Basel Capital Standards

Contact: Jeff Sigmund, ABA Public Relations (202) 663-5439 or jsigmund@aba.com

Capital is the financial cushion that protects banks and their customers from potential losses.

- Currently, U.S. banks hold nearly $2 trillion in capital and reserves to support all banking activities, making the U.S. banking system the most financially sound in the world.

- Through an international accord, U.S. banking regulators agreed in 1988 to a risk-based capital requirement to ensure that banks' reserves better reflected actual risks.

The international agreement known as the Basel Accord established consistent risk-based capital standards for internationally active banks.

- The Basel Accord links the amount of money a bank holds to guard against losses to the type of assets in its portfolio and their relative risk.

- Most U.S. institutions are currently under a relatively simple standard, known as Basel I, where banks assign assets to risk buckets to determine their capital requirement. For example, the accord requires banks to hold $8 in capital against every $100 in commercial loans, $4 on every $100 in residential mortgages and $0 against U.S. Treasury securities.

- An updated version of the capital standards accord, known as Basel II, has been applied to internationally active banks. Basel II rules allow banks to develop their own models to measure the risks and capital needs for their unique business.

- As required by the Dodd-Frank Act in 2011, U.S. regulators adopted rules that establish Basel I as a "floor" for Basel II banks.

In July 2013, regulators approved the final U.S. version of the Basel III agreement.

- Generally, Basel III includes a narrower definition of capital, higher minimum capital levels (4.5 percent common equity), a capital conservation buffer (2.5 percent add-on) and higher risk-weighted asset amounts on certain assets.

- While the final Basel III rules included some concessions to community banks, many of these institutions remain frustrated with the rules treatment of subchapter S banks, mortgage servicing assets and the large compliance burden that comes with the new capital rules.

- Basel III penalizes banks that service too many mortgages, even though many customers prefer for their mortgage to be handled by the same bank that originated it. Mortgages are handled differently in Europe, and the Basel process didn't sufficiently take the American perspective into account.

- Regulators should create clearer rules that require banks to keep adequate capital levels commensurate with the diverse size, complexity and range of business models in U.S. financial markets.

Background:
The International Capital Accord (Basel I) was adopted by the Committee on Banking Supervision of the Bank for International Settlements in 1988 and established the current risk-based capital standards for most banking firms. After a decade of experience with the Basel Accord, the committee initiated a thorough review and

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proposed a new international accord, known as Basel II. In 2010, the committee agreed on the details of the Basel III rules text, which includes global regulatory standards on capital adequacy and liquidity. The Basel III requirements, which were designed for internationally active banks, were not expected to be applied to all banks regardless of size.

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