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Bank Capital Requirements for Derivatives to Change

WASHINGTON, D.C. -- A final rule will appear in the Federal Register on Tuesday, September 5, that alters the way risk-based capital rules account for the credit risk of some derivatives contracts. The rule is a joint agency publication by the Office of the Comptroller of the Currency, the Federal Reserve Board and the Federal Deposit Insurance Corporation. The final rule will increase the number of conversion factors that are used to measure the potential future credit risk of derivatives contracts. Conversion factors are add-ons to capital calculated by multiplying a set percentage by the notional principal amount of a derivatives contract.

At the present time, the capital rules treat contracts with maturities over five years the same as contracts with maturities under five years, even though the longer maturity contracts have potentially more credit risk. The final rule will increase capital requirements by increasing the conversion factors to account for the higher possible credit risk of the derivatives contracts with longer maturities. For example, national banks will now have a credit conversion factor of 7.5 percent on foreign exchange contracts with remaining maturities over 5 years. Previously, the factor was 5 percent.

The final rule will also set new conversion factors for derivatives contracts that are related to equities, precious metals, and other commodities. The current capital requirements explicitly address only interest rate and foreign exchange derivatives contracts. The effect of this change will be to increase capital requirements on these more volatile contracts. For example, new credit conversion factors applied to equity contracts will range from 6 to 10 percent, depending on the maturity of the contracts.

The final rule will also change the way that these potential risk add-ons are calculated in risk-based capital when the contracts are subject to a qualifying bilateral netting agreement, reducing the amount of capital required for netted contracts.

Today's changes are in accord with changes to the Basle Accord already adopted by the Basle Committee on Banking Supervision.

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