April 8, 2014

MEMORANDUM TO: Board of Directors

FROM: Doreen R. Eberley, Director
Division of Risk Management Supervision

SUBJECT: Final Rule: Implementation of Basel III and Related Amendments to the FDIC's Risk-Based and Leverage Capital Requirements and the Methodologies for Calculating Risk-Weighted Assets under the Standardized and Advanced Approaches

Summary: On August 30, 2012, the FDIC, together with the Federal Reserve Board ("Federal Reserve Board") and the Office of the Comptroller of the Currency ("OCC") (collectively, the "agencies"), published in the *Federal Register* three joint notices of proposed rulemaking seeking public comment on revisions to their risk-based and leverage capital requirements and the methodologies for calculating risk-weighted assets under the standardized and advanced approaches (together, "NPRs" or "proposed rules"). The proposed rules, in part, reflected agreements reached by the Basel Committee on Banking Supervision ("BCBS") to strengthen international capital standards, as set forth in "Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems" ("Basel III"), as well as subsequent changes to the Basel III framework and recent BCBS consultative papers. The proposed rules also included changes consistent with the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

After considering public comments received on the NPRs, on September 10, 2013, the FDIC issued the three proposals as a consolidated interim final rule ("Basel III interim final rule"). Concurrent with the FDIC Board of Directors' adoption of the Basel III interim final rule

Concur:

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Acting General Counsel

and the Federal Reserve Board's and the OCC's adoption of substantively identical final rules, the agencies issued a related notice of proposed rulemaking that would apply to large, interconnected U.S. banking organizations and strengthen the supplementary leverage ratio requirements under the Basel III interim final rule and final capital rules adopted by the Federal Reserve Board and the OCC ("enhanced supplementary leverage ratio NPR"). The Basel III interim final rule sought comments on the interaction between the Basel III interim final rule and the enhanced supplementary leverage ratio NPR.

Comments on the Basel III interim final rule largely reiterated those considered and addressed during the comment period following the issuance of the proposed rules.

The attached final rule is substantively identical to the Basel III interim final rule. Any revisions to the interim final rule in this final rule are technical revisions to conform this final rule to the final rules issued by the Federal Reserve Board and the OCC. In addition, staff notes that the attached Resolution, if adopted by the Board, would authorize the Executive Secretary and the General Counsel to make technical, non-substantive revisions to the attached final rule on an interagency basis with the Federal Reserve Board and OCC.

Recommendation: Staff recommends adopting the Basel III interim final rule, with certain technical changes, as a final rule, including the effective dates and transitional implementation framework set forth in the attached *Federal Register* document. The final rule is substantively identical to the interim final rule and the joint final rule issued by the Federal Reserve Board and the OCC in October 2013.

Discussion:

Background

The recent financial crisis exposed a number of shortcomings in the international capital standards that serve as the basis for the agencies' general risk-based capital rules. Accordingly, in July, 2009, the BCBS issued *Enhancements to the Basel II Framework* ("2009 Basel II Enhancements") to revise those standards by enhancing certain risk-based capital requirements and encouraging stronger management of credit and market risk. Specifically, the 2009 Basel II Enhancements strengthened the risk-based capital requirements for certain securitization exposures; increased the credit conversion factors for certain short-term liquidity facilities; and required that banking organizations conduct more rigorous credit analysis of their exposures.[1]

In 2010, the BCBS continued its effort to address weaknesses in international capital standards and published a more comprehensive capital reform package, Basel III, which is designed to improve the quality and the quantity of regulatory capital and build additional capacity into the banking system to absorb losses in times of future market and economic stress. The Basel III framework introduces or enhances a number of capital standards, including a stricter definition of regulatory capital, as well as a new minimum tier 1 common equity ratio, regulatory capital buffers, an international leverage ratio, and disclosure requirements for certain regulatory capital instruments.

The NPRs and the Basel III Interim Final Rule

Following notice and comment on the three NPRs[2], in July 2013 the FDIC Board adopted the NPRs on a consolidated, interim final basis and issued the Basel III interim final rule.[3] Concurrent with the adoption of the Basel III interim final rule, the FDIC Board also approved the enhanced supplementary leverage ratio NPR.[4] In that NPR, the FDIC sought comment on the interaction of the enhanced supplementary leverage ratio NPR and the Basel III interim final rule.

The FDIC received three comments regarding the Basel III interim final rule from two banking organizations and one trade association representing the financial services industry. The commenters reiterated concerns that were submitted to the agencies during the notice and comment period for the NPRs, considered by the agencies, and discussed in the preambles to the Basel III interim final rule and the joint final rule adopted by the Federal Reserve Board and the OCC. Accordingly, if it is approved, the attached final rule would implement the Basel III interim final rule with no changes.

[1] In July 2009, the BCBS also issued Revisions to the Basel II Market Risk Framework, available at http://www.bis.org/publ/bcbs193.htm. The agencies issued an NPR in January 2011 and supplement in December 2011 that included provisions to implement the market-risk related provisions. 76 FR 1890 (January 11, 2011); 76 FR 79380 (December 21, 2011).
[2] 77 FR 52792 (August 30, 2012); 77 FR 52888 (August 30, 2012); 77 FR 52978 (August 30, 2012).
[3] 78 FR 55340 (Sept. 10, 2013). The OCC and the Federal Reserve Board issued the three proposals as a consolidated final rule that was substantively identical to the FDIC's Basel III interim final rule (78 FR 62018 (Oct. 11, 2013)).
[4] 78 FR 51101 (Aug. 20, 2013).

This final rule would be substantively identical to the joint final rule issued by the Federal Reserve Board and the OCC. The discrepancies between the attached final rule and the final rules of the Federal Reserve Board and OCC are largely attributable to technical changes that were incorporated into the later published, Federal Reserve Board and OCC final rules. The changes include revisions to certain paragraph designations and cross-references and correction of a typographical error regarding the effective date for certain disclosures.

The Final Rule

Consistent with the Basel III interim final rule and the final rules adopted by the Federal Reserve Board and the OCC, the attached final rule would improve both the quality and quantity of regulatory capital. Specifically, the final rule would implement a revised definition of regulatory capital, a new common equity tier 1 minimum capital requirement, a higher minimum tier 1 capital requirement, and, for FDIC-supervised institutions subject to the advanced approaches rule, a supplementary leverage ratio that incorporates a broader set of exposures in the denominator of the ratio. These requirements would be incorporated into the FDIC's prompt corrective action framework.

To mitigate the pro-cyclicality of the regulatory capital framework, this final rule would establish limits on FDIC-supervised institutions' capital distributions and certain discretionary bonus payments of FDIC-supervised institutions if the institutions do not hold a specified amount of common equity tier 1 capital in addition to the amount necessary to meet their minimum risk-based capital requirements. With respect to the calculation of risk-weighted assets, the final rule would implement a Basel II-based standardized approach that would apply to all FDIC-supervised institutions, including serving as the risk-based capital floor for institutions subject to the advanced approaches rule. In addition, the final rule would amend the market risk capital rule to apply to state savings associations. The final rule is consistent with the requirements of section 171 (also, commonly referenced as the "Collins Amendment") and section 939A (pertaining to the use of credit ratings in agency regulations) of the Dodd-Frank Act.

In addition, staff notes that the attached Resolution, if adopted by the Board, would authorize the Executive Secretary and the General Counsel to make technical, non-substantive revisions to the attached final rule on an interagency basis with the Federal Reserve Board and OCC.

Conclusion

FDIC staff recommends that the FDIC Board adopt the attached final rule and authorize its publication in the *Federal Register*.

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