security for the projected life of the investment.

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Dated at Washington, DC, this 7th day of December 2011.

By order of the Board of Directors.

Federal Deposit Insurance Corporation.

Robert E. Feldman,

Executive Secretary.

[FR Doc. 2011–31883 Filed 12–13–11; 11:15 am]

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FEDERAL DEPOSIT INSURANCE CORPORATION

12 CFR Part 362

Guidance on Due Diligence Requirements for Savings Associations in Determining Whether a Corporate Debt Security Is Eligible for Investment

AGENCY: Federal Deposit Insurance Corporation.

ACTION: Proposed guidance with request for comment.

SUMMARY: The FDIC is seeking comment on proposed guidance that would assist savings associations in conducting due diligence to determine whether a corporate debt security is eligible for investment under a proposed rule published elsewhere in this issue of the **Federal Register**.

DATES: Comments must be received by February 13, 2012.

ADDRESSES: You may submit comments by any of the following methods:

- *Agency Web Site: http://www.fdic.gov/regulations/laws/federal/propose.html.* Follow instructions for submitting comments on the Agency Web Site.
- *Email: Comments@fdic.gov.*
- *Mail:* Robert E. Feldman, Executive Secretary, Attention: Comments, Federal Deposit Insurance Corporation, 550 17th Street NW., Washington, DC 20429.
- *Hand Delivery:* Comments may be hand delivered to the guard station at the rear of the 550 17th Street Building (located on F Street) on business days between 7 a.m. and 5 p.m.

Public Inspection: All comments received must include the agency name. All comments received will be posted without change to *http://www.fdic.gov/regulations/laws/federal/propose.html,* including any personal information provided. Paper copies of public comments may be ordered from the FDIC Public Information Center, 3501 North Fairfax Drive, Room E–1002, Arlington, VA 22226 by telephone at 1–(877) 275–3342 or 1–(703) 562–2200.

FOR FURTHER INFORMATION CONTACT: Kyle Hadley, Section Chief, Examination Support, (202) 898–6532, Division of Risk Management Supervision; Eric Reither, Capital Markets Specialist, (202) 898–3707, Division of Risk Management Supervision; Mark Handzlik, Counsel, Bank Activities Section, (202) 898–3990; Michael Phillips, Counsel, Bank Activities Section, (202) 898–3581; Rachel Jones, Honors Attorney, Legal Division (202) 898–6858.

SUPPLEMENTARY INFORMATION:

Background

Section 939(a) (''Section 939(a)'') of the Dodd-Frank Wall Street Reform and Consumer Protection Act (''Dodd-Frank Act'') amends section 28(d) (''Section 28(d)'') of the Federal Deposit Insurance Act (''FDI Act'') to prohibit a savings association from acquiring or retaining a corporate debt security that does not satisfy creditworthiness standards established by the Federal Deposit Insurance Corporation (''FDIC''). Elsewhere in today's **Federal Register**, the FDIC has published for public comment a proposed rule (''Proposed Rule'') to implement the requirements of Section 939(a). Under the Proposed Rule, an insured savings association would be prohibited from acquiring or retaining a corporate debt security unless it determines, prior to acquiring the security and periodically thereafter, that the issuer has adequate capacity to satisfy all financial commitments under the security for the projected life of the investment.

Under Section 28(d) of the FDI Act, Federal and state savings associations generally are prohibited from acquiring or retaining, either directly or indirectly through a subsidiary, a corporate debt security that is rated below investment grade. Section 939(a) amends Section 28(d) by replacing the investment-grade standard with a requirement that any corporate debt security investment by a savings association satisfy standards of creditworthiness established by the FDIC. This amendment is effective for all savings associations two years after the date of enactment of the Dodd-Frank Act, or as of July 21, 2012.

Elsewhere in today's **Federal Register**, the FDIC is seeking comment on the Proposed Rule to amend the FDIC's regulations in accordance with the requirements of Section 28(d), as amended by Section 939(a). Specifically, the Proposed Rule would amend section 362.11(b) of the FDIC's regulations to prohibit an insured savings association from acquiring or retaining a corporate debt security unless it determines, prior to acquisition and periodically thereafter, that the issuer has adequate capacity to satisfy all financial commitments under the security for the projected life of the investment. For purposes of the Proposed Rule, 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. The FDIC does not expect the Proposed Rule to change the scope of permissible corporate debt securities investments for insured savings associations. In accordance with the requirements of the Dodd-Frank Act, if promulgated in final form, the Proposed Rule would be effective as of July 21, 2012.

Proposed Guidance

The proposed guidance would provide supervisory expectations for savings associations conducting due diligence to determine whether a corporate debt securities investment satisfies the creditworthiness requirements of the Proposed Rule—that is, whether the issuer has adequate capacity to satisfy all financial commitments under the security for the projected life of the investment. The FDIC expects savings associations to conduct appropriate ongoing reviews of their corporate debt investment portfolios to ensure that the composition of the portfolio is consistent with safety and soundness principles and appropriate for the risk profile of the institution as well as the size and complexity of the portfolio.

Text of Proposed Guidance

The text of the proposed supervisory guidance regarding the FDIC's expectations for insured savings associations conducting due diligence to assess the credit risk of a corporate debt security, in accordance with the requirements of 12 CFR 362.11(b), follows.

Purpose

The Federal Deposit Insurance Corporation (''FDIC'') is issuing this guidance document (''Guidance'') to establish supervisory expectations for savings associations conducting due diligence to determine whether a corporate debt security is eligible for investment under 12 CFR part 362. Section 362.11(b) of the FDIC's regulations implements Section 28(d) of the FDI Act (as amended by section 939(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act), and prohibits an insured savings association from acquiring or retaining a corporate debt security unless it determines, prior to acquiring the security and periodically thereafter, that the issuer has adequate capacity to satisfy all financial commitments under the security for the projected life of the investment. An issuer satisfies 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. The investment also must be consistent with safe and sound banking practices.

Background

Part 362 of the FDIC's regulations sets forth the requirements for determining whether securities have appropriate credit quality and marketability characteristics to be purchased and held by insured savings associations. Under section 362.11(b), a savings association may acquire or retain a corporate debt security only if the issuer has adequate capacity to satisfy all financial commitments under the security for the projected life of the investment. An issuer satisfies 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.

Savings associations must be able to demonstrate that their investment securities meet applicable credit quality standards. This Guidance sets forth criteria that savings associations should consider when conducting due diligence to determine whether a security is eligible for investment under part 362.

The federal banking agencies have maintained long-standing supervisory guidance that banks and savings associations implement a risk management process to ensure that credit risk, including the credit risk of an investment portfolio, is effectively identified, measured, monitored, and controlled. The 1998 *Interagency Supervisory Policy Statement on Investment Securities and End-User Derivatives Activities* (Policy Statement) provides risk management standards for the securities investment activities of banks and savings associations.[1] The Policy Statement emphasizes the importance of an institution conducting a thorough credit risk analysis before and periodically after the acquisition of a security. Such analysis would allow an institution to understand and effectively manage the risks within its investment portfolio, including credit risk, and is an essential element of a sound investment portfolio risk management framework. The Policy Statement is generally consistent with the agencies' *Uniform Agreement on the Classification of Assets and Appraisal of Securities Held by Banks and Thrifts,* which describes the importance of management's credit risk analysis and its use in examiner decisions concerning investment security risk ratings and classifications.[2]

Determining Whether Securities Are Permissible Prior To Purchase

The FDIC expects savings associations to conduct an appropriate level of due diligence in determining whether a corporate debt security is eligible for investment under 12 CFR 362.11(b). This may include consideration of internal analyses, third-party research and analytics including internal risk ratings, external credit ratings default statistics, and other sources of information appropriate for the particular security. The depth of the due diligence should be a function of the security's credit quality, the complexity of the issuer's financial structure, and the size of the investment. As an issuer's financial structure becomes more complex, the more credit-related due diligence an institution should perform, even when the credit quality is perceived to be very high. Management should ensure they understand the security's structure and how the security will perform in various scenarios throughout the business cycle. The FDIC expects savings associations to consider a variety of factors relevant to the particular security when determining whether a security is a permissible and sound investment. The range and type of specific factors an institution should consider will vary depending on the particular type and nature of the security. As a general matter, a savings association will have a greater burden to support its determination if one factor is contradicted by a finding under another factor.

Although part 362 does not provide specific investment quality requirements, savings associations should conduct an appropriate level of due diligence prior to purchasing a corporate debt security to ensure that it is eligible for investment under part 362. A savings association should review and update this analysis periodically, as appropriate for size and risk profile of the security. By way of example, appropriate factors a savings association should consider include, but should not be limited to, the following:

- Confirm spread to U.S. Treasuries is consistent with bonds of similar credit quality;
- Confirm risk of default is low and consistent with bonds of similar credit quality;
- Confirm capacity to pay through internal credit analysis that can be supplemented with other third-party analytics;
- Understand applicable market demographics/economics; and
- Understand current levels and trends in operating margins, operating efficiency, profitability, return on assets and return on equity.

Maintaining an Appropriate and Effective Portfolio Risk Management Framework

Savings associations should have in place an appropriate risk management framework for the level of risk in their corporate debt investment portfolios. Failure to maintain an adequate investment portfolio risk management process, which includes understanding key portfolio risks, is considered an unsafe and unsound practice. Savings associations should conform to safe and sound banking practices and, similarly, should consider appropriate investment portfolio risks in connection with the acquisition of a corporate debt security.[3]

Having a strong and robust risk management framework appropriate for the level of risk of a savings association's investment portfolio is particularly critical for managing portfolio credit risk. A key role for management in the oversight process is to translate the risk tolerance levels established by the board of directors into a set of internal operating policies and procedures that govern the institution's investment activities. Specifically, investment policies should provide credit risk concentration limits. Such limits may apply to concentrations relating to a single or related issuer, a geographical area, and obligations with similar characteristics. Savings associations with investment portfolios that lack diversification in one of the aforementioned areas should enhance their monitoring and reporting systems. Safety and soundness principles warrant effective concentration risk management programs to ensure that credit exposures do not reach an excessive level.

[1] On April 23, 1998, the FDIC, together with the Federal Reserve Board, National Credit Union Administration, Office of the Comptroller of the Currency, and Office of Thrift Supervision, issued the ''*Supervisory Policy Statement on Investment Securities and End-User Derivatives Activities.*'' As issued by the OTS, the Policy Statement applied to both state and Federal savings associations.

[2] *See,* FDIC Financial Institution Letter, 70–2004 (June 15, 2004).

[3] *See supra* footnote 1.

Savings associations should identify and measure the risks of their investments periodically after acquisition. Such analyses allow an institution to understand and effectively manage the risks of its investment portfolio, including credit risk, and are an essential element of a sound investment portfolio risk management framework. Exposure to each type of risk for each security should be measured and aggregated with similar exposures on an institution-wide basis. Risk measurement should be obtained from sources independent of sellers or counterparties and should be periodically validated. Irrespective of any contractual or other arrangements, savings associations are responsible for understanding and managing the risks of all of their investments.

Request for Comment

The FDIC requests comment on all aspects of this proposed guidance. Specifically, the FDIC is seeking commenters' views on the following:

1. Does the proposed guidance sufficiently assist savings associations in meeting their due diligence requirements? How could the guidance be improved?

2. Should the guidance provide differentiation based on the size and scope of operations of a savings associations, specifically with respect to the factors a savings association should consider in conducting due diligence to determine the credit quality of a corporate debt security?

By order of the Board of Directors.

Dated at Washington, DC, this 7th day of December 2011.

Federal Deposit Insurance Corporation.

Robert E. Feldman,

Executive Secretary.

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