



6714-01-P

FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 362

RIN 3064-AD88

Permissible Investments for Federal and State Savings Associations: Corporate Debt Securities

AGENCY: Federal Deposit Insurance Corporation (FDIC)

ACTION: Final rule.

SUMMARY: This final rule amends FDIC regulations to prohibit any insured savings association from acquiring or retaining a corporate debt security unless it determines, prior to acquiring such security and periodically thereafter, that the issuer has adequate capacity to meet all financial commitments under the security for the projected life of the investment. An issuer would satisfy this requirement if, based on the assessment of the savings association, the issuer presents a low risk of default and is likely to make full and timely repayment of principal and interest.

This final rule adopts the proposed creditworthiness standard with the clarifying revision described below. In the final rule, the phrase “projected life of the investment” has been revised to “projected life of the security” to more closely track the language in the Office of the Comptroller of the Currency’s (“OCC”) final rule.¹ The clarifying revision addresses ambiguities in the proposed rule and harmonizes the final rule with the final rule adopted by the OCC regarding permissible investments for national banks.²

¹ 77 FR 35253. (June 13, 2012).

² *Id.* at 35257.

EFFECTIVE DATE: The final rule is effective on July 21, 2012.

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SUPPLEMENTARY INFORMATION:

I. BACKGROUND

Under section 28(d) (“Section 28(d)”) of the Federal Deposit Insurance Act (“FDI Act”), federal and state savings associations generally are prohibited from acquiring or retaining, either directly or through a subsidiary, a corporate debt security that is rated below investment grade. Section 939(a) (“Section 939(a)”) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) amends Section 28(d) by replacing the investment-grade standard with a requirement that any corporate debt security investment held by a savings association must satisfy standards of creditworthiness established by the FDIC. This amendment is effective for all savings associations on July 21, 2012.

On December 15, 2011, the FDIC issued a notice of proposed rulemaking (“NPR” or “Proposed Rule”), seeking comment on a proposal to amend the FDIC’s regulations in accordance with the requirements of Section 28(d). Specifically, the proposed rule would amend 12 CFR Part 362 to prohibit any insured savings association from acquiring or retaining a corporate debt security unless it determines, prior to acquiring such security and periodically thereafter, that the issuer has adequate capacity to meet all financial commitments under the

security for the projected life of the investment. An issuer would satisfy this requirement if, based on the assessment of the savings association, the issuer presents a low risk of default and is likely to make full and timely repayment of principal and interest.

This final rule adopts the proposed creditworthiness standard with the clarifying revision described below. In the final rule, the phrase “projected life of the investment” has been revised to “projected life of the security” to more closely track the language in the Office of the Comptroller of the Currency’s (“OCC”) final rule.³ The clarifying revision addresses ambiguities in the proposed rule and harmonizes the final rule with the final rule adopted by the OCC regarding permissible investments for national banks.⁴

Section 553(d)(3) of the Administrative Procedure Act (“APA”) provides that, for good cause found and published with the rule, an agency does not have to comply with the requirement that a substantive rule be published not less than 30 days before its effective date. The final rule will be effective on July 21, 2012. Consequently, the final rule’s publication will be less than 30 days before its effective date. The FDIC invokes this good cause exception to the 30 day publication requirement because the statutory amendment⁵ that this rule implements is effective on July 21, 2012. On that date savings associations will be prohibited from acquiring or retaining a corporate debt security that does not meet the creditworthiness standard established by the FDIC. As a result, until the FDIC establishes that standard, savings associations would not be able to comply with the statute. However, in order to allow saving associations sufficient time to fully develop their processes for making creditworthiness determinations, the FDIC is allowing institutions until January 1, 2013 to comply with this final rule.

Under Section 28(d)(1) of the FDI Act, federal and state savings associations generally

³ 77 F.R. 35253. (June 13, 2012).

⁴ *Id.* at 35257.

⁵ Section 939(a) of the Dodd Frank Wall Street Reform and Consumer Protection Act.

are prohibited from acquiring or retaining, either directly or through a subsidiary, a corporate debt security that is not “of investment grade.”⁶ Section 28(d)(4) defines investment grade as follows: “Any corporate debt security is not of ‘investment grade’ unless that security, when acquired by the savings association or subsidiary, was rated in one of the four highest ratings categories by at least one nationally recognized statistical rating organization” (each, an “NRSRO”).⁷

Consistent with the requirements of Section 28(d), section 362.11(b)(1) of the FDIC’s regulations generally prohibits a state savings association from acquiring or retaining a corporate debt security that is not of investment grade.⁸ Under 12 CFR § 362.10(b), the term “corporate debt securities that are not of investment grade” is defined, in a manner consistent with Section 28(d), as, “any corporate security that when acquired was not rated among the four highest rating categories by at least one nationally recognized statistical rating organization.”⁹

The FDIC currently may require a state savings association to take corrective measures in the event a corporate debt security experiences a downgrade (to non-investment grade status) following acquisition. For example, a savings association may be required to reduce the level of non-investment grade corporate debt security investments as a percentage of tier 1 or total capital, write-down the value of the security to reflect an impairment, or divest the security. The FDIC addresses nonconforming investments on a case-by-case basis through the examination

⁶ Section 28(d)(1) of the FDI Act, 12 U.S.C. 1831e(d)(1). Under Section 28(d)(2), the investment-grade requirement does not apply to a corporate debt security acquired or retained by a “qualified affiliate” of a savings association, defined as, (i) in the case of a stock savings association, an affiliate other than a subsidiary or an insured depository institution; and (ii) in the case of a mutual savings association, a subsidiary other than an insured depository institution, so long as all of the savings association’s investments in and extensions of credit to the subsidiary are deducted from the capital of the savings association.

⁷ 12 U.S.C. 1831e(d)(4)

⁸ 12 C.F.R. 362.11(b).

⁹ *Id.* at 362.10(b). Under section 28(d)(4)(C) of the FDI Act, however, this term does not include any obligation issued or guaranteed by a corporation that may be held by a federal savings association without limitation as a percentage of assets under section 5(c)(1)(D), (E), or (F) of the Home Owners Loan Act (“HOLA”).

process, and in view of the risk profile of the savings association and size and composition of its investment portfolio.

Section 939(a)(2) of the Dodd-Frank Act amends Section 28(d) by (a) removing references to NRSRO credit ratings, including the investment-grade standard under paragraph (1) and the definition of “investment grade” under paragraph (4); and (b) inserting in paragraph (1) a reference to “standards of creditworthiness established by the [FDIC]”. Section 939(a) is effective on July 21, 2012, and, therefore, as of this date federal and state savings associations will be permitted to invest only in corporate debt securities that satisfy creditworthiness standards established by the FDIC.¹⁰

On December 15, 2011, the FDIC issued the Proposed Rule to seek comment on a proposal to amend the FDIC’s regulations in accordance with the requirements of Section 28(d). Specifically, the NPR proposed to amend 12 CFR part 362 to prohibit any insured savings association from acquiring or retaining a corporate debt security unless it determines, prior to acquiring such security and periodically thereafter, that the issuer has adequate capacity to meet all financial commitments under the security for the projected life of the investment. For purposes of the NPR, an issuer would satisfy this requirement if, based on the assessment of the savings association, the issuer presents a low risk of default and is likely to make full and timely repayment of principal and interest. In addition, on December 15, 2011, the FDIC proposed guidance to assist savings associations in meeting due diligence requirements in assessing credit risk for portfolio investments.

The FDIC received five comments on the proposed rule and guidance document from bank trade groups, a bank, and an individual. The commenters generally supported the NPR and stated that it presented a workable alternative to the use of credit ratings. The commenters also

¹⁰ See section 939(g) of the Dodd-Frank Act.

raised specific issues, which are addressed in more detail below.

After considering the comments, the FDIC has decided to finalize the proposed creditworthiness standard, with the clarifying revision described below. Additionally, to assist savings associations in making these creditworthiness determinations, the FDIC is publishing a final guidance document today in this issue of the Federal Register. The final guidance document reflects the clarifying revisions in the final rule, but otherwise remains unchanged from the proposal.

The final rule revises the proposed creditworthiness standard to address ambiguities in the proposed rule and harmonize the final rule with a final rule adopted by the OCC regarding permissible investments for national banks.¹¹ In the final rule, the phrase “projected life of the investment” has been revised to “projected life of the security” to more closely track the language in the OCC’s final rule. This revision also clarifies that, for purposes of the final rule, federal and state savings associations are required to evaluate the credit risk of a security through its maturity or projected maturity date.

II. Description of the Final Rule

In accordance with the requirements of Section 939(a), the final rule amends sections 362.9 and 362.11(b)(1) of the FDIC’s regulations. In section 362.11(b)(1), the final rule replaces the investment-grade standard, applicable to permissible corporate debt securities investments of a state savings association, with a requirement, applicable to federal and state savings associations, that prior to acquiring a corporate debt security and periodically thereafter, the savings association must determine that the issuer has adequate capacity to meet all financial commitments under the security for the projected life of the security. An issuer satisfies this requirement if the savings association appropriately determines that the obligor presents low

¹¹ 77 FR 35253, 35257.

default risk and is likely to make timely payments of principal and interest. The FDIC notes that, in addition to the requirements of the final rule, any savings association investment in a corporate debt security must be consistent with safety and soundness principles.

In determining whether an issuer has an adequate financial capacity to satisfy all financial commitments under a security for the projected life of the security, the FDIC expects savings associations to consider a number of factors commensurate with the risk profile and nature of the issuer. Although savings associations are permitted to consider an external credit assessment for purposes of such determination, they must supplement any external credit assessment with due diligence processes and analyses that are appropriate for the size and complexity of the security. A security rated in the top four rating categories by an NRSRO is not automatically deemed to satisfy the creditworthiness standard. The more complex a security's structure, the greater the expectations, even when the credit quality is perceived to be very high.

Comments from industry associations expressed concern regarding the scope and depth of the proposed due diligence requirements, particularly for smaller institutions. The FDIC believes that the proposed standard of creditworthiness and associated due diligence requirements are consistent with those under the ratings-based standard and existing due diligence requirements and guidance. Under the existing ratings-based standard set forth in part 362, savings associations are expected to avoid sole reliance on a credit rating to evaluate the credit risk of a security, and consistently have been advised through guidance and other supervisory materials to supplement any use of credit ratings with additional research on the credit risk of a particular security. Accordingly, the FDIC does not expect the final rule to materially change the investment risk-management practices of most savings associations or the scope of permissible corporate debt securities investments under part 362.

Also, in today's Federal Register, the FDIC is publishing a final guidance document to assist savings associations in determining whether a corporate debt security is permissible for investment under part 362, and to further explain the FDIC's expectations with regard to regulatory due diligence requirements. The final guidance document reflects the clarifying revisions in the final rule, but otherwise remains unchanged from the proposed guidance document. The final guidance document describes the factors savings associations should consider in evaluating the creditworthiness of an issuer; particularly the issuer's capacity to satisfy all financial commitments under the security for the projected life of the security. While the guidance explains the FDIC's expectations in more detail, the FDIC's regulations require savings associations to understand and evaluate the risks of purchasing investment securities. Savings associations should not purchase securities for which they do not understand the relevant risks.

The FDIC is not revising its current supervisory practice with respect to nonconforming corporate debt securities investments. That is, if a security acquired in compliance with the final rule experiences credit impairment or other deterioration following its acquisition, the FDIC may require a savings association to take corrective measures on a case-by-case basis.

In addition to the revisions described above, the final rule makes conforming, technical amendments to section 362.9 of the FDIC's regulations to expand the scope of the rule to federal savings associations¹² and reflect the abolishment of the Office of Thrift Supervision under section 313 of the Dodd-Frank Act.

Effective Date

In the NPR, the FDIC proposed an effective date of July 21, 2012, in accordance with the requirements of section 939(a) of the Dodd-Frank Act. However, industry commenters

¹² Currently, section 362.11(b) applies only to insured state savings associations.

expressed concern that savings associations would not have sufficient time to develop processes for making creditworthiness determinations on new securities purchased before the effective date of this final rule. These commenters suggested that the FDIC adopt a one-year transition period before the FDIC requires compliance with the rule. One commenter also requested an additional year beyond the transition period to allow for review of existing securities held by the institution. The FDIC recognizes that it may take time for some savings associations to develop the systems and processes necessary to make creditworthiness determinations under the new standard. Therefore, the FDIC is providing a transition period until January 1, 2013, to allow savings associations to come into compliance with this final rule. However, as proposed, the final rule is effective as of July 21, 2012.

The final rule does not grandfather any corporate debt securities acquired before the effective date and, therefore, savings associations are permitted to retain only those securities for which the savings association determines that (as of the effective date and periodically thereafter) the issuer has adequate capacity to satisfy all financial commitments under the security for the projected life of the security. This treatment for previously acquired securities is consistent with the requirements of Section 28(d) and the final rule, which prohibit a savings association from acquiring or retaining any corporate debt security that does not satisfy the creditworthiness standard described in this final rule. Accordingly, the final rule seeks to emphasize that savings associations must periodically re-evaluate the likelihood of repayment for securities retained in their investment portfolios in view of any changes in economic conditions that may affect a security's credit risk. Savings associations will still have until the end of the transition period, January 1, 2013, to evaluate their existing holdings and ensure that they meet the revised standard.

III. Implementation Guidance

Together with this final rule, the FDIC is publishing guidance for savings associations' investment activities. This final guidance document reflects the FDIC's expectations for savings associations as they review their systems and consider any changes necessary to comply with the provisions for assessing credit risk in this final rule. The guidance describes factors institutions should consider with respect to certain types of investment securities to assess creditworthiness and to continue conducting their activities in a safe and sound manner.

As noted above, FDIC regulations require that savings associations conduct their investment activities in a manner that is consistent with safe and sound practices. Neither the final rules, nor the final guidance document, change this requirement. The FDIC expects savings associations to continue to follow safe and sound practices in their investment activities.

IV. Regulatory Analyses

A. Administrative Procedure Act (APA)

Section 553(d)(3) of the APA (5 U.S.C. 500 *et seq.*) provides that, for good cause found and published with the rule, an agency does not have to comply with the requirement that a substantive rule be published not less than 30 days before its effective date. The final rule will be effective on July 21, 2012. Consequently, the final rule's publication will be less than 30 days before its effective date. The FDIC invokes this good cause exception to the 30 day publication requirement because the statutory amendment¹³ that this rule implements is effective on July 21, 2012. On that date savings associations will be prohibited from acquiring or retaining a corporate debt security that does not meet the creditworthiness standard established by the FDIC. As a result, until the FDIC establishes that standard, savings associations would not be able to comply with the statute. However, in order to allow saving associations sufficient time to fully

¹³ Section 939(a) of the Dodd Frank Wall Street Reform and Consumer Protection Act.

develop their processes for making creditworthiness determinations, the FDIC is allowing institutions until January 1, 2013 to comply with this final rule.

B. Paperwork Reduction Act (PRA)

No new collection of information pursuant to the PRA (44 U.S.C. 3501 *et seq.*) is contained in this final rule.

C. Regulatory Flexibility Act Analysis

Pursuant to section 605(b) of the Regulatory Flexibility Act (RFA),¹⁴ the regulatory flexibility analysis otherwise required under section 604 of the RFA is not required if an agency certifies that the rule will not have a significant economic impact on a substantial number of small entities (defined for purposes of the RFA to include banks with assets less than or equal to \$175 million)¹⁵ and publishes its certification and a short, explanatory statement in the Federal Register along with its rule. For the reasons provided below, the FDIC certifies that the Final Rule does not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required.

As discussed in this Final Rule, Section 28(d) of the FDI Act, as amended by Section 939(a) of the Dodd-Frank Act, prohibits federal and state savings associations from acquiring or retaining a corporate debt security that does not meet FDIC's standards of creditworthiness. In accordance with the requirements of amended Section 28(d), this final rule prohibits savings associations from investing in a corporate debt security unless the savings association determines that the issuer has adequate capacity to meet all financial commitments under the security for the projected life of the security. Consequently, this final rule only impacts savings associations that hold corporate debt security investments.

¹⁴ 5 U.S.C. 605(b).

¹⁵ 5 U.S.C. 601 *et seq.*

In determining whether this final rule has a significant economic impact on a substantial number of small savings associations, the FDIC reviewed the March 2012 Reports of Condition and Income (Call Report) data to evaluate the number of savings associations with corporate debt securities. There are 1044 insured state and federal savings associations. Of these 1044 insured savings associations, 356 reported investments in other domestic debt securities on the Call Report, where thrifts report their investment in corporate bonds.¹⁶ Even assuming the entire amount of other domestic debt securities listed on the Call Report represents investment in corporate debt securities, other domestic debt securities represents only 0.97 percent of the aggregate total assets of the 1044 savings associations.

Moreover, only savings associations with total assets of \$175 million or less apply for purposes of the RFA analysis. When applying this additional size criterion, only 80 institutions list other domestic debt securities in their Call Report. For these smaller savings institutions, the total amount listed as investment in other domestic debt securities represents only 0.45 percent of the total assets. And only eight of these smaller thrifts have concentrations in other domestic debt securities that exceed 50 percent of their tier 1 capital. Due to the small investment in corporate debt securities on small savings associations' balance sheets and due to the existing need to do due diligence relating to any investment in order to assure that a savings association is operating in a safe and sound manner, the additional compliance burden does not result in a significant economic impact on a substantial number of small savings associations.

C. Small Business Regulatory Enforcement Fairness Act (SBREFA)

¹⁶ This line item is where the dollar exposure to corporate debt securities, along with other forms of investment, should be slotted according to the Call Report instructions. This line may also include investments in instruments other than corporate debt securities, this limited granularity does not permit a precise understanding of the exposure to corporate debt securities.

The Office of Management and Budget has determined that the Final Rule is not a “major rule” within the meaning of the relevant sections of the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA) (5 U.S.C. 801, *et seq.*). As required by SBREFA, the FDIC will file the appropriate reports with Congress and the Government Accountability Office so that the final rule may be reviewed.

D. Plain Language

Each Federal banking agency, such as the FDIC, is required to use plain language in all proposed and final rules published after January 1, 2000. (12 U.S.C. 4809) In addition, in 1998, the President issued a memorandum directing each agency in the Executive branch, to use plain language for all new proposed and final rulemaking documents issued on or after January 1, 1999. The FDIC sought to present the Proposed Rule in a simple and straightforward manner. The FDIC received no comments on the use of plain language, and the Final Rule is identical to the Proposed Rule except for a clarifying revision.

List of Subjects in 12 CFR Part 362

Administrative practice and procedure, Authority delegations (Government agencies), Bank deposit insurance, Banks, banking, Investments, Reporting and recordkeeping requirements.

Authority and Issuance

For the reasons stated in the preamble, the Federal Deposit Insurance Corporation amends part 362 of chapter III of Title 12, Code of Federal Regulations as follows:

PART 362—ACTIVITIES OF INSURED STATE BANKS AND INSURED SAVINGS ASSOCIATIONS

1. The authority citation for part 362 continues to read as follows:

Authority: 12 U.S.C. 1816, 1818, 1819(a) (Tenth), 1828(j), 1828(m), 1828a, 1831a, 1831e, 1831w, 1843(l).

2. Amend § 362.9 by revising paragraph (a) to read as follows:

§ 362.9 Purpose and scope.

(a) This subpart, along with the notice and application procedures in subpart H of part 303 of this chapter, implements the provisions of section 28(a) of the Federal Deposit Insurance Act (12 U.S.C. 1831e(a)) that restrict and prohibit insured state savings associations and their service corporations from engaging in activities and investments of a type that are not permissible for a Federal savings association and their service corporations. This subpart also implements the provision of section 28(d) of the Federal Deposit Insurance Act (12 U.S.C. 1831e(d)) that restricts state and federal savings associations from investing in certain corporate debt securities. The phrase “activity permissible for a Federal savings association” means any activity authorized for a Federal savings association under any statute including the Home Owners’ Loan Act (HOLA) (12 U.S.C. 1464 *et seq.*), as well as activities recognized as permissible for a Federal savings association in regulations issued by the Office of the Comptroller of the Currency (OCC) or in bulletins, orders or written interpretations issued by the OCC, or by the former Office of Thrift Supervision until modified, terminated, set aside, or superseded by the OCC.

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3. Amend § 362.11 by revising the section heading, removing the last sentence of paragraph (b)(1), and adding two sentences in its place to read as follows:

§ 362.11 Activities of insured savings associations.

* * * * *

(b) * * *

(1) * * * On and after July 21, 2012, an insured savings association directly or through a subsidiary (other than, in the case of a mutual savings association, a subsidiary that is a qualified affiliate), shall not acquire or retain a corporate debt security unless the savings association, prior to acquiring the security and periodically thereafter, determines that the issuer of the security has adequate capacity to meet all financial commitments under the security for the projected life of the security. Saving associations have until January 1, 2013 to come into compliance with this treatment of corporate debt securities.

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By order of the Board of Directors.

Dated at Washington, DC this 18th day of July, 2012.

Federal Deposit Insurance Corporation

Robert E. Feldman,

Executive Secretary

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