November 8, 2006

MEMORANDUM TO: Executive Secretary

FROM: Christopher Bellotto
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SUBJECT: Meeting between FDIC and Representatives of the Shadow Financial Regulatory Committee to Discuss an International Leverage Ratio and the FDIC's Proposed Rulemaking on Risk-Based Pricing of Deposit Insurance Assessments

Please include this memorandum in the public file on the Notice of Proposed Rulemaking for Risk-Based Assessments and in the public file for the Joint Notice of Proposed Rulemaking for Risk-Based Capital Standards: Advanced Capital Adequacy Framework (Basel II NPR). The Basel II NPR was published for comment in the *Federal Register* on September 25, 2006.

On October 11, 2006, representatives of the Shadow Financial Regulatory Committee (Committee) met with FDIC staff for a general discussion of the reasons and need for an international leverage ratio in the context of the implementation by banking organizations of the risk-based capital requirements in the Basel II NPR. In addition, the Committee and FDIC staff discussed the Notice of Proposed Rulemaking for Risk-Based Assessments published by the FDIC in the *Federal Register* on July 24, 2006. The following FDIC board members were in attendance: Chairman Bair, Vice-Chairman Gruenberg, and Director Curry. Committee members in attendance were: George Kaufman, George Benston, Charles Caloramis, Paul Horvitz, and Peter Wallison.

International Leverage Ratio

The international leverage ratio discussion began with FDIC staff giving an overview of issues related to international capital requirements, including capital levels, capital dispersion among banking organizations, and competitive impacts. There was general discussion of the international leverage ratio proposal presented by Chairman Bair in a recent speech, and strategies in support of it as well as opposition to it. Members of the Committee noted the potential impact on the United States of lower risk-based capital requirements in the Basel II NPR, discussed the possible benefits in convincing European Union (EU) nations to support higher capital levels for banking organizations, and urged the inclusion of subordinated debt in risk-based capital measurements. Committee members viewed subordinated debt as a buffer for the deposit insurance fund and a signal that institutions might be experiencing problems. Additional discussion involved the view of large U.S. banks that an international competitive disadvantage could result from potentially lower capital requirements for EU nations. The Committee discussed the possibility of establishing a task force or subcommittee to focus on international capital levels for banking organizations.

Risk-Based Assessments

The Committee's discussion of risk-based assessments was generally consistent with its September 18, 2006 comment letter. The FDIC was urged to price deposit insurance using "actuarial fairness" by charging assessments only on insured deposits; focusing on the magnitude of loss once failure occurs; including more data regarding fraud; imposing, at least temporarily, a flat 3 basis point rate for Category I institutions; and assessing Risk Category IV institutions higher than proposed. The Committee also suggested that the FDIC structure premiums to provide banks with incentives to issue subordinated debt and take more than the 270 days set by Congress to develop new pricing regulations. The Committee's latter point was questioned in light of the requirements in existing law when the reserve ratio falls below 1.25 percent.