

FEDERAL RESERVE BANK OF SAN FRANCISCO
101 MARKET STREET, SAN FRANCISCO, CALIFORNIA

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**BANKING SUPERVISION AND REGULATION:
IMPLEMENTATION OF BASEL II
FRAMEWORK**

To State Member Banks, Bank
Holding Companies, U.S. Branches
and Agencies of Foreign Banks,
and Others Concerned,
in the Twelfth Federal Reserve District

Agencies Announce Revised Plan for Implementation of Basel II Framework

The Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision have announced their revised plans for the U.S. implementation of the “International Convergence of Capital Measurement and Capital Standards: A Revised Framework,” otherwise known as Basel II. The agencies previously announced on April 29, 2005, that they were delaying issuance of a notice of proposed rulemaking (NPR), pending additional analysis of the quantitative impact study (QIS4) submissions. The agencies intend to move forward with an NPR for domestic implementation of Basel II, but plan to introduce additional prudential safeguards in the NPR to address concerns identified in the analysis of the results of the QIS4 conducted with the industry. The agencies expect that the U.S. Basel II proposal will be available in the first quarter of 2006.

The agencies’ Basel II implementation plan includes the following elements:

- The agencies expect to propose a revised implementation timeline for Basel II. Under this revised timeline, the first opportunity for a U.S. banking institution to conduct a parallel run would be January 2008. In addition, U.S. institutions adopting the Basel II-based capital rules would be subject to a minimum three-year transition period during which the agencies would apply limits on the amount by which each institution’s risk-based capital could decline with the application of Basel II. These limits would be implemented through floors that are intended to be simpler in design and more conservative in effect than those set forth in Basel II.

For institutions that plan to implement the Basel II framework at the earliest possible implementation date, the following timetable and transitional arrangements would be proposed in the NPR:

<i>Year</i>	<i>Transitional Arrangements</i>
2008	Parallel Run
2009	95% floor
2010	90% floor
2011	85% floor

- An institution’s primary federal supervisor would assess that institution’s readiness to operate under the Basel II-based capital rules consistent with the above schedule. As part of this assessment, the primary federal supervisor will make a decision on the termination of the floors after 2011 on an institution-by-institution basis.

- Using information received during the U.S. Basel II implementation process (including the transition period), the agencies will continue to evaluate the effectiveness of the Basel II-based capital rules. The agencies anticipate that there will be further revisions to the U.S. Basel II-based capital rules prior to the termination of the floors.
- The agencies will retain both the existing Prompt Corrective Action and leverage capital requirements in the proposed domestic implementation of Basel II.

The agencies expect to shortly publish for notice and comment an advance notice of proposed rulemaking on possible modifications to the risk-based capital rules for banks that do not become subject to Basel II-based capital rules. The revised transition schedule for the domestic implementation of the Basel II framework will permit industry consideration of and public comment on these two rulemaking initiatives along similar timeframes.

Additional Information

All circulars and documents are available on the Internet through the Federal Reserve Bank of San Francisco's Internet site, at <http://www.frbsf.org/banking/letters>.

For additional information about the revised plan, please contact our Banking Supervision and Regulation Department at (415) 974-3206.

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