PRESS RELEASE
Federal Deposit Insurance Corporation

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FDIC PROPOSES NEW RISK-BASED CAPITAL RULES FOR CREDIT ENHANCEMENTS, EQUITY SECURITIES; ADOPTS FINAL RULE ON SMALL BUSINESS LOAN RECOURSE

FOR IMMEDIATE RELEASE

The FDIC Board of Directors took three actions today involving the agency's rules governing minimum capital levels that FDIC-supervised banks must maintain against the risks to which they are exposed. Specifically, the agency:

- Proposed a rule that would make risk-based capital standards consistent for two types of credit enhancements -- "recourse" arrangements and "direct credit substitutes" - and require different amounts of capital for different risk positions in asset securitization transactions;

- Proposed a separate rule to permit limited amounts of unrealized gains on equity securities to be recognized for risk-based capital purposes; and

- Adopted a final rule lowering the risk-based capital requirements for certain small business loans and leases sold with recourse.

The three items have been developed in consultation with the three other federal regulators of banks and savings associations.

Credit enhancements are provided by banks for the protection of investors who purchase loans and securities. Recourse arrangements arise when an institution retains all or part of the risk of loss on an asset it has sold to another financial institution, a government agency or some other party. A direct credit substitute is an arrangement, such as a standby letter of credit or a guarantee, in which an institution assumes all or part of the risk of loss on an asset owned by a third party even though the institution hadn't owned or sold the asset.

Under current standards, different amounts of capital now can be required for recourse arrangements and direct credit substitutes even when the transactions pose equivalent risk. In addition, the standards do not recognize differences in risks associated with different loss positions in asset securitizations. The proposal would eliminate these inconsistencies by extending the current risk-based capital treatment of recourse obligations to direct credit substitutes (except for qualifying enhancements that would receive a more favorable risk-based capital treatment) and implementing a multilevel approach to capital requirements for asset securitizations. For positions in securitizations that are traded, the multilevel approach would be based on credit ratings from nationally recognized rating agencies. For positions in securitizations that are not traded, the proposal presents three alternative approaches for capital requirements.

The proposal would require institutions to maintain higher amounts of capital against certain direct credit substitutes, but would reduce the risk-based capital charge for positions in asset securitizations with the highest credit quality. In addition, loss positions in securitizations that meet the proposed criteria would receive a more favorable risk-based capital treatment than would otherwise apply to recourse obligations and direct credit substitutes. Written comments on this proposal, which the FDIC will publish jointly with the other three regulatory agencies, are due within 90 days of its publication in the Federal Register.

The separate proposal on equity securities would permit institutions to include in Tier 2 capital 45 percent of the net unrealized pre-tax gains on available-for-sale equity securities. The proposal would increase the amount of regulatory capital for some institutions. This proposal is consistent with the Basle Accord, which serves as the international regulatory capital framework for risk-based capital standards. The FDIC also will publish this proposal jointly with the other agencies, with written comments due within 60 days of its publication in the Federal Register. The final rule on small business loans and leases sold with recourse essentially makes permanent an interim interagency rule in effect since 1995 that reduced the minimum capital levels that institutions must maintain for these transactions. It also implements Section 208 of the Riegle Community Development and Regulatory Improvement Act of 1994.

Prior to the 1995 interim rule, a bank generally would be required to maintain capital against the full amount of assets transferred with recourse. Under the interim and final rules, however, a qualifying institution that sells small business loans and leases with recourse must hold capital only against the amount of recourse retained. In general, a qualifying institution is well-capitalized under the FDIC's "prompt corrective action rules." The amount of recourse that can receive the preferential capital treatment cannot exceed 15 percent of the institution's total risk-based capital.

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