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June 7, 2000

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20219

Mr. Robert E. Feldman
Executive Secretary
Attn: Comments/OES
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Communications Division, Third Floor
Office of the Comptroller of the Currency
Attn: Docket No. 00-06
250 E Street, SW
Washington, DC 20219

Manager, Dissemination Branch
Record Management & Information Policy
Attn: Docket No. 2000-15
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552

Re: Risk-Based Capital Standards; Recourse and Direct Credit Substitutes

Ladies and Gentlemen:

Bank One Corporation ("Bank One") appreciates the opportunity to comment on the March 8, 2000 Joint Notice of Proposed Rulemaking relating to Risk-Based Capital Standards; Recourse and Direct Credit Substitutes (the "Proposal"). Bank One is a multi-bank holding company with managed assets in excess of $315 billion as of December 31, 1999.

We commend the efforts of the various banking regulatory agencies (the "Agencies") to more closely align bank capital requirements with the actual risks that capital is meant to cover.

In general, Bank One supports the use of internal models as the primary driver of capital requirements. Capital levels should be measured and driven by internal evaluation processes, overseen by supervisors, and validated by financial markets. The Proposal specifically addresses consistency of treatment for recourse obligations and other transactions involving similar risk. Bank One favors a consistent approach, which is applied to all types of credit risk, not just securitization transactions. The consultative paper "A New Capital Adequacy Framework" was issued by the Basel Committee on Banking Supervision in June 1999. The Basel Paper and the Proposal cover some common ground, although the Basel Paper has much broader application. Among its comments on the Basel Paper, Bank One advocated introducing more gradation to the risk weighting schedule to avoid the "cliff effect"; applying risk weightings consistently across similarly rated credits; and using a process where capital is driven by internal evaluation processes.

Our specific comments on the Proposal cover the following topics:

- Multi-Seller Conduits
- Revolving Securitizations
- Premium Refunds
- Loan Servicing Arrangements

I. Multi-Seller Conduits

Bank One is participating with other institutions to provide a more detailed joint response to the Proposal, as it relates to multi-seller conduits issuing asset-backed commercial paper. We summarize three issues here, which are of key concern to Bank One.

Capital Levels for Securitization Positions

In our view, the Agencies' proposed risk weights overstate the risk associated with securitization positions. The risk in this business activity is mitigated by strong structural protection, and historical losses reflect this low risk.

We would encourage a framework that takes collateral or other structural protection into account when determining capital requirements. Risk weightings, as indicators of likelihood of default, should be applied consistently across similarly rated credits, with further distinction in capital levels arising from differences in structural protection as this affects the ultimate loss severity.

Finer Distinction in Ratings Categories

The increase to five risk weightings in the current Proposal is appreciated. However, we strongly advocate introducing still more gradation to the proposed risk weighting schedule. In particular, there should be at least one additional level below BB- before the gross-up method is applied.

Our current internal risk rating scale has 7 levels for non-impaired loans, and our goal is to expand to at least 10. Bank One's internal capital model currently attributes approximately 30 times as much capital to an unsecured 3 year credit exposure at the low quality end of the risk scale as at the high end. This is done with the intent of encouraging risk-based pricing, facilitating portfolio management and supporting resource allocation decisions based on risk-adjusted returns on equity.

Under the Proposal, the incremental capital load resulting when, for example, a AA- credit is downgraded to A+ is excessive relative to the increase in risk. As currently structured, the Proposal could lead to non-economic capital management decisions, could put pressure on institutions to maintain high credit ratings even though a downgrade is warranted, and may encourage capital arbitrage practices.

Use of Internal Models

Bank One strongly favors the use of internal rating systems as the basis to establish capital charges. The Proposal permits the use of internal risk ratings in limited circumstances. However, we strongly encourage the use of internal ratings for capital allocation purposes for all of an institution's commercial credit exposures, rather than limiting applicability to unrated credit enhancement positions in securitization structures. Furthermore, the Proposal limits the applicable risk weight using an internal risk rating to no less than 100%. We believe this limitation to be overly and arbitrarily conservative, and one, which would lead to inconsistencies in capital assessment across different products.

The use of internal ratings maintains consistency in the evaluation of risk across all credit products, and eliminates ambiguity associated with unrated credits. This introduces an appropriate level of gradation, and smoothes out the increase in capital consumption as a credit deteriorates in quality. Supervisory review would ensure that the internal risk ratings are adequate. An initial implementation might require banks to map internal risk grades to expected default probabilities, to be subsequently aligned with an appropriate risk weight. Banks that do not have the necessary internal processes to qualify for this treatment, as determined by supervisory review, would be subject to the standardized framework utilizing the external ratings.

II. Revolving Securitizations

We understand that the Proposal seeks comment and guidance on the following:

- The purpose of early amortization provisions.
- The proposed managed assets approach with respect to revolving structure securitizations

Bank One is also participating with other institutions to provide a more detailed joint response to the Proposal, as it relates to master trusts.

In general, we believe that changes in risk-based capital charges should be applied consistently across all products and institutions, and that the Agencies should avoid a piecemeal approach to risk-based capital methodology changes. The Proposal only deals with a limited set of circumstances, and would lead to an imbalance in the treatment received by different products. In this respect, Bank One supports the broader direction taken by the Basel Paper; however in the context of the Proposal's limited scope, we have outlined our views below.

Overview

The Proposal includes a managed asset approach on securitization structures, which include an early amortization feature. Specifically, a capital charge would be imposed on off-balance sheet securitized receivables by including them in risk-weighted assets when determining risk-based

capital. These off-balance sheet assets would receive a risk weighting of twenty percent creating a 1.6% capital charge. Under current rules, where the issuing bank does not retain any recourse in the securitization, no capital is required for these off-balance sheet assets.
We understand the managed assets approach is a response to the belief that revolving structure securitizations with early amortization features by their nature contain credit risk and implicit recourse beyond pre-existing contractual obligations. The managed assets approach also attempts to address the risk that additional funding will be required should existing transactions amortize early.

Early Amortization

Credit card securitization structures are designed to provide term funding for receivables with short average lives. By agreeing to sell newly generated receivables to a master trust, the sponsor of a master trust can cause the trust to issue an asset-backed security (the "investor interest") with an original maturity of, say, five years backed by receivables with much shorter lives. Under expected levels of receivables performance, the investor interest remains outstanding over its expected life with the investor's credit losses covered by the investor's allocation of finance charges on the receivables.

Bank One sells, in a typical structure, all three classes created in a credit card securitization. These classes are rated by public bond rating agencies that assign credit risk ratings to each class based on their relative risk in a senior-subordinated structure. Since these classes of securities can only look to the underlying existing receivables for the payment of interest and principal, the rating agencies insist that deals begin to unwind when finance charges and fees are becoming insufficient to pay investor interest and servicing. Credit enhancement is sized assuming early amortization and is primarily influenced by the time it takes for cash flows on the receivables to fully pay out investors. The credit enhancement required by the rating agencies does not rely on the sponsoring bank to assist in the coverage of losses. Once an early amortization event is triggered, investors in subordinated classes are exposed to credit losses with no recourse back to the selling bank. It is also important to point out that even under an early amortization, the seller's allocation of finance charges is unavailable to investors and therefore is not subordinated to the interests of investors. Bank One believes strongly that early amortization does not create additional credit risk with respect to existing securitized receivables and therefore additional capital is unnecessary.

Liquidity

The managed assets approach appears, in part, designed to address the additional funding required upon an early amortization. We stress that this has not typically been the role of risk-based capital and we believe is better addressed through the bank's current funding and liquidity management practices. These methods are well established and part of the regulatory oversight process.

Implicit Recourse

We do not support the use of increased capital to address the *possibility* that a bank issuer could provide additional recourse beyond the contractual terms of the securitization. A bank has many options (e.g., account repricing) other than recourse to positively influence the performance of its credit card portfolio. Implicit recourse should not be presumed. Under current regulatory authority, additional capital charges can be imposed on a bank that provides recourse to revolving transactions. We believe it is far better to penalize a bank that chooses this option rather than impose additional costs on all banks.

Disclosure

Bank One supports adequate disclosure for both investors and for the purposes of regulatory oversight. However this can be costly and burdensome and is best applied on a case-by-case basis. We believe the regulatory oversight process, combined with current public bank holding company and asset-backed securities disclosures, provide sufficient information to analyze potential risks in amortizing structures.

III. Premium Refunds

Bank One does not support the treatment of "premium refund" clauses as recourse because they do not expose a seller of assets to credit risk. Refunds paid to investors are a function of loan prepayments, which reflect reinvestment risk. Additionally, the Financial Accounting Standards Board has addressed this issue through the release of SFAS No. 125. Paragraph 11 (b) and (c) of such release requires an institution to recognize all assets and liabilities incurred in consideration as proceeds of a sale at fair value. A "premium refund" falls under the definition of a liability. In effect, the institution holds dollar for dollar capital against the fair value of the liability. Rather than treating a "premium refund" as recourse that results in an additional burden to hold capital, the Agencies should focus on accounting compliance through the review process.

IV. Loan Servicing Arrangements

The classification of servicer cash advances as "insignificant" should be expanded beyond one percent of principal for any one loan. We suggest the Agencies should base the limit for "insignificance" not to exceed 3 monthly payments advanced, rather than a fixed percentage.

As stated in the proposal, it is common industry practice for real estate servicers to advance uncollected interest payments as long as the servicer reasonably expects to be repaid. This threshold is generally limited to 3 monthly payments. For a second lien loan with an interest rate of 12%, such an advance could equal 3%. A one percent limitation will entice some banks to transfer the servicing of their securitizations to institutions not governed by the Proposal.

Conclusion

Bank One agrees in principal with the goal of better aligning capital with risk. We reiterate our support for a process where capital is driven by internal evaluation processes. We favor the establishment of an equitable method of determining regulatory capital requirements across product types and market participants, but believe an institution's ultimate capital requirements should be driven by individual circumstances, supervisory oversight and market discipline.

Again, Bank One appreciates the opportunity to comment on the Proposal.

Respectfully,

Eileen Kennedy
Senior Vice President and Treasurer