Key Aspects of the Proposed Rule on Advanced Capital Adequacy Framework--Basel II: Establishment of a Risk-Based Capital Floor

On June 14, 2011, the FDIC Board of Directors approved a joint final rule to implement certain requirements of Section 171 of the Dodd Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), more generally known as the Collins Amendment.

Section 171 requires, among other things, that the agencies' generally applicable capital requirements serve as a floor for other capital requirements the agencies may establish. Along with the Office of the Comptroller of the Currency (OCC) and the Board of Governors of the Federal Reserve System (Federal Reserve), the FDIC is modifying the advanced approaches capital rules consistent with Section 171.

Section 171 defines the "generally applicable" risk-based capital requirements as those applied to insured institutions under the agencies' Prompt Corrective Action regulations regardless of total consolidated assets or foreign exposure. The agencies' general risk-based capital rules establish minimum capital requirements pursuant to Prompt Corrective Action for all insured institutions regardless of size. Accordingly, the agencies' general risk-based capital rules are the "generally applicable risk-based capital requirements" as the term is defined in Section 171.

Again, as specified in Section 171, the generally applicable risk-based capital requirements must serve as a floor for other capital requirements the agencies may establish. However, the advanced approaches rules allows banks to operate with capital requirements potentially well below the requirements generally applicable to other banks.

For this reason, the FDIC is joining with the OCC and the Federal Reserve in modifying the advanced approaches rules to be consistent with the capital floor provisions of Section 171. The advanced approaches rule currently provides a series of transitional floors allowing banks to operate during three transition periods with risk-based capital requirements that are 95 percent, 90 percent, and 85 percent, respectively, of the risk-based capital requirements under the general capital rules. The advanced approaches rule also provides the potential, after these transition periods, for banks to operate without any floor on risk-based capital requirements.

Consistent with Section 171, the agencies are eliminating the transitional floors in the advanced approaches rules and replacing them with a permanent risk-based capital floor equal to 100 percent of the capital requirements under the agencies' general risk-based capital requirements.

Section 171 does not prevent the agencies from amending the generally applicable capital requirements over time. However, as noted in the preamble to the final rule, the new generally applicable capital requirements would become the new floor for banking organizations using the advanced approaches rules.

Section 171 also provides that future versions of the generally applicable capital requirements should not be quantitatively lower than the requirements in effect as of the enactment of the Dodd-Frank Act. The preamble to the final rule notes the agencies would envision performing quantitative analyses to avoid an impermissible reduction in capital requirements. For example, the preamble states the agencies would not anticipate requiring banks to compute two sets of generally applicable requirements (the July 2010 requirements and some future modified set of requirements).

The agencies also are allowing banks, in limited circumstances, to use the capital requirements

applicable to bank holding companies. These circumstances are limited to situations where a bank could not hold the asset except under special authority, and the asset has a risk profile lower than other assets receiving a risk weight less than 100 percent. This change is intended to allow the Federal Reserve increased flexibility to craft appropriate capital requirements for low-risk nonbank assets in a way that is consistent with Section 171 and does not provide material opportunities for depository institutions to engage in capital arbitrage.

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