LaSalle Bank
ABN AMRO

LaSalle Bank Corporation
135 South LaSalle Street
Suite 325
Chicago, Illinois 60603
(312) 904-6873
Fax. (312) 904-5755
terry.bulger@abnamro.com

Terry Bulger
Executive Vice President
Chief Risk Officer

Risk Management Department

February 13, 2007

Office of the Comptroller of the Currency
250 E Street, SW., Mail Stop 1-5
Washington, DC 20219
(Docket No. 06-09 / RIN 1557-AC91)

Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
(RIN 3064-AC73)

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
(Docket No. R-1261)

Regulation Comments
Chief Counsel's Office, Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552, Attention: No. 2006-33
(RIN 1550-AB56)

Dear Sir or Madam:

Subject: Submission of comments on the Risk-Based Capital Standards: Advanced Capital Adequacy Framework, Notice of Proposed Rulemaking (NPR)

LaSalle Bank Corporation (LBC) is pleased to have the opportunity to comment on the Agencies' joint Notice of Proposed Rulemaking *"Risk Based Capital Standards: Advanced Capital Adequacy Framework and Market Risk; Proposed Rules and Notices"* (NPR). We have participated in a number of trade group comment letters and will therefore limit our comments here to a handful of questions/issues where LBC's status as a foreign owned, but U.S. licensed institution makes the differences between the NPR and the Basel Committee's November 2005 *"International Convergence of Capital Measurement and Capital Standards: A Revised Framework"* (International Accord) problematic. In general these differences will require LBC (as well as any other bank with a foreign parent and/or substantial foreign holdings) to spend an inordinate amount of time, money and resources building multiple (in our case U.S. and European) compliant risk management systems.

LBC and its parent, ABN AMRO Bank N.V. strongly support the concept of a more robust, risk-based approach to minimum regulatory capital for banks. However, the NPR includes a number of significant changes to the International Accord which represent substantive revisions of and divergences from an approach which was agreed to by the Basel Committee and is being implemented without significant deviations by all of the other members of the Basel Committee. These changes will:

- Undermine the comparability of regulatory capital requirements across different jurisdictions;
- Significantly increase the time, effort and cost of implementation;
- Risk interfering with sound business practices;
- Undermine the use test; and
- Reduce risk-sensitivity.

While we appreciate the Agencies' apparent concern about the capital numbers likely to be produced by a full implementation of the International Accord and the need for conservatism, we believe these concerns would be better dealt with through Pillar 2[1] of the International Accord.

Question 5: Comment on the use of capital floors to ensuring that overall capital objectives are achieved.

The series of capital floors in the NPR differ from the International Accord in several significant ways:

- There are three transition periods in the NPR versus two in the International Accord.
- The two International Accord transition periods are each one year long, the three U.S. transition periods are each <u>at least</u> one year long and may vary from bank to bank.
- The U.S. percentage floors during each transition period are higher than those in the International Accord.

[1] While we recognize that the NPR does not contemplate a formal adoption of Pillar 2 of the International Accord, the concepts and authority granted to regulators under Pillar 2 are already part of U.S. banking regulations.

- The NPR states that a 10% aggregate reduction in system wide minimum regulatory capital (absent the effect of the above transitional floors) will be viewed as prima facie evidence that the risk functions in the U.S. rules need to be reset to produce a less than 10% reduction (in effect, an aggregate system wide floor).
- The U.S. leverage ratio requirement remains in place.

While we again appreciate the Agencies' apparent concern that the minimum capital numbers produced by a full implementation of the new capital rules may be lower than they originally intended; the cumulative effect of the above floors largely negate the basic concept on which Basel II is based, risk sensitivity. The fact that these floors will only be applied to a handful of U.S. banks will put these banks at a competitive disadvantage vis-à-vis the rest of the world.

The lack of risk sensitivity in the leverage ratio will in certain circumstances cancel out the risk sensitivity of Basel II. A bank with a relatively low risk portfolio of assets will find its regulatory capital requirements dictated by the leverage ratio as opposed to the Basel II rules. Banks that invest in low-risk assets will be penalized for adopting a perfectly safe and sound strategy because the leverage ratio makes no distinction between high and low risk activities. This will in fact encourage those banks who find themselves constrained by the leverage ratio to acquire riskier assets until their regulatory risk-based capital and leverage capital requirements are equalized.

The 10% system wide trip-wire links the minimum capital requirements of all banks implementing Basel II in the U.S. such that a large decline at some of the banks could impact the capital rules for all. This holding of all U.S. based Basel II banks accountable for the actions of their peers runs contrary the basic principles of a free market economy, fair competition and the rights of a firm to make its own strategic decisions.

Furthermore, during strong economic periods as credit conditions improve, a drop in system-wide minimum required regulatory capital of 10% or more may well be appropriate (just as increases of 10% or more may be appropriate during weak economic periods). An arbitrary (reduction only) 10% system wide trip-wire (not part of the International Accord), which only applies to a handful of U.S. based banks will put these banks at a competitive disadvantage vis-à-vis the rest of the world.

Lastly, the leverage ratio, the 10% system wide trip-wire, the longer transitional period and the higher floors are not needed as the Agencies already have the ability to increase the minimum capital of any individual bank through existing supervisory rules. These added NPR provisions increase the complexity of the U.S. rules which will in turn significantly increase the time and cost of implementing Basel II, undermine the comparability of regulatory capital requirements across different jurisdictions, and reduce risk transparency.

Question 14: Comment on the proposed definition of default (wholesale).

The NPR definition of default is inconsistent with the International Accord.

NPR: A bank's wholesale obligor would be in default if, for any credit exposure of the bank to the obligor, the bank has:

- Placed the exposure on non-accrual status;
- Taken a full or partial charge-off or write-down on the exposure due to the distressed financial condition of the obligor; or
- Incurred a credit-related loss of 5% or more of the exposure's initial carrying value in connection with the sale of the exposure or the transfer of the exposure to the held-for-sale, available-for-sale, trading account, or other reporting category.

International Accord: A default is considered to have occurred with regard to a particular obligor when either or both of the two following events have taken place:

- The obligor is past due more than 90 days on any material credit obligation to the banking group.
- The bank considers that the obligor is unlikely to pay its credit obligations to the banking group in full, without recourse by the bank to actions such as realizing security (if held).

  Indications of an unlikeliness to pay include:

  - The bank puts the credit obligation on non-accrued status.
  - The bank makes a charge-off or account-specific provision resulting from a significant perceived decline in credit quality subsequent to the bank taking on the exposure.
  - The bank sells the credit obligation at a material credit-related economic loss.
  - The bank consents to a distressed restructuring of the credit obligation where this is likely to result in a diminished financial obligation caused by the material forgiveness, or postponement, of principal, interest or fees.
  - The bank has filed for the obligor's bankruptcy or a similar order in respect of the obligor's credit obligation to the banking group.
  - The obligor has sought or has been placed in bankruptcy or similar protection where this would avoid or delay repayment of the credit obligation to the banking group.

The gap that exists between the two definitions – an obligor who is unlikely to pay its credit obligations to the banking group in full, but because of the existence of sufficient collateral no charge-off is taken (an International Accord default, but not an NPR default) – will produce lower PDs (Probability of Default) and higher LGDs (Loss Given Default) in the U.S. While it is unclear which definition will produce the higher or lower capital requirement, it is clear that U.S. Basel II banks with overseas parents or subsidiaries will be forced to calculate and validate PDs, EADs (Exposure at Default) and LGDs under both definitions which will again significantly increase the time and cost of implementing Basel II, undermine the comparability of regulatory capital requirements across different jurisdictions, raise a whole host of 'use test' issues and reduce risk transparency.

Question 16: Comment on definitions of LGD and ELGD (Expected Loss Given Default).

As defined by the NPR, ELGD is plain economic loss given default, while LGD is loss given default in a downturn condition. The International Accord also defines LGD in the context of a downturn, stating that: "a bank must take into account the potential for the LGD of the facility to be higher than the default-weighted average during a period when credit losses are substantially higher than average". The International Accord further describes downturn LGD usage as "banks may use averages of loss severities observed during periods of high credit losses, forecasts based on appropriately conservative assumptions, or other similar methods."

The real difference between the two approaches is the formal requirement under the NPR that a bank define and track ELGD and the use of a mapping function to convert that ELGD to a LGD (LGD = 0.08 + 0.92 * ELGD). The mapping function creates an artificial floor on LGDs which translates into an additional capital cushion / burden for U.S. Basel II banks. The all or nothing requirement on using the mapping function effectively means U.S. Basel II banks will be subject to this burden for the foreseeable future (and potentially forever given the relatively low default nature of banks and municipalities which could conceivably never have enough default observations to validate downside LGDs).

While we appreciate the Agencies' concerns about the ability of banks to truly measure downturn LGDs given the lack of a meaningful broad based recession in the U.S. over the last decade, these concerns would be better dealt with on a bank by bank and portfolio by portfolio basis than this one size fits all solution. As with the definition of default, ELGD and the mapping function to LGD will significantly increase the time and cost of implementing Basel II, undermine the comparability of regulatory capital requirements across different jurisdictions, raise a whole host of 'use test' issues and reduce risk transparency. The mapping function itself will increase capital levels at all U.S. Basel II banks putting these banks at a competitive disadvantage vis-à-vis the rest of the world.

Question 25: Comment on the consistency of the proposed treatment of SMEs.

The elimination of the size function in the calculation of RWA (Risk Weighted Assets) on a SME (Small to Medium Enterprise) is yet another difference between the NPR and the International Accord. The difference will clearly increase capital levels (vis-à-vis the International Accord), but will also undermine the comparability of regulatory capital requirements across different jurisdictions and reduce risk transparency.

Question 29, 42, 43 & 44: Comment on the approach to guarantees on retail exposures.

Guarantees on retail exposures may include Credit Default Swaps (CDS), stand-by guarantees from Agencies or private parties and insurance contracts. The effect of the guarantee and the CDS are essentially to reduce the LGD of the exposure. These guarantees normally provide a commitment to pay at a pre-agreed upon condition of default. Effectively, substantial risk is transferred from the obligor to the guarantor. The International Accord recognizes credit risk mitigants like guarantees on individual obligations or a pool of exposures through either an adjustment of PD or LGD estimate such that the adjusted risk weight must not be less than that of a comparable direct exposure.

The NPR; 1) proposes to exclude tranched guarantees that apply only to an individual retail exposure from the securitization framework, thereby effectively allowing the recognition of recoveries from both the obligor and guarantor in the calculation of ELGD and LGD; 2) seeks to segregate retail guarantees by eligible and non-eligible, defining eligible guarantees as insurance contract (PMI). (i) For eligible guarantees the NPR proposes to adjust the ELGD and LGD for the segment to reflect recoveries from the guarantor. (ii) For non-eligible guarantees it proposes to desegment the guaranteed portion of the portfolio and apply wholesale treatment. The NPR proposals are all similar in nature with the end result of LGD substitution. The proposal could qualify retail guarantees and apply an LGD substitution for all retail exposures that are guaranteed.

The International Accord does not impose any restriction on eligible guarantors but advises Bank's to have clear policies on guarantors, the International Accord allows LGD substitution only to those banks' that are allowed to use own estimates of LGD, and, the International Accord allows PD or LGD substitution for an individual obligation or a pool.

LaSalle Bank Corporation
Member of the ABN AMRO Group

The proposed divergent treatment of guarantees for retail exposures by the NPR may cause Banks to treat guarantees in disparate ways. These varied treatment of guarantees increase the complexity of the U.S. rules which will in turn significantly increase the time and cost of implementing Basel II, undermine the comparability of regulatory capital requirements across different jurisdictions, and reduce risk transparency.

NPR calculation of capital for defaulted assets differs from International Accord.

In addition to answering a number of the questions included in the NPR, we would also like to discuss the difference in calculation in the NPR of capital for defaulted assets, compared to the International Accord.

The NPR proposes that the dollar risk-based capital for defaulted retail segments equal 0.08 multiplied by the EAD of the segment. The International Accord prescribes that the capital requirement for defaulted assets be equal to the greater of zero and the difference between the individual exposures LGD and the bank's best estimate of expected loss. Best Estimate of Expected Loss should not be less than the sum of provisions and charge-off.

The proposed methodology under the NPR would disadvantage banks as they would hold capital for loans that are in default, which they have already provided for under the loan loss calculation as directed under FAS114 of US GAAP. This would result in capital depletion as current earnings to be transferred to retained earnings would be lower as a result of provisions and capital would also be restrained by application of the NPR rules.

Thank you again for the opportunity to provide these comments. Should you wish to discuss this material further, please contact me directly, or Paul Widuch at (312) 904-6445.

Sincerely,

Terry Bulger
Executive Vice President
Chief Risk Officer