

**Statement of
John C. Dugan
Comptroller of the Currency
Before the
Federal Deposit Insurance Corporation
September 5, 2006**

The Federal Deposit Insurance Corporation (FDIC) voted September 5 to publish in the Federal Register two notices of proposed rulemaking (NPR) relating to the U.S. implementation of the new international capital accord entitled “International Convergence of Capital Measurement and Capital standards: A Revised Framework” (Basel II). These two NPRs – the Basel II NPR and the Market Risk NPR – were developed jointly by the four Federal banking agencies. Comptroller Dugan’s statements on these proposals at the FDIC board meeting are provided below:

Statement on the Basel II NPR

Before considering these important documents, I want to commend the staffs of all of the agencies for their work in this area. This has been a hugely difficult assignment, and I personally appreciate your dedication in seeing this through.

I support the FDIC joining the other banking agencies in authorizing the publication of these Basel II-related materials for public comment. The OCC has already approved these materials, and I understand the OTS and the Federal Reserve Board have done likewise. Today’s actions reflect a consensus by all U.S. agencies that implementation of the Basel II Framework should move forward.

The proposals we vote on today are a critical component of the U.S. banking agencies’ plans to update and enhance our regulatory capital program, which in turn advances our primary supervisory mission: to improve the long-term safety and soundness of our banking system. In that context, the agencies have reached a consensus on two fundamental points: first, supervisors must ensure that regulatory capital rules appropriately address existing and emerging risks, and second, the current, simplistic Basel I framework no longer does that for our more complex banks.

Indeed, the inadequacies of the current framework are especially pronounced with respect to our larger banks, which we know well, because the OCC is the primary federal supervisor for the five largest. These institutions, some of which hold more than \$1 trillion in assets, have complex balance sheets, take complex risks, and have complex risk management needs that are fundamentally different from those faced by community and mid-sized banks. For that reason, the agencies have developed this first set of proposals that we vote on today. They are themselves complex and would be required to apply only to a dozen of our largest and most internationally active U.S. banks.

The purpose of these proposals is not only to align capital requirements much more closely to the complex risks inherent in these largest institutions, which they attempt to do. At least as important – and this is a total departure from the existing capital framework – the proposals would also require our largest banks to substantially improve their risk management systems and controls. This improved risk management would be accomplished using a common framework and a common language across banks that would allow us regulators to better quantify aggregate risk exposures, make more informed supervisory decisions, and make peer comparisons in ways that we cannot today. If successful, such improvements would establish a more rigorous relationship among risk, risk management and capital in our supervisory structure and measurably strengthen our safety and soundness regime for our largest institutions.

The complex NPR we vote on today, however, is neither necessary nor appropriate for the vast majority of U.S. banks. Many of these institutions need meaningful but simpler improvements in their risk-based capital rules to more closely align capital with risk. The agencies remain committed to issuing in the near future our so-called Basel IA proposal – rules that will establish capital requirements for banks not adopting Basel II. We believe that overlapping comment periods for these two rulemakings is a critical element of our on-going effort to assess the potential competitive effects of both sets of proposals on the U.S. banking industry.

Let me touch on two additional points with respect to the Basel II NPR. First, as has been widely reported, we have received several comments on a draft version of this NPR that was released earlier this year. Certain of those commenters requested that we amend the NPR to permit Basel II banks the option of using simpler approaches in the

calculation of capital requirements for credit risk and operational risk. To ensure that all interested parties have the opportunity to comment on this fundamentally important issue, the agencies added a question to the Basel II preamble addressing this issue. As I mentioned earlier, one of the primary goals of the agencies in developing these proposals is – as much as possible – to tailor a bank’s capital rules to the complexity of its risks. Thus, the advanced approaches of Basel II, which are the essence of the proposals we vote on today, are targeted to large, complex banks. By the same token, the simpler Basel II approaches as well as the forthcoming Basel IA proposal have been developed with an eye towards less complex banks with more traditional risk profiles and activities. In this regard, we are very interested in comments on the appropriateness of permitting simpler alternatives to the advanced approaches for our largest, most complex banks, especially as it relates to safety and soundness and competitive equity concerns. I believe this is a legitimate question, given that the largest banks in other Basel II countries have the option of simpler alternatives to the advanced approaches. On the other hand, as the agencies note in the preamble to this proposal, virtually all non-US banks comparable in size and complexity to our core banks appear to be adopting the advanced approaches, though not with the changes that we propose in the draft NPR. I hope commenters will take all these factors into account when responding to the question.

My second point relates to bank concerns about the potential competitive effects of this proposal on U.S. banks relative to their international competitors. The agencies have received comments from U.S. banks expressing concerns about what they believe is the excessive conservatism of the NPR. Many of the specific provisions of the NPR cited by the banks relate to safeguards put in place by the agencies after an assessment of the results of the QIS-4 process, including the enhancement of the NPR’s transition period to strictly limit potential reductions in capital requirements through capital floors and other devices. As I have stated in the past, and as the proposal requires, we need to strictly limit capital reductions through capital floors during a meaningful transition period for implementation – the ability to scrutinize the early days of the Basel II systems in operation with safeguards like these is critical to our ability to move forward while addressing our safety and soundness responsibilities. Nevertheless, we are very interested in comments from US banks with respect to concerns about international

competitiveness. This would include comments about elements of the proposal that are perceived to be overly conservative and unnecessary to accomplish our supervisory mandate.

The OCC has been a frequent critic of many elements of the Basel II Framework, and we have worked hard to make important changes to the proposal that we thought made sense. But it is also true that, at critical points in the process, the OCC has supported moving forward towards implementation. Our reason for doing so is simple – an appropriate Basel II regime assists both banks and supervisors in addressing the increasingly complex risks faced by our largest institutions. While we may not have all the details of the proposals right yet, and we will surely make changes as a result of the public comment process, I fully support moving forward with the NPR and receiving comments from all interested parties.

Statement on the Market Risk NPR

I fully endorse the publication of the NPR amending our existing risk-based capital rules for market risk. These proposed revisions to the 1996 market risk rule are based on the collaboration between bank supervisors and securities regulators under the auspices of both the Basel Committee and the International Organization of Securities Commissions.

The nature and volume of bank trading activity as well as the methods to measure the related market risk have evolved since the current market risk rule was published in the Federal Register, almost exactly 10 years ago -- on September 6, 1996. The proposed modifications to that rule that we are considering today are designed to recognize the changing nature of bank trading activities and apply a more risk sensitive capital framework.

As bank trading activity has grown over the past 10 years, banks are increasingly competing directly with securities firms. The collaboration with the securities regulators, particularly the SEC, has resulted in comparable proposed capital frameworks for the trading activity of both banks and securities firms.

I applaud the efforts of staff in developing this proposal in such a collaborative manner.

Statement on Information Collection Templates

While the FDIC board is not voting on this particular matter, I want to comment briefly on another aspect of the Basel II package that will shortly go out for comment. The agencies will publish for notice and comment proposed new regulatory reporting requirements for banks adopting Basel II-based rules. These information collection templates relate to both Basel II and market risk public reporting requirements as well as confidential data required to be submitted to supervisors.

All acknowledge that enhanced regulatory reporting requirements are necessary for banks adopting advanced approaches under Basel II. I am, however, particularly interested in comments on regulatory burden and effectiveness of this particular information collection proposal, and we look forward to commenter suggestions on this issue.