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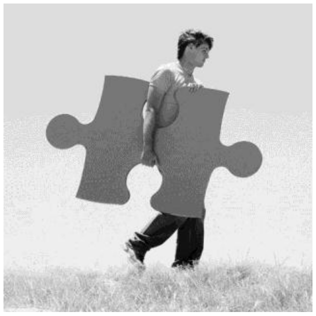

Regulatory Capital: January 1, 2013 Deadline Eased

This morning, the three federal bank regulatory agencies announced[1] that their proposed new capital rules based on Basel III (and other Basel standards)[2] would *not* take effect on January 1, 2013, a date previously proposed apparently in order to adhere to international consensus. The announcement was overdue. The comment period for the three proposed capital rules ended only a few weeks ago on October 22, 2012. The agencies received hundreds of comments that they will have to digest in order to finalize the rules, making implementation on January 1, 2013, a practical impossibility.

January 1, 2013, was set by international agreement as the effective date for new Basel-based rules in all countries. The United States will not be the only jurisdiction to miss this deadline. The Basel Committee on Banking Supervision (the "BCBS") released preliminary reviews of the implementation of Basel III in the European Union, the United States, and Japan. Only Japan has new rules in place. The European Parliament is expected to take up its version of the new rules, colloquially known as CRD IV, on November 20, 2012, in plenary session. If Parliament approves CRD IV, it will go to the European Council for review. Finalization, accordingly, will take several months.

The announcement leaves two questions that the agencies did not answer.

First, since January 1, 2013, is not the effective date, what will be the effective date? Several factors come into play here. The U.S. regulators will not want to lag too far behind their European counterparts, both as a matter of comity and in order to avoid complaints of an un-level playing field. The proposed U.S. rules have now become a political issue, in large part because the rules have been pushed down below the U.S. banks of the size the BCBS intended to cover—i.e., those with total consolidated assets of more than $250 billion or foreign exposures greater than $10 billion or that otherwise are deemed systemically important.[3] The Senate Banking Committee will hold a hearing on the U.S. proposals on November 14, 2012. Congressional oversight could delay completion, but if the

[1] The announcement is available at http://www.federalreserve.gov/newsevents/press/bcreg/20121109a.htm.

[2] The agencies issued three proposals (collectively, the "Proposals") on June 12, 2012: the "Basel III Proposal," based on the Basel III standards for new capital ratios and the components of capital, 77 Fed. Reg. 52792 (Aug. 30, 2012), available at http://www.gpo.gov/fdsys/pkg/FR-2012-08-30/pdf/2012-16757.pdf; the "Standardized Approach Proposal," based on the standardized approach in Basel II, 77 Fed. Reg. 52888 (Aug. 30, 2012), available at http://www.gpo.gov/fdsys/pkg/FR-2012-08-30/pdf/2012-17010.pdf; and the "Market Risk Proposal," based on portions of Basel 2.5, 77 Fed. Reg. 52978 (Aug. 30, 2012), available at http://www.gpo.gov/fdsys/pkg/FR-2012-08-30/pdf/2012-16761.pdf. We reviewed the Proposals in two analyses: *The Federal Banking Agencies' Regulatory Capital Proposals – A Summary* (June 13, 2012), available at http://www.mofo.com/files/Uploads/Images/120613-Federal-Banking-Agencies-Regulatory-Capital-Proposals-Summary.pdf; and *The Banking Agencies' New Regulatory Capital Proposals* (June 2012), available at http://www.mofo.com/files/Uploads/Images/120613-Banking-Agencies-New-Regulatory-Capital-Proposals.pdf.

[3] The Dodd-Frank Act calls for enhanced capital standards (among other requirements) for bank holding companies with more than $50 billion in total consolidated assets, and there has been no objection to pushing Basel III down to these companies.

U.S. agencies are prepared to simplify (or abandon) new rules for community banks, then that may expedite completion of the rules.

Second, what is the practical effect of the delay? Although the answer to the first question is unclear, the delay can only facilitate a more orderly transaction to new capital requirements under Basel III and the Dodd-Frank Act. January 1, 2013 was unworkable. U.S. banks will need time to adjust to the new rules.

Specifically, the delay may affect the phase-in of certain Basel III standards. The BCBS designed various multi-year transition periods for the new capital ratios, new limits on the components of capital, and new methods of calculating risk weights to take full effect. The U.S. Proposals have adjusted the phase-in periods, partly as a result of requirements in the Dodd-Frank Act. In any event, a handful of requirements were to begin to phase in next year. Most adjustments to capital do not start to phase in until 2014, and the new risk weights do not become effective until 2015. The provisions that may be affected include the following:

Requirement	**2013 Requirement**	**Fully Effective**
Common Equity Tier 1 ratio	3.5%	2015 – 4.5%
Tier 1 Capital Ratio	4.5%	2015 – 6.0%
Percentage of unrealized gains on AFS equity securities that may be included in Tier 2 capital	45%	2018 – 0%
Percentage of non-qualifying capital instruments included in additional Tier 1 or Tier 2 capital for bank and thrift holding companies of $15 billion or more	75%	2016 – 0%
Percentage of non-qualifying capital instruments included in additional Tier 1 or Tier 2 capital for bank and thrift holding companies under $15 billion or more, banks, savings associations, and mutual holding companies	90%	2022 – 0%

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