PRESS RELEASE
Federal Deposit Insurance Corporation

FOR IMMEDIATE RELEASE
November 10, 2005

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Maintain Current Leverage Ratio in New Basel II Framework, FDIC Chairman Recommends

Powell Tells Senate Banking Committee That QIS-4 Results Were 'Unacceptable'

In testimony before the Senate Banking Committee this morning, FDIC Chairman Donald Powell underscored the need to maintain Prompt Corrective Action (PCA) regulations, particularly existing U.S. leverage requirements, as part of the U.S. implementation of the Basel II Framework, an international effort to modernize the bank capital regime.

While emphasizing his support for a recent interagency agreement to move forward with Basel II in the U.S., Powell said serious questions had been raised as a result of recent testing of Basel II among 26 of the largest U.S. banking organizations. Powell's testimony outlined an analysis of the most recent quantitative impact study (QIS-4), suggesting that Basel II's formulas would, for most banks, require far less capital than current statutory Prompt Corrective Action regulations would allow.

Powell said: "The FDIC views the extremely low capital numbers coming out of Basel II's formulas . . . as examples of why, under Basel II, the leverage ratio would play a more important role than ever in ensuring the soundness of our banking system."

Powell also expressed concerns about the potential detrimental effects the new framework could have on competition within the U.S. banking sector. To foster an open dialogue about the competition issue, the federal financial regulatory agencies have issued an Advance Notice of Proposed Rulemaking that outlines potential changes to risk-based capital regulations for all U.S. banks (Basel 1-A ANPR). "The FDIC is aware that competitive equity concerns are not the same for all banks," Powell said. "Some community banks choose to maintain large amounts of risk-based capital – not because they operate in a risky manner, but rather because they have lower risk appetites or tolerances. Therefore, we are requesting comments in the Basel 1-A ANPR concerning the possibility of allowing these types of institutions to opt out of proposed changes."

Powell said that the additional implementation time and safeguards described in a September 30 interagency announcement would allow Basel II to fulfill its potential to bring about positive change in U.S. capital regulation. He said, "Basel II will require better risk management for adopting banks, and give the agencies better data to identify emerging risks."

"There is more work to be done," Powell concluded. "I hope and believe that future leaders of the agencies will continue to insist on the best of both worlds: sophisticated risk management and a clear cut minimum of regulatory capital to protect against future banking crises."

Chairman Powell's complete testimony can be found at: http://www.fdic.gov/news/news/speeches/archives/2005/chairman/spnov1005.html