WELLS FARGO

Wells Fargo's Response

The Joint Notice of Proposed Rulemaking
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Part I: Executive Summary
Part II: Detailed Responses

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WELLS FARGO

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Regulation Comments
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Dear Sir or Madam:

Wells Fargo & Company appreciates the opportunity to comment on the Notice for Proposed Rulemaking (the "NPR"). We are a diversified financial services company, providing banking, insurance, investments, mortgage and consumer finance from more than 6,000 stores. On behalf of our employees, customers, and shareholders we have a keen interest in the framing of the domestic implementation of the Basel II Accord and hope that the comments that we offer in this letter will be of assistance in providing solutions to the issues that exist in the current proposal.

We are generally supportive of introducing a more risk-sensitive regulatory capital scheme in the United States; we agree with the Agencies' assessment that the current scheme is outdated for many reasons. However, we continue to have several fundamental differences of opinion with the path on which the Agencies are proceeding and feel that certain aspects of the NPR must be changed in order for it to be acceptable.

In summary, we believe that:

- U.S. Implementation Should Return to the Principles-Based Intent of the Basel II Accord;
- The Agencies Should Conform U.S. Regulations to International Standards;

- Pillar II Disclosure Requirements are Onerous and Based Upon an Objective that is Unlikely to Succeed;

- Pillar III Disclosure Requirements are Inappropriate and Unnecessary; and

- The Agencies Should Resolve Inter-Agency Differences and Issue Comprehensive, Final Guidance as Soon as Possible.

These points are articulated in more detail below. In a separate document we have responded to the detailed questions (generally more technical) posed by the Agencies in the NPR.

U.S. Implementation Should Return to the Principles-Based Intent of the Basel II Accord

The original intent of Basel II was to allow banks to use flexible, risk-based approaches to identify the requisite capital for activities. To prevent this from being abused, Pillar II and Pillar III are intended to act as counter-balances. However, with over 500 pages of guidance to date, the Agencies' implementation of Pillar I has become entirely too prescriptive and is in stark contrast to the original supposition of Basel II – that each bank would be allowed to continue the use of its existing risk management practices, so long as they could be shown to have been effective over time. We believe the philosophical shift reflected in the NPR is unnecessary and counter-productive.

It is unnecessary because the Agencies continue to have significant powers under Pillar II that can be used to ensure that banks respond quickly to emerging problems and to any other concerns that may arise. The process of carefully evaluating a bank's approach to and execution of calculating required capital under a risk-based, principle-based approach is certainly challenging. However, with on-site examiners that are engaged in continuous supervision, complemented by specialists throughout the system, it is no more challenging than the ongoing supervision work done today. In addition, the limited number of mandatory and opt-in banks makes this an achievable task.

It is counter-productive because no matter how well-intentioned, a rules-based approach will always lag market innovations. Further, the broad scope of evaluating capital adequacy does not lend itself to a rules-based approach. In essence, calculating requisite capital for a firm is the distillation of the risks arising from all of its activities. This is a significant task for a single firm, but it is immense to contemplate specifying the process by which this will be done for an entire industry. Success in that endeavor would require that regulators comprehensively identify and specify the calculation methods for every activity undertaken by the top U.S. financial institutions – essentially every financial instrument in existence. In addition, it would require continual updating to reflect market innovations. We believe such an effort cannot be successful and will result in a series of rules that are incomplete and/or inadequate, will be made obsolete very quickly, and will not result in a risk-based framework. Doing so will cause banks to perform two different calculations: a "regulatory" calculation based upon the rules, and an internal calculation, based upon industry best-practices, for business purposes. Divergence between these calculation methods is not in the best interest of a scheme that seeks to be risk-based.

Instead, we believe that within broad guidelines, approaches for calculating required capital should be left to market participants, who are in the best position to understand the myriad of risks they face. This approach has worked well in the past. For example, interest rate risk, similar to capital in that it is pervasive in a firm's activities, is now considered a well-managed risk in the Industry. This was accomplished through principle-based regulations and a close, interactive examination process between Industry and Regulators.

We urge the Agencies to simplify the U.S. implementation of the Basel II Framework and move forward under a principles-based approach.

The Agencies Should Conform U.S. Regulations to International Standards

The rule proposed by the Agencies is substantially different from the Basel II Capital Framework (the "Framework") agreed upon by U.S. and International Regulators in June 2004. In addition to the numerous prescriptions described above, we remain concerned that the NPR imposes a cumulative conservatism that is unwarranted given the substantial powers present in Pillar II. Ultimately, this will place U.S. banking institutions at a competitive disadvantage to foreign banks. Our major concerns include:

- A longer phase-in period (3 years in the U.S. vs. 2 years in Europe)
- Higher phase-in floors (95/90/85% in the U.S. vs. 90/80% in Europe)
- The imposition of a minimum leverage requirement
- Aggregate reduction in capital of no more than 10%
- Numerous prescriptive requirements that dramatically increase complexity and conservativism (e.g. multiple definitions of LGD, no distinction for SME vs. Large Corporate Loans, etc.)

These differences will result in higher U.S. capital requirements for identical activities. Since capital is not restrained by national borders, the imposition of an uneven regulatory burden will cause business to flow outside of the U.S., threatening the prominence of U.S. Banking organizations among the world's largest and most profitable banks.

The intended purpose of many of these requirements seems to be the mitigation of unanticipated declines in capital levels. While certainly something to be mindful of, we think it important to make several key points:

- The results of QIS-4 are not a valid basis for implementing changes to the framework. This study was done with systems that were not fully developed, limited data and with limited oversight and guidance by the Agencies.
- We believe that in Pillar II, U.S. Regulators already have sufficient latitude to require higher levels of capital if needed. The use of this existent structure is preferable to continuing to promulgate rules-based, non-risk-based measures of capital adequacy.

- Imposition of a leverage floor seems prudent during the transition process, but in the long-term it should be evaluated based upon actual results. If the risk-based systems are functioning as intended, then this floor will not be necessary.
- The 10% aggregate limit is arbitrary. Therefore, breeching this limit is not a valid indication that the Framework is fundamentally flawed. Additionally, administration of this rule, given the wide latitude firms have in which to enter the parallel and transition phases, is very challenging and has not been specified by the Agencies.

In summary, we recommend that the Agencies conform the U.S. approach to the Framework, and rely on existing controls under Pillar II to ensure capital levels are not reduced below a prudent threshold.

Pillar II Disclosure Requirements are Onerous, and Based Upon an Objective that is Unlikely to Succeed

The Pillar II disclosure requirements seem to be designed to facilitate detailed comparisons across institutions. While this is conceptually sound, it is very difficult to implement practically, and we believe it is unlikely to succeed.

Many activities not contemplated by the Basel II Framework impact capital levels. For example, it is well understood that a firm's collection activities dramatically impact the performance of a portfolio. If two firms had an identical portfolio of loans, but substantially different collection practices, we would expect that while PDs would be identical, the LGDs would be different. No amount of comparative activities of capital data between the two institutions would be able to describe why the LGDs were different. This same concept extends to other practices as well, including portfolio management activities, operational processes, etc. Even if calculated using the same framework, results between and across banks could be materially different for justifiable reasons that could not be identified by detailed comparisons. Accordingly, we contend that detailed comparisons are of little or any value.

Historically, meaningful comparisons across institutions have been very challenging, both to the Agencies and to the Industry. Outside of very limited areas such as the Shared National Credit process where exposures are identical, we can think of few examples where gathering and analyzing cross-industry data has yielded practical results.

This comparison becomes further complicated should the Agencies follow our recommendation to become more, not less, principles-based. We urge the Agencies to dramatically scale back their plans for disclosure for the purposes of performing detailed comparisons across Banking organizations.

Pillar III Disclosure Requirements are Inappropriate and Unnecessary

We believe that the Pillar III requirements are not appropriate because public disclosure requirements ought to be set solely by those agencies that safeguard the interests of investors (i.e.

the SEC, the FASB, and the rating agencies), not by Regulators who have neither the responsibility, nor the expertise to take on that role. Furthermore, such requirements seem unnecessary to us because, quite outside of Basel, the market will dictate those elements of bank risk management disclosure that are most necessary to improve transparency.

The Agencies Should Resolve Inter-Agency Differences and Issue Comprehensive, Final Guidance as Soon as Possible.

We are sensitive to the size and complexity of this endeavor. However, we encourage the Agencies to redouble their efforts to effectively implement Basel II in the U.S. by addressing two issues that have contributed to the Industry's overall concern about this effort:

- First, we ask the Agencies to move forward quickly with clear, comprehensive, and final guidance. The repeated delays and uncertainties around implementation have added to the already high cost of implementation, and have placed us behind other Countries implementing the Framework.
- Second, while we appreciate the difficulties in harmonizing the different perspectives of each Agency, we urge the Agencies to commit their senior leadership to resolving differences in a clear and timely manner.

Sincerely,

Paul R. Ackerman
Executive Vice President & Treasurer

Question #1: "Look-back" portfolio

The agencies seek comment from the industry concerning the feasibility of collecting certain additional information beyond that described in this proposal. The purpose of this additional information is to help identify the causes of changes in credit risk regulatory capital requirements (for example, due to changes in exposure mix or changes in the bank's assessment of risk).

To facilitate such analyses, reporting banks would be required to submit additional data items that summarize current and previous risk parameters for exposures that were in wholesale and retail credit portfolios as of the previous reporting period (for example, prior quarter, prior year) -- the "lookback" portfolio. The intent of this lookback-portfolio approach would be to allow the agencies to better identify reasons for observed changes in regulatory credit risk capital requirements and allow for peer comparisons of changes from period to period.

A lookback-portfolio approach would require additional data collection and processing. For example, banks would need to retain data on the internal risk rating category to which each exposure was previously assigned, and the previous EAD of each exposure. The agencies believe that this data maintenance requirement is consistent with supervisory expectations described in the NPR and proposed AIRB guidance in that banks subject to the Advanced Capital Adequacy Framework are expected to be able to evaluate and explain changes in risk parameters in order to assess their risk parameter estimation procedures.

The agencies specifically seek industry comment on the following questions:

- *What aggregate summary information might banks submit that best describes or characterizes period-to-period migration across internal rating grades or retail segments?*
- *If such information were required, are there particular formats or other considerations that would reduce the reporting burden for banks?*

We oppose the proposal to submit additional data that summarizes the impact of current versus previous risk parameters for exposures that existed in wholesale and retail credit portfolios as of the previous reporting period (for example, prior quarter, prior year) – the "look-back" portfolio. The stated intent of this proposal is to allow the agencies to better identify reasons for observed changes in regulatory credit risk capital requirements and to allow for peer comparisons of changes from period to period.

The 'mechanics' of this proposal are not sufficiently clear from the Agencies' description. Nevertheless, we can surmise that this proposal would be complex to produce from an operational standpoint, particularly on a routine, quarterly reporting basis. If the Agencies desire a 'migration' analysis, then we believe this should be focused on specific portfolios and should be a special request under Pillar II, when and if needed, and should not be a fixed requirement under the U.S. version of Pillar III.

The "look-back" would entail re-running the entire capital calculation process, without interfering with the regular production cycle, not just the calculation for the impacted portfolios. We are amenable to the suggestion of maintaining historical data such as the PD and EAD as of prior reporting periods for each exposure. In situations where there has been an immaterial change in the capital requirements, we do not see the reason to perform the calculation twice. These types of comprehensive "what-if" scenarios are not appropriate in routine quarterly reports.

We urge the Agencies to re-address this "look-back" proposal after completion of the full implementation of Basel II in the U.S. in order to evaluate the utility of this particular solution.

Question #2: Internal ratings

The agencies are considering another alternative reporting treatment with respect to the wholesale and retail portions of the above proposal (Schedules C-R). This alternative treatment would complement the lookback-portfolio approach just described but could be implemented whether or not the lookback-portfolio approach was implemented. Under this approach, banks would submit data according to each of their internal obligor rating grades or segments, rather than in the fixed bands defined in the current regulatory reporting proposal. In this case, each reporting bank could submit a different number of rows corresponding to the number of internal risk rating/segmentation categories employed by that bank for the given portfolio.

The agencies specifically seek industry comment on the following question:

- *Would reporting burden be lessened if banks submitted data using internally-defined obligor grades or segments, rather than aggregating the grades or segments in supervisory reporting bands?*

We agree with the Agencies' counterproposal to allow banks to report Schedules C to R according to their own PD (internal rating grades) segments. This is consistent with the international version.

The agencies' current proposal for mandated PD ranges requires setting up a calculation process for weighted averages within each range. This is one more incremental process and reporting burden caused by the U.S. version which generally would not exist if banking organizations were allowed to use their own rating grades.

Question #3: Public reporting

The agencies request comment on the appropriateness of making the data items on Schedules A and B and data items 1 through 7 of the operational risk reporting schedule (Schedule V) available to the public for each reporting entity for data collected during periods subsequent to its parallel run reporting periods as currently proposed. Comments are requested on the extent to which banks are already providing these data to the public or are planning to make such data public as well as the timing of these disclosures. In addition, comments are requested on the perceived risks associated with public reporting of these data items.

In general, it is reasonable to make Schedules A and B available to the public once a banking organization's Basel II process has been approved for use by the regulators. However, we are concerned about the timing of these schedules being public during the full transition period and we recommend that they be delayed (as are the public schedules) until after the second year of transition due the agencies' delays in issuing final rules and related guidance.

We are concerned about the high volume of interpretations needed for the underlying data and potential for adjustments in reported figures. Therefore, the agencies and banking organizations need a sufficient period to be comfortable with this level of detail. Furthermore, the Agencies must develop guidelines for dealing with adjustments that are flexible and fair and published in advance to the banking organizations due to the newness and complexity of the data for all parties.

Question #4

What changes in the proposed regulatory reporting requirements for the Advanced Capital Adequacy Framework, including additional data or definitions, would better assist the agencies in reaching their stated goals? In this regard, the agencies also seek input on possible alternative ways to capture the requested information and the appropriateness of the requested data given the stated purposes of the information collections and the associated reporting burden.

Banking organizations should be allowed to apply standardized methods, whether Basel II or Basel I, to portfolios for which it is not cost-effective – or not statistically feasible – to estimate the appropriate credit risk parameters. Such portfolios should be included in Line Item 30 on Schedule B (and similar lines on subsequent schedules) and the Line's title should be changed from "Immaterial Exposures" to "Credit Exposures on Other Methods". Using the term "immaterial" is subject to judgmental interpretations and disagreements. The need for this category is based on real-world fact patterns (i.e., lack of a statistical basis for an internal rating on the portfolio) and not solely on immateriality considerations.

Question #1 & #2: Asset Value Correlations

#1: The agencies seek comment on and empirical analysis of the appropriateness of the proposed rule's AVCs for wholesale exposures in general and for various types of wholesale exposures (for example, commercial real estate exposures).

#2: *The agencies seek comment on and empirical analysis of the appropriateness and risk sensitivity of the proposed rule's AVC for residential mortgage exposures – not only for long-term, fixed-rate mortgages, but also for adjustable-rate mortgages, home equity lines*

Changes in Asset Value Correlations (AVCs) should be instituted by the Basel Committee as a whole, to avoid competitive inequities and compliance burden. We believe that the Framework's AVCs are much higher than best practice estimates for several retail product categories and somewhat higher than best practice in wholesale. Additionally, the equation defining the relationship between wholesale AVCs and PD may be inappropriate.

With respect to the PD-AVC relationship in wholesale, we believe that AVCs are related to size of obligor – larger obligors, all things being equal, will have asset values that are more sensitive to macro economic conditions – thus, AVCs are lower (defaults more idiosyncratic) for small to medium-sized enterprises.

In commercial real estate (CRE) lending, many observers believe that multi-family lending (MFL) should have lower AVCs than other C&I lending because a multi-family loan has some of the characteristics of a retail loan – being highly sensitive to local market conditions rather than to the (single) macro risk variable associated with the Basel II wholesale credit risk model.

From our internal analysis using actual loss data, our calculated AVCs are lower than those prescribed by agencies in the federal register (and by the BIS in the Basel II Accord/Framework).

Question #3: Allowance for Loan Losses Vs. Expected Loss

The agencies seek comment and supporting data on the appropriateness of this limit.

We believe that ALLL should be counted as 'true' equity (as also defined by rating agencies) as it is the first 'type' of capital to absorb credit losses. Furthermore, there should be no limit to how much ALLL that can be included in Tier 2 capital, i.e. without the 0.6% cap on 'EL minus ALLL'. The 0.6% cap only affects banks with EL greater than ALLL.

In addition, the U.S. Basel II rules should be harmonized with the Basel II Accord on RWA. In particular, the area of the increased capital requirement for RWA introduced by the U.S. Regulators (deducting ELGD*PD from RWA, instead of LGD*PD).

Question #4: Retail Portfolio Segmentation

The agencies seek comment on the use of a segment-based approach rather than an exposure-by-exposure approach for retail exposures.

We believe that the exposure by exposure approach for calculating capital offers the maximum opportunity for more precisely measuring capital and maximum flexibility for conducting analysis on the portfolio.

Question #5: Transitional Floor Periods

The agencies are, in short, identifying a numerical benchmark for evaluating and responding to capital outcomes during the parallel run and transitional floor periods that do not comport with the overall capital objectives outlined in the ANPR. At the end of the transitional floor periods, the agencies would reevaluate the consistency of the framework, as (possibly) revised during the transitional floor periods, with the capital goals outlined in the ANPR and with the maintenance of broad competitive parity between banks adopting the framework and other banks, and would be prepared to make further changes to the framework if warranted. The agencies seek comment on this approach to ensuring that overall capital objectives are achieved.

U.S. Basel II rules differ from the Basel II Accord in the some key areas; there is a longer phase-in period (3 years in the U.S. Basel II rules vs. 2 years in the Basel II Accord), and higher phase-in floors (95/90/85% vs. 90/80%), with the phase-in floors applied to both the Total and Tier 1 Capital ratios.

Furthermore, the U.S. agencies still retain the requirement for the minimum leverage requirement and have reserved the right to amend the U.S. Basel II requirements if the aggregate reduction in capital is greater than 10%.

These differences will result in higher U.S. capital requirements for identical activities, placing U.S. banks at a competitive disadvantage relative to non-U.S. banks.

We believe that this is not in the best interest of the long-term competitiveness of the U.S. banking system. We also believe that under Pillar II, U.S. regulators have sufficient latitude to require higher levels of capital, if needed.

Question #6: Competitiveness

The agencies seek comment on all potential competitive aspects of this proposal and on any specific aspects of the proposal that might raise competitive concerns for any bank or group of banks.

The original intent of Basel II was to allow banks to use flexible, risk-based approaches to identify the requisite capital for activities. To prevent this from being abused, Pillar II and Pillar III would act as counter balances. However, with over 500 pages of guidance to date, Pillar 1 has become entirely too prescriptive and early dialogue with the Agencies indicate a rules-based approach to implementation. We believe this is unnecessary and counterproductive. Unnecessary, because the Agencies continue to have significant powers under Pillar II, that can be used to mitigate any shortcomings identified. Also, with an extremely limited number of mandatory and opt-in banks, a principle-based approach is not an overwhelming task. Counterproductive, because no matter how well intentioned, a rules-based approach will always be behind market innovations, much the same way Basel I was made obsolete by innovations such as securitization. In addition, the scope of Basel II does not lend itself to a rules-based approach – accounting for the risk in every activity undertaken is so immense – essentially requiring the identification and quantification of risk for every activity undertaken by U.S. financial institutions – that no single agency or even several agencies will be able to address it in its entirety. Rather, this task should be left to market participants, and subject to the appropriate and existent checks and balances.

We urge the agencies toward a principles-based scheme, much like 99-18 or interest rate risk, rather than persisting in a rules-based approach that produces a sub-optimal approach.

Question #7: Alternate Approaches

The agencies request comment on whether U.S. banks subject to the advanced approaches in the proposed rule (that is, core banks and opt-in banks) should be permitted to use other credit and operational risk approaches similar to those provided under the New Accord. With respect to the credit risk capital requirement, the agencies request comment on whether banks should be provided the option of using a U.S. version of the so-called "standardized approach" of the New Accord and on the appropriate length of time for such an option.

At Wells Fargo, operating risks are small relative to other core banks with high volume, high dollar clearing operations. If we can adequately support our contention to the supervisors that advanced risk measurement techniques are not necessary for certain portfolios (e.g., they do not meaningfully increase transparency or improve risk management processes), then we should be able to use the standardized approach. We believe this is completely in line with the risk-based intent of Basel II.

Question #8: Insurance Subsidiaries

A) The Board seeks comment on the proposed BHC consolidated non-insurance assets threshold relative to the consolidated DI assets threshold in the ANPR.

Wells Fargo has no comment on this issue.

Question #8: Insurance Subsidiaries

B) The agencies seek comment on the proposed scope of application. In particular, the agencies seek comment on the regulatory burden of a framework that requires the advanced approaches to be implemented by each subsidiary DI of a BHC or bank that uses the advanced approaches.

The application at the DI level versus the enterprise level appears to have little value with an excess burden of cost and complexity.

Question #9: Subsidiaries of Foreign Banks

The agencies seek comment on the application of the proposed rule to DI subsidiaries of a U.S. BHC that meets the conditions in Federal Reserve SR letter 01-01 and on the principle of national treatment in this context.

Wells Fargo has no comment on this issue.

Question #10: Transitional Floor Periods

The agencies seek comment on this approach, including the transitional floor thresholds and transition period, and on how and to what extent future modifications to the general risk-based capital rules should be incorporated into the transitional floor calculations for advanced approaches banks.

The transitional floors and the timing of the floors are a significant departure from the Basel II Accord. This divergence creates competitive inequities that favor non-U.S. banks. The basis of this transitional matrix has little business or risk-based rational.

U.S. regulators should simply adopt the international transitional floors and timing.

Question #11: Additional Information for Overall Capital Goals

The agencies seek comment on what other information should be considered in deciding whether those overall capital goals have been achieved.

See Well Fargo's Executive Response to the NPR.

Question #12: Timetable

The agencies seek comment on this proposed timetable for implementing the advanced approaches in the United States.

The delayed timetable and guidance places U.S. banks at a competitive disadvantage to other non-U.S., Basel II banks. See also our response to question 10.

We support the use of the standardized approach for select portfolios which would help in the transition process.

Question #13: Obligor Rating

The agencies seek comment on this aspect of the proposed rule and on any circumstances under which it would be appropriate to assign different obligor ratings to different exposures to the same obligor (for example, income-producing property lending or exposures involving transfer risk).

Each obligor should be assigned a PD, either through an internal grading system or directly through rating models. Each loan should be assigned an LGD, again either through an internal grading system or directly through rating models. The LGD being assigned is independent of PD, and as such should be independent of other loans of the same obligor.

We believe there should be no cross-default effect on loans of the same obligor.

Question #14: Definition of Default

The agencies seek comment on this proposed definition of default and on how well it captures substantially all of the circumstances under which a bank could experience a material credit-related economic loss on a wholesale exposure. In particular, the agencies seek comment on the appropriateness of the 5 percent credit loss threshold for exposures sold or transferred between reporting categories. The agencies also seek commenters' views on specific issues raised by applying different definitions of default in multiple national jurisdictions and on ways to minimize potential regulatory burden, including use of the definition of default in the New Accord, keeping in mind that national bank supervisory authorities must adopt default definitions that are appropriate in light of national banking practices and conditions.

The process of calculating PD and LGD under the rule that asset sales at a "credit related" loss of 5% or more should be treated as a "default" seems incorrect. If you have a single obligor with multiple exposures, the rules treat the entire obligor as defaulted, which distorts precise capital measurement. We further wish to emphasize two other issues: the definition of default issue is a Pillar II issue, and the LGD effect on the capital charge equation is linear while the PD effect is non-linear.

The linear versus non-linear effects of LGD versus PD show a bias toward default definitions that lower PDs and raise LGDs.

Question #15: Downturn Conditions

In light of the possibility of significantly increased loss rates at the subdivision level due to downturn conditions in the subdivision, the agencies seek comment on whether to require banks to determine economic downturn conditions at a more granular level than an entire wholesale or retail exposure subcategory in a national jurisdiction.

Applying a sub-product category requirement will add further complexity to implementation of the U.S. Basel II rules. Furthermore, this results in greater inequalities between the U.S. banks, which implement the U.S. Basel II rules and the non-U.S. banks, which implement the Basel II Accord.

Product diversification, whether it be geographical or industry sector concentration, is an efficient way for banks to reduce portfolio risk. Over-analyzing or over-regulating such risk-reducing tools leads to a disincentive to banks from using these tools, thus increasing risk – the opposite of what Basel II is meant to do.

Question #16: Empirical Analysis

The agencies seek comment on and supporting empirical analysis of (i) the proposed rule's definitions of LGD and ELGD; (ii) the proposed rule's overall approach to LGD estimation; (iii) the appropriateness of requiring a bank to produce credible and reliable internal estimates of LGD for all its wholesale and retail exposures as a precondition for using the advanced approaches; (iv) the appropriateness of requiring all banks to use a supervisory mapping function, rather than internal estimates, for estimating LGDs, due to limited data availability and lack of industry experience with incorporating economic downturn conditions in LGD estimates; (v) the appropriateness of the proposed supervisory mapping function for translating ELGD into LGD for all portfolios of exposures and possible alternative supervisory mapping functions; (vi) exposures for which no mapping function would be appropriate; and (vii) exposures for which a more lenient (that is, producing a lower LGD for a given ELGD) or more strict (that is, producing a higher LGD for a given ELGD) mapping function may be appropriate (for example, residential mortgage exposures and HVCRE exposures).

Theoretically, ELGD is a historical LGD, while LGD is a stressed (or economic downturn) LGD. Thus, the U.S. Basel II rules, by adding a differentiation between types of LGD, versus the Basel II Accord that does not, leads to greater international inequality.

The assumption that ELGD*PD reflects expected losses (versus the Accord's LGD*PD) not only increases RWA, but also leads to a reduction in the applicability of ALLL (which can only be used to cover EL). If ALLL is less than EL, the difference would be evenly deducted from Tier 1 and Tier 2 capital; if ALLL is greater than EL (which can be a result of reducing EL through the use of ELGD), the difference capped at 0.6% can only be returned to Tier 2 capital. The increase in RWA results in reduced ratios, thus a need for greater capital; the reduction of ALLL can lead to a slight increase in capital, but not sufficiently to counteract the RWA growth.

The resultant dissimilarity between the calculations of RWA and ratios (between the U.S. Basel II rules and the Basel II Accord) negates any benefit of using Pillar III to compare U.S. and non-U.S. banks.

Question #17: Procyclicality

The agencies seek comment on the extent to which ELGD or LGD estimates under the proposed rule would be pro-cyclical, particularly for longer-term secured exposures. The agencies also seek comment on alternative approaches to measuring ELGDs or LGDs that would address concerns regarding potential pro-cyclicality without imposing undue burden on banks.

Continuing the logic on from Question 16 (i.e. ELGD is an historical LGD, while LGD is a stressed LGD), LGD will not be cyclical. On the other hand, ELGD can be found to be cyclical as both historical (long-run) averages and the point-in-time inputs to the models being used, such as loan-to-value (LTV) ratios or FICO scores, will change over time – whether that be in the short-term (i.e. monthly) or in the long-term (i.e. annually). However, we feel that such cyclicality is a true nature of market conditions and an attempt to remove these will cloud the use of the final ratios.

We also believe that banks should be allowed to continue using their internal models to estimate both ELGD and LGD (even though we would prefer moving back to the Basel II Accord's definitions), rather than using the U.S. Basel II rules' formula of deriving

LGD from ELGD, which will introduce an additional cyclical aspect to the RWA formula.

In summary, we believe that the less prescriptive, more principles-based approach found in the Basel II Accord needs to replace the one in the U.S. Basel II rules. Pillar II is a strong enough safeguard to ensure conservative compliance.

Question #18: Wholesale Pay-Downs

The agencies seek comment on the feasibility of recognizing such pre-default changes in exposure in a way that is consistent with the safety and soundness objectives of this proposed rule. The agencies also seek comment on appropriate restrictions to place on any such recognition to ensure that the results are not counter to the objectives of this proposal to ensure adequate capital within a more risk-sensitive capital framework. In addition, the agencies seek comment on whether, for wholesale exposures, allowing ELGD and LGD to reflect anticipated future contractual paydowns prior to default may be inconsistent with the proposed rule's imposition of a one-year floor on M (for certain types of exposures) or may lead to some double-counting of the risk-mitigating benefits of shorter maturities for exposures not subject to this floor.

If one follows the logic proposed in the U.S. Basel II rules, ELGD/LGD would be dependent on EAD, not the bank's actual exposure at default. This presupposes that EAD has not been adjusted to equal the bank's actual exposure at default. Thus, if EAD is greater than the bank's actual exposure at default, ELGD and LGD will be lower.

We do not believe there is a need for increased prescriptive regulations on this topic as it is the responsibility of the banks to ensure that their EAD, ELGD, and LGD estimates truly reflect the situation. There is sufficient oversight to ensure this is the case, both through management oversight and through regulatory oversight.

Question #19: Operational Risk

The agencies solicit comment on all aspects of the proposed treatment of operational loss and, in particular, on (i) the appropriateness of the proposed definition of operational loss; (ii) whether the agencies should define operational loss in terms of the effect an operational loss event has on the bank's regulatory capital or should consider a broader definition based on economic capital concepts; and (iii) how the agencies should address the potential double-counting issue for premises and other fixed assets.

The definition seems appropriate and at the right level of granularity. Operational losses should be defined in terms of the direct effect of a loss event on the regulatory capital of the enterprise. Risk from damage to physical assets should only be included in Operational Risk Capital to avoid double counting.

Question #20: Mergers and Acquisitions

The agencies seek comment on the appropriateness of the 24-month and 30-day time frames for addressing the merger and acquisition transition situations advanced approaches banks may face.

The 24-month window for incorporation of an acquired bank seems reasonable, especially with the discretionary 12-month supervisory extension.

This notwithstanding, we do believe the 30-day period to file an implementation plan is arguably too aggressive a target; this presupposes that (i) the purchasing bank had access to all the acquired bank's systems, (ii) the acquired bank's systems are similar enough to the purchasing bank's systems allow such quick analysis, and (iii) the same credit analysts that are analyzing the deal have had time to also analyze the Basel II implications. We feel that the 30-day window should be extended to a 3-month window with an additional discretionary 3-month supervisory extension.

Question #21: Elements of Capital

Commenters are encouraged to provide views on the proposed adjustments to the components of the risk-based capital numerator as described below. Commenters also may provide views on numerator-related issues that they believe would be useful to the agencies' consideration of the proposed rule.

Subsequent to the inception of the existing Risk-Based Capital Accord in 1988, the accounting principles (GAAP) that affect the treatment of the Goodwill asset on the balance sheet have changed. Under GAAP today, Goodwill must be revalued to its fair market value on a quarterly basis. As such, we believe that Goodwill now represents an asset with an accepted value equal to its recorded balance sheet amount, and should no longer be a required deduction from Tier 1 Capital in the regulatory capital calculations. In contrast to other banking assets that, by GAAP standards, are subjected to similar impairment analyses on an ongoing basis, the capital treatment of Goodwill is disproportionately harsh.

We suggest that placing limits on the use of tax-advantage Trust Preferred for Basel II banks runs counter to the objectives of prudential policy. At a minimum, the proposed limit of 15% should be at least doubled, since such preferred is significantly less costly than new equity share issuances but serves the same purpose of helping to meet the insolvency-probability soundness standard.

Question #22: Expected Loss

The agencies seek comment on the proposed ECL approach for defaulted exposures as well as on an alternative treatment, under which ECL for a defaulted exposure would be calculated as the bank's current carrying value of the exposure multiplied by the bank's best estimate of the expected economic loss rate associated with the exposure (measured relative to the current carrying value), that would be more consistent with the proposed treatment of ECL for non-defaulted exposures. The agencies also seek comment on whether these two approaches would likely produce materially different ECL estimates for defaulted exposures. In addition, the agencies seek comment on the appropriate measure of ECL for assets held at fair value with gains and losses flowing through earnings.

We believe there is no need for an additional treatment as the existing treatment is sufficient. Furthermore, assets held at fair value (be they trading assets or 'held for sale') would not require any share of ALLL as the asset will be marked-to-market.

Question #23: Insurance Regulatory Capital

The Board seeks comment on this proposed treatment and in particular on how a minimum insurance regulatory capital proxy for tier 1 deduction purposes should be determined for insurance underwriting subsidiaries that are not subject to U.S. functional regulation.

The treatment of insurance subsidiaries under the U.S. Basel II rules is very punitive. The assets (appropriately risk-weighted) are added to the denominator, while capital (which could be used to offset this increase) is being removed from the numerator – leading to a decrease in capital ratios.

We believe that such one-sided cherry-picking of what can and cannot be used is both unfair and can lead to erroneous conclusions being made from Pillar III reporting. We are not against the inclusion of insurance assets to RWA, but that should be matched with the inclusion of insurance capital to Total and Tier 1 Capital.

Question #24: HVCRE

The agencies seek comment on how to strike the appropriate balance between the enhanced risk sensitivity and marginally higher risk-based capital requirements obtained by separating HVCRE exposures from other wholesale exposures and the additional complexity the separation entails.

It is difficult to apply all the HVCRE exclusions and as such a large number of CRE or ADC loans are being categorized as HVCRE. Furthermore, tracking such exclusions may be a complex issue. The marginal increase in capital is not worth the effort of tracking these loans.

Question #25: SME Portfolios

The agencies request comment and supporting evidence on the consistency of the proposed treatment with the underlying riskiness of SME portfolios. Further, the agencies request comment on any competitive issues that this aspect of the proposed rule may cause for U.S. banks.

Our analysis has shown that SME portfolios have significantly lower correlations compared to portfolios with large counterparties. However, under the U.S. regulations, we will need to hold the same amount of capital for two loans with identical PDs and LGDs (one to an SME and one to a large counterparty).

We would like to emphasize that the lower, more appropriate capital requirement for SME loans made by foreign-owned banks constitutes a competitive disadvantage for U.S. banks and, in the extreme, could reduce the flow of loanable funds to small businesses in the U.S.

Question #26: Non-Financial Exposures in Securitizations

The agencies request comment on the appropriate treatment of tranched exposures to a mixed pool of financial and non-financial underlying exposures. The agencies specifically are interested in the views of commenters as to whether the requirement that all or substantially all of the underlying exposures of a securitization be financial exposures should be softened to require only that some lesser portion of the underlying exposures be financial exposures.

The regulations should not stand in the way of the development of innovative securitization structures, especially those that including underlying positions that are "non-financial" under the regulatory definition of such assets.

We believe that as the field of securitization is still evolving, so should the regulations surrounding securitization. If rating agencies see fit to rate individual tranches of a securitization (as defined by the market not as defined by Basel II), the regulations should allow those securitization to be treated as such. The ability to securitize seemingly non-financial assets can, using a look-through approach, become financial assets.

Thus, with a rating, the RBA can be applied; where tranches are missing ratings either the IAA or SFA can be applied.

Question #27: Boundary between Credit and Operational

The agencies seek commenters' perspectives on other loss types for which the boundary between credit and operational risk should be evaluated further (for example, with respect to losses on HELOCs).

We believe that the boundaries between the credit risk and operational risk should be left to the discretion of the banks, with the approval of their regulators – as mentioned before Pillar II allows sufficient oversight to ensure compliance.

Question #28: Boundary between Credit, Operational, and Market

The agencies generally seek comment on the proposed treatment of the boundaries between credit, operational, and market risk.

We believe that the boundaries between these risks should be left to the discretion of the banks, with the approval of their regulators – as mentioned before Pillar II allows sufficient oversight to ensure compliance.

Question #29: Guarantees on Retail Exposures

The agencies seek comment on this approach to tranched guarantees on retail exposures and on alternative approaches that could more appropriately reflect the risk mitigating effect of such guarantees while addressing the agencies' concerns about counterparty credit risk and correlation between the credit quality of an obligor and a guarantor.

The approach to tranched guarantees seems reasonable, especially their exclusion from the securitization treatment. We also agree with the inclusion of loss prevention in the models.

Pillar II oversight negates any need for further regulations on this topic.

Question #30: Unavailability of PD, ELGD, LGD

The agencies seek comment on wholesale and retail exposure types for which banks are not able to calculate PD, ELGD, and LGD and on what an appropriate risk-based capital treatment for such exposures might be.

In the case of unavailability of PD, ELGD, LGD the bank should be given the option to either use the standardized approach or use inferred ratings when available. The clause for immaterial portfolios should be changed. This should be determined by the bank and not mandated by the regulators. The real issue is the amount at risk (5% of 1st liens is very different from 5% of sub-prime unsecured loans).

For retail margin loans, loss data are rare because margin calls are made when the value of the underlying asset falls. The inability to measure PDs and LGDs flows from this lack of internal loss data which in turn flows from the extreme high quality of the loans. In such cases, acceptable practice should be to use an aggregated internal-data approach. Such an approach, for example, might be to observe loss levels at the portfolio level which are then coupled with assumptions or data on default rates in order to "back into" LGDs. In the absence of such aggregated internal data, such loans should be subject to no more than the current rule (risk weight of 100%), which would still be extremely conservative.

Question #31: Effective Maturity

The agencies seek comment on the appropriateness of permitting a bank to consider prepayments when estimating M and on the feasibility and advisability of using discounted (rather than undiscounted) cash flows as the basis for estimating M.

M should be estimated in alternative ways, depending on the exact nature of the portfolio Economic Capital methodology of the bank. In models in which capital is measured in relation to a distribution of changes-in-market-values, the MTM process would include the effects of expected prepayments. In default-mode models, M might be measured either as a duration concept (expected cash flows with or without prepayments) or as remaining term.

Question #32: Loans under the RTCRRI Act

The agencies seek comment on whether the agencies should impose the following underwriting criteria as additional requirements for a Basel II bank to qualify for the statutory 50 percent risk weight for a particular mortgage loan: (i) that the bank has an IRB risk measurement and management system in place that assesses the PD and LGD of prospective residential mortgage exposures; and (ii) that the bank's IRB system generates a 50 percent risk weight for the loan under the IRB risk-based capital formulas.

Wells Fargo has no comment on this issue.

Question #33: 1-4 Family Residential Loans

The agencies seek comment on all aspects of the proposed treatment of one-to-four family residential pre-sold construction loans and multifamily residential loans.

Wells Fargo has no comment on this issue.

Question #34

For purposes of determining EAD for counterparty credit risk and recognizing collateral mitigating that risk, the proposed rule allows banks to take into account only financial collateral, which, by definition, does not include debt securities that have an external rating lower than one rating category below investment grade. The agencies invite comment on the extent to which lower rated debt securities or other securities that do not meet the definition of financial collateral are used in these transactions and on the CRM value of such securities.

This restriction on what can and cannot be used as collateral seems to be too prescriptive. A more principles-based approach would be to allow banks the use of all types of collateral, as long as there is sufficient documentation. An appropriate haircut can be agreed upon; Pillar II gives the regulators the right to disagree, but at least it will lead to a discussion. As this is an area that is still in flux, it would be futile to have a select set of options.

Question #35

The agencies recognize that criterion (iii) above may pose challenges for certain transactions that would not be eligible for certain exemptions from bankruptcy or receivership laws because the counterparty—for example, a sovereign entity or a pension fund—is not subject to such laws. The agencies seek comment on ways this criterion could be crafted to accommodate such transactions when justified on prudential grounds, while ensuring that the requirements in criterion (iii) are met for transactions that are eligible for those exemptions.

Wells Fargo has no comment on this issue.

Question #36

The agencies seek comment on the appropriateness of requiring that a bank have a perfected, first priority security interest, or the legal equivalent thereof, in the definition of financial collateral.

Both industry practice and international laws are at odds with the U.S. Basel II requirement; we feel this should be eliminated.

Question #37

The agencies recognize that this is a conservative approach and seek comment on other approaches to consider in determining a given security for purposes of the collateral haircut approach.

Wells Fargo has no comment on this issue.

Question #38

The agencies seek comment on methods banks would use to ensure enforceability of single product OTC derivative netting agreements in the absence of an explicit written legal opinion requirement.

Wells Fargo has no comment on this issue.

Question #39

The agencies request comment on all aspect of the effective EPE approach to counterparty credit risk, and in particular on the appropriateness of the monotonically increasing effective EE function, the alpha constant of 1.4, and the floor on internal estimates of alpha of 1.2.

Wells Fargo has no comment on this issue.

Question #40

The agencies request comment on the appropriateness of these criteria in determining whether the risk mitigation effects of a credit derivative should be recognized for riskbased capital purposes.

Wells Fargo believes the current requirements are reasonable.

Question #41

The agencies are interested in the views of commenters as to whether and how the agencies should address these and other similar situations in which multiple credit risk mitigants cover a single exposure.

Wells Fargo believes the current approach is reasonable.

Question #42

The agencies seek comment on this alternative approach's definition of eligible retail guarantee and treatment for eligible retail guarantees, and on whether the agencies should provide similar treatment for any other forms of wholesale credit insurance or guarantees on retail exposures, such as student loans, if the agencies adopt this approach.

Question #43

The agencies seek comment on the types of non-eligible retail guarantees banks obtain and the extent to which banks obtain credit risk mitigation in the form of non-eligible retail guarantees.

Question #44

The agencies seek comment on both of these alternative approaches to guarantees that cover retail exposures. The agencies also invite comment on other possible prudential treatments for such guarantees.

Wells Fargo is in alignment with the RMA in these areas.

These three questions deal with the treatment of guarantees for retail credits. The agencies have made two alternative proposals and seek input with regard to which proposal, or combination of proposals, or alternative proposal, to choose.

1. The proposed treatment for "eligible" retail guarantees.

   The proposal makes sense in that the bank may assess the effect of the guarantee (in the form of PMI from a highly rated insurer or a guarantee from a sovereign) on ELGD and LGD, but not on PD. Further, the proposal helps to reduce compliance cost. However, the definition of an "eligible" guarantee seems to be too narrow. For example, guaranteed student loans, where a state not the federal government is the guarantor, are not clearly included as "eligible." Still other guarantees might be included within the definition of "eligible", including guarantees such as student loan guarantees from highly-rated private organizations (e.g., those with a single A or higher rating)

In addition, the proposal brings up the question of the degree to which assessing and recording the credit rating of the PMI provider needs to be a continuous function of the bank. For most mortgages, for example, as the loan is amortized and as any inflation in house prices occurs, the effective LTV declines and the exposure to the insurer declines. Moreover, as the exposure declines, the insurance fee (charged to the borrower) does not decline, further reducing risk to the insurer. We believe, therefore, that it would be sufficient to assess the eligibility of the PMI insurer only at the point at which the bank first uses a particular insurer. Such a rule would reduce the compliance burden for the bank, without leading to a significant concern regarding the counterparty risk of the guarantee.

2. The proposed treatment for "ineligible" guarantees.

The CWG is concerned that, with respect to "ineligible" guarantees, it may prove difficult to implement a procedure in which the retail exposure is essentially converted to a wholesale exposure and then the rating of the wholesale guarantor is substituted for the rating of the obligor. Expanding the coverage of "eligible" guarantees, as recommended above, would alleviate this problem. At the same time, however, for those AIRB banks that are able to use the alternative "wholesale oriented" approach, this flexibility should be afforded them.

3. The NPR proposes a separate alternative to the treatment for retail guarantees in a) and b) above, in which the bank would adjust the ELGD and LGD of all eligible guarantees that cover retail (without regard to the rating of the insurer), but the resulting capital calculation would be subjected to a <u>floor</u> (in the range of 2% to 6% on the exposures).

We are opposed to such an alternative, since it harks back to the Basel I type of capital allocation and would, in general, be significantly too conservative for the treatment of such important asset classes as PMI mortgages and guaranteed student loans.

Question #45: Originator vs. Investor

The agencies seek comment on this differential treatment of originating banks and investing banks and on alternative mechanisms that could be employed to ensure the reliability of external and inferred ratings of non-traded securitization exposures retained by originating banks.

We do not believe that originating banks should be treated differently from investing banks. Rating agencies cannot be influenced by originating banks any more so than by investing banks. A rating agency cannot know what will be retained and what will be sold; it would go against their interests to rate securities any other way. The added originator requirement, which does not appear in the Basel II Accord, is an additional regulatory burden to U.S. banks with no benefits.

Furthermore, for international consistency, we feel that the final rules permit banks to use the lower of the two highest ratings if an exposure has more than two ratings. It is felt that applying the worst rating is too conservative as it allows for the effect of outliers.

Question #46: Inferred Rating

The agencies seek comment on whether they should consider other bases for inferring a rating for an unrated securitization position, such as using an applicable credit rating on outstanding long-term debt of the issuer or guarantor of the securitization exposure.

Qualifying banks should be permitted to use the IAA on unrated exposures even if the unrated exposures have inferred ratings based on rated, junior exposures. The IAA should also be offered as option in place of inference and/or SFA.

Question #47 & #48: Seniority & Granularity

Question 47

The agencies seek comment on the appropriateness of basing the risk-based capital requirement for a securitization exposure under the RBA on the seniority level of the exposure.

Banks should be given the option to opt-out of tracking seniority and use column 2 (Granular & Not Senior) of Table G instead.

Question#48

The agencies seek comment on how well this approach captures the most important risk factors for securitization exposures of varying degrees of seniority and granularity.

Further to the comments to Question #47, calculating N, especially as an investor is not an easy option. Although it is felt that the effective number of 6 is arbitrary, we support the use of this number. We also support the opt-out clauses of retail and ≥ 25 underlying exposures.

Nevertheless, tracking N over time may be costly with few benefits. Especially for securitizations where the underlying pools consist of hundreds of exposures, N will not decrease to less than 6 in the lifetime of the securitization. Ultimately, we believe that with a substantially granular pool, N should be assumed to stay >6 for the lifetime of the securitization.

In situations where N starts near 6, it may be prudential to allow either the option to move to column 3 (Not Granular) of Table G, or (better yet) have the option of recalculating N periodically (but not greater than once every two years). Pillar II covers this 'problem' sufficiently without any additional regulations.

Question #49: Re-Securitization

The agencies seek comment on suggested alternative approaches for determining the N of a re-securitization.

The proposed treatment of re-securitization under the RBA should allow for the pooling of the underlying loans. As the securities are linked to the underlying loans, the granularity of the security should be taken into consideration when calculating the granularity of the re-securitization, irrespective of the mixture of securities and loans.

We feel that if a single security is classed as being granular, that benefit should be reflected in a subsequent re-securitization. Nevertheless, we cannot at this time assess whether the pooling should be done on a one-to-one basis or if the N of each security needs to be used with an appropriate conversion factor. Not allowing for pooling will be punitive.

Question #50: Eligible Disruption Liquidity Facility

The agencies have not included this concept in the proposed rule but seek comment on the prevalence of eligible disruption liquidity facilities and a bank's expected use of the SFA to calculate risk-based capital requirements for such facilities.

Wells Fargo has no comment on this issue.

Question #51: Revolving Securitizations

The agencies seek comment on the appropriateness of these additional exemptions in the U.S. markets for revolving securitizations.

Wells Fargo has no comment on this issue.

Question #52, #53, & #54: Early Amortization

Question #52

The agencies solicit comment on the distinction between controlled and non-controlled early amortization provisions and on the extent to which banks use controlled early amortization provisions. The agencies also invite comment on the proposed definition of a controlled early amortization provision, including in particular the 18-month period set forth above.

Question #53

The agencies seek comment on the appropriateness of the 4.5 percent excess spread trapping point and on other types and levels of early amortization triggers used in securitizations of revolving retail exposures that should be considered by the agencies.

Question #54

The agencies seek comment on and supporting empirical analysis of the appropriateness of a more simple alternative approach that would impose at all times a flat CF on the entire investors' interest of a revolving securitization with a controlled early amortization provision, and on what an appropriate level of such a CF would be (for example, 10 or 20 percent).

Wells Fargo has no comment on this issue.

Question #55: Definition of a Publicly Traded Equity

The agencies seek comment on this definition.

We agree with the definition.

Question #56: Definition of Adjusted Carry Value for Off-Balance Sheet

The agencies seek comment on the approach to adjusted carrying value for the off-balance sheet component of equity exposures and on alternative approaches that may better capture the market risk of such exposures.

We agree with the definition.

Question #57: Internal Models Approach

The agencies seek comment on the proposed rule's requirements for IMA qualification, including in particular the proposed rule's use of a 99.0 percent, quarterly returns standard.

Presently, it is unknown as to whether there are any substantial benefits to applying an IMA on either only on the publicly-traded equities or both the publicly-traded and non-publicly-traded equities. Given its ambiguous application (i.e. whether the IMA is applied to all publicly-traded and non-publicly-traded equities or only those that exceed the materiality threshold), the benefit of the 100% versus a minimum of 200% or 300% does not seem a beneficial option.

If we assume that the IMA is to be applied in an 'all-or-nothing' approach, the materiality benefit gets lost. For example, if the IMA is being applied to all non-publicly-traded equities, it also must apply to all publicly-traded equities. Given that the materiality rule allows publicly-traded equities to be risk weighted at 100% prior to applying the 100% risk weight to non-publicly-traded equities, the regulators will expect that under the IMA no equity will have the 100% materiality risk weight applied.

If the above assumption is true, we propose that the IMA rules be amended to allow the use of the IMA to only those exposures that exceed the materiality threshold, even if these are only non-publicly-traded. The option should also be available to allow the use of the IMA for exposures that would otherwise have been classed as "material". This also means that the IMA rules will need to be amended to allow selective application of the IMA on equity exposures.

Question #58: IMA Floors

The agencies seek comment on the operational aspects of these floor calculations (for IMA Approach).

We do not agree with arbitrary floors if we are already applying a VaR approach to our equity portfolio. We do, however, agree to the application of the risk weight at the aggregate level rather than individually.

Question #59: Investment Funds

The agencies seek comment on the necessity and appropriateness of the separate treatment for equity exposures to investment funds and the three approaches in the proposed rule. The agencies also seek comment on the proposed definition of an investment fund.

We are in agreement with the different treatments of investment funds, especially the ability to apply different approaches to different funds. However, we feel that there should be more granular risk weight levels between 400% and 1250% (in Table L). The 1250% risk weight seems to be a simple catch-all for any exposures not addressed in the risk-weights 0% to 400%, in addition to including OTC derivatives.

Furthermore, clarification is needed on the need to omit hedge funds from these approaches. It is felt that treating them as securitizations is erroneous; they should be explicitly classed as investment funds.

Finally we believe that the 7% risk-weight floor should be applied at the aggregate level, not the fund level.

Question #60: Operational Risk

The agencies are interested in commenters' views on other business lines or event types in which highly predictable, routine losses have been observed.

Predictable losses occur in many areas of large enterprises (e.g., fraud in many businesses, not just credit card) and should not be limited to just those identified. Discretion should be allowed to identify and quantify the predictable nature of the losses and apply offsets where appropriate.

Question #61 & #62: Disclosure

Question #61

The agencies seek commenters' views on all of the elements proposed to be captured through the public disclosure requirements. In particular, the agencies seek comment on the extent to which the proposed disclosures balance providing market participants with sufficient information to appropriately assess the capital strength of individual institutions, fostering comparability from bank to bank, and reducing burden on the banks that are reporting the information.

Question #62

Comments on regulatory reporting issues may be submitted in response to this NPR as well as through the regulatory reporting request for comment noted above.

We believe that the disclosure requirements ought to be set solely by those agencies that safeguard the interests of investors (i.e. the SEC, FASB, and the rating agencies), not by regulators who have neither the responsibility nor the expertise to take on that role. Furthermore, such requirements seem unnecessary to us because, quite outside of Basel, the market will dictate those elements of bank risk management disclosure that are most necessary to improve transparency.