NRC Staff Responses to Licensing Board's Second Set of Supplemental Questions Regarding Financial Assurance

Question B: *As noted above, in its January 14 response the staff places significant reliance on regulation of a prospective LOC issuer by a federal or state agency. The staff states that it "defer[s] to the expertise of the appropriate federal or state financial regulatory bodies to set and monitor the qualifications that the issuer must meet." See NRC000027, at 1. Relative to this statement, we request that the staff explain why it believes such federal or state regulatory oversight, in lieu of specific capitalization or credit rating requirements for an LOC issuer, is adequate to ensure that any AES-procured LOC will be sufficient to satisfy the issuer's obligations to the NRC to provide drawings that will be adequate to cover the total cost of decommissioning and depleted uranium disposition.*

Response B (R. Przygodzki, C. Dean, and M. Matamoros): NUREG-1757, Volume 3, Appendix A.10.1 (NRC000063) states that "[a] bank issuing a letter of credit to a licensee should be a financial institution whose operations are regulated and examined by a Federal or State agency." Consistent with NUREG-1757, Volume 3, Appendix A.10.1 (NRC000063), the staff's standard practice is to ensure that the LOC issuer's operations are regulated and examined by a Federal or State agency. Importantly, this approach is not unique to the AES application and the staff's review thereof.

Three other federal agencies, the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the Federal Reserve fulfill this regulatory function at the federal level. The regulations of these agencies prescribe minimum capital requirements and lending limits that financial institutions must meet. (Some of these regulations apply to state banks as well.) Due to lending limits, if AES relies upon a single LOC, the financial institution providing the LOC would likely need to be large, as a small bank would likely not be able to issue a large LOC. The purpose of these lending limits is to "protect the safety and soundness of national banks by preventing excessive loans to one person . . . ." *See* Title 12 of the *Code of Federal Regulations* (12 C.F.R) Section 32.1(b).

Part of OCC's regulatory duties and expertise is to regulate and supervise all national banks. Under 12 C.F.R. Part 3, Subpart B, the OCC uses sophisticated mathematical models to establish minimum capital ratios for each individual bank subject to its jurisdiction. Although the

OCC regulations contain highly detailed procedures for determining risk-based capital requirements, which take into account both the shareholders' equity in the bank (tier 1 capital) and several categories of supplementary capital (tier 2 capital) and compare it to the risk-adjusted assets of the entity (*i.e.*, its outstanding loans and other obligations), the OCC does not rely exclusively on these procedures. OCC regulations in 12 C.F.R. § 3.11 provide that "[t]he appropriate minimum capital ratios for an individual bank cannot be determined solely through the application of a rigid mathematical formula or wholly objective criteria. *The decision is necessarily based in part on subjective judgment ground in agency expertise*. The factors to be considered in the determination will vary in each case . . . ." (emphasis added). Thus, OCC considers, among other things, the "conditions or circumstances leading to the Office's determination that higher minimum capital ratios are appropriate or necessary for the bank;" as well as the "overall condition, management strength, and future prospects of the bank," and "the bank's liquidity, capital, risk asset and other ratios, compared to the ratios of its peer group." While LOCs are considered to be off-balance sheet financial instruments, under OCC's risk based capital guidelines, LOCs factor into the evaluation of the adequacy of a bank's capital. *See* 12 C.F.R. Part 3, Appendix A, §§ 3(a) and 3(b). Any credit losses related to a LOC are counted as liabilities. *See* OCC, "Comptroller of the Currency Bank Accounting Advisory Series," 68 (October 2010) (NRC000130).

The OCC conducts intensive on-site examinations of banks under its jurisdiction. National banks are examined by the OCC every 12 months. Smaller institutions meeting certain criteria may be evaluated only once every 18 months. *See* 12 C.F.R. § 4.6. However, the OCC may place banks on a "watch list" and examine them on a more frequent basis or, if necessary, take "such administrative action or sanctions as the OCC considers appropriate." 12 C.F.R. § 3.14 and 12 C.F.R. Subpart E.

OCC's regulations in 12 C.F.R. § 32.3 state that "[a] national bank's total outstanding loans and extensions of credit to one borrower may not exceed 15 percent of the bank's capital

and surplus, plus an additional 10 percent of the bank's capital and surplus, if the amount that exceeds the bank's 15 percent general limit is fully secured by readily marketable collateral . . . ." As set forth in 12 C.F.R. § 32.2(k)(i), loans and extensions of credit, referenced in 12 C.F.R. § 32.3, include "[a] contractual commitment to advance funds . . . ." 12 C.F.R. § 32.2(f)(iv) states that a contractual commitment to advance funds, referenced in 12 C.F.R. § 32.2(k)(i), includes an "[a]dvance [of] funds under a standby letter of credit . . . ." This means that if the LOC issuer cannot meet the requirements set forth in 12 C.F.R. § 32.3, it would not be able to issue the LOC.

One of FDIC's roles is that it "directly examines and supervises more than 4,900 banks and savings banks for operational safety and soundness," which constitutes "more than half of the institutions in the banking system." *See* FDIC, "Who Is the FDIC?" (NRC000131). Additionally, "[t]he FDIC is the primary federal regulator of banks that are chartered by the states that do not join the Federal Reserve System" (NRC000131).

The FDIC addresses letters of credit specifically in its regulations in 12 C.F.R. § 337. Under § 337.2(b), the FDIC provides that a standby letter of credit issued by an insured State bank "shall be combined with all other standby letters of credit and all loans for purposes of applying any legal limitation on loans of the bank (including limitations on loans to any one borrower, on loans to affiliates of the bank, or on aggregate loans) . . . ." FDIC member banks are examined by FDIC every 12 months. Smaller institutions meeting certain criteria may be evaluated only once every 18 months. FDIC examinations may be done in alternating 12 or 18 month periods if FDIC determines that state conducted examinations are sufficient. *See* FDIC, "Risk Management Manual of Examination Policies," Section 1.1 (2005) (NRC000132). The Federal Financial Institution Examination Council (FFIEC) collects quarterly Reports of Condition and Income (Call Reports) for FDIC member banks. Information on LOCs issued by FDIC member banks is available in the FDIC Institution Directory, which includes bank asset

and liability reports. LOCs are counted under "Total unused commitments" which are listed under "Memoranda."

The Federal Reserve's "Regulation H" (12 C.F.R. Part 208) addresses the capital adequacy of state banks that are members of the Federal Reserve system or applying for membership in that system. Under § 208.4, a bank's capital must be adequate to the character and condition of its assets and to its existing and prospective liabilities and other corporate responsibilities. Section 208.4 also sets standards and guidelines for evaluating the capital adequacy of a member bank. Standby LOCs are counted by the Federal Reserve system in determining a member bank's statutory lending limits. State member banks are examined by the Federal Reserve every 12 months. Smaller institutions meeting certain criteria may be evaluated only once every 18 months. *See* Federal Reserve Bank Division of Banking Supervision and Regulation, "Commercial Bank Examination Manual," Section 1000.1 (March 1994) (NRC000133).

Based on the information above regarding the expertise of the OCC, FDIC, and Federal Reserve in the review and assessment of the capitalization and financial strength of potential issuers of LOCs, the staff believes that such federal or state regulatory oversight is adequate and, coupled with NRC requirements and guidance (as further discussed in the response to the Board's question C below), will ensure that any AES-procured LOC will be sufficient to satisfy the issuer's obligations to the NRC to provide drawings that will be adequate to cover the total cost of decommissioning and depleted uranium disposition.

Question C: *Notwithstanding the staff's indication that it considers an LOC issued by an entity that is regulated by a federal or state agency to be adequate without any inquiry into the LOC issuer's specific capitalization or credit rating, are there any other requirements that will be placed on a LOC issuer by either AES or the staff to ensure the LOC issuer ultimately can pay AES's decommissioning and depleted uranium disposition costs?*

Response C (R.Przygodzki): Yes, the LOC relied on by AES must meet the requirements set forth in 10 C.F.R. §§ 30.35(f)(2)(i)-(iii), 40.36(e)(2)(i)-(iii), and 70.25(f)(2)(i)-(iii). NRC guidance

contained in NUREG-1757, Volume 3, Appendix A.10.4 (NRC000063) provides model LOC language that the NRC would find acceptable. In its application, AES stated that its LOC would "be structured and adopted consistent with applicable NRC regulatory requirements and in accordance with NRC regulatory guidance contained in NUREG-1757." *See* AES SAR Rev. 2, § 10.2.1, Page 10.2-1 (AES000037). The language of AES's draft LOC, consistent with NRC guidance, contains a clause wherein "[t]he [LOC issuer] shall give immediate notice to the applicant and NRC of any notice received or action filed alleging (1) the insolvency or bankruptcy of the financial institution or (2) any violation of regulatory requirements that could result in suspension or revocation of the [LOC issuer's] charter or license to do business" (AES000037). Such notification would provide the NRC with information needed to decide whether or not to draw on the LOC, and place the funds in the Standby Trust.