**BOARD OF GOVERNORS**
OF THE
**FEDERAL RESERVE SYSTEM**
WASHINGTON, D.C. 20551

DIVISION OF BANKING
SUPERVISION AND REGULATION

January 23, 2001

**TO ALL STATE MEMBER BANKS AND**
**BANK HOLDING COMPANIES**

**SUBJECT:** Proposal to Revise the Basel Capital Accord

Since the late 1980s, the regulatory capital requirements applicable to U.S. banking organizations have been based, in part, upon the risk-based capital framework developed under the auspices of the Basel Committee on Banking Supervision.[1] For some time U.S. regulators, in cooperation with foreign authorities, have been working to revise the risk-based capital framework, also known as the Basel Accord, to take account of changing risks and risk management practices in the banking and financial services industry.

On January 16, 2001, the Basel Committee issued a consultative paper setting forth for public comment proposed changes to the Accord. The purpose of the revisions is to ensure that banking organizations maintain prudent levels of capital, to make regulatory capital standards more reflective of banking risks, and to provide incentives for organizations to enhance their risk management capabilities. While many of these changes address the activities of internationally active banks, some elements of the proposal, including a revised basic or standardized risk-based capital framework, could affect all U.S. banking organizations.

The complete Basel Committee package includes an overview paper, the proposed new Basel Capital Accord, and seven technical supporting papers, all of which are available on the Basel Committee's Web site at http://www.bis.org. The proposal embodies a "three-pillars" approach for assessing a banking organization's capital adequacy. These pillars are: a more risk-sensitive minimum regulatory capital requirement; effective supervisory oversight; and strengthened market discipline through enhanced public disclosures. A summary of the new Basel Committee proposal prepared by the U.S. bank regulatory agencies is attached, along with a series of questions that are intended to focus commenters' attention on certain key issues raised by the proposal.

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[1] The Basel Committee on Banking Supervision is a committee comprising banking supervisors from the United States and other G-10 countries and was established by the central bank governors of the G-10 countries in 1975.

The Basel consultative paper represents a substantial step, but additional work remains to be done before a revised framework can be applied to U.S. banking organizations. Many aspects of the new framework, especially those dealing with internal credit grading systems and internal capital assessment processes, reflect evolving sound and best practices already employed to varying degrees by well-run banking institutions. Nevertheless, the final structure of the new Basel framework, the manner and extent to which it will apply to U.S. banking organizations, and the timing of its application will depend on further analysis and work by U.S. regulators, additional discussions at the international level, and further dialogue (through public comment and other forums) with the public, market participants, and the banking industry.

In addition to soliciting public reactions to the Basel proposals, U.S. regulators will issue and seek comment on a specific U.S. proposal to modify the federal agencies' capital guidelines before any final changes are made to the regulatory capital requirements applicable to banking organizations in this country. The U.S. banking agencies also will give careful consideration to comments on the "Simplified Capital Framework for Non-Complex Institutions" that they issued for public comment on November 3, 2000. At this point, the Basel Committee hopes to issue a final version of the capital framework by year-end 2001; final implementation is planned for 2004 in order to give supervisors and banks time to prepare for the new framework.

Given the importance of this initiative, U.S. regulators encourage interested parties to review and comment on all aspects of the Basel Committee's proposal and to consider particularly the specific issues identified in the attachment. Comments will be accepted through May 31, 2001. Comments may be sent directly to the Federal Reserve at:

Federal Reserve Board
Basel 2001 Capital Proposal, Mail Stop 179
21st and C Streets, NW
Washington, DC 20551

Upon request, these comments will be treated as confidential. Commenters also are encouraged to submit comments directly to the Basel Committee at:

Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002, Basel, Switzerland

Comments can be submitted electronically to the Basel Committee at BCBS.Capital@bis.org. Unless otherwise requested, the Basel Committee will make comments available on its public web site.

For further information please contact the following individuals: Norah Barger, Deputy Associate Director, at 202-452-2402, or Barbara Bouchard, Assistant Director, at 202-452-3072, for questions on procedural matters, the revised standardized approach, or credit risk mitigation; Tom Boemio, Senior Supervisory Financial Analyst, at 202-452-2982, for questions on asset securitization; Bill Treacy, Senior Supervisory Financial Analyst, at 202-452-3859, for questions on the IRB approach; and Charles Holm, Assistant Director, at 202-452-3502, for questions on disclosure.

(Signed) Richard Spillenkothen

Richard Spillenkothen
Director

Attachment2