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MEMORANDUM

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To Our Clients and Friends

Re: Risk-Based Capital: Advanced Capital Adequacy Framework

The federal bank regulatory agencies¹ have issued a final rule to amend the advanced risk-based capital adequacy standards (“advanced approaches rules”) to be consistent with the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”). The rule applies to bank holding companies and banks that use the advanced approaches rules to calculate their risk-based capital requirements.

In December 2007, the agencies implemented the advanced approaches rule under the Basel Accord, which applied to certain banks and bank holding companies that met certain asset or foreign exposure thresholds. To provide a smooth transition to the advanced approaches rules, the advanced approaches rules established a series of transitional floors. During the transitional floor periods, a banking organization that used the advanced approaches rules would be permitted to operate with lower minimum risk-based capital requirements, and potentially thereafter, than would be required under the general risk-based capital rules.

The Dodd-Frank Act requires that the agencies establish minimum risk-based capital requirements for depository institutions, holding companies and nonbank financial institutions supervised by the Federal Reserve pursuant to a designation by the Financial Stability Oversight Council (“FSOC”). The minimum requirements may not be less than the “generally applicable” capital requirements the agencies have established. Generally applicable risk-based capital requirements are those applied under Prompt Correction Action regulations.

In order to harmonize these rules with the Dodd-Frank Act, each organization implementing the advanced approaches rules will continue to calculate its risk-based capital requirements under the agencies’ general risk-based capital rules, and the capital requirement it computes under those rules will serve as a floor for its risk-based capital

¹ The agencies are the Federal Reserve Board, Federal Deposit Insurance Corporation, and the Comptroller of the Currency.

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requirement computed under the advanced approaches rules. The effect of the rule is to preclude certain reductions in capital requirements that might have occurred in the future, absent the rule and absent any further changes to the capital rules. The rule will not have an immediate effect on banking organizations' capital requirements because organizations subject to the advanced approaches rules are currently computing their capital requirements under the general risk-based capital rules. For bank holding companies subject to the advanced approaches rule, the final rule provides that they must calculate their floor requirement under the general risk-based capital rules for state member banks.

The agencies also included a modification to the risk-based capital rules to address the appropriate capital requirement for low-risk assets held by holding companies or by nonbank financial companies supervised by the Board pursuant to a designation by FSOC, where there is no explicit risk-weight category for such exposures under the general risk-based capital rules. The agencies determined that such exposures will receive the capital treatment applicable under the capital guidelines for bank holding companies under limited circumstances, which allow for an appropriate capital requirement for low-risk, nonbanking exposures without creating unintended new opportunities for depository institutions to engage in capital arbitrage. The agencies limited this treatment to cases in which a depository institution is not authorized to hold the asset under applicable law other than as an asset held in connection with the satisfaction of a debt previously contracted, and where the risks associated with the asset are substantially similar to the risks of assets that otherwise are assigned a risk weight of less than 100 percent under the general risk-based capital rules. However, the agencies retained a reservation of authority to assign alternate risk-based capital requirements if they determine that such action is warranted.

The final rule is effective 30 days after publication in the *Federal Register*. A copy of the final rule can be found at our website at <http://www.schwartzandballen.com/news.html>

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