May 3, 2006

MEMORANDUM TO: The Board of Directors

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

Fred Selby
Director, Division of Finance

Douglas H. Jones
Acting General Counsel

SUBJECT: Notice of Proposed Rulemaking to Implement the One-time Assessment Credit

RECOMMENDATION:

We recommend that the Board of Directors ("Board") issue a notice of proposed rulemaking to amend Part 327 of the FDIC's rules and regulations to implement the one-time assessment credit required by section 7(e)(3) of the Federal Deposit Insurance Act ("FDI Act") as amended by the Federal Deposit Insurance Reform Act of 2005 ("Reform Act").[1] The rulemaking must determine the aggregate amount of the one-time credit, the institutions that are eligible to receive credits, and the amount of each eligible institution's credit, which for some institutions may be largely dependent on how the FDIC defines "successor" for these purposes. The FDIC also must establish the qualifications and procedures governing the application of assessment credits, and provide a reasonable opportunity for an institution to challenge administratively the amount of the credit pursuant to section 7(e)(4).

As set out more fully below, we recommend that the Board: rely on the 1996 assessment base figures contained in the Assessment Information Management System (AIMS II)[2]; define "successor" as the resulting institution in a merger or consolidation, while seeking comment on alternative definitions; determine that the FDIC will automatically apply each institution's credit against future assessments to the maximum extent allowed consistent with the limitations in the FDI Act; and provide an appeals

[1] The Reform Act was included as Title II, Subtitle B, of the Deficit Reduction Act of 2005, Pub. L. No. 109-171, 120 Stat. 9, which was signed into law by the President on February 8, 2006.

[2] The current Assessment Information Management Systems (commonly referred to as AIMS II) contains a record for quarterly reports of condition data from institutions with bank and thrift charters. The FFIEC Central Data Repository ("FFIEC-CDR") for banks and the Thrift Financial Report for thrifts provide AIMS II with the values of the deposit line items that are used in the calculation of an institution's assessment base.

process for administrative challenges to credit amounts that culminates in review by the Assessment Appeals Committee (AAC).

We also recommend that, shortly after publication of the notice of proposed rulemaking, each affected insured depository institution be given the opportunity to review and verify its 1996 assessment base, as well as information related to mergers or consolidations to which it was a party.

BACKGROUND:

Section 7(e)(3) of the FDI Act, as amended by the Reform Act, requires that the Board provide by regulation an initial, one-time assessment credit to each “eligible” insured depository institution (or its successor) based on the assessment base of the institution as of December 31, 1996, as compared to the combined aggregate assessment base of all eligible institutions as of that date ("the 1996 assessment base ratio"), taking into account such other factors as the Board may determine to be appropriate. The aggregate amount of one-time credits is to equal the amount that the FDIC could collect if it imposed an assessment of 10.5 basis points on the combined assessment base of the Bank Insurance Fund ("BIF") and Savings Association Insurance Fund ("SAIF") as of December 31, 2001.

An “eligible” insured depository institution is one that:

1. was in existence on December 31, 1996, and paid a Federal deposit insurance assessment prior to that date;[3] or

2. is a “successor” to any such insured depository institution.

The FDI Act requires the Board to define "successor" for these purposes and provides that the Board “may consider any factors as the Board may deem appropriate.” The amount of a credit to any eligible insured depository institution must be applied by the FDIC to the assessments imposed on such institution that become due for assessment

[3] Prior to 1997, the assessments that SAIF member institutions paid were diverted, at least in part, to the Financing Corporation ("FICO"), which had a statutory priority to those funds. Beginning with enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA," Pub. L. No. 101-73, 103 Stat. 183) and ending with the Deposit Insurance Funds Act of 1996 ("DIFA," Pub. L. No. 104-208, 110 Stat. 3009, 3009-479), FICO had authority, with the approval of the FDIC's Board, to assess against SAIF members to cover anticipated interest payments, issuance costs, and custodial fees on FICO bonds. The FICO assessment could not exceed the amount authorized to be assessed against SAIF members pursuant to section 7 of the FDI Act, and FICO had first priority against the assessment. 12 U.S.C. 1441(f), as amended by FIRREA. Beginning in 1997, the FICO assessments were no longer drawn from SAIF. Rather, the FDIC began collecting a separate FICO assessment. 12 U.S.C. 1441(f), as amended by DIFA. Payments to SAIF prior to December 31, 1996, therefore, are considered deposit insurance assessments for purposes of the one-time assessment credit. The new law does not change the existing process through which the FDIC collects FICO assessments.

periods beginning after the effective date of the one-time credit regulations required to be issued within 270 days after enactment.[4]

There are three statutory restrictions on the use of credits:

1. As a general rule, for assessments that become due for assessment periods beginning in fiscal years 2008, 2009, and 2010, credits may not be applied to more than 90 percent of an institution's assessment. (This 90 percent limitation does not apply to 2007 assessments.)

2. For an institution that exhibits financial, operational, or compliance weaknesses ranging from moderately severe to unsatisfactory, or is not at least adequately capitalized (as defined pursuant to section 38 of the FDI Act) at the beginning of an assessment period, the amount of any credit that may be applied against the institution's assessment for the period may not exceed the amount the institution would have been assessed had it been assessed at the average rate for all institutions for the period.

3. If the FDIC is operating under a restoration plan to recapitalize the Deposit Insurance Fund ("DIF") pursuant to section 7(b)(3)(E) of the FDI Act, as amended by the Reform Act, the FDIC may elect to restrict credit use; however, an institution must still be allowed to apply credits up to three basis points of its assessment base or its actual assessment, whichever is less.

The regulations that the FDIC must adopt to provide the one-time credit must establish the qualifications and procedures governing the application of assessment credits. These regulations also must include provisions allowing a bank or thrift a reasonable opportunity to challenge administratively the amount of credits it is awarded.[5] Any determination of the amount of an institution's credit by the FDIC pursuant to these administrative procedures is final and not subject to judicial review.[6]

ANALYSIS:

As part of this rulemaking, the FDIC must, among other things: determine the aggregate amount of the one-time credit; determine the institutions that are eligible to

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[4] Reform Act § 2109 also requires the FDIC to prescribe, within 270 days, rules on the designated reserve ratio, changes to deposit insurance coverage, the dividend requirement, and assessments. An interim final rule on deposit insurance coverage was published on March 23, 2006. See 71 Fed. Reg. 14629. A notice of proposed rulemaking on the dividend requirement and a notice of proposed rulemaking on operational changes to the FDIC's assessment regulations are both being considered by the Board of Directors at the same time as this notice on the one-time assessment credit. Additional rulemakings on the designated reserve ratio and risk-based assessments are expected to be proposed in the near future.

[5] Similarly, for dividends under the FDI Act as amended by the Reform Act, the regulations must include provisions allowing a bank or thrift a reasonable opportunity to administratively challenge the amount of dividends it is awarded. 12 U.S.C. 1817(e)(4).

[6] 12 U.S.C. 1817(b)(3)(E)(i), (e)(3) & (4).

receive credits; and determine the amount of each eligible institution's credit, which for some institutions may be largely dependent on how the FDIC defines "successor" for these purposes. The FDIC also must establish the qualifications and procedures governing the application of assessment credits, and provide a reasonable opportunity for an institution to challenge administratively the amount of the credit. The FDIC's determination after such challenge is to be final and not subject to judicial review.

I. Aggregate Amount of One-time Assessment Credit

The aggregate amount of the one-time assessment credit is expected to be $4,707,580,238.19, which is calculated by applying an assessment rate of 10.5 basis points to the combined assessment base of BIF and SAIF as of December 31, 2001. Staff recommends that the FDIC rely on the assessment base numbers available from each institution's certified statement (or amended certified statement), filed quarterly and preserved in AIMS II, which records the assessment base for each insured depository institution. AIMS II is the FDIC's official system of records for determination of assessment bases and assessments due.

II. Determination of Eligible Insured Depository Institutions and Each Institution's 1996 Assessment Base Ratio

The FDIC must determine the assessment base of each eligible institution on December 31, 1996, and any successor institutions to determine the 1996 assessment base ratio. In making these determinations, the Board has the authority to take into account such factors as the Board may determine to be appropriate. 12 U.S.C. 1817(e)(3)(A).

Stated simply, the denominator of the 1996 assessment base ratio is the combined aggregate assessment base of all eligible insured depository institutions and their successors. The numerator of each eligible institution's 1996 assessment base ratio is its assessment base as of December 31, 1996, together with the assessment base as of December 31, 1996, of each institution (if any) to which it is a successor. An eligible insured depository institution is one in existence on December 31, 1996, that paid an assessment prior to that date (or a successor to such institution).

A. Determination of Eligible Institutions

As a starting point, staff recommends that the FDIC use the December 31, 1996 assessment base for each institution, as it appears on the institution's certified statement or as subsequently amended and as is recorded in AIMS II. Those numbers reflect the bases on which institutions that existed on December 31, 1996, paid assessments. As of December 31, 2005, it appears that there were approximately 7,400 active insured depository institutions that may be eligible for the one-time assessment credit -- that is, they were in existence on December 31, 1996, and had paid an assessment prior to that date.

1. Effect of Voluntary Termination or Failure

The FDIC has identified those institutions that have voluntarily terminated their insurance or failed since December 31, 1996, which otherwise would have been considered eligible insured depository institutions for purposes of the one-time credit. It is recommended that the definition of "successor" (discussed more fully below) govern the determination of whether an institution that voluntarily terminated is eligible and its credits transfer to a successor. Whether an institution that voluntarily terminated would have a successor would depend on the specific circumstances surrounding its termination. Staff recommends that an insured depository institution that has failed would not have a successor.

2. *De Novo* Institutions

The FDIC has identified those institutions newly in existence as of December 31, 1996 ("*de novo* institutions") that did not pay deposit insurance premiums prior to December 31, 1996. Under the statute, those institutions could not be eligible insured depository institutions for purposes of the one-time assessment credit.

Our records indicate that there were approximately 90 institutions that became newly insured between July 1, 1996, and December 31, 1996, that did not pay any deposit insurance assessment and did not acquire another institution that had paid assessments before year-end 1996. These institutions are not eligible for credits under the terms of the statute.

In addition, our records indicate that there are two *de novo* institutions that did not pay assessments directly, but each acquired by merger an institution that had paid assessments before December 31, 1996. Under traditional corporate law rules, the surviving or resulting institution in a merger or consolidation is considered to have acquired the rights, privileges, powers, franchises, and property of the terminating institution, as well as the liabilities, restrictions, and duties of that institution. The surviving or resulting institution effectively continues the business of the terminating institution. 15 William Meade Fletcher et al., Fletcher Cyclopedia of the Law of Private Corporations §§ 7041-7100 (perm. ed., rev. vol. 1999). On that basis, it is recommended that a *de novo* institution that acquired, through merger or consolidation, an existing insured depository institution that had paid a deposit insurance assessment be considered to have stepped into the shoes of the existing institution for purposes of determining eligibility for the one-time assessment credit.

B. Definition of "Successors"

As noted above, an insured depository institution in existence on December 31, 1996, that paid deposit insurance premiums is eligible for the one-time assessment credit. An institution also may be eligible as a "successor" to such an institution. In making the preliminary determinations of eligible insured depository institutions, their assessment bases as of December 31, 1996, and the combined assessment base of the BIF and the

SAIF as of the same date, staff has relied on the institution's certified statement (as amended, if necessary), as recorded in AIMS II.

Many institutions that existed at the end of 1996 no longer exist. Some have disappeared through merger or consolidation. In fact, it appears that approximately 3,850 additional institutions that were in existence on December 31, 1996, have since combined with other institutions. In addition, 38 other institutions have failed and no longer exist, while the FDIC has to date identified approximately 90 institutions that voluntarily relinquished federal deposit insurance coverage or had their coverage terminated. The FDIC does not maintain complete records on sales of branches or blocks of deposits, but various sources suggest that at least 1,400 and possibly over 1,800 branch or deposit transactions have occurred since 1996.

Section 7(e)(3)(F) of the FDI Act expressly charges the FDIC with defining "successor" by regulation for purposes of the one-time credit, and it provides the FDIC with broad discretion to do so. The Board may consider any factors it deems appropriate.

In reaching their recommendations regarding the definition of "successor," staff viewed the issue in the context of two fundamental questions: what would be most consistent with the purpose of the one-time credit and what would be operationally viable. While a number of definitions of "successor" are possible in light of the discretion accorded the FDIC in defining the term, on balance, staff concluded that one approach was more consistent with the purpose of the credit and more operationally viable.

Staff considered definitions that would focus on the institution itself and definitions that linked credits to deposits and considered the arguments in support of those definitions. Proponents of an institution-based approach might argue that it is the institution that paid deposit insurance premiums to capitalize the insurance funds, that the potential one-time credit would be one of the rights or privileges of an institution that would be acquired through merger or consolidation under general principles of corporate law, and that a different approach could result in institutions that had not paid premiums to capitalize the funds receiving credits. Proponents of a “follow-the-deposits” definition, however, might argue that the one-time credit should adhere to deposits because the one-time credit is to be allocated based on deposits and is intended to offset future assessments to be paid on deposits. Staff also considered the operational viability of these approaches to the definition and found that the FDIC’s existing systems of records could support an institution-based approach, but a follow-the-deposits approach would require collection of information from the industry before it could be fully implemented.

For the reasons set forth below, staff recommends that the FDIC define "successor" for purposes of the one-time credit as the resulting institution in a merger or consolidation occurring after December 31, 1996. As recommended, the definition would not include a purchase and assumption transaction, even if substantially all of the assets and liabilities of an institution are acquired by the assuming institution. However, staff further recommends that the FDIC request comment on whether to include in this

definition a regulatory definition of a *de facto* merger to recognize that the results of some transactions, which are not technically mergers or consolidations, largely mirror the results of a merger or consolidation.

a. Merger or Consolidation Rule

Defining "successor" as the resulting institution in a legal merger or consolidation is consistent with the clear purpose of the one-time assessment credit -- to recognize the contributions that some insured depository institutions made to capitalize the deposit insurance funds and conversely to recognize that many newer institutions have never paid assessments because they were chartered after the reserve ratios of BIF and SAIF reached 1.25 percent and most institutions were charged nothing.[7] In addition, staff believes that this definition is consistent with the general expectations of the industry, because it reflects the common legal meaning of the word "successor" and the principle that the resulting corporation in a merger or consolidation generally receives the rights, privileges, interests, and liabilities of the merging or consolidating corporations. 15 William Meade Fletcher et al., Fletcher Cyclopedia of the Law of Private Corporations §§ 7041-7100 (perm. ed., rev. vol. 1999). Institutions that acquired other institutions by way of merger or consolidation would have believed that they were acquiring *all* of the rights and privileges of the acquired institution, known or unknown.

While it is possible that some state banking laws may differ, this definition is consistent with the National Bank Consolidation and Merger Act.[8] The FDIC has significant discretion in defining the term "successor" for these purposes, and a single federal standard is essential to allow the FDIC to implement and administer the one-time credit requirement in a timely and efficient manner.

Mergers and consolidations require regulatory approval under section 18(c) of the FDI Act, and the FDIC maintains records on true mergers and consolidations.[9] Only if the FDIC's records are incomplete or in error will institutions have to provide information to the FDIC. Because the merger or consolidation rule relies on existing data, it is operationally viable. In addition, a merger or consolidation rule would not advantage or disadvantage parties simply on the basis of whether they kept records on transactions for which the statute of limitations has expired.[10]

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[7] Prior to the effective date of changes to the FDIC's assessment authority by the Reform Act, the FDIC is required to set assessments when necessary and only to the extent necessary to maintain the reserve ratio at 1.25 percent of estimated insured deposits, except for those institutions that exhibit financial, operational, or compliance weaknesses ranging from moderately severe to unsatisfactory, or are not well capitalized. 12 U.S.C. 1817(b)(2)(A) (2005).

[8] 12 U.S.C. 215, 216.

[9] See 12 U.S.C. 1828(c). Approximately 3,850 mergers and consolidations have taken place since December 31, 1996.

[10] Section 7(b)(5) of the FDI Act currently requires institutions to maintain assessment-related records for five years, and section 7(g) provides a five-year statute of limitations for assessment actions. The Reform

b. *De Facto* Merger Alternative

Some transactions may effectively parallel the results of a merger or consolidation. Staff looked to traditional principles of corporate law for guidance on this issue and found a useful analogy. Traditional corporate law principles provide for certain exceptions to the general rule that liabilities do not transfer with the sale of assets, including an exception for a transaction that amounts to a *de facto* merger or consolidation ("de facto merger").

Staff recognizes, however, that a *de facto* merger exception could be viewed as a departure to some extent from the clear, bright line that a strictly applied merger or consolidation rule would provide. Staff, therefore, recommends that the FDIC seek comment on whether to include *de facto* mergers in the definition of "merger" for purposes of the one-time assessment credit and to provide a definition of *de facto* merger. A *de facto* merger for these purposes could be defined, for example, as an eligible institution conveying all of its deposit liabilities and substantially all of its assets to a single acquiring institution, so long as the conveying institution subsequently terminated its deposit insurance. This type of transaction might have arisen, for example, as part of a voluntary liquidation. Even under this alternative, unless an eligible institution actually merged or consolidated with another institution, it would not have a successor if it conveyed its assets and deposit liabilities to more than one acquiring institution.

2. Alternative Approaches to Definition of Successor that Would "Follow the Deposits"

Staff also explored alternative definitions of successor that allowed credits to follow deposits (regardless of the means by which deposits were transferred, including merger, consolidation, branch sale, or other deposit transfer). These alternative definitions might be based on a view that credits should adhere to deposits, as described above. Under these alternative definitions, credits could be transferred on a *pro rata* basis with the deposits transferred or they could be split between the parties to the deposit transfer transaction. Splitting the credits associated with a deposit transfer between the buyer and seller would be a compromise solution and would recognize that, as a practical matter, it is unlikely the parties to most of these deposit transfers took into account the potential for assessment credits at the time of the transactions.

After considering the arguments, staff concluded that a "follow-the-deposits" approach seemed less consistent with the purpose of the one-time credit and did not reflect the reasonable expectations of parties to transactions based on general corporate law principles. In addition, staff had serious concerns about the operational viability of a "follow-the-deposits" approach because of: an absence of reliable existing data; the number of interrelated transactions that would have to be resolved due to the passage of time and consolidation in the industry; and the potential inequities and litigation risks inherent in mechanisms (such as thresholds or other choices) that might be used to reduce

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Act includes amendments to those provisions, prospectively shortening both to three years, effective on the date that new assessment regulations take effect. Reform Act §§ 2104(b), (d) and 2109(a)(5).

the number of potential claims to a more manageable level. Potential inequities also arise in connection with the data issue because institutions that engaged in very similar transactions could be treated differently solely because some institutions retained records long past the expiration of the statute of limitations and others did not.

The FDIC does not routinely maintain the detailed data on all deposit transfer transactions that would be necessary to implement a "follow-the-deposits" rule. Thus, most, if not all, of the necessary information would have to be collected from the industry and disputes between institutions resolved before a "follow-the-deposits" approach to allocating the one-time credit could be fully implemented. As previously noted, available data suggests that, in addition to roughly 3,850 mergers and consolidations, at least 1,400 and possibly over 1,800 branch or deposit transactions have occurred since 1996.

Because of the possibility of a chain of mergers, consolidations, and deposit transfers, resolving one institution’s claim to one-time credits first might require examining claims from many transactions in the chain. In most cases, the FDIC would have to review and rely on the records of the institutions involved in the deposit transfer. Appeals of credit determinations could become lengthy fact finding exercises involving the comparison of the available evidence from all of the institutions involved.

Staff explored developing a type of *de minimis* rule under which, for example, only deposit transfers (or a series of transfers) from one institution to another that, in total, exceeded some percentage threshold, such as 15 percent of the transferor’s total domestic deposits or 30 percent of the transferee's deposits as determined at the time of the transfer, might be considered. Staff's concern with this approach was that thresholds or other choices to limit the number of institutions covered by a rule by their nature may result in disparate treatment of otherwise similarly situated institutions.

Because the statute of limitations will have expired with respect to many deposit transfer transactions from the late 1990s, institutions may not have retained records of these transactions. Institutions that saved their records would have a significant advantage over those that did not, potentially leading to results based solely on the availability of records.

Staff recommends that comments be specifically sought on the definition of "successor" for these purposes, because that definition plays such a critical role in determining the allocation of the one-time credit and is expected ultimately to affect as well the distribution of future dividends required under section 7(e)(2) of the FDI Act, as amended by the Reform Act. Staff further recommends that the notice of proposed rulemaking specifically request comment on the purpose of the one-time credit and the extent to which the various possible definitions of "successor" are viewed as consistent with that purpose. The recommendation is also to request suggestions on whether a "follow-the-deposits" approach could be made more operationally viable, including how the data issue might be addressed.

3. No Successor Identified

Staff recommends that, if there is no successor to an institution that would have been eligible for the one-time assessment credit before the effective date of the final rule, because an otherwise eligible institution ceased to be an insured depository institution before that date, then that portion of the aggregate one-time credit amount that institution would have been entitled to receive would be redistributed among the eligible institutions. For example, if an otherwise eligible insured depository institution failed after December 31, 1996, but before the issuance of the final rule implementing the one-time credit, that institution would be excluded from the calculation. As a result, the remaining eligible institutions would receive a proportionate share of that failed institution's share of the one-time credit.

On the other hand, if there is no successor to an eligible insured depository institution that ceases to exist after the Board adopts the final rule, staff recommends that that institution's credits expire unused. One example would be the failure of an eligible institution after it has received its one-time credit amount. Under those circumstances, any remaining one-time credit amount would simply expire.

III. Notification of 1996 Assessment Base Ratio and Credit Amount

Staff recommends that the FDIC make available, after the publication of the Notice of Proposed Rulemaking, a searchable database provided through the FDIC's public website (www.fdic.gov) that shows each currently existing institution and its predecessors by merger or consolidation from January 1, 1997, onward, based on information contained in certified statements, AIMS II, and the Structure Information Management System ("SIMS").[11] The database would include corresponding December 31, 1996 assessment base amounts for each institution and its predecessors and a preliminary estimate of the amount of one-time credits that the existing institution would receive based on the proposed definition of successor.

The database will allow searching by institution name or insurance certificate number to ascertain which current institution (if any) would be considered a successor to an institution that no longer exists. Institutions would have the opportunity to review this information, which could reduce the time needed to determine successors even if one of the "follow-the-deposits" alternatives for defining "successor" is adopted in the final rule. Institutions should be aware that this preliminary estimate could change, for example, because of a change in the definition of "successor" adopted in the final rule or because of a change in the information available to the FDIC for determining eligibility or successorship.

Staff recommends that the FDIC notify each insured depository institution of its 1996 assessment base ratio and share of the one-time assessment credit as soon as

[11] SIMS maintains current and historical non-financial data for all institutions that is retrieved by AIMS II to identify all currently assessable institutions for each quarterly assessment invoice cycle. SIMS offers institution-specific demographic data, including a complete set of information on merger or consolidation transactions. SIMS, however, does not contain complete information about deposit or branch sales.

practicable after the Board approves the final rule, based on the information developed through the FDIC's searchable database. The notice would take the form of a Statement of One-time Credit (or "Statement"): informing every institution of its 1996 assessment base ratio; itemizing the 1996 assessment bases to which the institution may now have claims pursuant to the successor rule based on existing successor information; providing the amount of the institution's one-time credit based on that 1996 assessment base ratio as applied to the aggregate amount of the credit; and providing the explanation as to how ratios and resulting amounts were calculated generally. Staff recommends that the Statement of One-time Credit be provided through FDIC*connect* or by mail in accordance with existing practices for assessment invoices.

If an institution has any questions as to the calculation of its 1996 assessment base ratio or its credit amount, staff recommends that the institution be advised to contact the Division of Finance. Staff believes that institutions should be encouraged to discuss and attempt to resolve perceived discrepancies due to the omission of a merger or consolidation, or due to disagreement about the size of an institution's 1996 assessment base, while the notice of proposed rulemaking is out for comment.[12] As described below, each institution would have the opportunity to challenge formally the amount of its assessment credit, regardless of whether the institution sought an informal resolution during the rulemaking. Depending upon the definition of "successor" ultimately adopted, some challenges may not be resolved prior to the collection of assessments after the effective date of the final rule. However, staff recommends that the FDIC make available any credit amounts that are not in controversy. For example, if an eligible institution argues that it may be entitled to a larger share of the one-time credit as a successor, the amount of its original 1996 base ratio and share will be available (assuming they are not in dispute), and any potential additional amounts would be frozen until resolution of the challenge.

IV. Requests for Review of Credit Amounts

Section 7(e)(4) of the FDI Act requires the FDIC's credit regulations to include provisions allowing an institution a reasonable opportunity to challenge administratively the amount of its one-time credit. The FDIC's determination of the amount following any such challenge is to be final and not subject to judicial review. The administrative procedures that staff recommends are intended generally to parallel the process for requesting revision of computation of quarterly assessment payments. Deadlines, however, would be shorter because of the need to resolve credit appeals quickly so institutions can use the credits to offset assessments.

As noted above, the FDIC expects to notify each institution of its one-time credit share as soon as practicable after the issuance of the one-time assessment credit final rule through FDIC*connect* and by mail. The Statement of One-time Credit would include the 1996 assessment base ratio for the institution, the amount of the assessment credit to be

[12] Staff believes that the information developed through the searchable database would be useful even if the final rule defines "successor" in a way that follows deposits, because a "follow-the-deposit" definition would include recognition of deposits actually transferred as part of a merger or consolidation.

awarded to the institution, and a discussion of the basis for these calculations, based on the FDIC's definition of "successor" and any other relevant factors.

After this initial notification, it is recommended that an updated notice of the remaining amount of one-time credit, as well as any appropriate adjustment to an institution's 1996 assessment base ratio due to a subsequent merger or consolidation, be included with the each quarterly assessment invoice. The initial Statement and any subsequent assessment invoices advising of the remaining credit amount or an adjustment to the assessment base ratio would also advise institutions of their right to challenge the calculation and the procedures to follow.

It is recommended that the proposed rule provide that an institution could request review if: (1) it disagrees with the FDIC's determination of eligibility or ineligibility for the credit; (2) it disagrees with the computation of the credit amount on the initial Statement or any subsequent invoice; or (3) it believes that the Statement or a subsequently updated invoice does not fully or accurately reflect appropriate adjustments to the institution's 1996 assessment base ratio. For example, the institution may believe that its 1996 assessment base ratio has not been adjusted to reflect its acquisition through merger of an eligible institution.

It is recommended that an institution that disagrees with the FDIC's determination have 30 days from the date the FDIC made available its Statement of One-time Credit to file a request for review with the Division of Finance. The request would have to be accompanied by any documentation supporting the institution's claim. Staff recommends that, if an institution does not submit a timely request for review, the institution be barred from subsequently requesting review of its one-time assessment credit amount.

In addition, staff recommends that the requesting institution be required to identify all other institutions of which it knew or had reason to believe would be directly and materially affected by granting the request for review and provide those institutions with copies of the request for review, supporting documentation, and the FDIC's procedures for these requests for review. Staff further recommends that the FDIC make reasonable efforts, based on its official systems of records, to determine that such institutions have been identified and notified. These institutions would then have 30 days to submit a response and any supporting documentation to the FDIC's Division of Finance, copying the institution making the original request for review. Staff recommends that, if an institution is identified and notified through this process and does not submit a timely response, the institution be: (1) foreclosed from subsequently disputing the information submitted by any other institution on the transaction(s) at issue in the review process; and (2) foreclosed from any appeal of the decision by the Director of the Division of Finance (discussed below).

The FDIC also may request additional information as part of its review, and it is recommended that the proposed rule require the institution to supply that information within 21 days of the date of the FDIC's request for additional information.

It is recommended that the FDIC temporarily freeze the distribution of the amount of the proposed credit that is in dispute for the institutions involved in the challenge until the challenge is resolved.

Staff also recommends that the proposed rule require a written response from the FDIC's Director of the Division of Finance ("Director"): (1) within 60 days of receipt by the FDIC of the request for revision, (2) if additional institutions have been notified by the requesting institution or the FDIC, within 60 days of the date of the last response, or (3) if additional information has been requested by the FDIC, within 60 days of receipt of any additional information due to such request, whichever is later. Whenever feasible, the response would notify the requesting institution and any materially affected institutions of the determination of the Director as to whether the requested change is warranted. In all instances in which a timely request for review is submitted, the Director will make a determination on the request as promptly as possible and notify the requesting institution and any other materially affected institutions in writing of the determination. Notice of the procedures applicable to reviews will be included with the initial Statement and any subsequent assessment invoice providing notification of the amount of credit and any change to the institution's 1996 assessment base ratio.

Under the recommended rule, the institution that filed the request for review, or a materially affected institution, that disagrees with the determination of the Director may appeal its credit determination to the AAC. An appeal would have to be filed within 15 calendar days from the date of the Director's written determination. Notice of the procedures applicable to appeals will be included with that written determination. The AAC's determination would be final and not subject to judicial review.

A number of challenges may arise in connection with the distribution of the one-time credit, in large part because many transactions occurred after 1996 and before the Reform Act provided for a one-time credit, and because this will be the first time that an institution's 1996 assessment base ratio is calculated. Once those challenges are resolved, and each institution's 1996 assessment base ratio for purposes of its one-time credit share is established, unforeseen circumstances or issues may lead to other challenges of credit share, and administrative procedures will remain in place to address those challenges.

Once the Director or the AAC has made the final determination, as appropriate, the FDIC would adjust the affected institutions' 1996 assessment base ratios consistent with that determination and correspondingly update each affected institution's share of the one-time credit.

V. Using credits

Staff recommends that the FDIC track each institution’s one-time credit amount and automatically apply an institution’s credits to its assessment to the maximum extent allowed by law. For fiscal year 2007 assessment periods, for most institutions, credits generally can offset 100 percent of the institution's assessment. For assessments that become due for assessment periods beginning in fiscal years 2008, 2009, and 2010, the FDI Act provides that credits may not be applied to more than 90 percent of an

institution's assessment. Thus, under the recommendation, credits would automatically apply to 90 percent of an institution's assessment, assuming the institution has sufficient credits, subject to the other two statutory limitations on usage. The FDI Act does not define a "fiscal year," thereby giving the FDIC the discretion to define it for these purposes. Staff recommends that the FDIC interpret the term "fiscal year" to mean the calendar year.

One of the other limitations is that, for an institution that exhibits financial, operational, or compliance weaknesses ranging from moderately severe to unsatisfactory, or is not adequately capitalized at the beginning of an assessment period, the amount of any credit that may be applied against the institution's assessment for the period may not exceed the amount the institution would have been assessed had it been assessed at the average rate for all institutions for the period.

Staff recommends that the FDIC interpret the phrase "average assessment rate" to mean the aggregate assessment charged all institutions in a period divided by the aggregate assessment base for that period. The FDI Act does not define "average assessment rate" for these purposes, leaving that to the discretion of the FDIC. On balance, staff views the recommended approach as preferable to an average calculated by the sum of all assessment rates divided by the number of institutions, because the recommended interpretation is viewed as more accurately reflecting the average rate actually charged all insured institutions.

Section 7(b)(3)(E) of the FDI Act, as added by section 2106 of the Reform Act, also will give the FDIC the discretion to limit the application of the one-time credit, when the FDIC establishes a restoration plan to restore the reserve ratio of the DIF to the range established for it.[13] That discretion, however, is restricted by the statute. During the time that a restoration plan is in effect, the FDIC shall apply one-time credit amounts against any assessment imposed on an institution for any assessment period in an amount equal to the lesser of (1) the amount of the assessment, or (2) the amount equal to three basis points of the institution's assessment base.

Credit amounts may not be used to pay FICO assessments pursuant to section 21(f) of the Federal Home Loan Bank Act, 12 U.S.C. 1441(f). The Reform Act does not affect the authority of FICO to impose and collect, with the approval of the FDIC's Board, assessments for anticipated interest payments, issuance costs, and custodial fees on obligations issued by FICO.

VI. Transferring credits

The FDI Act provides for transferring one-time credits through successors to eligible insured depository institutions. A successor institution, as defined by regulation,

[13] Section 2105 of the Reform Act, amending section 7(b)(3) of the FDI Act to establish a range for the reserve ratio of the DIF, will take effect on the date that final regulations implementing the legislation with respect to the designated reserve ratio become effective. Those regulations are required to be prescribed within 270 days of enactment. Reform Act § 2109(a)(1).

would succeed to the predecessor institution's credits and to its 1996 assessment base ratio for purposes of any future dividends.

Staff recommends that the FDIC further propose to allow transfer of credits and adjustments to 1996 assessment base ratios by express agreement between insured depository institutions prior to the FDIC's final determination of an eligible insured depository institution's 1996 assessment base ratio and one-time credit amount pursuant to these regulations. It is possible that such agreements might already be part of deposit transfer contracts drafted in anticipation of deposit insurance reform legislative changes. Alternatively, institutions involved in a dispute over successorship, their 1996 assessment base ratio, and their shares of one-time credit might reach a settlement over the disposition of the one-time credit. In either case, staff recommends that the FDIC require submission of a written agreement signed by legal representatives of the involved institutions. Upon the FDIC's receipt of the agreement, it is recommended that appropriate adjustments be made to the institutions' affected one-time credit amounts and 1996 assessment base ratios. Adjustments to each institution's credit amount and 1996 assessment base ratio would then be reflected with the next quarterly assessment invoice, so long as the institutions submit the written agreement at least 10 business days prior to the FDIC's issuance of invoices for the next assessment period. If the FDIC does not receive the written agreement at least 10 days before the next assessment invoice, the FDIC shall retroactively adjust the invoice or invoices in later assessment periods.

Similarly, after an institution's credit share has been finally determined and no request for review or appeal is pending with respect to that credit amount, staff recommends that the FDIC recognize an agreement between insured depository institutions to transfer a portion of the one-time credit from the eligible institution to another institution. It is recommended that institutions be required to submit a written agreement signed by legal representatives of the involved institutions. Adjustments to each institution's credit amount would then be reflected with the next quarterly assessment invoice, so long as the institutions submit the written agreement to the FDIC at least 10 business days prior to the FDIC's issuance of invoices for the next assessment period. If the FDIC does not receive the transfer agreement in sufficient time to reallocate credits for that invoice, the FDIC will make a retroactive adjustment to the invoice or invoices in later periods.

With respect to these transactions occurring after the determination of each eligible institution's 1996 assessment base ratio and share of the one-time credit as of the effective date of these regulations, staff proposes not to adjust the transferring institution's 1996 assessment base ratio. Adjustments to the 1996 ratios would be made only to reflect mergers or consolidations occurring after the effective date of these regulations. There would seem to be less likelihood of disputes over successorship going forward, because institutions would be aware of the definition of "successor" and could take that into account in future contracts as the parties deem appropriate. Thus, there seems little need to allow the sale of an institution's 1996 assessment base ratio, which the FDIC would have to track on an ongoing basis for future dividends.

CONCLUSION:

For the reasons discussed above, we recommend that the Board adopt the proposed rule to implement the one-time assessment credit required by section 7(e)(3) of the FDI Act, as amended by the Reform Act.

Staff members knowledgeable about this case: Munsell W. St. Clair, Donna M. Saulnier, and Kymberly K. Copa

Attachments

RESOLUTION

WHEREAS, section 7(e)(3 of the Federal Deposit Insurance Act (FDI Act), as amended by the Federal Deposit Insurance Reform Act of 2005 (Reform Act), requires the FDIC to provide for a credit to each eligible insured depository institution (or a successor insured depository institution), based on the assessment base of the institution on December 31, 1996, as compared to the combined aggregate assessment base of all eligible insured depository institutions, taking into account such factors as the Board of Directors may determine to be appropriate; and

WHEREAS, such statute requires the FDIC to define the term "successor" by regulation for purposes of the credit, and in so doing the FDIC may consider any factors the Board may deem appropriate; and

WHEREAS, such statute requires the FDIC to prescribe by regulation, after notice and opportunity for comment, the qualifications and procedures governing the application of assessment credits, and section 2109(a)(4) of the Reform Act requires that regulations implementing the credit requirement be prescribed not later than 270 days after the date of enactment; and

NOW, THEREFORE, BE IT RESOLVED, that the Board hereby authorizes publication in the Federal Register of the attached notice of proposed rulemaking through which part 327 would be amended to implement the credit requirement enacted by the Reform Act.

BE IT FURTHER RESOLVED, that the Board hereby delegates authority to the Executive Secretary, or his designee, and the General Counsel, or his designee, to make technical, nonsubstantive, or conforming changes to the attached notice and to take such other actions and issue such other documents incident and related to the foregoing as they deem necessary or appropriate to fulfill the Board's objective in connection with this matter.