COMMENT DOCUMENT
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Synovus Financial Corp.

Comments on the Advance Notice of Proposed Rule-Making in Relation to the Implementation of the New Basel Capital Accord ("Basel II")

The following are the most significant issues and concerns of Synovus Financial Corp. regarding the Advance Notice of Proposed Rule-Making ("ANPR") in relation to the implementation of Basel II.

OVERALL COMMENTS

1. **BIFURCATED BANKING SYSTEM.** We believe that the bifurcated regulatory framework, namely a certain set of regulations for Basel II banks and another set for Basel I banks, will create a bifurcated banking system in the U.S. This creates five issues for us:
   - COMPETITIVE EQUALITY. The assets of U.S. banks that will be required to adhere to Basel II's most advanced approaches constitute two-thirds of the total domestic assets. The risk measurement practices and consequent capital allocation adjustments will have a significant impact on the competitive environment and on Basel I banks' abilities to compete fairly with Basel II banks.
   - BANK RATINGS. There is some concern that even if the methodology allows banks to reduce their levels of capital, ratings agencies will look unfavorably on this benefit of Basel II compliance. For those not complying with Basel II, there is concern that a Basel I bank will be viewed as a separate (and lower) class of financial institution.
   - COST AND AVAILABILITY OF FUNDS. Should Basel I banks be viewed as a lower class of institution by the ratings agencies, cost and availability of funds will be adversely and significantly affected.

- VIEWS OF THE MARKET. If Basel I banks are viewed as a lower class of institution by the shareholder, we believe that the market capitalization of publicly held banks will be adversely affected.
- REGULATORY ENVIRONMENT. Due to resource constraints, we are concerned that U.S. regulatory agencies will not be able to adequately supervise both Basel II and Basel I banks in the future, thus resulting in regulators eventually pursuing one set of rules.

2. **BOARD AND MANAGEMENT OVERSIGHT.** Regulations should not mandate the exact manner in which the Board of a bank is involved in determining risk management policy, organization or implementation. Senior executive management, in consultation with the Board, should be charged with reviewing and approving the risk management framework to ensure that (a) its scope and approach is appropriate, (b) it is well implemented, and (c) it is properly audited.

3. **CHANGE IN REGULATORY STATUS.** There is concern that a bank's regulatory status will change because of Basel II rather than because of a change in the bank's risk profile.

4. **CONSISTENT IMPLEMENTATION.** . Regulators may have difficulty with the intricacies and complexity of Basel II, particularly in their ability to ensure consistent implementation of Basel requirements across states, districts, and countries.

5. **COSTS.** The costs of developing and implementing Basel II approved risk assessment and data collection systems may outstrip banks' abilities to comply.

6. **FLEXIBILITY AND ADAPTABILITY.** Basel II requires banks to use specific processes for internal management in many areas, regardless of whether they are relevant for business practices. By prescribing specific processes for internal management, Basel II may unintentionally slow the progress and introduction of better private sector risk management techniques.

7. **THIRD PARTY UNDERSTANDING.** We are concerned that third parties (e.g., investors) will not be able to understand the disclosures outlined in Basel II. We agree that regulators need full disclosure, but we request a limited universe of disclosures given to the public.

8. **TIMEFRAME.** It is believed that the current timetable—particularly the mid-2004 release date of the final Accord and the full implementation of Basel II in 2006—is unrealistic. Banks will not have enough lead time to implement any mid-2004 changes in data collection retroactively effective January 1, 2004 resulting in an inability to gather appropriate data for the three years leading to the final implementation date.

9. **Transition Periods.** We request a flexible transition period reflective of the scope of mergers and acquisitions between Basel I and Basel II banks.

Pillar 1: Minimum Capital Requirements

Credit Risk Management: Identification, Assessment, Monitoring, and Mitigation/Control

1. **Commercial Real Estate (CRE) Lending Markets.** CRE lending constitutes an important component of our loan portfolio and those of other regional banks in the U.S. If economic capital is based on special criteria rather than actual loan loss experience, Basel II may have a significant impact on regional banks' competitive position compared to other banks and non-bank lenders. This impact has the potential to disrupt CRE lending markets.

2. **Concentration Limits in Ratings Grades.** Concentration limits are not realistic for some (particularly high quality) portfolios. The more objective the criteria used for determining ratings, the less there is a need for limits.

3. **Credit Risk Charges for Commercial Real Estate Lending.** Credit risk charges are still too high in view of loan loss experience, even after taking into consideration CP3's Advanced IRB formula for High-Volatility Commercial Real Estate (HVCRE). All CRE loans should be treated comparably like other corporate exposures.

4. **Definition of Classified Assets.** There is concern that shifting focus primarily to borrower credit rating could increase the level of classified assets for businesses with high PDs/low LGDs.

5. **Definition of Default.** Basel II's definition of default (the 90 days past due standard) is not necessarily appropriate for all types of exposures and business lines, and it conflicts with historical loss data. We suggest replacing the default definition with more flexible guidelines to truly reflect internal ratings-based methodology.

6. **Definition of Loss Given Default (LGD).** Basel II's shift from a cycle-neutral LGD to a recession-based LGD may result in overly conservative capital calculations for all types of assets. We suggest a cycle-adjusted definition instead.

7. **Expected Losses (EL).** Since expected losses are covered by loan loss reserves and are factored by banks into pricing transactions, there is concern that economic

capital requirements will count expected loss twice. We welcome the regulators' recent agreement to reconsider the treatment of expected loss.

8. **MATURITY (M).** We do not believe that the stated maturity of a loan should be a factor in the capital calculation, particularly in instances where maturities can be managed to meet the targeted risk hurdle rate and not in the best interest of the borrower.

9. **PRESCRIPTIVE NATURE OF CREDIT RISK MANAGEMENT.** We are concerned that Basel II's credit risk methodology, has become too prescriptive. We request assurance that there will be enough flexibility in the Basel methodology to allow for advances in risk management as they occur.

10. **QUALIFYING REVOLVING RETAIL EXPOSURES (CREDIT CARDS).** The credit risk capital charges for credit cards are too high under the IRB approaches (especially for high-quality cards) and may negatively affect the competitive equality of U.S. banks' abilities to compete in other countries whose banks will be allowed to use standardized approaches.

11. **RESIDENTIAL MORTGAGE LENDING – LGD FLOOR.** The 10% floor on LGD for residential mortgages should be eliminated, given that historical data is below 10% for many mortgage portfolios.

12. **RETAIL LENDING.** A preferable approach to determining credit risk capital charges for retail lending would be a framework based on expected loss. Banks should be able to rely on the volatility of expected loss that they experience in their own portfolios to determine capital requirements.

Operational Risk Management: Identification, Assessment, Monitoring, and Mitigation/Control

1. **EXPECTED LOSSES (EL).** We recommend expected operational losses be omitted from the operational risk capital allocation. We are concerned that expected losses are accounted for in operational costs before they can be excluded from the operational risk capital charge, thus resulting in counting operational losses twice. Regulators should require only unexpected operational losses to be covered by regulatory capital.

2. **EXTERNAL DATA.** The availability and quality of external data on operational risk is a source of concern. Guidance would be appreciated on issues relating to the availability and scaling of external data.

3. **Operational Risk Loss Data.** Loss data that is considered in credit risk and market risk capital charges should not also be required to be captured in operational risk calculations.

4. **Pillar 1 Treatment.** Despite the discussions that have been on-going, we believe that Operational Risk methodology should remain in Pillar 1 of Basel II.

5. **Risk Mitigation/Insurance.** Any offset for insurance should be related to a reasoned assessment of its quality. The 20% ceiling and the standards that banks and insurance companies have to meet for the banks to qualify for this offset will inhibit the development of this important risk mitigation tool. We suggest modifying the criteria so as to address the issues of the extent of coverage, the certainty of coverage, and insurer solvency. Additionally, regulations should provide flexibility, allowing for recognition of other risk mitigation products that emerge in the future.

Pillar 2: Supervisory Review Process

1. **Consistent Application.** More guidance is needed on Pillar 2 review standards to reduce the risk of inconsistent application, domestically as well as internationally. Examiners should be provided guidance, direction and training to ensure that assessments are objective and consistent. Parameters for determining when additional capital is to be required should be formalized by supervisors internationally.

2. **Corporate Governance.** Since we recommend that Board oversight of banks' approaches to capital allocation be limited to a strictly oversight/supervisory position, we believe that the adequacy of Corporate Governance should be evaluated under Pillar 2.

3. **Minimum Capital Requirements.** Pillar 2 reviews should not become a vehicle for imposing *de facto* higher across-the-board minimum capital requirements. Only in cases of identified significant risk management deficiencies should Pillar 2 require capital increases above institutions' own economic capital assessments.

4. **Risk Management Culture.** A bank's earnings volatility or stability should be given greater weight when supervisors evaluate the strengths of the institution's risk management practices, rather than mandating changes to existing risk management processes as part of eligibility standards under Pillar 1 advanced approaches. Care

should be taken not to disrupt successful risk management cultures that have been developed through years of training and experience.

PILLAR 3: MARKET DISCIPLINE

Though we fully support transparency in disclosures about our risk profile and risk management process, a distinction should be made between the information needs of supervisors and those disclosures that are meaningful for the markets and the general public.

We also ask that the regulatory agencies ensure that risk management practices are able to mature beyond the concepts now embedded in Basel II. Basel II methodologies already lag market best practices. Consequently, it is expected that Pillar 1 calculations will no longer be considered good measures of risk for all products. Therefore, banks must be given the flexibility to alter disclosures to represent emerging best practices without waiting for formal changes in Basel II.

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