FDIC

Federal Deposit Insurance Corporation
550 17th Street NW, Washington, D.C. 20429-9990

Financial Institution Letter
FIL-88-2010
December 16, 2010

RISK-BASED CAPITAL STANDARDS

Proposed Rule on Advanced Capital Adequacy Framework—Basel II; *Establishment of a Risk-Based Capital Floor*

Summary: The federal bank regulatory agencies have jointly issued the attached notice of proposed rulemaking to amend the advanced risk-based capital adequacy standards (advanced approaches rules) to be consistent with certain provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Act), and to amend the general risk-based capital rules to provide limited flexibility consistent with section 171(b) of the Act for recognizing the relative risk of certain assets generally not held by depository institutions.

Distribution:
FDIC-Supervised Banks (Commercial and Savings)

Suggested Routing:
Chief Executive Officer
Chief Financial Officer
Chief Risk Officer

Related Topics:
Risk-Based Capital Rules
12 CFR Part 325
Basel II

Attachment:
Joint Notice of Proposed Rulemaking, Risk-Based Capital Standards: Advanced Capital Adequacy Framework—Basel II; Establishment of a Risk-Based Capital Floor

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Note:
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Highlights:

The proposed rule:

- Applies to all banks that use the advanced approaches rules to calculate their risk-based capital requirements.
- Consistent with Section 171 of the Act, replaces the “transitional floors” in the advanced approaches rules with a permanent floor equal to the minimum capital requirement computed using the agencies’ general risk-based capital rules.
- Amends the agencies’ general risk-based capital rules to allow banks to use the Bank Holding Company capital rules in limited circumstances to determine the capital requirements for low-risk assets not typically held by banks.
- Requests comment on how the proposed rule should be applied to foreign banks in evaluating their capital equivalency in the context of applications to establish branches or make bank or nonbank acquisitions in the United States, and in evaluating capital comparability in the context of foreign bank financial holding company declarations.

The deadline for comments is 60 days from the date of publication in *The Federal Register*.

Key Aspects of the Proposed Rule on Advanced Capital Adequacy Framework— Basel II; *Establishment of a Risk-Based Capital Floor*

On December 14, 2010, the FDIC of Directors approved a joint Notice of Proposed Rulemaking (NPR) to implement certain requirements of Section 171 of the Dodd Frank Wall Street Reform and Consumer Protection Act. Section 171 is more generally known as the Collins Amendment.

Section 171 requires, among other things, that the agencies' generally applicable capital requirements serve as a floor for other capital requirements the agencies may establish. Along with the Office of the Comptroller of the Currency (OCC) and the Board of Governors of the Federal Reserve System (Federal Reserve), the FDIC is proposing to modify the advanced approaches capital rule consistent with Section 171.

Section 171 defines the "generally applicable" risk-based capital requirements as those applied to insured institutions under the agencies' Prompt Corrective Action regulations regardless of total consolidated assets or foreign exposure. The agencies' general risk-based capital rules establish minimum capital requirements pursuant to prompt corrective action for all insured institutions regardless of size. Accordingly, the agencies' general risk-based capital rules are the "generally applicable capital risk-based capital requirements" as that term is defined in Section 171.

Again as specified in section 171, the generally applicable risk-based capital requirements must serve as a floor for other capital requirements the agencies may establish. The advanced approaches rule, however, allows banks using it to operate with capital requirements potentially well below the requirements generally applicable to other banks.

That is why the FDIC is joining with the OCC and the Federal Reserve in proposing to modify the advanced approaches rule to be consistent with the capital floor provisions of section 171. The advanced approaches rule currently provides a series of transitional floors allowing banks using it to operate during three transition periods with risk-based capital requirements that are 95 percent, 90 percent and 85 percent respectively of the risk-based capital requirements computed under the general capital rules. The advanced approaches rule also provides the potential, after these transition periods, for banks to operate without any floor on risk-based capital requirements.

Consistent with section 171, the agencies are proposing to eliminate the transitional floors in the advanced approach and replace them with a permanent risk-based capital floor equal to 100 percent of the capital requirement computed under the agencies general risk-based capital requirements.

Section 171 does not prevent the agencies from amending the generally applicable capital requirements over time. As noted in the preamble to the NPR, however, those new generally applicable capital requirements would become the new floor for banking organizations using the advanced approach.

Section 171 also provides that future versions of the generally applicable capital requirements should not be quantitatively lower than the requirements in effect as of the enactment of the Dodd Frank Act. The preamble to the NPR notes that the agencies would envision performing quantitative analyses designed to avoid an impermissible reduction in capital requirements. The preamble specifically states that the agencies would not envision, for example, requiring banks to compute two sets of generally applicable requirements (the July 2010 requirements and some future modified set of requirements).

The agencies are also proposing to allow banks in limited circumstances to use the capital requirements applicable to Bank Holding Companies. These circumstances are limited to situations where a bank would not be able to hold the asset except under special authority and the asset has a risk-profile lower than that of other assets receiving a risk-weight of less than 100 percent. This proposed change is intended to allow the Federal Reserve increased flexibility to craft appropriate capital requirements for low risk nonbank assets, in a way that is consistent with Section 171 and that does not provide material opportunities for depository institutions to engage in capital arbitrage.

Comments on this NPR are due 60 days after its publication in The Federal Register. The Office of Thrift Supervision (OTS) has indicated its intention to publish a similar NPR.