



On Friday February 27, 2009, the FDIC issued the proposed final rules for insurance assessments for 2009. The proposed final rules reflect adjustments to the proposed rules issued on October 7, 2008. Those rules were the first effort to create a risk-based assessment schedule where banks with greater risk of causing a cost to the Deposit Insurance Fund (DIF) pay a higher assessment. The FDIC established assessment rates for the first quarter of 2009, and these proposed final rules establish the assessments for the final three quarters of 2009. The purpose of this memo is to outline the new rules.

The proposed final rules for 2009 make the following changes to the proposed rules first issued:

1. Expands the range between minimum and maximum initial assessment rates institutions in Risk Category I
2. Adds a new financial ratio-adjusted brokered deposit ratio to the financial ratio method for institutions in Risk Category I
3. Adds the financial ratio method assessment rate to the assessment rate formula for large institutions with a long-term debt rating (the large bank method)
4. Increases the maximum possible Risk Category I large bank adjustment
5. Provides for an unsecured debt adjustment for institutions in all risk categories
6. Provides for a secured liability adjustment for institutions in all risk categories
7. Provides for a brokered deposit adjustment for institutions in Risk Category II, III, and IV
8. Establishes new assessment rates for each risk category

In addition to issuing the proposed final rules, the FDIC also passed the Deposit Insurance Fund Restoration Plan (the "Plan"). This Plan is an effort to bring the DIF back to minimum coverage ratios. The minimum coverage ratio is now defined as a range between 1.15% and 1.25% of total deposits covered by the DIF. Instead of getting back to that coverage ratio in five years as mandated, the FDIC is now proposing to recover to those levels in seven years.

The primary method to increase coverage ratios is through a special assessment. The proposed Plan calls for a twenty (20) basis point special assessment on deposit balances as of June 30, 2009, and payable on September 30, 2009. In addition, the Plan allows the FDIC to make another ten (10) basis points special assessment should coverage ratios not meet projected levels in the future.

Assessment Rate Schedule

The adoption of the proposed final rules will result in significant increases in the cost of deposits. From a management standpoint, the most important control effort is to be a Risk Category I bank. The following table reflects the process of assigning risk to banks with the roman numerals reflecting the Risk Category:

<u>Capital Category</u>	<u>Supervisory Group</u>		
	A	B	C
Well Capitalized	I	II	III
Adequately Cap	II	II	III
Undercapitalized	III	III	IV

The assignment of each bank to a specific supervisory group is based on the regulatory determined review. Group A consists of financially sound institutions with only a few minor weaknesses. Group B consists of institutions that demonstrate weaknesses which, if not corrected, could result in significant deterioration of the institution and increased risk of loss to the insurance fund. Group C consists of institutions that pose a substantial probability of loss to the insurance fund unless effective corrective action is taken. Generally, banks with a CAMELS rating of 1 or 2 are assigned to supervisory Group A, those with a camels rating of 3 to Group B and those with a CAMELS rating of 4 or 5 to Group C.

The following is the Initial Assessment rate schedule for each Group:

Rate (bp)	Risk Category				
	I		II	III	IV
	<u>Minimum</u>	<u>Maximum</u>			
	12	16	22	32	45

In addition to the assessment rates as provided above, adjustments will be made to reflect certain funding conditions. Those adjustments are as follows:

Rate (bp)	Risk Category				
	I		II	III	IV
	<u>Minimum</u>	<u>Maximum</u>			
	12	16	22	32	45
Unsecured Debt	-5 - 0	-5 - 0	-5 - 0	-5 - 0	-5 - 0
Secured Liability	0 - 8	0 - 8	0 - 11	0 - 16	0 - 22
Brokered Deposit			0 - 10	0 - 10	0 - 10
Total Base Rate (bp)	7 - 24.0	7 - 24.0	17 - 43.0	27 - 58.0	40 - 77.5

The proposed final rules raise the Initial Assessment rates beginning April 1, 2009. That means the first date when the higher rates affect the deposit premium paid will be September 30, 2009. The purpose of this memo is not to discuss what factors cause an individual bank to fall within a specific Risk Category. Those banks that want to discuss the steps needed to move up in Risk Categories should contact Austin Associates.

For those banks that are in Risk Category I, the Initial Assessment rate will be determined by using a combination of supervisory ratings (CAMELS) and the following financial ratios:

1. Tier 1 Leverage Ratio
2. Loans past due 30-89 days/gross assets
3. Nonperforming assets/gross assets
4. Net loan charge-offs/gross assets
5. Net income before taxes/risk-weighted assets
6. Adjusted brokered deposit ratio (see appendix)

The weighted CAMELS components and financial ratios are multiplied by statistically derived pricing multipliers and the products, along with a uniform amount applicable to all institutions subject to the financial ratios method, are summed to derive the Initial Assessment rate. The multipliers used were determined by the FDIC to generate a specific percentage Risk Category I banks that pay either the minimum or maximum Initial Assessment. Additionally, for large banks (defined as banks with total assets in excess of \$10 billion) that have issued debt that has been rated by an independent rating agency,

that debt rating will be added to the CAMELS and financial ratio analysis to determine that banks Initial Assessment charge. The proposed final rules provide that no Risk Category I bank will pay less than the minimum or more than the maximum assessment rates no matter what the results of these calculations.

Under the proposed final rules, an institution's Total Base Assessment rate can vary from the initial rate as the result of adjustments. Those adjustments and the definitions are as follows:

Unsecured Debt Adjustment

The bank's ratio of long-term unsecured debt or Tier 1 capital to domestic deposits can lower the institution's initial assessment. Long-term unsecured debt is used for large banks, while a portion of the Tier 1 capital is used for small banks. The maximum reduction is five (5) basis points. The adjustment excludes senior unsecured debt that the FDIC has guaranteed under its Temporary Liquidity Guarantee Program.

Secured Liability Adjustment

The ratio of secured liabilities (including FHLB advances and repurchase agreements) to domestic deposits can increase the initial assessment rate for banks in all risk categories. A bank's ratio of secured liabilities to domestic deposits, if greater than 25%, will increase its assessment rate but that increase can be no larger than fifty (50) percent greater than it was before the adjustment.

Brokered Deposits

For banks in Risk Category II, III, and IV, the initial assessment can be increased. The bank's ratio of brokered deposits to domestic deposits, if greater than ten (10) percent will increase the bank's assessment rate. The adjustment can be no larger than ten (10) basis points. For the purposes of making this calculation, reciprocal deposits (CDARS) are included as a brokered deposit. There is no adjustment for brokered deposits for banks in Risk Category I since they are included in the financial ratios adjustment for these banks. However, for Risk Category I banks, reciprocal deposits are excluded from brokered deposits.

The only other step management can take to control these risks is to fund the bank in such a way as to lower any adjustments that add to the initial assessment charge.



Appendix

Brokered Deposit Ratio

The proposed final rules for FDIC assessments include a new ratio in the financial ratio portion of the assessment process for Risk Category I banks. The ratio is designed to measure the extent to which brokered deposits are funding rapid asset growth. The ratio will affect only those established Risk Category I banks whose total gross assets are more that 40 percent greater than they were four years previously, adjusting for mergers and acquisitions. The ratio is brokered deposits (excluding reciprocal deposit, i.e. CDARS) as a percentage of domestic deposits.

Even within this definition, there is a growth component to the amount it affects the initial assessment by the FDIC. Therefore, the following steps are taken to determine the impact to a Risk Category I bank's initial assessment:

1. If an institution's ratio of brokered deposits to domestic deposits is ten (10) percent or less, or if the institution's asset growth over the previous four years is less than forty (40) percent, the adjusted brokered deposit ratio will be zero and will have no effect on the institution's initial assessment rate
2. If an institution's ratio of brokered deposits to domestic deposits exceeds ten (10) percent, and its asset growth in the previous four years is more than seventy (70) percent, the adjusted brokered deposit ratio will equal the institution's ratio of brokered deposits to domestic deposits less the ten (10) percent threshold.
3. If an institution's ratio of brokered deposits to domestic deposits exceeds ten (10) percent, but its asset growth over the previous four years is between forty (40) and seventy (70) percent, overall asset growth rates will be converted into an asset growth rate factor ranging between 0 and 1, so that the adjusted brokered deposit ratio will equal a gradually increasing fraction of the ratio of brokered deposits to domestic deposits minus the ten (10) percent threshold. The asset growth factor is derived by multiplying by 3.33 an amount equal to the overall rate of growth minus forty (40) percent and expressing the result as a decimal fraction rather than as a percentage. The adjusted brokered deposit ratio will never be less than zero.

The following table presents the FDIC's example of five different calculations using different circumstances:

A	B	C	D	E	F
	Brokered Deposits to Domestic Deposits	Brokered Deposits to Domestic Deposits minus 10% Threshold	Cumulative Asset Growth Rate over 4 Years	Asset Growth Rate Factor	Adjusted Brokered Deposit Ratio (Col C Times Col E)
1	5.0%	0.0%	5.0%	-	0.0
2	15.0%	5.0%	5.0%	-	0.0
3	5.0%	0.0%	35.0%	-	0.0
4	35.0%	25.0%	55.0%	.50	12.5%
5	25.0%	15.0%	80.0%	1.0	15.0%