

Federal Reserve Bank of San Francisco
101 Market Street, San Francisco, California 94105

September 4, 2007

**BANKING SUPERVISION AND REGULATION:
AGREEMENT ON BASEL II IMPLEMENTATION**

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

Banking Agencies Issue Agreement on Basel II Implementation

The Federal Reserve, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Federal Deposit Insurance Corporation reached an agreement regarding the implementation of Basel II in the United States. The agreement resolves major outstanding issues and will now lead to finalization of a rule implementing the advanced approaches for computing large banks' risk-based capital requirements.

The agencies have agreed that rules implementing the advanced approach should be finalized expeditiously, and should be technically consistent in most respects with international approaches. The agreement retains the NPR's transitional floor periods. After the parallel run in 2008, those transitional floors provide for maximum cumulative reductions of 5 percent during the first year of implementation, 10 percent in the second year, and 15 percent in the third year.

After the end of the second transition year period, the agencies will publish a study that evaluates the new framework to determine if there are any material deficiencies. If the study finds there are such material deficiencies that cannot be addressed by existing tools, banks will not be permitted to exit the third transitional period unless the deficiencies are first addressed by changes to the regulation. However, if a primary supervisor disagrees with a finding of material deficiency, it may authorize banks it supervises to exit the third transitional period, but only if it first provides a public report explaining its reasoning. The agencies have also agreed to eliminate language in the Notice of Proposed Rulemaking (NPR) concerning a 10 percent limitation on aggregate reductions in risk-based capital requirements.

The agencies believe the annual review process by which they will assess the performance of the new rules is consistent with recommendations of the U.S. Government Accountability Office and provides a structured and prudent framework for managing the implementation of Basel II in the United States. The agencies also agreed to proceed promptly to issue a proposed rule that would provide all non-core banks with the option to adopt a standardized approach under the Basel II Accord. This would replace the earlier proposed rule to adopt the "Basel IA" option. The agencies intend that the proposed standardized option would be finalized before the core banks begin the first transition period year under the advanced approaches of Basel II. The agencies re-affirm our commitment to strive to achieve consensus throughout implementation.

Additional Information

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

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

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Attachments: [Statement by Chairman Bernanke](#)
[Statement by Governor Kroszner](#)