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MEMORANDUM

December 5, 2006

To Our Clients and Friends

Re: Basel 1A Risk-Based Capital Proposal

The Federal Reserve Board and the Federal Deposit Insurance Corporation today issued a draft interagency proposal, referred to as Basel IA, that revises the current risk-based capital guidelines applicable to depository institutions and bank holding companies. The Office of the Comptroller of the Currency and the Office of Thrift Supervision are expected to consider the proposal in the near future. Public comments will be accepted for 90 days after publication of the proposal in the *Federal Register*.

PROPOSED CHANGES

Under the proposal, banking organizations would have the option of complying with the current guidelines, known as Basel I, or adopting the new guidance, which is more sensitive to risk. Basel IA would not be available to large, complex international banking organizations subject to the proposed Basel II advanced capital framework. The following presents the most significant proposed changes:

- Use loan-to-value ratios to risk-weight most residential mortgages
- Add three additional risk-weight categories (35, 75 and 150 percent)
- Expand the use of external credit ratings for certain exposures
- Expand the range of recognized collateral and eligible guarantors
- Increase the credit conversion factor for certain commitments with original maturities of less than one year
- Assess a risk-based capital charge for early amortization in securitizations of revolving exposures
- Remove the 50-percent limit on the risk weight for certain derivative contracts

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MONITORING AND LEVERAGE RATIO

The proposal provides that the agencies intend to closely monitor the level of risk-based capital at those banking organizations that choose to opt in to Basel IA. If they detect any significant decline in the aggregate level of risk-based capital for these banking organizations, the notice indicates that the agencies may modify the proposed risk-based capital rules. The proposal indicates, however, that no changes are proposed to the existing leverage ratio requirement (*i.e.*, Tier 1 capital to total assets).

The agencies' notice can be found on our website at http://www.schwartzandballen.com/whats_new.html.

If you have any questions, please call Gilbert Schwartz, Robert Ballen, Tom Fox or Heidi Wicker at (202) 776-0700.