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**DEPARTMENT OF THE TREASURY**

**Office of the Comptroller of the Currency**

**[Docket ID OCC-2012-0003]**

**FEDERAL RESERVE SYSTEM**

**FEDERAL DEPOSIT INSURANCE CORPORATION**

**Joint Report: Differences in Accounting and Capital Standards  
Among the Federal Banking Agencies; Report to Congressional Committees**

**AGENCIES:** Office of the Comptroller of the Currency (OCC), Treasury; Board of Governors of the Federal Reserve System (Board); and Federal Deposit Insurance Corporation (FDIC).

**ACTION:** Report to the Congressional Committees.

**SUMMARY:** The OCC, the Board, and the FDIC (collectively, the agencies) have prepared this report pursuant to section 37(c) of the Federal Deposit Insurance Act. Section 37(c) requires the agencies to jointly submit an annual report to the Committee on Financial Services of the U.S. House of Representatives and to the Committee on Banking, Housing, and Urban Affairs of the U.S. Senate describing differences between the capital and accounting standards used by the agencies. The report must be published in the Federal Register.

**FOR FURTHER INFORMATION CONTACT:**

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FDIC: David W. Riley, Senior Analyst (Capital Markets), (202) 898-3728, Division of Risk Management Supervision, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429.

**SUPPLEMENTARY INFORMATION:** The text of the report follows:

**Report to the Committee on Financial Services of the U.S. House of Representatives and to the Committee on Banking, Housing, and Urban Affairs of the U.S. Senate Regarding Differences in Accounting and Capital Standards Among the Federal Banking Agencies**

**Introduction**

The Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Board), and the Federal Deposit Insurance Corporation (FDIC) (collectively, the agencies) must jointly submit an annual report to the Committee on Financial Services of the U.S. House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the U.S. Senate describing differences between the accounting and capital standards used by the agencies. The report must be published in the Federal Register.

Prior to 2011, the Office of Thrift Supervision (OTS) joined the agencies in submitting an annual report to Congress. Title III of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010) (Dodd-Frank Act),

transferred the powers, authorities, rights and duties of the OTS to other federal banking agencies on July 21, 2011 (the transfer date), and the OTS was abolished 90 days later. Under Title III, the OCC assumed all functions of the OTS and the Director of the OTS relating to federal savings associations, and thus the OCC has responsibility for the ongoing supervision, examination, and regulation of federal savings associations as of the transfer date. Title III transferred all supervision, examination, and certain regulatory functions of the OTS relating to state savings associations to the FDIC and all functions relating to the supervision of any savings and loan holding company and non-depository institution subsidiaries of such holding companies to the Board. Accordingly, this report is being submitted by the OCC, Board, and FDIC.

The agencies are submitting this joint report, which covers differences between their uses of accounting or capital standards existing as of December 31, 2011, pursuant to section 37(c) of the Federal Deposit Insurance Act (12 U.S.C. 1831n(c)), as amended. This report covers 2010 and 2011 and describes capital differences similar to those presented in previous reports.<sup>1</sup>

Since the agencies filed their first reports on accounting and capital differences in 1990, the agencies have acted in concert to harmonize their accounting and capital standards and eliminate as many differences as possible. Section 303 of the Riegle Community Development and Regulatory Improvement Act of 1994 (12 U.S.C. 4803) also directs the agencies to work jointly to make uniform all regulations and guidelines implementing common statutory or supervisory policies. The results of these efforts must be “consistent with the principles of safety and soundness, statutory law and policy,

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<sup>1</sup> See, e.g., 75 FR 47900 (August 9, 2010).

and the public interest.”<sup>2</sup> In recent years, the agencies have revised their capital standards to address changes in credit and certain other risk exposures within the banking system and align the amount of capital institutions are required to hold more closely with the credit risks and certain other risks to which they are exposed. These revisions have been made in a uniform manner whenever possible and practicable to minimize interagency differences. Although the differences in capital standards have diminished over time, a few differences remain, some of which are statutorily mandated.

In addition to the specific differences in capital standards noted below, the agencies may have differences in how they apply certain aspects of their rules. These differences usually arise as a result of case-specific inquiries that have been presented to only one agency. Agency staffs generally seek to minimize these occurrences by coordinating responses to the fullest extent reasonably practicable. Furthermore, while the agencies work together to adopt and apply generally uniform capital standards, there are wording differences in various provisions of the agencies’ standards that largely date back to each agency’s separate initial adoption of these standards before 1990.

The federal banking agencies have substantially similar capital adequacy standards.<sup>3</sup> These standards are based on a common regulatory framework that establishes minimum leverage and risk-based capital ratios for depository institutions<sup>4</sup> (banks and savings associations). The agencies view the leverage and risk-based capital requirements as minimum standards, and most institutions generally are expected to

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<sup>2</sup> 12 U.S.C. 4803(a).

<sup>3</sup> The agencies’ general risk-based capital rules are at 12 CFR part 3 (for national banks) and 12 CFR part 167.6 (for federal savings associations); 12 CFR parts 208 and 225, appendix A (Board); 12 CFR part 325, appendix A (FDIC); and 12 CFR part 390, subpart Z (state savings associations).

<sup>4</sup> 12 U.S.C. 1813(c).

operate with capital levels well above the minimums, particularly those institutions that are expanding or experiencing unusual or high levels of risk.

The agencies note that, with respect to the agencies' advanced approaches capital adequacy framework based on Basel II,<sup>5</sup> there are no significant differences across the agencies' rules because the agencies adopted a joint rule establishing a common advanced approaches framework in December 2007,<sup>6</sup> with subsequent joint revisions.<sup>7</sup> Therefore, the risk-based capital differences described below pertain to the agencies' Basel I-based risk-based capital standards.<sup>8</sup>

With respect to reporting standards, the OCC, the Board, and the FDIC, under the auspices of the Federal Financial Institutions Examination Council (FFIEC), have developed the uniform Consolidated Reports of Condition and Income (Call Report) for all insured commercial banks and certain state-chartered savings banks. The OTS required OTS-supervised savings associations and certain state-chartered savings banks to file the Thrift Financial Report (TFR). The reporting standards for recognition and measurement of regulatory capital in the Call Report and the TFR were consistent with U.S. generally accepted accounting principles. There were no significant differences in regulatory accounting standards for regulatory reports filed with the federal banking agencies. In 2011, the agencies required changes to the reporting requirements for

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<sup>5</sup> The agencies' advanced approaches rules are at 12 CFR part 3, appendix C (national banks) and 12 CFR part 167, appendix C (federal savings associations); 12 CFR part 208, appendix F, and 12 CFR part 225, appendix G (Board); 12 CFR part 325, appendix D (FDIC); and 12 CFR part 390, subpart Z, appendix A (state savings associations).

<sup>6</sup> See 72 FR 69288 (December 7, 2007).

<sup>7</sup> See 76 FR 37620 (June 28, 2011). Some minor differences remain in the application of the advanced approaches rule to savings associations, as statutorily mandated.

<sup>8</sup> On August 30, 2012, the agencies issued three proposed rules that would revise and replace the agencies' current capital rules. See 77 FR 52792, 77 FR 52888, 77 FR 52978. If the proposed rules were adopted as final rules, a majority of the non-statutory differences described in this report would be eliminated.

savings associations.<sup>9</sup> The changes (which are described in greater detail below) include a transition from the quarterly TFR to the quarterly Call Report.

## **Differences in Capital Standards Among the Federal Banking Agencies**

### Financial Subsidiaries

The Gramm-Leach-Bliley Act (GLBA), also known as the Financial Services Modernization Act of 1999, established the framework for financial subsidiaries of banks.<sup>10</sup> GLBA amended the Revised Statutes to permit national banks to conduct certain expanded financial activities through financial subsidiaries. Section 5136A of the Revised Statutes (12 U.S.C. 24a) imposes a number of conditions and requirements upon national banks that have financial subsidiaries, including the regulatory capital treatment applicable to equity investments in such subsidiaries. The statute requires that a national bank deduct from assets and tangible equity the aggregate amount of its equity investments in financial subsidiaries. The statute further requires that the financial subsidiary's assets and liabilities not be consolidated with those of the parent national bank for applicable capital purposes.

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<sup>9</sup> See 76 FR 39981 (July 7, 2011).

<sup>10</sup> A national bank that has a financial subsidiary must satisfy a number of statutory requirements in addition to the capital deduction and deconsolidation requirements described in the text. The bank (and each of its depository institution affiliates) must be well capitalized and well managed. Asset size restrictions apply to the aggregate amount of the assets of the bank's financial subsidiaries. Certain debt rating requirements apply, depending on the size of the national bank. The national bank is required to maintain policies and procedures to protect the bank from financial and operational risks presented by the financial subsidiary. It is also required to have policies and procedures to preserve the corporate separateness of the financial subsidiary and the bank's limited liability. Finally, transactions between the bank and its financial subsidiary generally must comply with the Federal Reserve Act (FRA) restrictions on affiliate transactions, and the financial subsidiary is considered an affiliate of the bank for purposes of the anti-tying provisions of the Bank Holding Company Act. See 12 U.S.C. 5136A.

State member banks may have financial subsidiaries subject to the same restrictions that apply to national banks.<sup>11</sup> State nonmember banks may also have financial subsidiaries, but they are subject only to a subset of the statutory requirements that apply to national banks and state member banks.<sup>12</sup>

The OCC, the FDIC, and the Board adopted final rules implementing their respective provisions arising from section 121 of the GLBA for national banks in March 2000, for state nonmember banks in January 2001, and for state member banks in August 2001. The GLBA did not provide new authority to savings associations to own, hold, or operate financial subsidiaries, as defined, and thus the capital rules for savings associations do not contain parallel provisions.

#### Non-financial Subsidiaries and Subordinate Organizations of Savings Associations

Banks supervised by the OCC, the Board, and the FDIC generally consolidate all significant majority-owned subsidiaries other than financial subsidiaries for regulatory capital purposes. For subsidiaries other than financial subsidiaries that are not consolidated on a line-by-line basis for financial reporting purposes, joint ventures, and associated companies, the parent banking organization's investment in each such subordinate organization is, for risk-based capital purposes, deducted from capital or assigned to the 100 percent risk-weight category, depending upon the circumstances. The

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<sup>11</sup> See 12 U.S.C. 335 (state member banks are subject to the "same conditions and limitations" that apply to national banks that hold financial subsidiaries).

<sup>12</sup> The applicable statutory requirements for state nonmember banks are as follows: the bank (and each of its insured depository institution affiliates) must (1) be well capitalized, (2) comply with the capital deduction and deconsolidation requirements, and (3) satisfy the requirements for policies and procedures to protect the bank from financial and operational risks and to preserve corporate separateness and limited liability for the bank. In addition, the statute requires that any transaction between the bank and a subsidiary that would be classified as a financial subsidiary generally shall be subject to the affiliate transactions restrictions of the FRA. See 12 U.S.C. 1831w.

Board's and the FDIC's rules also permit banks to consolidate the investment on a pro rata basis under appropriate circumstances.

The capital regulations for savings associations are different in some respects because of statutory requirements. A statutorily-mandated distinction is drawn between subsidiaries, which generally are majority-owned, that are engaged in activities that are permissible for national banks and those that are engaged in activities impermissible for national banks.<sup>13</sup> When subsidiaries engage in activities that are impermissible for national banks, the regulations governing savings associations require deduction of the parent's investment in these subsidiaries from the capital of the parent organization. If a subsidiary's activities are permissible for a national bank, that subsidiary's assets are generally consolidated with those of the parent organization on a line-by-line basis. If a subordinate organization, other than a subsidiary, engages in impermissible activities, investments in and loans to that organization generally are deducted from the savings association's capital.<sup>14</sup> If a subordinate organization engages solely in permissible activities, depending on the nature and risk of the activity, investments in and loans to that organization may be assigned either to the 100 percent risk-weight category or deducted from capital.

#### Leverage Ratio Denominator

Banks supervised by the Board, the OCC, and the FDIC use average total assets to calculate the denominator of the leverage ratio. In contrast, savings associations use quarter-end total assets. Under the rules governing the reservation of authority for

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<sup>13</sup> See 12 U.S.C. 1464(t)(5).

<sup>14</sup> The definitions of subsidiary and subordinate organization are provided in 12 CFR 159.2 (federal savings associations) and 12 CFR 390.251 (state savings associations).

savings associations, the OCC and the FDIC reserve the right to require federal and state savings associations, respectively, to compute capital ratios on the basis of average, rather than period-end, assets.<sup>15</sup>

### Collateralized Transactions

The risk-based capital rules of the Board assign a zero percent risk weight to claims collateralized by cash on deposit in the institution or by securities issued or guaranteed by U.S. Government agencies or the central governments of countries that are members of the Organization for Economic Cooperation and Development (OECD), provided there is daily mark-to-market of collateral and maintenance of a positive margin of collateral. The OCC rules with respect to national banks incorporate similar conditions for such collateralized claims eligible for a zero percent risk weight. However, while the Board's rules require such claims to be fully collateralized, the OCC's rules governing national banks permit partial collateralization.

Under the FDIC rules for state nonmember banks and the FDIC and OCC rules for state and federal savings associations, respectively, portions of claims collateralized by cash or by securities issued or guaranteed by OECD central governments or U.S. Government agencies receive a 20 percent risk weight. However, these institutions may assign a zero percent risk weight for claims on certain qualifying securities firms that are collateralized by cash on deposit in the institution or by securities issued or guaranteed by the U.S. Government, U.S. Government agencies, or other OECD central governments.

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<sup>15</sup> See 12 CFR 167.11(b) (federal savings associations) and 12 CFR 390.470(b) (state savings associations).

### Noncumulative Perpetual Preferred Stock

Under the agencies' capital standards, noncumulative perpetual preferred stock is a component of tier 1 capital. The capital standards of the Board, the FDIC with respect to state nonmember banks, and the OCC with respect to national banks, require noncumulative perpetual preferred stock to give the issuer the option to waive the payment of dividends and provide that waived dividends neither accumulate to future periods nor represent a contingent claim on the issuer.

As a result of these requirements, under the risk-based capital rules of the OCC (with respect to national banks), the Board, or the FDIC, if a bank issues perpetual preferred stock and is required to pay dividends in a form other than cash (e.g., dividends in the form of stock, when cash dividends are not or cannot be paid and when the bank does not have the option to waive or eliminate dividends), the perpetual preferred stock would not qualify as noncumulative. Under the capital requirements for savings associations, a savings association may request supervisory approval to treat perpetual preferred stock as noncumulative if it requires the payment of dividends in the form of stock when cash dividends are not paid.

### Equity Securities of Government-sponsored Enterprises

The risk-based capital rules of the Board and the FDIC and the capital regulations governing savings associations apply a 100 percent risk weight to equity securities of government-sponsored enterprises (GSEs).<sup>16</sup> In contrast, the OCC's regulation governing national banks applies a 20 percent risk weight to all GSE equity securities.

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<sup>16</sup> However, Federal Home Loan Bank stock held by banking organizations as a condition of membership receives a 20 percent risk weight.

Conversion Factors for Off-balance Sheet Contracts

Under the agencies’ general risk-based capital rules, the credit equivalent amount of a derivative contract that is not subject to a qualifying bilateral netting contract is equal to the sum of the derivative contract’s current credit exposure and the potential future credit exposure. The potential future exposure is estimated by multiplying the notional principal amount of the contract by a credit conversion factor by type of derivative contract. The regulations of the Board, the FDIC with respect to state nonmember banks, and the OCC with respect to national banks provide a chart illustrating the applicable credit conversion factors, as follows:

<b>Remaining maturity</b>	<b>Interest rate (percent)</b>	<b>Exchange rate and gold (percent)</b>	<b>Equity (percent)</b>	<b>Precious metals, except gold (percent)</b>	<b>Other commodities (percent)</b>
One year or less	0.0	1.0	6.0	7.0	10.0
More than one year to five years	0.5	5.0	8.0	7.0	12.0
More than five years	1.5	7.5	10.0	8.0	15.0

In contrast, the regulations governing savings associations, as currently incorporated into the FDIC’s and the OCC’s regulations, provide a table of conversion factors that is less granular as to the types of contracts to which it applies as well as their remaining maturity.

<b>Remaining maturity</b>	<b>Interest rate contracts (percent)</b>	<b>Foreign exchange rate contracts (percent)</b>
One year or less	0.0	1.0

Over one year	0.5	5.0
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### Limitation on Subordinated Debt and Limited-Life Preferred Stock

The risk-based capital rules of the Board, the FDIC with respect to state nonmember banks, and the OCC with respect to national banks limit the amount of subordinated debt and intermediate-term preferred stock that may be treated as part of tier 2 capital to 50 percent of tier 1 capital. Such a restriction is not imposed on savings associations. However, the agencies limit the amount of tier 2 capital to 100 percent of tier 1 capital for all banks and savings associations.

In addition, under the risk-based capital rules of the Board, the FDIC with respect to state nonmember banks, and the OCC with respect to national banks, at the beginning of each of the last five years of the life of a subordinated debt or limited-life preferred stock instrument, the amount eligible for inclusion in tier 2 capital is reduced by 20 percent of the original amount of that instrument (net of redemptions). However, the regulations governing savings associations provide the option of using either the discounting approach described above or an approach that, during the last seven years of the instrument's life, allows for the full inclusion of all such instruments, provided that the aggregate amount of such instruments maturing in any one year does not exceed 20 percent of the savings association's total capital.

### Tangible Capital Requirement

Unlike banks, savings associations, by statute, must satisfy a 1.5 percent minimum tangible capital requirement.<sup>17</sup> However, under the Prompt Corrective Action framework all insured depository institutions are considered critically undercapitalized if

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<sup>17</sup> See 12 U.S.C. 1464(t)(1)(A)(ii) and (t)(2)(B).

their tangible common equity falls below 2 percent.<sup>18</sup> Therefore, the 1.5 percent minimum tangible capital requirement for savings associations is no longer a meaningful limit.

### Market Risk Rule

In 1996, the Board, the FDIC with respect to state nonmember banks, and the OCC with respect to national banks, adopted rules requiring banks and bank holding companies with significant exposure to market risk to measure and maintain capital to support that risk.<sup>19</sup> However, the rules governing savings associations do not include a market risk framework because no savings association engaged in the threshold level of trading activity when the market risk capital rule was adopted.<sup>20</sup>

### Pledged Deposits, Nonwithdrawable Accounts, and Certain Certificates

The capital regulations governing mutual savings associations permit such institutions to include in tier 1 capital pledged deposits and nonwithdrawable accounts to the extent that such accounts or deposits have no fixed maturity date, cannot be withdrawn at the option of the accountholder, and do not earn interest that carries over to subsequent periods. The regulations also permit the inclusion of net worth certificates, mutual capital certificates, and income capital certificates complying with applicable regulations in savings associations' tier 2 capital. The risk-based capital rules of the

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<sup>18</sup> See 12 U.S.C. 1831o(c)(3); see also 12 CFR 6.4, 12 CFR 165.4 (OCC); 12 CFR 208.45 (Board); 12 CFR 325.105, 12 CFR 390.455 (FDIC).

<sup>19</sup> See 61 FR 47358 (September 6, 1996).

<sup>20</sup> On August 30, 2012, the agencies published a revised market risk final rule that: (1) enhances the market risk rule's sensitivity to risks that are not adequately captured under the prior market risk rule, (2) increases transparency through enhanced disclosures, and (3) does not rely on credit ratings, consistent with section 939A of the Dodd-Frank Act. See 77 FR 53060. On the same day, the agencies also issued a proposed rule that would subject federal and state savings associations to the market risk rule. See 77 FR 52978 (August 30, 2012). Thus, if the proposed rule is adopted as a final rule, the difference described above would be eliminated.

Board, the FDIC with respect to state nonmember banks, and the OCC with respect to national banks do not expressly address these instruments.

#### Assets Subject to FDIC or Federal Savings and Loan Insurance Corporation Agreements

The risk-based capital rules of the Board, the OCC for national banks, and the FDIC for state nonmember banks generally place assets subject to guarantee arrangements by the FDIC or the former Federal Savings and Loan Insurance Corporation (FSLIC) in the 20 percent risk-weight category. The regulations governing savings associations place certain assets in the zero percent risk-weight category, provided the assets are fully covered against capital loss and/or by yield maintenance agreements initiated by the FSLIC, regardless of any later successor agency such as the FDIC.

The federal banking agencies issued a joint statement, Clarification of the Risk Weight for Claims on or Guaranteed by the FDIC, on February 26, 2010, that clarifies the risk weights for claims on or guaranteed by the FDIC for purposes of banking organizations' risk-based capital requirements. Recent loss-sharing agreements entered into by the FDIC with acquirers of assets from failed institutions are considered conditional guarantees for risk-based capital purposes due to contractual conditions imposed on the acquiring institution. The guaranteed portion of assets subject to an FDIC loss-sharing agreement may be assigned a 20 percent risk weight. Any such assets reported by a savings association, other than those meeting the requirements provided in 12 CFR 167.6(a)(1)(i)(F) (federal savings associations) and 12 CFR 390.466(a)(1)(i)(F) (state savings associations) may similarly receive a 20 percent risk weight.

## **Differences in Accounting Standards Among the Federal Banking Agencies**

### Specific Valuation Allowances

There was a difference in regulatory reporting of “specific valuation allowance” between Call Report and TFR filers.<sup>21</sup> Under the TFR, if a savings association determined that it was likely the amount of a loan loss classification would change due to market conditions, it could record the loss associated with the loan by either (1) creating a specific valuation allowance or (2) recognizing a charge-off.<sup>22</sup> In contrast, Call Report instructions require a charge-off for all confirmed losses and do not provide for this use of specific valuation allowances.

### Regulatory Reporting

In 2011, subsequent to the Dodd-Frank Act, the agencies changed regulatory reporting requirements, including requiring savings associations to file the quarterly Call Report rather than the TFR.<sup>23</sup> As a result, institutions supervised by the agencies are subject to uniform regulatory reporting requirements.

Savings associations continued their existing reporting processes until the effective dates cited below, but they were permitted to convert early to the Call Report for report dates after July 21, 2011. Savings associations that elected to early adopt the Call Report were still required to submit other applicable reports (Cost of Funds, Holding

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<sup>21</sup> Effective March 30, 2012, this difference was eliminated when savings associations began to file the Call Report.

<sup>22</sup> A savings association is not permitted to use a specific valuation allowance in lieu of a charge-off when it classifies certain credits as a loss, such as unsecured loans, consumer loans, and credit cards, and in instances where the collateral underlying a secured loan would likely be acquired through foreclosure or repossession. In those cases, only a charge-off is permitted.

<sup>23</sup> See 76 FR 39981 (July 7, 2011).

Company, and Consolidated Maturity/Rate Schedule) through the December 31, 2011, reporting period.

Specific changes to reporting requirements for savings associations include:

- A requirement to file the quarterly Call Report, beginning with the March 31, 2012, report date. Effective on that date, all required schedules of the TFR (including Schedules CMR – Consolidated Maturity Rate and HC – Thrift Holding Company) were eliminated;
- A requirement to file data through the Summary of Deposits with the FDIC, beginning with the June 30, 2011, report date. Effective on that date, the OTS Branch Office Survey was eliminated; and
- Ending collection of monthly median cost-of-funds data from savings associations, effective January 31, 2012. The last cost-of-funds indices were published as of December 31, 2011.

Dated: December 13, 2012

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Thomas J. Curry,  
Comptroller of the Currency.

By order of the Board of Governors of the Federal Reserve System, December 10,  
2012.

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Robert deV. Frierson,  
Secretary of the Board.

Dated: December 11, 2012

Federal Deposit Insurance Corporation.

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Robert E. Feldman,  
Executive Secretary.

**BILLING CODES: 4810-33-P; 6210-01-P; 6714-01-P**

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