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January 25, 2005

Office of the Comptroller of the Currency
250 E Street, SW
Mail stop1–5
Washington, DC 20219
Attention: Docket No. 04–22

Robert E. Feldman
Executive Secretary
Attention: Comments/Legal ESS
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Jennifer J. Johnson,
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave., NW
Washington, DC 20551.
Attention: Docket No. OP–1215

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attention: No 2004-48

Re: Response to the Agencies' Invitation to Comment on the Internal Ratings-Based Systems for Retail Credit Risk for Regulatory Capital

Ladies and Gentlemen:

This letter is MBNA America Bank, N.A.'s response to the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of Thrift Supervision's (together the "Agencies") invitation to comment on the Internal Ratings-Based Systems for Retail Credit Risk for Regulatory Capital (the "Guidance") as it pertains to the International Convergence of Capital Measurement and Capital Standards – A Revised Framework, issued June 2004 (the "Framework").

We appreciate the opportunity to provide comment on the Guidance. We believe changes incorporated in the Framework and Guidance have been positive for retail banking and reflect opportunity for continued improvement to occur.

MBNA America Bank, N.A. is the principal subsidiary of MBNA Corporation, and has two additional banking subsidiaries, MBNA Europe Bank Limited and MBNA Canada Bank (collectively herein referred to as "MBNA"). MBNA's primary business is retail lending, providing credit cards and other retail lending products to individuals and small businesses. At December 31, 2004, MBNA reported assets net of securitizations totaling \$61.7 billion. MBNA's managed assets, including securitized loans were approximately \$149.6 billion as of December 31, 2004. We believe that our focus on consumer lending (primarily unsecured revolving retail lending) makes us uniquely qualified to provide independent comment on the proposed Guidance. Because our focus is narrow and specific, without requiring compromises to accommodate other lines of business we believe that our macro business model is particularly insightful on the issue of appropriate capital levels for unsecured revolving retail lending and asset securitization.

In general, we believe the Guidance is much more prescriptive than necessary when compared to the Framework. We believe the Guidance should be more principles based, allowing flexibility in application, particularly in the areas of policies and procedures, validation, data maintenance, and control and oversight. If the Agencies conclude that no changes to the Guidance are warranted, we ask that there be enough flexibility to permit application of the Guidance that considers each individual bank's specific circumstances. We believe that the current level of prescriptiveness may curtail continued development of best practices when those practices diverge from the Guidance even when achieving the underlying Framework objectives.

We also encourage the Agencies to continue to advance Basel towards a full models approach. We believe that for some products, particularly for large portfolios of assets such as credit cards that possess reasonably predictable cash flows, Asset Valuation Correlations ("AVCs") remain high. Although changing the AVC for Qualifying Revolving Exposures ("QREs") to 4% was a step in the right direction, many of the major U.S. credit card issuers can support still lower AVCs, which should be considered.

Below we provide more specific comments and questions based on our understanding of the Guidance. We would be happy to discuss any of these issues if you require further clarification.

Definition of Default

We concur with incorporating reference to the FFIEC Uniform Retail Credit Classification and Account Management Policy (the "Policy") into the definition of default for retail credits. This definition corresponds with that in Paragraph 452, footnote 82 of the Framework which describes default for retail loans based on days past due. We suggest that banks not be precluded from recognizing default more conservatively than the FFIEC's Policy in recognition that banks may do so for a variety of reasons consistent with sound risk management practices.

As described, Paragraph 98 of the Guidance includes placing an account on non-accrual in the definition of default. The proposed Guidance also recognizes that banks are not required to place consumer loans on non-accrual, although some banks choose to do so. We do not believe that placing an account on a non-accrual status requires that it also be treated as a default. We recommend that banks should be allowed to recognize default consistent with the definition used within their internal systems as long as default is recognized no later than what is required under FFIEC Policy. We note that the population of accounts at issue represent approximately 0.3% of managed outstanding loans. We note further that under MBNA's credit risk management system, adding non-accrual to the definition of default would require significant incremental system enhancement expense to the company in order to track and model these accounts. In light of the foregoing, we urge that the Agencies not require that accounts placed on non-accrual fall within the definition of default. Agreeing to this approach would not, we believe, materially affect capital results.

Loss Given Default "LGD")
We believe it is difficult and unnecessary to provide more specific guidance on calculation of LGD at this time. We encourage flexibility by the Agencies over the next several years in order to allow best practice to continue to mature. The Guidance correctly recognizes that factors in addition to economic conditions can significantly impact LGD for a given portfolio within a given banking entity. At this time the definition of a downturn period is difficult to determine, as the downturn would need to be applicable to the characteristics of the banks current portfolio. Important characteristics would include such things as geography, industry makeup, and underwriting standards. Also, a determination of what time period within the downturn period would need to be made. It is not likely that a single time period of economic stress would apply across all of a bank's portfolios for calculating a stressed LGD.

The issue of portfolio diversification must also be addressed. It would not be appropriate to apply a stressed LGD to every portfolio at the same time, as it would not be likely that they would all experience a stressed condition simultaneously. This is particularly true of internationally diversified banks. If a stressed LGD is to be utilized, there must be some means of reflecting the benefit of diversification at the same time.

Therefore, we believe it is up to each bank to determine an appropriate time period and methodology for LGD measurement for each loan portfolio with supporting explanation for regulatory review. With proper explanation it should be transparent to regulators as to the factors considered in choosing the appropriate LGD time period. In cases where adjustments are required to the LGD, banks should be permitted to use judgmental or statistical techniques, as they deem most appropriate for the modeled exposure. Any additional adjustment could be made under Pillar II as needed.

Non-Material Exposures
Paragraph 9 of the Guidance recognizes that banks may designate some retail exposures as nonmaterial and, thus not subject to the retail IRB approach. This position is consistent with Paragraph 259 of the Framework, which allows for exposures that are immaterial in terms of size and perceived risk profile to be exempt from IRB treatment. We strongly support this position, as all banks are likely to have immaterial portfolios, where the cost to fully model the exposures under the advanced IRB approach significantly outweighs the benefit of improved risk measurement.

Materiality can be susceptible to subjective judgment, or it can be defined specifically. In this case, in order to promote fair and consistent treatment globally, we would suggest that the Agencies establish a specific definition in line with that being proposed by other regulatory authorities. For example, we suggest the definition that is proposed by the U.K. Financial Services Authority (the "FSA") in Consultative Paper 189, Annex 3.9, is an appropriate threshold for aggregate IRB credit risk. The FSA proposes that the combined sum of exempted exposures be no more than 15% of the total Pillar I banking book credit risk capital requirement. We believe this is a reasonable level, which is neither so low as to be meaningless nor so high as to negate the risk sensitivity goal of the Basel Framework.

Paragraph 9 further states that minimum capital requirements for a nonmaterial retail portfolio will be in accordance with capital standards for non-IRB banks. We would like to clarify that this standard is in fact the Basel I standard in the U.S. and the Standardized or Foundation approaches of Basel II for U.S. owned subsidiaries in foreign countries.

Qualifying Revolving Exposures ("QRE")

One of the criteria to qualify as a QRE is that the maximum exposure is limited to $100,000. We propose that regulators allow some flexibility in this requirement for modeling efficiencies where the number of accounts exceeding this threshold is a small proportion of the total QRE population. This limit is much lower than the point at which MBNA currently begins to manage unsecured revolving retail exposures on an individual basis rather than a pooled basis. We believe that a change to our credit risk models to accommodate this limitation will be costly and will result in little if any benefit. Within MBNA's QRE portfolios, customers exceeding the $100,000 threshold represent 0.50% of QRE exposures. As such, we recommend that either the limit be increased or banks be allowed to include immaterial volumes as QRE. If the regulators are intent on keeping a maximum exposure amount to qualify for QRE, we would support a $250,000 threshold.

We also suggest that consideration be given to the current exclusion of business credit cards from QRE qualification. For purposes of this discussion, we are excluding business credit cards issued to companies that are managed on an individual basis. For MBNA, our business credit card portfolio is managed on a pool basis and consists primarily of exposures to individuals for business use, or businesses that are predominantly sole proprietors or small business entities. In terms of credit risk, the portfolio is very similar to self-employed individuals in the retail card portfolio. Virtually every business credit card account is guaranteed by the owner/principal and the credit decision is based upon the personal credit bureau information of that guarantor. We believe all aspects of the QRE definition are met (other than issued on behalf of a business), including the low volatility of loss requirement.

The QRE definition refers specifically to credit cards and overdraft lines on individual checking accounts as covered products. We want to clarify that products meeting the QRE definition, regardless of method of access, are intended to be included. This would properly capture other existing products, such as those accessed via a check or electronic transfer, as well as potential new access methods such as cell phones and other devices.

Quantification of IRB Systems

Paragraph 78 states that risk parameter estimates must be updated at least quarterly at a minimum, and more frequently if deemed necessary. We wish to clarify that this requirement pertains to updating of the risk parameter variables utilized in segmenting accounts, and not of the actual models for calculating PD, LGD and EAD. Updating and validating all of the IRB related models in an organization on a quarterly basis would be an enormous and costly undertaking that would not be necessary. It is unlikely that model results would shift significantly within one quarter without a dramatic corresponding economic shift. Of course as a matter of prudential risk management should an unusual and significant event occur, appropriate changes to parameter estimates would be made – and these would be subject to Pillar II review.

In regards to updating of risk parameters for exposures, it is not current practice today to perform quarterly updates of all parameters for all types of exposures. We would propose that the frequency of update should be flexible and more specific to the type of loan. For example, for credit cards it is not unusual to update certain risk parameters on a transaction, monthly, or quarterly basis. On the other hand, for SME exposures, some parameters may only be updated as part of an annual credit review. Quarterly updates of risk parameter data could require an institution to be acquiring externally provided data on a more frequent basis than needed for conducting business, increasing costs unnecessarily. We believe it is up to each individual bank to determine appropriate frequency of update and to document such in policy as required.

Seasoning

Paragraph 110 of the Guidance requires that segments containing unseasoned loans should have the PD calculated as the annualized cumulative default rate over the segments expected remaining life. We are concerned that this method for computing PD is inconsistent with the Basel ASRF credit risk model, which is developed and calibrated to use a one-year PD. We feel changing the PD of a loan in the manner defined to adjust for seasoning changes will corrupt both the intended results of the ASRF calculations and determination of expected loss. Using an annualized cumulative PD for unseasoned accounts will also make it difficult, if not impossible, to perform back testing of the model as predicted results would be distorted by the adjustment.

We propose that the issue of seasoning is better addressed in Pillar II. This will retain the integrity of the Pillar I model, facilitate the validation of the PD model, and still allow recognition of seasoning in the overall capital requirement when necessary.

Exposure at Default ("EAD")
Paragraph 137 of the Guidance states that EAD is to include accrued, but unpaid, interest and fees. This appears to be a requirement of the U.S. Regulatory Agencies only, as it is not included in the definition of EAD of the Framework. We are seeking clarification of the intent of the Guidance as to the definition of accrued interest and fees. We believe what is actually intended to be included in EAD is billed, but unpaid interest and fees, which is consistent with the definition utilized for LGD. Accrued interest and fees for retail products, which are managed on a pool basis, are generally not calculated on an individual loan basis. They are typically calculated for a portfolio of loans and often are carried on the balance sheet as part of "Other Assets" rather than as "Loans." Not all loan systems calculate accrued interest on an individual loan basis. This is further complicated in that for some loans, such as credit cards, the loan balance may be incurring multiple interest rates. The systems modifications necessary to track accrued but unbilled interest and fees at an account level would be extraordinarily expensive for what we believe is an insignificant exposure. Interest and fee accruals are normally adjusted monthly at a minimum, so the impact of any defaulted accounts would be reflected in the next accrual estimate.

Based on our interpretation of the Guidance, we propose that flexibility be allowed in calculating EAD depending on the capabilities of the bank. EAD should be calculated inclusive of billed but unpaid interest and fees when tracked at the account level. Accrued interest and fees, and billed but unpaid interest and fees may be carried in separate accounts at a 100% risk weight when they are not tracked at the loan level. For many retail products, this will be more conservative than if accrued interest and fees were applied to the loan exposure.

Paragraphs 139 – 149 of the Guidance refer to calculation of the EAD for undrawn lines using a loan equivalency ("LEQ") approach. We seek to clarify that this is not the only permitted approach by U.S. regulators. Paragraph 474 of the Framework allows flexibility in determining exposure to undrawn lines. We believe U.S. regulators should allow such flexibility where a bank has a different viable approach to determining exposure to undrawn lines. Implicit in the LEQ approach is the premise that the available credit line is the driving factor for undrawn exposure. For some types of loans, e.g. credit cards, this may not be the case. Banks today authorize nearly 100% of credit card transactions on a real time basis. While a customer may have sufficient available line for a given transaction, a bank may prohibit access to all or part of that line for a variety of reasons. Therefore, the LEQ approach, while relatively simple, may not be the most appropriate predictor of undrawn exposures.

Loan Sales
Paragraph 155 of the Guidance states that risk parameters for loans to be sold are to be determined as if the loan will be held to maturity. We believe there are cases where this is not appropriate. If loans are being originated under a specific agreement to be sold to a specific third party within a specified timeframe, we believe it is appropriate to estimate

the risk parameters commensurate to the actual exposure duration. This will likely have the greatest impact on the PD measure. These positions are also subject to mark-to-market controls and accounting discipline.

QRE Treatment Qualification

To qualify for QRE treatment, a portfolio must demonstrate a low volatility of loss rate relative to average loss rates, particularly in low PD segments, as defined in paragraphs 160 – 164 of the Guidance. We are concerned about the interpretation of such a test at this time. First, past loss volatility is not necessarily indicative of the current portfolio. Factors such as collection practices, consumer regulation, and bankruptcy laws can all impact loss rates beyond economic factors. Past changes in these factors may introduce volatility that is not applicable to current and future credit loss environments that describe the underlying risk behavior of the portfolio.

We suggest that the interpretation of a test that requires comparison to other QRE and non-QRE portfolios within the bank will be problematic. It is unclear as to what the benefit of comparison is to unlike portfolios that may demonstrate higher or lower volatility. Additionally, a bank will not be in a position to compare results with other banks' portfolios, as the data would be unavailable without some type of global industry sharing arrangement. The conclusion derived from such comparisons appears to be arbitrary in nature. This makes consistency in applying the test difficult within the U.S., let alone on a global basis.

We also believe that application of this test at the segment level will be costly to perform, with potentially little value. Retail credit card models have advanced to a level of sophistication that provides very accurate prediction of default – thereby enabling granular segmentation of PD. This results in very little volatility, particularly in the narrow low PD segments.

We support the proposed solution to this test offered by the Risk Management Association (the "RMA"). That solution would be to calculate the actual volatility of the QRE portfolio and compare it to the implied volatility under the Basel ASRF model at a portfolio level. As long as the actual volatility was at or below the implied volatility, the portfolio would meet the low volatility test. This provides a methodology that is simple to perform, will be consistent for all banks, and removes the arbitrary aspects of the current proposal.

Independent Review of Retail IRB Processes

Paragraphs 234 – 235 of the Guidance describe the requirements for an independent review process. This appears to be a new U.S. requirement beyond that contained in the Framework. It appears this would require a minimum of three independent groups to meet IRB requirements: an independent credit control group, an independent validation group, and an independent internal audit group. We feel this additional independent validation group is an unnecessary burden, particularly for small organizations that might otherwise opt into Basel II. The Guidance requires sound techniques be followed in developing, documenting and validating the models and systems used. When properly followed, these techniques are more than adequate to enable management, regulators, and auditors to assess the fitness of the systems and models without the need of yet another independent group. We believe fulfillment of this role by internal audit would be sufficient.

Other Items
Paragraph 11 of the Guidance states that cross border issues for retail and other portfolios will be addressed in future documents. We encourage regulators to complete such guidance prior to issuing the NPR to enable appropriate scrutiny and feedback.

Paragraph 120 of the Guidance states that all material credit-related losses are to be included in the LGD, and further states that credit-related losses are to be broadly defined. We suggest this paragraph be amended to specify that fraud losses are not credit-related losses.

We appreciate the opportunity to provide these comments to the Agencies. If you have any questions regarding this submission or if we can provide further information, please contact me directly by telephone at 302-432-1935 or by e-mail at kevin.schindler@mbna.com.

Respectfully submitted,

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