

assess key information about an institution's risk profile and its associated level of capital.

The Agencies do not expect the implementation of the New Accord to result in a significant decrease in aggregate capital requirements for the U.S. banking system. Individual banking organizations may, however, face increases or decreases in their minimum risk-based capital requirements because the New Accord is more risk sensitive than the 1988 Accord and the Agencies' existing risk-based capital rules (general risk-based capital rules). The Agencies will continue to analyze the potential impact of the New Accord on both systemic and individual bank capital levels.

C. Overview of U.S. Implementation

The Agencies believe that the advanced risk and capital measurement methodologies of the New Accord are the most appropriate approaches for large, internationally active banking organizations. As a result, large, internationally active banking organizations in the United States would be required to use the A-IRB approach to credit risk and the AMA to operational risk. The Agencies are proposing to identify three types of banking organizations: institutions subject to the advanced approaches on a mandatory basis (core banks); institutions not subject to the advanced approaches on a mandatory basis, but that choose voluntarily to apply those approaches (opt-in banks); and institutions that are not mandatorily subject to and do not apply the advanced approaches (general banks). Core banks would be those with total banking (and thrift) assets of \$250 billion or more or total on-balance-sheet foreign exposure of \$10 billion or more. Both core banks and opt-in banks (advanced approach banks) would be required to meet certain infrastructure requirements (including complying with specified supervisory standards for credit risk and operational risk) and make specified public disclosures before being able to use the advanced approaches for risk-based regulatory capital calculation purposes.³

General banks would continue to apply the general risk-based capital rules. Because the general risk-based capital rules include a buffer for risks not easily quantified (for example, operational risk and concentration risk), general banks would not be subject to an

additional direct capital charge for operational risk.

Under this proposal, some U.S. banking organizations would use the advanced approaches while others would apply the general risk-based capital rules. As a result, the United States would have a bifurcated regulatory capital framework. That is, U.S. capital rules would provide two distinct methodologies for institutions to calculate risk-weighted assets (the denominator of the risk-based capital ratios). Under the proposed framework, all U.S. institutions would continue to calculate regulatory capital, the numerator of the risk-based capital ratios, as they do now. Importantly, 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.⁴ It is recognized that in some cases, under the proposed framework, the leverage ratio would serve as the most binding regulatory capital constraint.

Implementing the capital framework described in this ANPR would raise a number of significant practical and conceptual issues about the role of economic capital calculations relative to regulatory capital requirements. The capital formulas described in this ANPR, as well as the economic capital models used by banking organizations, assume the ability to assign precisely probabilities to future credit and operational losses that might occur. The term "economic capital" is often used to refer to the amount of capital that should be allocated to an activity according to the results of such an exercise. For example, a banking organization might compute the amount of income, reserves, and capital that it would need to cover the 99.9th percentile of possible credit losses associated with a given type of lending. The desired degree of certainty of covering losses is related to several factors including, for example, the banking organization's target credit rating. The higher the loss percentile the institution wishes to provide protection against, the less likely the capital held by the institution would be insufficient to cover losses, and the higher would be the institution's credit rating.

While the Agencies intend to move to a framework where regulatory capital is more closely aligned to economic capital, the Agencies do not intend to

place sole reliance on the results of economic capital calculations for purposes of computing minimum regulatory capital requirements. Banking organizations face risks other than credit and operational risks, and the assumed loss distributions underlying banking organizations' economic capital calculations are subject to the risk of error. Consequently, the Agencies continue to view the leverage ratio tripwires contained in existing PCA and other regulations as important components of the regulatory capital framework.

The A-IRB Approach for Credit Risk

Under the A-IRB approach for credit risk, an institution's internal assessment of key risk drivers for a particular exposure (or pool of exposures) would serve as the primary inputs in the calculation of the institution's minimum risk-based capital requirements. Formulas, or risk weight functions, specified by supervisors would use the banking organization's estimated inputs to derive a specific dollar amount capital requirement for each exposure (or pool of exposures). This dollar capital requirement would be converted into a risk-weighted assets equivalent by multiplying the dollar amount of the capital requirement by 12.5—the reciprocal of the 8 percent minimum risk-based capital requirement. Generally, banking organizations using the A-IRB approach would assign assets and off-balance-sheet exposures into one of three portfolios: wholesale (corporate, interbank, and sovereign), retail (residential mortgage, qualifying revolving, and other), and equities. There also would be specific treatments for securitization exposures and purchased receivables. Certain assets that do not constitute a direct credit exposure (for example, premises, equipment, or mortgage servicing rights) would continue to be subject to the general risk-based capital rules and risk weighted at 100 percent. A brief overview of each A-IRB portfolio follows.

Wholesale (Corporate, Interbank, and Sovereign) Exposures

Wholesale credit exposures comprise three types of exposures: corporate, interbank, and sovereign. Generally, the meaning of interbank and sovereign would be consistent with the general risk-based capital rules. Corporate exposures are exposures to private-sector companies; interbank exposures are primarily exposures to banks and securities firms; and sovereign exposures are those to central governments, central banks, and certain

³ The Agencies continue to reserve the right to require higher minimum capital levels for individual institutions, on a case-by-case basis, if necessary to address particular circumstances.

⁴ Thus, for example, to be in the well-capitalized PCA category a bank must have at least a 10 percent total risk-based capital ratio, a 6 percent Tier I risk-based capital ratio, and a 5 percent leverage ratio. The other PCA categories also would not change.