Key Provisions of the Basel III and Standardized Approach NPRs as Compared to the Current Risk-Based and Leverage Capital Rules[i]

Aspect of Proposed Requirements	Proposed Treatment	Current Treatment/Comments
1. Basel III NPR		
Minimum Capital Ratios		
Common equity tier 1 capital ratio (section 10)	Introduces a minimum requirement of 4.5 percent.	Currently 2% under Basel II, but this is a new requirement in the US. This is the ratio of common equity Tier 1 capital to the bank's risk-weighted assets. A bank's common equity Tier 1 capital would be its outstanding common equity Tier 1 capital instruments (i.e., common stock) and related surplus, retained earnings, accumulated other comprehensive income and minority interests (subject to certain limits), minus regulatory adjustments and deductions as provided in the rule. KPMG says this is likely to cause some well-capitalized banks in the US and Europe to be non-compliant and may lead to reduction in credit availability generally and an increase in costs of credit overall.

Tier 1 capital ratio (section 10)	Increases the minimum requirement from 4.0 percent to 6.0 percent.	This is the ratio of the bank's Tier 1 capital to its total risk-weighted assets.
Total capital ratio (section 10)	Minimum unchanged (remains at 8.0 percent).	This is the ratio of the bank's total capital to its total risk-weighted assets.
Leverage ratio (section 10)	Modifies the minimum leverage ratio requirement based on the new definition of tier 1 capital. Introduces a supplementary leverage ratio requirement for advanced approaches banking organizations.	The new ratio is 4%. This is the ratio of Tier 1 capital to average consolidated assets, net of amounts deducted from Tier 1 capital. Advanced approaches banking organizations would need to meet a supplementary leverage ratio of 3, which is the ratio of Tier 1 capital to total leverage exposure. Total leverage exposure would include not only average consolidated assets but also certain off-balance sheet assets, such as potential future exposures associated with derivative contracts to which the banking organization is a counterparty.
Components of Capital and Eligibility Criteria for Regulatory Capital Instruments (sections 20-22)	Enhances the eligibility criteria for regulatory capital instruments and adds certain adjustments to and deductions from regulatory capital, including increased deductions for MSAs and DTAs and new limits on the inclusion of minority interests in capital. Provides that unrealized gains	

	and losses on all AFS securities and gains and losses associated with certain cash flow hedges flow through to common equity tier 1 capital.	
Capital Conservation Buffer (section 11)	Introduces a capital conservation buffer of common equity tier 1 capital above the minimum risk-based capital requirements, which must be maintained to avoid restrictions on capital distributions and certain discretionary bonus payments.	This is a new requirement. The buffer is 2.5% of total risk-weighted assets. The buffer would be measured as the lowest of: (a) the amount by which the banking organization's common equity tier 1 capital ratio exceeds 4.5%, (b) the amount by which its tier 1 capital ratio exceeds 6%, and (c) the amount by which its total capital ratio exceeds 8%. KPMG comments that "as a result of this requirement, a banking organization must have a common equity tier 1 capital ratio greater than 7%, a tier 1 capital ratio greater than 8.5%, and a total capital ratio greater than 10.5%." The restrictions imposed are greater the worse the bank's ratios are.
Countercyclical Capital Buffer	Introduces for advanced approaches banking organizations a mechanism to	This is a new requirement. The buffer would consist entirely of common equity

(section 11)	increase the capital conservation buffer during times of excessive credit growth.	Tier 1 capital. If the bank has private sector credit exposure to companies in different national jurisdictions, the buffer is calculated using a weighted average of the countercyclical buffer requirements of each of the different jurisdictions. In the US, the initial countercyclical buffer requirement is 0, but it may go up as high as 2.5% depending on market conditions.
2. Standardized Approach NPR		
Risk-weighted Assets		KPMG comments that some banks may see their risk-weighted assets increase significantly under the new rules. It further comments, "… the fundamental approach introduced by Basel II for determining credit risk-weighted assets through internal models has not changed. As with Basel II, Basel III remains a 'risk-based' capital regime. Banks should therefore keep in mind that regulators will continue to focus on risk management and governance in underpinning a robust financial sector. Those that do not are likely to find themselves subject to even greater requirements and scrutiny."
Credit exposures to:	Unchanged.	

U.S. government and its agencies U.S. government-sponsored entities U.S. depository institutions and credit unions U.S. public sector entities, such as states and municipalities (section 32)		
Credit exposures to: Foreign sovereigns Foreign banks Foreign public sector entities (section 32)	Introduces a more risk-sensitive treatment using the Country Risk Classification measure produced by the Organization for Economic Cooperation and Development.	This varies from 0% - 150%, depending upon the country.
Corporate exposures (section 32)	Assigns a 100 percent risk weight to corporate exposures, including exposures to securities firms.	Currently 100% for corporate exposures (20% for certain qualifying securities firms).
Residential mortgage exposures (section 32)	Introduces a more risk-sensitive treatment based on several criteria, including certain loan characteristics and the loan-to-value-	Residential mortgages are divided into two categories based upon underwriting criteria and seniority. Assigned risk

	ratio of the exposure.	weights vary from 35% – 200% depending on the loan to value ratio. Current risk weight is 50% for prudently underwritten first loans on owner-occupied or rented residences < 90 days past due. The weight for multifamily loans is 50% for those meeting certain criteria, otherwise, 100%.
High volatility commercial real estate exposures (section 32)	Applies a 150 percent risk weight to certain credit facilities that finance the acquisition, development or construction of real property.	Currently 100%
Past due exposures (section 32)	Applies a 150 percent risk weight to exposures that are not sovereign exposures or residential mortgage exposures and that are more than 90 days past due or on nonaccrual.	Currently, the risk weight doesn't change except for 1-4 family properties > 90 days past due, for which the risk weight is 100%.
Securitization exposures (sections 41-45)	Maintains the gross-up approach for securitization exposures. Replaces the current ratings-based approach with a formula-based approach for determining a securitization exposure's risk weight based on the underlying assets and exposure's relative position in the	Currently, there is a ratings-based "gross-up" approach

	securitization's structure.	
Equity exposures (sections 51-53)	Introduces more risk-sensitive treatment for equity exposures.	Currently there is a 100% or incremental deduction approach for nonfinancial equity investments.
Off-balance Sheet Items (sections 33)	Revises the measure of the counterparty credit risk of repo-style transactions. Raises the credit conversion factor for most short-term commitments from zero percent to 20 percent.	According to the FDIC instructions for calculating risk-weighted assets: Summary of credit conversion factors: Direct credit substitutes (e.g., financial standby letters of credit (LOCs), risk participations, etc.) are converted at 100%, transaction-related contingencies (e.g., performance standby LOCs, unused commitments with an original maturity exceeding one year, etc.) are converted at 50%, and short-term, self-liquidating, trade-related contingencies (e.g., commercial LOCs) are converted at 20%.
Derivative Contracts (section 34)	Removes the 50 percent risk weight cap for derivative contracts.	Under the NPR for Basel II, the Fed explains that equity derivatives contracts usually fall under the equity exposures category. So the risk-weighted category usually will be sum of its risk-based capital requirement for the derivative counterparty credit risk and for the

		underlying exposure.
Cleared Transactions (section 35)	Provides preferential capital requirements for cleared derivative and repo-style transactions (as compared to requirements for non-cleared transactions) with central counterparties that meet specified standards. Also requires that a clearing member of a central counterparty calculate a capital requirement for its default fund contributions to that central counterparty.	
Credit Risk Mitigation (section 36)	Provides a more comprehensive recognition of collateral and guarantees.	
Disclosure Requirements (sections 61-63)	Introduces qualitative and quantitative disclosure requirements, including regarding regulatory capital instruments, for banking organizations with total consolidated assets of $50 billion or more that are not subject to the separate advanced approaches disclosure requirements.	

Links:

KPMG Summary of Basel III: http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Documents/basell-III-issues-implications.pdf

Arnold & Porter summary of Notice of Proposed Rulemaking, including as an appendix a detailed chart of current and proposed risk-weights: Arnold & Porter's summary, including a detailed appendix table that compares current and proposed risk weights for various bank assets.
http://www.arnoldporter.com/resources/documents/Advisory%20The_Federal_Banking_Agencies_Proposed_Rules_Impleme nt%20Basel_III_&_Otherwise_Revise_Regulatory%20Capital_Framework.pdf

Federal Reserve Notice of Proposed Rulemaking on Basel II:
http://www.federalreserve.gov/generalinfo/basel2/draftnpr/npr/section_5.htm

FDIC instructions for calculating risk-weighted assets: http://www.fdic.gov/news/news/inactivefinancial/1998/fil9833d.pdf

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[i] The first two columns of this table and its title are taken from the Notice of Proposed Rulemaking.