and Income (Call Report) or the Thrift Financial Report (TFR) beginning with the second quarter of 2011.

[6] Appendix 1 to the NPR describes in detail the statistical analysis that forms the basis for the proposed scorecard.

used for most large Risk Category I institutions, which combines weighted-average CAMELS composite scores, the financial ratios method and long-term debt issuer ratings.[7] For example, in 2006, the proposed measures would have predicted staff analysts' year-end 2009 risk ranking of large IDIs more than twice as well as the risk measures in the existing financial ratios method, which applies to large IDIs without debt ratings.

Chart 1

Various Measures' Ability to Predict Current Expert Judgment Risk Ranking[8,9]



[7] Lack of historical debt ratings for a significant percent of large IDIs makes it difficult to compare the predicative accuracy of proposed measures to risk measures included in the current large bank method. However, for a smaller sample with available debt ratings, adding debt ratings to other risk measures included in the current small bank model does not improve the predicative accuracy of the model.

[8] The rank ordering of risk for large institutions as of the end of 2009 (based on a consensus view of staff analysts) is largely based on the information available through the FDIC's Large Insured Depository Institution (LIDI) program. Large institutions that failed or received significant government support over the period are assigned the worst risk ranking and are included in the statistical analysis. Appendix 1 to the NPR describes the statistical analysis in detail.

[9] The percentage approximated by factors is based on the statistical model for that particular year. Actual weights assigned to each scorecard measure are largely based on the average coefficients for 2005 to 2008, and do not equal the weight implied by the coefficient for that particular year (See Appendix 1 to the NPR).

III. Scorecard for Large IDIs (Other than Highly Complex IDIs)

A "large institution" would continue to be defined as an IDI that has had $10 billion or more in total assets for at least four consecutive quarters. The proposal would apply to all large IDIs, including new IDIs.[10] Insured branches of foreign banks would not be defined as large IDIs.

Staff proposes to use a scorecard to calculate an initial assessment rate that reflects the risk that large IDIs pose to the DIF. Each IDI's scorecard uses risk measures to produce a performance score, measuring the IDI's performance and its ability to withstand stress, and a loss severity score, measuring the relative magnitude of potential losses to the FDIC in the event of the IDI's failure.

Table 1 shows the large IDI scorecard measures and their relative contribution to the performance score or loss severity score. The score for all scorecard measures is calculated based on the minimum and maximum cutoff values for each measure, which are derived from data over a ten-year period beginning with the first quarter of 2000—a period that includes both good and bad economic times.[11] Most of the minimum and maximum cutoff values for each risk measure equal the 10th and 90th percentile values of that particular measure among large IDIs.[12]

The score for each measure, other than the weighted average CAMELS rating, ranges between 0 and 100, where 100 equals the highest risk and 0 equals the lowest risk for that measure. A value reflecting lower risk than the cutoff value receives a score of 0. A value reflecting higher risk than the cutoff value receives a score of 100. A risk measure value between the minimum and maximum cutoff values converts linearly to a score between 0 and 100.[13] The weighted average CAMELS rating is converted to a score between 25 and 100, where 100 equals the highest risk and 25 equals the lowest risk.

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[10] In almost all cases, an IDI that has had $10 billion or more in total assets for four consecutive quarters will have a CAMELS rating; however, in the rare event that a large IDI has not yet received CAMELS ratings, it would be given a weighted average CAMELS rating of 2 for assessment purposes until actual CAMELS ratings are assigned.

[11] The detailed results of the statistical analysis used to select risk measures and the weights are provided in Appendix 1 to the NPR. Cutoff values are rounded to the nearest integer. An online calculator will be available on the FDIC's website to allow IDIs to determine how their assessment rates would be calculated under this NPR.

[12] The 10th and 90th percentiles are not used for the higher-risk assets to Tier 1 capital and reserves measure and the criticized and classified items ratio due to data availability. Data on the higher-risk assets to Tier 1 capital and reserves measure are available consistently since second quarter 2008, while criticized and classified items are available consistently since first quarter 2007. The maximum cutoff value for the higher-risk assets to Tier 1 capital and reserves measure is close to but does not equal the 75th percentile. The maximum cutoff value for the criticized and classified items ratio is close to but does not equal the 80th percentile value. These alternative cutoff values are partly based on recent experience.

[13] The resulting score is rounded to 3 decimal points.

Table 1
Scorecard for Large IDIs

	Scorecard Measures	Weights within Component	Component Weights
P	Performance Score		
P.1	*Weighted Average CAMELS Rating*	*100%*	*30%*
P.2	*Ability to Withstand Asset-Related Stress:*		*50%*
	Tier 1 Leverage Ratio	10%	
	Concentration Measure	35%	
	Core Earnings/Average Quarter-End Total Assets*	20%	
	Credit Quality Measure	35%	
P.3	*Ability to Withstand Funding-Related Stress*		*20%*
	Core Deposits/Total Liabilities	60%	
	Balance Sheet Liquidity Ratio	40%	
L	Loss Severity Score		
L.1	*Loss Severity*		*100%*
	Potential Losses/Total Domestic Deposits (loss severity measure)	75%	
	Noncore Funding/Total Liabilities	25%	

* Average of five quarter-end total assets (most recent and four prior quarters)

A. Performance Score

The performance score measures a large IDI's performance and its ability to withstand stress. The performance score for large IDIs would be the weighted average of three inputs: (1) weighted average CAMELS rating; (2) ability to withstand asset-related stress measures; and (3) ability to withstand funding-related stress measures. Table 1 includes the weight given to each of these three inputs.

1. Weighted Average CAMELS Score

To derive the weighted average CAMELS score, an IDI's CAMELS component ratings are multiplied by the weights that are applied in the existing rule as shown in Table 2.[14] The results are then summed.

Table 2
Weights for CAMELS Component Ratings

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

The weighted average CAMELS score increases at an increasing rate as the weighted average CAMELS rating increases.

2. Ability to Withstand Asset-Related Stress Component

The ability to withstand asset-related stress component contains the following measures:

- Tier 1 Leverage ratio;
- Concentration measure (the higher of the ratio of higher-risk assets to the sum of Tier 1 capital and reserves or the growth-adjusted portfolio concentrations measures);
- The ratio of core earnings to quarter-end total assets; and
- Credit quality measure (the higher of the ratio of criticized and classified items to the sum of Tier 1 capital and reserves measure or the ratio of underperforming assets to the sum of Tier 1 capital and reserves measure).

In general, these measures proved to be the most statistically significant measures of a large IDI's ability to withstand asset-related stress.[15]

Table 3 provides the cutoff values for each measure and shows the weight assigned to the measure to derive a score for an IDI's ability to withstand asset-related stress.

[14] 12 CFR 327, Subpt.A, App. A (2010).

[15] Appendix A to the NPR describes these measures in detail and provides the source of the data used to determine them.

Table 3

Cutoff Values and Weights for Ability to Withstand Asset-Related Stress Measures

Scorecard Measures	Cutoff Values		Weight
	Minimum	Maximum	
Tier 1 Leverage Ratio	6	13	10%
Concentration Measure:			35%
Higher–Risk Assets to Tier 1 Capital and Reserves; or	0	135	
Growth-Adjusted Portfolio Concentrations	3	57	
Core Earnings/Average Quarter-End Total Assets*	0	2	20%
Credit Quality Measure:			35%
Criticized and Classified Items/ Tier 1 Capital and Reserves; or	8	100	
Underperforming Assets/ Tier 1 Capital and Reserves	2	37	

* Average of five quarter-end total assets (most recent and four prior quarters)

Each score is multiplied by its respective weight and the resulting weighted score for each measure is summed to arrive at an ability to withstand asset-related stress score, which could range from 0 to 100.

Table 4 illustrates how the ability to withstand asset-related stress score would be calculated for a hypothetical bank, Bank A.

Table 4

Ability to Withstand Asset-Related Stress Component for Bank A

Scorecard Measures	Value	Score*	Weight	Weighted Score
Tier 1 Leverage Ratio	6.98	86.00	10%	8.60
Concentration Measure:		100.00	35%	35.00
Higher Risk Assets/Tier 1 Capital and Reserves; or	162.00	100.00		
Growth-Adjusted Portfolio Concentrations	43.62	75.22		
Core Earnings/Average Quarter-End Total Assets	0.67	66.50	20%	13.30
Credit Quality Measure:		100.00	35%	35.00
Criticized and Classified Items/Tier 1 Capital and Reserves; or	114.00	100.00		
Underperforming Assets/Tier 1 Capital and Reserves	34.25	92.14		
Total ability to withstand asset-related stress score				91.90

* In the example, scores are rounded to two decimal points for Bank A.

Bank A's higher risk assets to Tier 1 capital and reserves score (100) is higher than its growth-adjusted portfolio concentrations score (75.22). Thus, the higher risk assets to Tier 1 capital and reserves score would be multiplied by the 35 percent weight to get a weighted score of 35 and the growth-adjusted portfolio concentration score would be ignored. Similarly, Bank A's criticized and classified items to Tier 1 capital and reserves score (100) is higher than its underperforming assets to Tier 1 capital and reserves score (92.14). Therefore, the criticized and classified items to Tier 1 capital and reserves score would be multiplied by the 35 percent weight to get a weighted score of 35.00 and the underperforming assets to Tier 1 capital and reserves score would be ignored. These weighted scores, along with the weighted scores for the Tier 1 leverage ratio (8.6) and core earnings to quarter-end total assets ratio (13.3), would be added together, resulting in the ability to withstand asset-related stress component score of 91.90.

3. Ability to Withstand Funding-Related Stress

The ability to withstand funding-related stress component contains two measures—a core deposits to total liabilities ratio, and a balance sheet liquidity ratio, which measures the amount of highly liquid assets to cover potential cash outflows in the event of stress.[16] These ratios are significant in predicting a large IDI's long-term performance in the statistical test described in Appendix 1 to the NPR.

[16] Staff has modified data elements included in the liquid assets to short-term liability ratio proposed in the April NPR, and termed it as the balance sheet liquidity ratio to better reflect what the ratio is designed to capture. See Appendix A to the NPR for detailed description of the measure.

The ability to withstand funding-related stress component score is the weighted average of the two measure scores. Table 5 shows the cutoff values and weights for these measures. Weights assigned to each of these two risk measures were based on statistical analysis as described in detail in Appendix 1 to the NPR.

Table 5

Cutoff Values and Weights for Ability to Withstand Funding-Related Stress Measures

Scorecard Measures	Cutoff Values		Weight
	Minimum	Maximum	
Core Deposits/Total Liabilities	3	79	60%
Balance Sheet Liquidity Ratio	7	188	40%

Bank A's ability to withstand funding-related stress score would be 40.97 as shown in Table 6.

Table 6

Ability to Withstand Funding-Related Stress Component for Bank A

Scorecard Measures	Value	Score*	Weight	Weighted Score
Core Deposits/Total Liabilities	60.25	24.67	60%	14.80
Balance Sheet Liquidity Ratio	69.58	65.43	40%	26.17
Total ability to withstand funding-related stress score				40.97

* In the example, scores are rounded to 2 decimal points for Bank A

4. Calculation of Performance Score

The weighted average CAMELS score, the ability to withstand asset-related stress score, and the ability to withstand funding-related stress score are multiplied by their respective weights and the results are summed to arrive at the performance score. This score cannot be less than 0 or more than 100 under the proposal.

For Bank A, the performance score would be 69.33 as shown in Table 7, assuming that Bank A has a weighted average CAMELS score of 50.6, which results from a weighted CAMELS rating of 2.2.

Table 7
Performance Score for Bank A

Performance Score Components	Weight	Score	Weighted Score
Weighted Average CAMELS Score	30%	50.60	15.18
Ability to Withstand Asset-Related Stress Score	50%	91.90	45.95
Ability to Withstand Funding-Related Stress Score	20%	40.97	8.20
Total Performance Score			69.33

B. Loss Severity Score

The loss severity score quantifies the relative magnitude of potential losses to the FDIC in the event of the IDI's failure using a loss severity measure and the ratio of noncore funding to total liabilities.

The loss severity measure applies a standardized set of assumptions based on recent failures regarding liability runoffs and the recovery value of asset categories to calculate possible losses to the FDIC. The ratio of noncore funding to total liabilities is included since FDIC's experience proves that an IDI's heavy reliance on secured liabilities or other types of noncore funding reduces its potential franchise value in case of failure, resulting in an increase in losses to the FDIC.

The loss severity score is the weighted average of the two ratio scores. Table 8 shows cutoff values and weights for these measures.

Table 8

Cutoff Values and Weights for Loss Severity Score Measures

Scorecard Measures	Cutoff Values		Weight
	Minimum	Maximum	
Potential Losses/Total Domestic Deposits (Loss Severity Measure)	0	29	75%
Noncore Funding/Total Liabilities	21	97	25%

Bank A's loss severity score would be 68.57 as shown in Table 9.

Table 9

Loss Severity Score for Bank A

Scorecard Measures	Ratio	Score*	Weight	Weighted Score
Potential Losses/Total Domestic Deposits (Loss severity measure)	23.62	81.49	75%	61.09
Noncore Funding/Total Liabilities	43.76	29.95	25%	7.49
Total Loss Severity Score				68.57

* In the example, scores are rounded to two decimal points for Bank A.

C. Total Score

Once the performance and loss severity scores are calculated, these scores are converted to a total score in two steps. The loss severity measure is first converted to a loss severity factor that ranges from 0.8 to 1.2. The performance score is then multiplied by the loss severity factor to produce a total score (total score = performance score * loss severity factor), which could be up to 20 percent higher or lower than the performance score.

For example, if Bank A's loss severity score is 68.57, its loss severity factor would be 1.12, calculated as follows:

$$0.8 + [(68.57 – 5) * 0.005] = 1.12$$

If Bank A's performance score is 69.33 and its loss severity factor is 1.12, its total score would be 12 percent greater than its performance score, calculated as follows:

$$69.33 * 1.12 = 77.65$$

An IDI's total score cannot be less than 30 or more than 90. The total score could be adjusted, up or down, by a maximum of 15 points, based upon significant risk factors that are not captured in the scorecard. The resulting scores, however, cannot be less than 30 or more than 90. Staff would use a process similar to the current large bank adjustment to determine the amount of the adjustment to the total score.[17] This discretionary adjustment is discussed in more detail below.

IV. Scorecard for Highly Complex Institutions

As mentioned above, those IDIs that are structurally and operationally complex or that pose unique challenges and risks in case of failure (highly complex IDIs) have a different

[17] 12 CFR 327.9(d)(4) (2010).

scorecard under the proposal. A "highly complex institution" is defined as: (1) an IDI (excluding credit card banks) that has had $50 billion or more in total assets for at least four consecutive quarters that either is controlled by a parent company that has had $500 billion or more in total assets for four consecutive quarters, or is controlled by one or more intermediate parent companies that are controlled by a holding company that has had $500 billion or more in assets for four consecutive quarters, or (2) a processing bank or trust company that has had $10 billion or more in total assets for at least four consecutive quarters.[18] Highly complex IDIs have a scorecard with measures tailored to the risks posed by these IDIs.

The scorecard for a highly complex IDI is similar to the scorecard for other large IDIs. Like the scorecard for other large IDIs, it contains a performance score and a loss severity score. However, the scorecard for a highly complex IDI considers two measures that do not appear in the scorecard for other large IDIs: (1) a market risk measure, which contributes to the ability to withstand asset-related stress component of the performance score; and (2) an average short-term funding to average total assets ratio, which contributes to the ability to withstand funding-related stress component of the performance score. These new measures are added because highly complex IDIs have a greater involvement in the market and these measures assess vulnerability to market changes.[19]

[18] A parent company would have the same meaning as "depository institution holding company" in section 3(w) of the FDI Act. 12 USC 1813(w)(1) (2001). Control would have the same meaning as in section 2 of the Bank Holding Company Act of 1956. See 12 USC 1841(a)(2)(2001). A credit card bank would be defined as a bank for which credit card plus securitized receivables exceed 50 percent of assets plus securitized receivables. A processing bank or trust company would be defined as an institution whose last 3 years' non-lending interest income plus fiduciary revenues plus investment fees exceed 50 percent of total revenues (and last 3 year's fiduciary revenues are non-zero).

[19] Appendix A in the NPR describes these measures in detail and provides the source of the data used to calculate the measures.

Table 10 shows the scorecard measures and the weights assigned to those measures. As with the large IDI scorecard, most of the minimum and maximum cutoff values for each scorecard measure in the highly complex IDI scorecard equal the 10th and 90th percentile values of the particular measure among large IDIs based upon data from the period between the first quarter of 2000 and the fourth quarter of 2009.[20]

Table 10

Scorecard for Highly Complex Institutions

	Scorecard Measures	Weights within Component	Component Weights
P	Performance Score		
P.1	*Weighted Average CAMELS Rating*	*100%*	*30%*
P.2	*Ability to Withstand Asset-Related Stress:*		*50%*
	Tier 1 Leverage Ratio	10%	
	Concentration Measure	35%	
	Core Earnings/Average Quarter-End Total Assets	20%	
	Credit Quality Measure and Market Risk Measure	35%	
P.3	*Ability to Withstand Funding-Related Stress*		*20%*
	Core Deposits/Total Liabilities	50%	
	Balance Sheet Liquidity Ratio	30%	
	Average Short-Term Funding/Average Total Assets	20%	
L	Loss Severity Score		
L.1	*Loss Severity*		*100%*
	Potential Losses/Total Domestic Deposits (loss severity measure)	75%	
	Noncore Funding/Total Liabilities	25%	

[20] Some measures used in the highly complex IDI scorecard (and that are not used in the scorecard for other large IDIs) do not use the 10th and 90th percentile values as cutoffs due to lack of historical data. These measures include the following: top 20 counterparty exposures to Tier 1 capital and reserves, largest counterparty exposures to Tier 1 capital and reserves, and level 3 trading assets measures. The cutoffs for the top 20 counterparty exposures to Tier 1 capital and reserves, largest counterparty exposures to Tier 1 capital and reserves, and level 3 trading assets measures are based partly upon recent experience, but the minimum cutoffs range from just under the 5th and 10th percentile values and the maximum cutoffs range from the 80th to 85th percentile values of these measures among only highly complex IDIs from the period between the first quarter of 2000 and the fourth quarter of 2009.

A. Performance Score

The scorecard for highly complex IDIs, like the scorecard for other large IDIs, contains a performance score and a loss severity score. The performance score for highly complex IDIs is the weighted average of three inputs: (1) weighted average CAMELS rating; (2) ability to withstand asset-related stress score; and (3) ability to withstand funding-related stress score. Table 10 shows the component weight given to each of these three inputs. To calculate the performance score for highly complex IDIs, the weighted average CAMELS score, the ability to withstand asset-related stress score, and the ability to withstand funding-related stress score are multiplied by their respective weights and the results are summed to arrive at the performance score. The performance score is capped at 100.

The April NPR included a market indicator—senior bond spreads—as one of the performance score components for highly complex IDIs. While staff continues to believe that market indicators provide valuable market perspectives on a highly complex IDI's performance, staff thinks that market indicators may be best considered on a bank-by bank case through the large bank adjustments, given concerns regarding market liquidity and other idiosyncratic factors.[21]

1. Weighted Average CAMELS Score

The weighted average CAMELS score for highly complex IDIs is calculated by multiplying the IDI's CAMELS component ratings by the weights that are applied under the existing rule and shown above in Table 2. The results are then summed.

2. The Ability to Withstand Asset-Related Stress

The ability to withstand asset-related component contains measures that staff finds relevant to assessing a highly complex IDI's ability to withstand such stress:

- Tier 1 leverage ratio;
- Concentration measure (the higher of the ratio of higher-risk assets to the sum of Tier 1 capital and reserves, the ratio of top 20 counterparty exposure to Tier 1 capital and reserves, or the ratio of the largest counterparty exposure to Tier 1 capital and reserves);
- The ratio of core earnings to average quarter-end total assets;
- Credit quality measure (the higher of the ratio of criticized and classified items to the sum of Tier 1 capital and reserves measure or the ratio of underperforming assets to

[21] Staff has included a question in the NPR asking whether market data should be considered as part of the performance score and if so, what type of data should be included.

the sum of Tier 1 capital and reserves measure), and the market risk measure (the weighted average of a ratio of four-quarter trading revenue volatility to Tier 1 capital, a ratio of market risk capital to Tier 1 capital, and a ratio of level 3 trading assets to Tier 1 capital).

Two of the four measures used to assess a highly complex IDI's ability to withstand asset-related stress (the Tier 1 leverage ratio and the core earnings to average total assets ratio) are determined in the same manner as in the scorecard for other large IDIs. However, the method used to calculate the other remaining measures—the concentration measure, and the credit quality and market risk measure—differ and are discussed below.

Concentration measure

As in the large IDI scorecard, the concentration measure for highly complex IDIs includes the higher-risk assets to Tier 1 capital and reserves ratio. However, the concentration measure in the highly complex IDI scorecard substitutes the top 20 counterparty exposure to Tier 1 capital and reserves and the largest counterparty exposure to Tier 1 capital and reserves for the growth-adjusted portfolio concentrations measure used in the large IDI scorecard (and in the April NPR).

The experience of the recent crisis shows that the concentration of an highly complex IDI's exposures to a small number of counterparties—either through lending or derivatives activities—significantly increases a highly complex IDI's vulnerability to unexpected market events. Staff proposes to use the top 20 counterparty exposures and the largest counterparty exposure to capture such risk.

Credit quality measure and market risk measure

As in the large IDI scorecard, the ability to withstand asset-related stress includes a credit quality measure. However, the highly complex IDI scorecard also includes a market risk measure that consists of three risk measures—trading revenue volatility, market risk capital, and level 3 trading assets. All three risk measures are calculated relative to a highly complex IDI's Tier 1 capital and multiplied by their respective weights to calculate the market risk measure. All three measures can be calculated using Call Report or Thrift Financial Report (TFR) data. Staff believes that combining these three risk measures better captures a highly complex IDI's market risk than any single measure.

The trading revenue volatility measures the sensitivity of the IDI's trading revenue to market volatility. The market risk capital measure is largely based on regulatory 10-day 99th percentile Value-at-Risk (VaR), but it incorporates specific market risk and a multiplication factor to determine the capital charge, which accounts for the number of days actual losses exceeded daily VaR measures, making the measure more comparable across highly complex

IDIs.[22,23, 24] The level 3 trading assets measure is a potential indicator of illiquidity in the trading book.

Staff recognizes that the relevance of credit risk and market risk in assessing a highly complex IDI's vulnerability to stress depends on the IDI's asset composition. An IDI with a significant amount of trading assets could be as risky as an IDI that focuses on lending even though the primary source of risk may differ. In order to treat both types of IDIs fairly, staff proposes to assign a combined weight of 35 percent to the credit risk measure and the market risk measure. The relative weight between the two may vary depending on the ratio of average trading assets to the sum of average securities, loans, and trading assets (trading asset ratio) as follows:

- Weight for Credit Quality Measure = (1 – Trading Asset Ratio) * 0.35; and,
- Weight for Market Risk Measure = Trading Asset Ratio * 0.35.

Table 12 shows the cutoff values and weights for the ability to withstand asset-related stress measures.

[22] Regulatory 10-day 99th percentile Value-at-Risk (VaR) is the estimate of the maximum amount that the value of covered positions could decline during a 10-day holding period within a 99th percent confidence level measured in accordance with section 4 of Appendix C of Part 325 of the FDIC Rules and Regulations. . http://www.fdic.gov/regulations/laws/rules/2000-4800.html#fdic2000appendixctopart325.

[23] Specific risk as defined in Appendix C of Part 325 of the FDIC Rules and Regulations means changes in the market value of specific positions due to factors other than broad market movements and includes event and default risk as well as idiosyncratic variations. http://www.fdic.gov/regulations/laws/rules/2000-4800.html#fdic2000appendixctopart325.

[24] The multiplication factor is based on the number of exceptions based on backtesting—the number of business days for which the magnitude of the actual daily net trading loss, if any, exceeds the corresponding daily VAR measures. The backtesting compares each of the IDI's most recent 250 business days' actual net trading profit or loss with the corresponding daily VAR measures generated for internal risk measurement purposes and calibrated to a one-day holding period and a 99 percent, one-tailed confidence level. . http://www.fdic.gov/regulations/laws/rules/2000-4800.html#fdic2000appendixctopart325.

Table 12

Cutoff Values and Weights for Ability to Withstand Asset-Related Stress Measures

Scorecard Measures	Cutoff Values		Sub-Component Weight	Weight
	Minimum	Maximum		
Tier 1 Leverage Ratio	6	13		10%
Concentration Measure:				35%
Higher Risk Assets/Tier 1 Capital and Reserves;	0	135		
Top 20 Counterparty Exposure/Tier 1 Capital and Reserves; or	0	125		
Largest Counterparty Exposure/Tier 1 Capital and Reserves	0	20		
Core Earnings/Average Quarter-End Total Assets	0	2		20%
Credit Quality Measure*:				35% * (1-Trading Asset Ratio)
Criticized and Classified Items to Tier 1 Capital and Reserves; or	8	100		
Underperforming Assets/Tier 1 Capital and Reserves	2	37		
Market Risk Measure*:				35% * Trading Asset Ratio
Trading Revenue Volatility/Tier 1 Capital	0	2	60%	
Market Risk Capital/Tier 1 Capital	0	10	20%	
Level 3 Trading Assets/Tier 1 Capital	0	35	20%	

* Combined, the credit quality measure and the market risk measure would be assigned a 35 percent weight. The relative weight between the two measures would depend on the ratio of average trading assets to the sum of average securities, loans and trading assets (trading asset ratio).

3. Ability to Withstand Funding-Related Stress

The ability to withstand funding-related stress component contains three measures that are most relevant to assessing a highly complex IDI's ability to withstand such stress—a core deposits to total liabilities ratio, a balance sheet liquidity ratio, and an average short-term assets to average total assets ratio.[25] Two of the measures (the core deposits to total liabilities ratio and the balance sheet liquidity ratio) in the ability to withstand funding-related stress component are determined in the same manner as in the scorecard for large IDIs, although their weights differ. However, staff adds an additional measure—the average short-term funding to average total assets ratio—to the ability to withstand funding-related stress component in the highly complex IDI scorecard because the experience during the recent crisis shows that heavy reliance on short-term funding significantly increases a highly complex IDI's vulnerability to unexpected adverse developments in the funding market.

Table 13 shows the minimum and maximum cutoff values and weights for the ability to withstand funding-related stress measures.

Table 13

Cutoff Values and Weights for Ability to Withstand Funding-Related Stress Measures

Scorecard Measures	Cutoff Values		Weight
	Minimum	Maximum	
Core Deposits/Total Liabilities	3	79	50%
Balance Sheet Liquidity Ratio	7	188	30%
Average Short-term Funding/Average Total Assets	0	20	20%

4. Calculating the Performance Score

To calculate the performance score for a highly complex IDI, the weighted average CAMELS score, the ability to withstand asset-related stress score, and the ability to withstand funding-related stress score are multiplied by their respective weights and the results are summed to arrive at the performance score. The score is capped at 100 under the proposal.

B. Loss Severity Score

The loss severity score for highly complex IDIs is calculated the same way as the loss severity score for other large IDIs.

[25] Staff has modified data elements included in the liquid assets to short-term liability ration proposed in the April NPR, and termed it as the balance sheet liquidity ratio to better reflect what the ratio is designed to capture. See Appendix A for detailed description.

C. Total Score

The total score for highly complex IDIs is calculated in the same manner as for other large IDIs. As is the case for other large IDIs, the total score cannot be less than 30 or more than 90. The total score for highly complex IDIs could be adjusted, up or down, by a maximum of 15 points, based upon significant risk factors that are not captured in the scorecard. The resulting score, however, cannot be less than 30 or more than 90. Staff would use a process similar to the current large bank adjustment to determine the amount of any adjustments.[26] This discretionary adjustment is discussed in more detail below.

V. Large Bank Adjustment to the Total Score

Under current rules, large IDIs and insured branches of foreign banks within Risk Category 1 are subject to an assessment rate adjustment (the large bank adjustment).[27] The large bank adjustment was designed to preserve consistency in the relative risk rankings of large IDIs as indicated by assessment rates, and to ensure that assessment rates take into account all available information that is relevant to the FDIC's risk-based assessment decision. Staff proposes that the large bank adjustment be retained, which would be imposed in the same manner (and subject to the same notice requirements) as under the current rule.[28]

Although the proposed scorecards are based on key uniform metrics and should improve the relative risk ranking of large IDIs over the long term, particularly during good economic times, staff continues to believe that discretionary adjustments are still needed. In considering the discretionary adjustment, staff would take into account idiosyncratic factors or other relevant risk factors that are not included in the scorecards when assessing the probability of failure and potential loss given failure. The large bank adjustment could be imposed on all large IDIs (including highly complex IDIs).

Staff 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 updated guidelines for evaluating whether assessment rate adjustments are warranted and the size of the adjustments. Staff will not adjust assessment rates until the updated guidelines are approved by the FDIC's Board. In addition, staff recommends that the FDIC publish aggregate statistics on adjustments each quarter.

VI. Initial Base Assessment Rate

A large IDI (or highly complex IDI) with a total score of 30 would pay the minimum initial base assessment rate and an IDI with a total score of 90 would pay the maximum initial

[26] 12 CFR 327.9(d)(4)(2010).

[27] 12 CFR 327.9(d)(4) (2010).

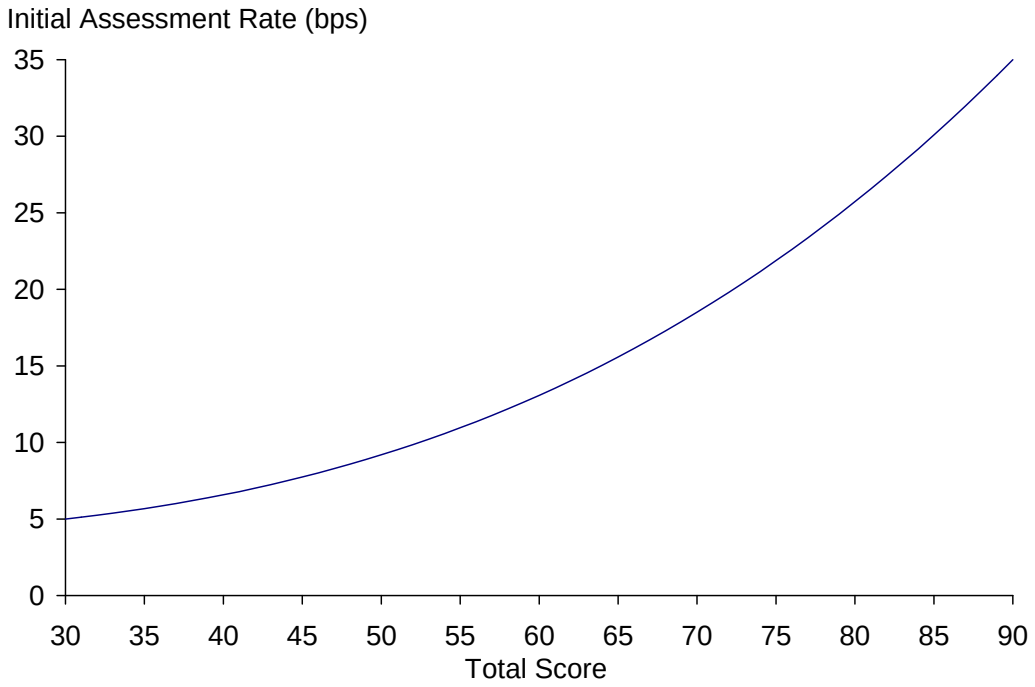
[28] 12 CFR 327.9(d)(4) (2010).

base assessment rate as proposed.[29, 30] For total scores between 30 and 90, initial base assessment rates would rise at an increasing rate as the total score increased.[31]

Chart 2 illustrates the initial base assessment rate based on a range of total scores, assuming the minimum and maximum initial base assessment rates of 5 basis points and 45 basis points.

Chart 2

Proposed Initial Base Assessment Rates



An IDI's initial base assessment rate could also be adjusted as a result of the unsecured debt adjustment, the depository institution debt adjustment, and the brokered deposit adjustment as discussed in the Assessment Base NPR.

[29] The score of 30 and 90 equals about the 13th and about the 99th percentile values, respectively, based on scorecard results as of first quarter 2006 through fourth quarter 2007.

[30] The initial base assessment rates, which staff applies in this NPR, are set out in the Assessment Base NPR (that is being proposed to the Board separately).

[31] The rate of increase in the initial base assessment rate is based on a statistical analysis of failure probabilities as described in Appendix 2 of the attached NPR.

VII. Appeals Process

Notifications involving an upward adjustment to an IDI's assessment rate would be made in advance of implementing such an adjustment so that the IDI has an opportunity to respond to or address the FDIC's rationale for proposing an upward adjustment. Adjustments would be implemented after considering the IDI's response to the notification and any subsequent changes either to the inputs or other risk factors that relate to the FDIC's decision.

VIII. Data Source

In most cases, staff proposes to use data that are currently publicly available to compute scorecard measures. Data elements required to compute four scorecard measures—higher-risk assets, top 20 counterparty exposures, the largest counterparty exposure and criticized/classified items—are currently gathered during the examination process. Rather than relying on the examination process as proposed in the April 2010 NPR, staff proposes that the FDIC collect the data elements for these four scorecard measures directly from IDIs. Staff anticipates that the necessary changes would be made to Call Reports or TFRs starting with the second quarter of 2011. The data elements would be kept confidential.

IX. Updating the Scorecard

The FDIC would have the flexibility to update the minimum and maximum cutoff values used in each scorecard annually without further rulemaking as long as the method of selecting cut-off values remains unchanged. As stated earlier, the cut-off values are generally based on the 10^{th} and 90^{th} percentile values for the ten-year period ending in 2009. In particular, staff could add new data for subsequent years to its analysis and could, from time to time, exclude some earlier years from its analysis. Updating the minimum and maximum cutoff values and weights will allow staff to use the most recent data, thereby improving the accuracy of the scorecard method.

On the other hand, if, as a result of its review and analysis, staff concludes that *additional* or *alternative* measures should be used to determine risk-based assessments, that the method of selecting cut-off values should be revised, that the weights assigned to the scorecard measures should be recalibrated, or that a new method should be used to differentiate risk among large IDIs and highly complex IDIs, these changes would be made through a future rulemaking.

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