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I. Executive Summary

A. Introduction

In the United States, banks, thrifts, and bank holding companies (banking organizations or institutions) are subject to minimum regulatory capital requirements. Specifically, U.S. banking organizations must maintain a minimum leverage ratio and two minimum risk-based ratios.¹ The

current U.S. risk-based capital requirements are based on an internationally agreed framework for capital measurement that was developed by the Basel Committee on Banking Supervision (Basel Supervisors Committee or BSC) and endorsed by the G-10 Governors in 1988.² The international framework (1988 Accord) accomplished several important objectives. It strengthened capital levels at large, internationally active banks and fostered international consistency and coordination. The 1988 Accord also reduced disincentives for banks to hold liquid, low-risk assets. Moreover, by requiring banks to hold capital against off-balance-sheet exposures, the 1988 Accord represented a significant step forward for regulatory capital measurement.

Although the 1988 Accord has been a stabilizing force for the international banking system, the world financial system has become increasingly more complex over the past fifteen years. The BSC has been working for several years to develop a new regulatory capital framework that recognizes new developments in financial products, incorporates advances in risk measurement and management practices, and more precisely assesses capital charges in relation to risk. On April 29, 2003, the BSC released for public consultation a document entitled "The New Basel Capital Accord" (New Accord) that sets forth proposed revisions to the 1988 Accord. The BSC will accept industry comment on the New Accord through July 31, 2003 and expects to issue a final revised Accord by the end of 2003. The BSC expects that the New Accord would have an effective date for implementation of December 31, 2006.

Accordingly, the Agencies are soliciting comment on all aspects of this ANPR, which is based on certain proposals in the New Accord. Comments will assist the Agencies in

regulatory capital as a percentage of both on- and off-balance-sheet credit exposures with some gross differentiation based on perceived credit risk. The Agencies' capital rules may be found at 12 CFR Part 3 (OCC), 12 CFR Parts 208 and 225 (Board), 12 CFR Part 325 (FDIC), and 12 CFR Part 567 (OTS).

² The BSC was established in 1974 by the central-bank governors of the Group of Ten (G-10) countries. Countries are represented on the BSC by their central bank and also by authorities with bank supervisory responsibilities. Current member countries are Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, the United Kingdom, and the United States. The 1988 Accord is described in a document entitled "International Convergence of Capital Measurement and Capital Standards." This document and other documents issued by the BSC are available through the Bank for International Settlements website at www.bis.org.

reaching a determination on a number of issues related to how the New Accord would be proposed to be implemented in the United States. In addition, in light of the public comments submitted on the ANPR, the Agencies will seek appropriate modifications to the New Accord.

B. Overview of the New Accord

The New Accord encompasses three pillars: minimum regulatory capital requirements, supervisory review, and market discipline. Under the first pillar, a banking organization must calculate capital requirements for exposure to both credit risk and operational risk (and market risk for institutions with significant trading activity). The New Accord does not change the definition of what qualifies as regulatory capital, the minimum risk-based capital ratio, or the methodology for determining capital charges for market risk. The New Accord provides several methodologies for determining capital requirements for both credit and operational risk. For credit risk there are two general approaches; the standardized approach (essentially a package of modifications to the 1988 Accord) and the internal ratings-based (IRB) approach (which uses an institution's internal estimates of key risk drivers to derive capital requirements). Within the IRB approach there is a foundation methodology, in which certain risk component inputs are provided by supervisors and others are supplied by the institutions, and an advanced methodology (A-IRB), where institutions themselves provide more risk inputs.

The New Accord provides three methodologies for determining capital requirements for operational risk; the basic indicator approach, the standardized approach, and the advanced measurement approaches (AMA). Under the first two methodologies, capital requirements for operational risk are fixed percentages of specified, objective risk measures (for example, gross income). The AMA provides the flexibility for an institution to develop its own individualized approach for measuring operational risk, subject to supervisory oversight.

The second pillar of the New Accord, supervisory review, highlights the need for banking organizations to assess their capital adequacy positions relative to overall risk (rather than solely to the minimum capital requirement), and the need for supervisors to review and take appropriate actions in response to those assessments. The third pillar of the New Accord imposes public disclosure requirements on institutions that are intended to allow market participants to

¹ The leverage ratio measures regulatory capital as a percentage of total on-balance-sheet assets as reported in accordance with generally accepted accounting principles (GAAP) (with certain adjustments). The risk-based ratios measure