

Press Releases

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OTS 04-24 - Banking Agencies Announce Publication of Revised Capital Framework and Describe U.S. Implementation Efforts

Office of Thrift Supervision

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Joint Release

**Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation
Office of the Comptroller of the Currency
Office of Thrift Supervision**

Banking Agencies Announce Publication of Revised Capital Framework and Describe U.S. Implementation Efforts

WASHINGTON -- The Basel Committee on Banking Supervision today released its document "International Convergence of Capital Measurement and Capital Standards: A Revised Framework." The Framework (also referred to as Basel II) represents the outcome of the work of the Basel Committee, with active participation by the U.S. banking and thrift agencies (Agencies), over recent years to secure international convergence on revisions to regulations and standards governing the capital adequacy of internationally active banking organizations. The Framework will form the basis upon which the Agencies, and representatives of the other Basel Committee member countries, develop proposed revisions to existing capital adequacy regulations and standards.

The Framework is available on the Basel Committee's website at www.bis.org, the Office of the Comptroller of the Currency's (OCC) website at www.occ.treas.gov, the Federal Reserve Board's (Federal Reserve) website at www.federalreserve.gov, the Federal Deposit Insurance Corporation's (FDIC) website at www.fdic.gov, and the Office of Thrift Supervision's (OTS) website at www.ots.treas.gov.

U.S. Implementation Plans

As noted, the Framework will form the basis upon which the Agencies develop proposed revisions to their existing risk-based capital adequacy regulations. As previously announced, the Agencies expect that only a small number of large, internationally active U.S. banking organizations would be required to use the Framework, and that those institutions would use only the most advanced approaches for determining their risk-based capital requirements. Application of the Framework's advanced approaches to other qualifying U.S. banking organizations would be at the banking organization's option.

The Agencies have developed a comprehensive plan to incorporate the advanced risk and capital measurement methodologies of the Framework into regulations and supervisory

guidance for U.S. institutions. This plan will ensure that U.S. implementation efforts are consistent with the Framework; reflect the unique statutory, regulatory and supervisory processes in the United States; and appropriately seek and consider comments on individual aspects of the plan from all interested parties.

Prior to implementation, it is expected that institutions using Framework-based regulations and guidance will first be subject to a year of "parallel running;" i.e. application of the advanced approaches in tandem with the current risk-based capital regime, beginning in January 2007. The Agencies anticipate that the Framework would become fully effective in the United States in January 2008. The Agencies plan to apply prudential floors to risk-based regulatory capital calculations in the two years immediately after adoption of the Framework. Qualified institutions that opt in to the Framework subsequent to the initial implementation period would be subject to a similar phase-in schedule (i.e. parallel running and floors).

Given the investments needed to qualify for the advanced approaches of the Framework, the Agencies believe that it would be prudent for banking organizations that expect to adopt the Framework on or near the effective date to begin planning their implementation efforts. In order to facilitate such efforts, the Agencies have described below the significant milestones in the development of Framework-based regulations, guidance, and policies. Additional information on these activities will be forthcoming.

Supervisory Guidance

The Agencies are developing supervisory guidance for various portfolios and risk exposures addressed by the Framework. This guidance is intended to provide U.S. institutions and supervisors with a clear description of the essential components and characteristics of the measurement and management structure for these risks and to describe relevant supervisory expectations for banking organizations adopting a Framework-based process for the determination of minimum regulatory risk-based capital requirements.

The Agencies have previously published for notice and comment draft supervisory guidance on Internal Ratings-Based Systems (IRB) for Corporate Credit and on the Advanced Measurement Approaches (AMA) for Operational Risk. See 68 Fed. Reg. 45949 (August 4, 2003). The Agencies expect to publish for notice and comment draft supervisory guidance on IRB Systems for Retail Credit in the third quarter of 2004. Over the course of the next year, the Agencies will publish for comment additional guidance on other aspects of IRB Systems.

Institutions that expect to adopt the Framework are encouraged to consider the supervisory standards articulated in the guidance in developing their implementation plans for the adoption of Framework-based systems. Specifically, institutions should begin to self-assess the extent to which their systems and processes comply with or differ from proposed supervisory standards. The Agencies expect to publish additional information regarding the process that will be used to assess individual institutions' efforts to meet IRB and AMA qualifying standards.

Additional Quantitative Impact Study

Later this year, the Agencies will conduct a fourth Quantitative Impact Study (QIS-4) to evaluate the potential effects of a U.S. implementation of the Framework. QIS-4 will assist banking organizations and their supervisors in better understanding the implications of this proposal on the regulatory capital requirements of individual institutions and may provide some insight with regard to the competitive implications of the new rules. A full or partial recalibration of the Framework may be considered based on the results of the QIS-4 exercise.

Although other countries may undertake joint or independent reviews similar to QIS-4, the forthcoming study, as implemented in the United States, will be tailored to the domestic interests of the Agencies and will focus on the effect of the proposal on U.S. banking organizations, especially those large internationally active institutions that the Agencies have proposed to require to conform to Framework-based regulations. Other institutions that anticipate adhering to Framework-based regulations on a voluntary basis may also participate in the study in order to understand better the nature of the internal risk measurement information that the new rules would require and to estimate their resulting capital requirements.

As before, the Agencies will request that participants submit requested information by completing a series of computerized spreadsheets - the Agencies will ensure consistency in responses through detailed instructions, questionnaires, and supervisory oversight. The Agencies expect to finalize and distribute survey materials to participating institutions in October 2004 and to request that institutions complete and return the survey results by mid-January 2005. Institutions that want to participate in the study should discuss the project with their federal supervisor(s) by the end of July 2004.

Revision of Capital Adequacy Regulations

In August of 2003, the Agencies published for notice and comment an advance notice of proposed rulemaking (ANPR) discussing possible revisions to U.S. risk-based capital adequacy regulations relating to an earlier iteration of the Framework. See 68 Fed. Reg. 45900 (August 4, 2003). With the publication of the Framework, the Agencies will continue this rulemaking process.

As provided in the ANPR, the Agencies expect that some U.S. banking organizations would use the most advanced approaches set forth in the Framework to determine their risk-based capital requirements, while others would continue to apply the existing capital rules. As a result, the United States would have a bifurcated regulatory capital framework. In conjunction with the assessment of U.S. risk-based capital adequacy regulations relating to the Framework, the Agencies are assessing possible changes to capital regulations for U.S. institutions not subject to Framework-based regulations. Importantly, all U.S. banking organizations would continue to be subject to a leverage ratio requirement under existing regulations, and Prompt Corrective Action (PCA) legislation and implementing regulations would remain in effect.

The Agencies expect that a notice of proposed rulemaking on possible revisions to risk-based capital adequacy regulations relating to the Framework will be published in mid-2005. After fully considering all comments, the Agencies expect to be in a position to publish final rules on this proposal in the second quarter of 2006. Possible changes to capital regulations for U.S. institutions not subject to the Framework-based regulations will be considered and addressed in this same general timeframe.

International Convergence of Capital Measurement and Capital Standards - A Revised Framework - 285 pages, (June 2004) - <http://www.occ.gov/static/news-issuances/ots/press-releases/ots-pr-2004-24a.pdf>

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The Office of Thrift Supervision (OTS), a bureau of the U.S. Treasury, regulates and supervises the nation's thrift industry. OTS's mission is to ensure the safety and soundness of thrift institutions and to support their role as home mortgage lenders

and providers of other community credit and financial services. For copies of news releases or other documents visit the OTS web page at www.ots.treas.gov.