Press Release

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Board approves final rules to implement Basel II risk-based capital framework

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The Federal Reserve Board on Friday approved final rules to implement new risk-based capital requirements in the United States for large, internationally active banking organizations. The new advanced capital adequacy framework, known as Basel II, more closely aligns regulatory capital requirements with actual risks and should further strengthen banking organizations' risk-management practices.

"Basel II is a modern, risk-sensitive capital standard that will protect the safety and soundness of our large, complex, internationally active banking organizations. The new framework is designed to evolve over time and adapt to innovations in banking and financial markets, a significant improvement from the current system," said Federal Reserve Board Chairman Ben S. Bernanke.

For banking organizations that meet the relevant qualifying criteria, Basel II would replace the current U.S. rules implementing the Basel Capital Accord of 1988 (Basel I). Basel II would be mandatory for large, internationally active banking organizations (so-called "core" banking organizations with at least $250 billion in total assets or at least $10 billion in foreign exposure) and optional for others. Under Basel II, core banking organizations would be required to enhance the measurement and management of their risks, including credit risk and operational risk, through the use of advanced approaches for calculating risk-based capital requirements.

"The improvements in risk management under Basel II will be valuable and important in promoting the resiliency of the banking and financial systems," said Federal Reserve Board Governor Randall S. Kroszner.

Core banking organizations also would be required to have rigorous processes for assessing their overall capital adequacy in relation to their total risk profile and to publicly disclose information about their risk profile and capital adequacy. Under Basel II, risk-based capital requirements will vary on the basis of a banking organization's actual risk profile and experience, which should lead institutions to make better decisions about extending credit, mitigating risks, and determining overall capital needs. Banking organizations with a higher risk profile will have higher regulatory capital requirements than those with a lower risk profile.

The new U.S. Basel II rule is technically consistent in most respects with international approaches and includes a number of prudential safeguards as originally proposed in September 2006. These safeguards include a requirement that banking organizations satisfactorily complete a four-quarter parallel run period before operating under the Basel II framework, a requirement that an institution satisfactorily complete a series of transitional periods before operating under Basel II without floors, and a commitment by the agencies to conduct ongoing analysis of the framework to ensure Basel II is working as intended. Importantly, Basel II in the United States will be implemented with retention of the leverage ratio and prompt corrective action (PCA) requirements, which will continue to bolster capital and complement risk-based measures.

Following a successful parallel run period, a banking organization would have to progress through three transitional periods (each lasting at least one year), during which there would be floors on potential declines in risk-based capital requirements.

Those transitional floors would limit maximum cumulative reductions of a banking organization's risk-based capital requirements to 5 percent during the first transitional floor period, 10 percent during the second transitional floor period, and 15 percent during the third transitional floor period. A banking organization would need approval from its primary federal regulator to move into each of the transitional floor periods, and at the end of the third transitional floor period to move to full Basel II. The federal banking agencies will publish a study after the end of the second transition year that examines the new framework for any material deficiencies.

"To ensure that banks maintain strong capital ratios, we will diligently monitor Basel II during every step of its implementation," Governor Kroszner said. "Our goal is for banks to have strong risk-based capital ratios that are substantially more representative of risk profiles, and more sensitive to changes in those risk profiles than they are today. If our analysis shows that any part of this goal is not being met, we will consider ways to improve the framework."

As the federal banking agencies said in July, the agencies intend to issue a proposed rule that would provide all non-core banking organizations, which are not required to adopt Basel II's advanced approaches, with the option to adopt a standardized approach under Basel II. The proposed rule is intended to be finalized before the core banking organizations may start their first transition period year under Basel II.

The Board authorized the staff to publish the final rules in the *Federal Register* after all of the federal banking agencies have completed their approval processes. The final rule is attached.

Statement by Chairman Ben S. Bernanke

Statement by Governor Randall S. Kroszner

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Board meeting materials

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