FDIC
Federal Deposit Insurance Corporation
550 17th Street NW, Washington, DC 20429

Division of Supervision

PROPOSED SUPERVISORY GUIDANCE ON INTERNAL RATINGS-BASED SYSTEMS FOR CORPORATE CREDIT AND OPERATIONAL RISK

FIL-62-2003
August 4, 2003

TO: CHIEF EXECUTIVE OFFICER

SUBJECT: Federal Banking and Thrift Regulatory Agencies Seek Comment on Proposed Supervisory Guidance on Internal Ratings-Based Systems for Corporate Credit and on Operational Risk Advanced Measurement Approaches for Regulatory Capital

Summary: *The Federal Deposit Insurance Corporation has approved the publication of proposed supervisory guidance related to the implementation of the New Capital Accord in the United States. The proposed "Supervisory Guidance on Internal Ratings-Based Systems for Corporate Credit" and "Supervisory Guidance on Operational Risk Advanced Measurement Approaches for Regulatory Capital" (Guidance) is being issued on an interagency basis by the federal banking and thrift regulatory agencies. The Guidance, which is attached, is being published in conjunction with an Advance Notice of Proposed Rulemaking regarding Risk-Based Capital Guidelines; Implementation of the New Capital Accord. The agencies are seeking comment on the proposal. Comments are due on November 3, 2003.*

The Basel Committee on Banking Supervision is proposing to update the internationally recognized capital standards embodied in the 1988 Accord. The Federal Deposit Insurance Corporation (FDIC), the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision are jointly issuing an Advance Notice of Proposed Rulemaking regarding Risk-Based Capital Guidelines; Implementation of the New Capital Accord (ANPR) in order to set forth their current views on how best to implement the New Capital Accord in the United States. In the ANPR, the agencies propose to adopt only the Advanced Internal Ratings-Based approach for credit risk (A-IRB) and the Advanced Measurement Approach for operational risk (AMA), as set forth in the New Capital Accord. The ANPR describes both methodologies in detail and requests comment as to the proposed scope of application and various other matters.

The A-IRB methodology is intended to enhance the credit risk sensitivity of regulatory capital requirements. To accomplish that objective, A-IRB harnesses an institution's own risk rating and quantification capabilities. Specifically, institutions qualified for treatment under A-IRB would implement complex credit risk measurement processes to develop internal estimates that would in turn be used as inputs to set minimum capital requirements for various types of credit. Similarly, institutions adopting the New Capital Accord framework would be granted substantial flexibility to choose a methodology for calculating the risk-based capital requirement for operational risk under the AMA. The attached Guidance provides regulatory standards and a range of acceptable practices for institutions seeking to qualify for the A-IRB and AMA framework.

The proposed "Supervisory Guidance on Internal-Ratings-Based Systems for Corporate Credit" specifies the supervisory standards that an institution's internal rating system for corporate exposures would have to satisfy for the institution to be eligible to use the A-IRB for credit risk. Under the proposed guidance, institutions generally would be expected to have an A-IRB system consisting of four interdependent components: (1) a system that assigns ratings and validates their accuracy; (2) a quantification process that translates risk ratings into A-IRB parameters; (3) a data maintenance system that supports the A-IRB system; and (4) oversight

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and control mechanisms that are designed to ensure the system is functioning as intended and producing accurate ratings.

The proposed “Supervisory Guidance on Operational Risk Advanced Measurement Approaches for Regulatory Capital” identifies supervisory criteria for an institution’s AMA framework for operational risk. In order to qualify for AMA, institutions generally would be expected to establish a risk management framework that encompasses all aspects of identifying, measuring, monitoring, and controlling operational risk.

More information on the New Capital Accord is available on the FDIC’s Web site at www.fdic.gov. For additional information, please contact Pete Hirsch, Basel Coordinator, at (202) 898-6751 (phirsch@fdic.gov) or your FDIC Division of Supervision and Consumer Protection regional office.

For your reference, FDIC Financial Institution Letters may be accessed from the FDIC's Web site at www.fdic.gov/news/news/financial/2003/index.html. To learn how to automatically receive FDIC Financial Institution Letters through e-mail, please visit www.fdic.gov/news/news/announcements/index.html.

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