THE FINANCIAL SERVICES ROUNDTABLE

1001 PENNSYLVANIA AVE., NW
SUITE 500 SOUTH
WASHINGTON, DC 20004
TEL 202-289-4322
FAX 202-628-2507

E-Mail rich@fsround.org
www.fsround.org

RICHARD M. WHITING
EXECUTIVE DIRECTOR
AND GENERAL COUNSEL

Communications Division
Public Information Room, Mail Stop 1-5
Office of the Comptroller of the Currency
250 E Street, S.W.
Washington, DC 20219
Attn: Docket number 05-16

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, N.W.
Washington, DC 20552
Attn: No. 2005-40

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal
Reserve System
20th Street and Constitution Ave., N.W.
Washington, DC 20551
Attn: Docket No. R-1238

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corp.
550 17th Street, N.W.
Washington, DC 20429
Attn: Comments/Legal ESS
RIN 3064-AC-96

Re: Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance; Domestic Capital Modifications

Dear Sir or Madam:

The Financial Services Roundtable[1] (the "Roundtable") appreciates the opportunity to comment on the joint Advanced Notice of Proposed Rulemaking (ANPR) published on October 20, 2005.[2] The joint ANPR was issued by the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and the Office of Thrift Supervision (the "Federal banking agencies") as the first step in the process of developing a revised Basel I capital framework that will be applicable to banking organizations that will not be subject to the Basel II standards ("Basel I-A").

I. Background

[1] The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, investment products and services to the American consumer. Roundtable member companies provide fuel for America's economic engine accounting directly for $18.3 trillion in managed assets, $678 billion in revenue, and 2.1 million jobs.

[2] 70 Federal Register 61068 (October 20, 2005).

In 1989, the Federal banking agencies implemented a risk-based capital framework for banking organizations based on an international agreement reached by members of the Basel Committee on Banking Supervision in 1988. This "Basel Capital Accord" established a uniform regulatory capital system for both foreign and domestic banking organizations. The Capital Accord adjusted capital levels based on the perceived risk of certain broad categories of banking assets. While this system was an improvement over the prior capital standards, it only provides a crude measure of credit risk, and the framework does not, for example, differentiate between the credit-worthiness of different counterparties within the same broad asset classification. The original Accord also does not take into account various methods of risk mitigation that have been developed since 1988, and to some extent encourages banking organizations to securitize their best assets and retain riskier assets on their books.

In light of these shortcomings, the Basel Committee proposed a new Capital Accord in June 1999, and after extensive public comment, a new agreement among the international banking regulators and central banks was reached on June 26, 2004. The Basel II proposal significantly increases the risk sensitivity of the capital standards by incorporating the use of modern risk measurement techniques to more accurately determine the risk of particular bank assets, provide capital credit for risk mitigation strategies, and more precisely adjusts capital requirements to the actual risk presented by a banking organization's assets and activities. The Roundtable applauds the agencies in this endeavor and agrees that the Basel II framework will more accurately measure risk and adjust capital requirements accordingly. Implementation of the new standards will enhance safety and soundness by encouraging banking organizations to utilize better risk management techniques, and by providing incentives for banking organizations to retain their best assets and securitize riskier assets.

The joint ANPR seeks to mitigate the concern that banking organizations subject to the Basel II framework will have a competitive advantage over non-Basel II banks, and that Basel II will lead to further consolidation of the banking industry. The ANPR issued by the Federal banking agencies on October 20, 2005 also proposes adjustments in the Basel I standards that are intended to make this framework more risk sensitive, but without the regulatory burdens that will be required under Basel II.

II. Summary Comments

The ANPR contains many useful proposals that will significantly improve the current Basel I capital standards. However, some of the proposals could be further enhanced to improve the correlation between risk and capital, to reduce regulatory burden, and to lessen competitive concerns inherent in a two-system approach to capital. For example, while much of the proposal is very similar to the Standardized approach found in Basel II, it applies a higher risk weight or additional requirements for certain assets than would be applicable under the Standardized methodology.[3] A better

[3] Compare the Standardized approach and the Basel I-A proposal with respect to loans with the same external ratings.

alignment between the proposal and the Standardized approach would improve the risk sensitivity of the proposal and assist in mitigating potential competitive issues that could arise when Basel II is fully implemented.[4]

While most of the data required to implement the proposal is currently collected by banks, access to that data in the manner required under the proposal may not be possible under current capabilities. Thus, extensive investments in new information systems could be required under the proposed changes, and in some instances, new information systems would have to be developed.

Under Basel II, banking organizations will be required for the first several years to compute their capital under the existing standard as well as under the Basel II framework. The amount of capital reduction that will be permitted under Basel II will be limited to a percentage of the existing requirement (the "floor"). The Roundtable urges that Basel II institutions not be required to use the Basel I-A standards in computing the floor. Such a mandate would result in these internationally active institutions having to complete three capital calculations: Basel II, Basel I-A in the United States, and Basel I for use abroad. This will create an expensive regulatory burden with little or no benefit. Instead, Basel II institutions should be given the option of using either Basel I or Basel I-A when computing the floor, thereby providing flexibility and reducing regulatory burden.

The remainder of this comment letter will elaborate on these points and also discuss in more detail all of our recommendations with respect to the ANPR.

III. Recommendations

A. Increase the Number of Risk Weight Baskets

The ANPR suggests increasing the number of risk weight baskets from five to nine, by adding new baskets of 35, 75, 150, and 350 percent. The Roundtable believes that additional risk weight baskets would make the current capital framework even more risk sensitive, and would be an improvement. However, whether or not this proposal will be beneficial depends on the risk weights to be assigned to specific types of assets. Thus, while in the abstract the addition of new risk weight baskets appears to be an improvement, it cannot be evaluated until further details are provided. In addition, the Roundtable suggests that risk sensitivity would be improved by adding a ten percent risk weight in recognition that some assets have very little credit risk. It is also important that the agencies assign weight baskets based on the true economic risk of that asset, and not based on a desire to incent or disincent a particular type of lending activity for social or other purposes. We also suggest removing the 350 percent risk weight basket. A 350 percent basket would result in an inappropriately high capital charge for prudently underwritten banking assets. If a particular asset poses unusually high risks, those risks

[4] Additionally, in some cases the proposal appears to use capital as a tool to discourage certain banking activities, such as nontraditional mortgage lending that would better be addressed through supervisory guidance.

are more appropriately controlled through the bank's risk management systems and if necessary, supervisory constraints, and not through capital standards.

B. Use of External Credit Ratings

Currently, the Basel I framework provides capital relief for certain assets, such as direct credit substitutes and asset-backed securities, if the asset has received the highest or next highest investment grade rating from a nationally recognized statistical rating organization (NRSRO). The ANPR suggests extending this treatment for other assets, such as corporate debt, and assigning a risk weight of between 20 percent and 350 percent depending on the external rating.

The Roundtable believes that an external rating of investment grade or better is a good indication that the asset has significantly lower than average credit risk, and that this fact should be recognized in the capital standards.[5] However, the proposal would also impose a capital penalty for assets that receive a below investment grade rating, despite the fact that such assets may have less credit risk than unrated positions. This creates an inconsistency with the overall goal of the ANPR to make the capital standards more risk sensitive. It would have the perverse effect of rewarding the flow of bank capital to unrated positions at the expense of rated positions that are below investment grade. Bank customers would have an incentive to abstain from obtaining external ratings. We therefore recommend that the agencies delete the punitive capital charges for below investment grade positions.

The proposal currently does not require more than one external rating, and the Roundtable urges that this requirement not be expanded to require additional ratings. Requiring more than one rating would be costly, increase regulatory burden, and significantly limit the benefit of the proposal.

The Roundtable also suggests that the proposal be clarified to assure that the capital treatment will be based on the external rating of the particular asset, or the external rating of the counter-party if the asset is not separately rated.

Finally, the requirement to use the lowest rating for exposures with more than one rating is burdensome and should be reconsidered. Consistent with the Basel II approach, banks should be able to rely on the rating of one of the nationally recognized statistical rating organizations.

C. Financial Collateral and Guarantors

[5] The Roundtable is concerned that this proposal would have only limited benefit for most commercial loan exposures since the counter-parties typically will not have an external rating, and the cost of obtaining such a rating would be prohibitive. Another approach that we support is to allow institutions to utilize other factors to rate these credits, provided these factors are consistent with risk. An alternative that might be especially beneficial to smaller institutions would be to assign a risk weight based on the historic loss experience for each business segment, e.g., loans to automobile dealers, loans to fast food restaurants, etc.

The Basel I framework currently provides beneficial capital treatment if an asset is collateralized or guaranteed by cash, U.S. or OECD Government securities, and similar Government related instruments. The ANPR proposes to expand the types of collateral that will be recognized for capital purposes to include externally rated debt and asset-backed securities and non-OECD Government obligations that have an investment grade rating. Guarantors will also be recognized if their long-term senior debt has an investment grade rating.

The Roundtable supports this proposal and believes that it would further the goal of making the new capital standard more risk sensitive. Also, we agree with the need for the banking organization to have systems to track and monitor collateral and readily determine its value. However, the regulation should recognize that individual banking organizations have developed different techniques for tracking and monitoring collateral, and the regulation should minimize regulatory burden by permitting individual institutions to continue to use such techniques, and not mandate new uniform collateral tracking and monitoring procedures.

The Roundtable also believes that non-financial collateral provides credit enhancement over unsecured loans, and that a risk sensitive capital framework should recognize the benefits of this collateral, regardless of the ratings of the borrower.

D. Residential Mortgage Loans

1. First Lien Residential Mortgage Loans

First lien residential mortgage loans currently are assigned to a 50 percent risk weight basket. The ANPR acknowledges that this "one size fits all" approach does not adequately assess the credit risks posed by such loans. Instead, the ANPR proposes to assign a risk-weight to first lien mortgage loans based either on the loan-to-value (LTV) ratio of the loan, or a combination of both the LTV and the credit-worthiness of the borrower, determined by credit rating, debt-to-income ratio, or other measure of credit quality. First lien mortgages loans would then be assigned a risk weight basket of between 20 and 100 percent.

The Roundtable agrees that the current capital treatment of prudently underwritten mortgage loans is in urgent need of refinement. These loans have historically low rates of default and result in low losses when defaults do occur. Banking organizations subject to the Basel II framework estimate that these loans have a less than 1 percent probability of default, and that the loss given a default would be less than 15 percent of the exposure.[6] As a result, under Basel II the tier 1 capital requirement for a first mortgage loan with an LTV ratio of 80 percent could be as low as 29 basis points, and the tier 1

[6] Fitch Ratings, Special Report: Demystifying Basel II: A Closer Look at the IRB Measures and Disclosure Framework 13 (August 25, 2004).

capital charge for a mortgage loan with an LTV ratio of 70 percent could be as low as 12 basis points.[7]

The ANPR proposes first mortgage liens with an LTV ratio of 70 percent be placed in the 20 percent risk weight basket, and mortgage loans with an LTV of 80 percent be placed in the 35 percent risk weight basket. Compared to the capital charge that would likely be required under Basel II, these risk weights appear to be much too high. Instead, the Roundtable suggests that prudently underwritten first mortgage liens should be assigned the 20 percent risk weight basket. Prudently underwritten mortgage loans that have a LTV ratio of 70 percent or less should be assigned to the 10 percent risk weight basket. These modifications would much more reasonably reflect the credit risk of these assets, and would better ameliorate the concerns raised by non-Basel II institutions regarding competitive equality.

The option of linking the capital charge to both the LTV ratio <u>and</u> credit-worthiness of the borrower is problematic and unnecessary in light of the current real estate underwriting guidelines and loss history for these loans. It would add considerable regulatory burden and in particular paperwork burden.[8] Further, it would create a disincentive for banking organizations to provide mortgages to <u>all</u> creditworthy borrowers in the population, and would also motivate lending institutions to increase mortgage rates for borrowers with lower credit scores to compensate for the higher capital charge. This rate would be over and above the rate necessary to compensate the lending institution for the actual risk posed by the loan.

2. <u>Private Mortgage Insurance</u>

The ANPR suggests that the LTV ratios would be computed after taking into account private mortgage insurance (PMI) provided by an insurance company with a long-term credit rating of "A" or higher. However, PMI would not be considered unless it was issued on an individual loan basis, and pool or portfolio coverage would not result in any capital benefit. In addition, if there were any responsibility for the lender to absorb a first loss before the PMI obligation is triggered, the PMI would not be recognized.

The Roundtable supports the recognition of PMI as a valuable enhancement that reduces risk to lenders. However, we believe that PMI provides credit protection whether written on an individual loan basis or on a pool or portfolio basis, and therefore recommend that such coverage be considered when developing a more risk sensitive capital standard. Further, PMI also reduces risk to a lending organization even if the lender must absorb a first loss. Rather than disregard such protection altogether, the

---

[7] Calem and Follain, Proposed Competitive Impacts of Basel II in the U.S. market for Residential Mortgages, Statement Before the House Subcommittee on Financial Institutions and Consumer Credit (May 11, 2005).

[8] The regulatory and paperwork burden would be mitigated somewhat by using a debt-to-income ratio rather than a credit score, and this standard would more accurately reflect the credit risk of the asset since current income is the primary source of repayment.

Roundtable suggests that the first loss be treated in the same manner as low-level recourse positions, and that if the banking organization holds appropriate capital against that first loss position, the benefits provided by PMI should be recognized for more senior positions.

3. Non-Traditional Mortgage Products

The ANPR solicits comments on non-traditional mortgages, such as loans with an LTV in excess of 100 percent, or with a negative amortization feature. The ANPR specifically asks if these products should be dealt with in the general mortgage matrix, or if they warrant a higher capital treatment. The Roundtable believes that these loans can raise safety and soundness concerns if not properly underwritten. On the other hand, these loans are often very appropriate products that are consistent with safety and soundness and provide a useful and popular financing option for many consumers.

To the extent that non-traditional mortgages raise safety and soundness concerns, we believe that this concern should be addressed through the supervisory process, and not by the "blunt instrument" of an excessive capital charge. Supervisory guidance can identify best practices for lending organizations to follow as well as practices to avoid. Liquidity will not be unnecessarily cutoff to borrowers seeking these products, and banking organizations will continue to innovate. If non-traditional loans are instead subject to a punitive capital charge, those lenders continuing in this line of business (it is likely that some lenders will decide to cease offering these products due to their increased capital costs) will be encouraged to make riskier loans in order to earn the higher fees and interest rates necessary to offset the higher capital charge. Instead of remediating the risks presented by non-traditional products, the increased capital requirement would motivate lenders offering these products to take greater risks. We therefore recommend that the Federal banking agencies subject non-traditional mortgage loans to the same matrix as other mortgage loans, and address any concerns through the normal supervisory process.

4. Second Liens and Credit Lines

The ANPR proposes increasing the risk weight basket for second mortgage liens and home equity lines of credit if the combined LTV ratio of the first lien and second lien (or line of credit) exceeds 90 percent. Under the proposal, the risk weight for such loans would be set in excess of 100 percent. The Roundtable believes that this proposal is not consistent with the risk posed by such loans when prudently underwritten, and notes that unsecured loans and lines of credit are generally risk weighted at 100 percent. It would be illogical to impose a higher risk weight for secured loans than for unsecured loans.[9] To the extent that the Federal banking agencies have concerns with underwriting practices used when extending second liens and lines of credit, the Roundtable urges that

[9] The Basel II Accord provides that no transaction in which a credit risk mitigation technique is used, such as collateralization, should receive a higher capital charge than would otherwise be imposed on that transaction without the credit risk mitigation technique. Basel II Accord ¶ 113.

these concerns also be dealt with through the supervisory process rather than imposing higher capital charges.

E. Other Retail Exposures

The ANPR requests comments on whether other retail exposures, such as consumer loans, credit cards, and automobile loans should be assigned risk weights based on the risk posed by the asset. Risk could be determined by reference to the credit score of the borrower, LTV ratio, or similar standard.

The Roundtable strongly believes that it is critical to narrow the differences in capital treatment for these exposures between the Basel II and non-Basel II institutions. This proposal could result in improved risk sensitivity, but could also create regulatory and paperwork burdens. Permitting banking organizations to elect one of several risk measures rather than mandating one particular measure would significantly reduce the regulatory burden. Under this scenario, a bank could choose to use objectively verifiable credit scores (such as FICO scores), LTV ratios or another factor, such as debt- to-income ratios, as a measure of risk, as long as the institution uses the same standard for all of its "other retail" exposures.[10] Another option would be to use the Standardized approach, which would assign these retail exposures to a 75 percent risk weight basket. In any event, we encourage the agencies to apply any change in this area to pools or portfolios of loans and not on a loan-by-loan basis, and to limit the paperwork and data collection requirements to LTV ratios.

F. Short-Term Commitments

Under the current standard, banking organizations are not required to hold capital against short-term commitments with a duration of less than one year. Longer-term commitments are converted to on-balance sheet items using a 50 percent conversion factor. The ANPR proposes either a 10 percent conversion factor for short-term commitments, or alternatively, imposes a 20 percent conversion factor for both long- and short-term commitments. The Roundtable agrees that short-term commitments carry a credit risk for which capital should be charged, unless the commitments are cancelable at any time by the banking organization, or automatically cancelable if there is a deterioration of the counter-party's credit-worthiness. In particular, the Roundtable supports the proposal to use a 10 percent conversion factor for short-term commitments, and to retain the 50 percent conversion factor for longer-term commitments. However, the Roundtable also believes that the criteria for determining if a commitment is short-term or long-term is the remaining life of that commitment, and not the original maturity.

G. Loans 90 Days Past Due or in Nonaccrual Status

The Roundtable supports assigning loans that are 90 days past due or in nonaccrual status to a 150 percent risk weight basket.

---

[10] This would also alleviate the concern that some of the proposed measures would not be applicable to all categories of "other retail." For example, LTV ratios are not applicable to credit card loans.

H. Commercial Real Estate

The Basel I framework assigns commercial real estate ("CRE") loans to the 100 percent risk weight basket. The ANPR would assign these loans to a higher risk-weight basket, unless the loan satisfies the prudential real estate lending guidelines and the loan is supported by a substantial equity investment by the borrower, such as 15 percent of the completion value.

The Roundtable notes that while commercial real estate lending has experienced cyclical difficulties, it is historically less risky than other types of commercial lending. In fact, a recent FDIC review of commercial real estate lending in the Atlanta Metropolitan Statistical Area found that insured institutions' risk controls and monitoring of commercial real estate loans have improved considerably since the downturn in the 1990s, and that "overall, bank management has implemented more effective grading systems, improved control and approval limits, and adequate loan review procedures."[11] The study also found that "financial reporting limitations may have contributed at times to overly negative assessments of the potential risks of CRE lending."[12] Similarly, a 2005 study by the Federal Reserve Bank of Philadelphia found that that with respect to CRE lending: "current real estate underwriting and risk management practices are considered to be materially better than in the late 1980s and early 1990s, and there is presently no evidence of emerging systemic problems in the banking sector."[13]

To the extent that the Federal banking agencies have concerns that certain banking organizations have excessive concentrations of CRE loans, or are extending credit to this sector in an unsafe manner, these concerns should be addressed through the supervisory process and not through capital standards. Imposing higher capital charges to address supervisory issues will unnecessarily restrict credit to this important segment of our economy, and could have the counter-productive effect of encouraging lenders to go further out on the risk curve in order to earn the additional fees and interest charges necessary to compensate for the higher capital charge. We therefore recommend that these loans continue to be assigned to the 100 percent risk weight basket. If, however, the agencies decide to assign these loans or a subset of these loans to a different basket, the changes should be applied on a pool or portfolio basis and not on a loan-by-loan basis.

We further note that under the Standardized approach, commercial real estate loans that have lower risk characteristics may receive a preferential risk weight. This approach should also be adopted in order to recognize the reduced risk of these exposures.

---

[11] FDIC Supervisory Insights, " Assessing Commercial Real Estate Portfolio Risk" (Summer 2004).

[12] Id.

[13] Federal Reserve Bank of Philadelphia, SRC Insights, "SVP Commentary on Top Commercial Real Estate Trends." (Second Quarter 2005). The study noted that there were poorly managed CRE concentrations in some institutions, and that bank supervisors should monitor CRE lending carefully.

I. Small Business Loans

The ANPR suggests improving the risk sensitivity to small business loans by lowering the risk weight basket for these assets, but only if the banking organization has less than $1 million in aggregate business loan exposure to the counter-party. The ANPR also asks if further limitations should be imposed. For example, only permitting small business loans to be assigned to the lower risk weight basket if they are fully performing and will be fully amortized within seven years. Another possibility is to limit the capital benefit to small business loans that are fully protected by collateral, or to require that the small business loan be personally guaranteed by one of the principals of the small business provided the individual has a prescribed credit rating.

The Roundtable supports this proposal and believes that it would make the capital charge for small business loans more commensurate with the risk of these loans. However, the Roundtable believes that the $1 million aggregate cap is unduly restrictive and should be reconsidered.[14] The Roundtable also notes that some of the proposed caveats would significantly limit the scope of this proposal to relatively few loans, or would impose significant paperwork burdens that could well offset any capital relief. The Roundtable therefore urges that the requirements for full collateralization, seven-year amortization, and personal guarantees not be included in the proposed regulation.[15]

J. Early Amortization

Credit card receivables and other revolving credits that are sold into a securitization structure are no longer on the balance sheet of the originating bank, and currently are not subject to a capital charge. As part of the securitization process for revolving credits, the originating bank will retain an on-balance sheet asset, the "seller's interest," that is necessary to permit public investors to receive regular and predicable payments during the life of the securitization. The bank, of course, holds capital for this on-balance sheet asset.

The ANPR raises the concern that the originating lender may be exposed to various risks in a securitization for which no capital is currently required. In particular, the ANPR focuses on the fact that many securitization programs provide for the "uncontrolled early amortization" of the arrangement if the securitization runs into trouble, usually indicated by a decrease in the "excess spread" to a predetermined level.[16]

---

[14] Under Basel II, loans to a small business that aggregate one million euro (approximately $1.2 million) or less may be treated as "retail" exposures. Loans in excess of this amount would be treated as a commercial loan and receive a capital charge based on the Basel II computation of risk. This treatment of larger loans is not available for banks that are not subject to the Basel II framework. Increasing the size limit for small business loans would help alleviate this disparity.

[15] To the extent that a collateralization requirement is retained, it would be important to define with specificity the phrase "full protection of collateral."

[16] The "excess spread" is an account funded by interest payments that are in excess of the amount needed to pay investors. The excess spread account serves as a buffer to provide a source of funds when

These early amortization provisions usually result in subordinating the payment of the seller's interest to that of the investors' interest, so that the investing public will be more likely to be made whole and it will be more likely that any losses will be absorbed by the originating lender. The ANPR also notes that an early amortization event could result in limiting the originating lender's ability to obtain liquidity, and this would increase the likelihood that the banking organization would attempt to prop up a troubled securitization.

In light of these concerns, the ANPR proposes to assess a capital charge against business and personal credit card receivables (and possibly other revolving assets) that are sold into a securitization pool that have early amortization features. One approach would be to convert 10 percent of these off-balance sheet assets to on-balance sheet assets. A more complicated approach would be to assess a capital charge on these off-balance assets based on the level of "excess spread" in the securitization structure. As the level of excess spread approaches the point when an early amortization would be triggered, a higher and higher percent of the off-balance sheet assets would be converted to on-balance sheet assets.

The Roundtable opposes the imposition of a flat 10 percent conversion factor for off-balance sheet interests in revolving asset securitizations. Such a flat charge would not further a risk sensitive capital approach, and would not encourage banking organizations to take steps to mitigate the risks that such securitizations may present. In fact, in light of the very infrequent occurrence of early amortization events, the Roundtable questions the need to impose any capital charge against these off-balance sheet assets.

However, if the agencies decide to go forward with this proposal, the Roundtable urges that the charge be made as risk sensitive as possible by correlating the charge to an objective measure of risk, such as the level of the spread account. Furthermore, the Federal banking agencies should also take into account measures that banking organizations may take to mitigate risks, including the development of liquidity plans to ensure the banking organization has alternative sources of funding in the event of an early amortization, the credit quality of the assets, and third party commitments and guarantees. The Roundtable also urges the agencies to consider the competitive affects that such capital charges may have when imposed on non-Basel II institutions that will not be permitted to use the advanced approaches for determining required capital.[17]

K. Application of Basel I-A

---

cardholder payments are insufficient, in any particular month, to make all required payments to security holders.

[17] The proposal could be improved in this regard by making the risk weight charges based on excess spread consistent with the risk weights proposed in the Basel II Standardized approach.

The ANPR asks if an asset size threshold should be adopted below which banking organizations will be permitted to use the existing Basel I framework without modification. The ANPR also asks if banking organizations should be permitted to choose among alternative approaches for some of the modifications to the existing capital rules that may be proposed.

The Roundtable believes that regulatory burden will be reduced if banking organizations have flexibility with respect to adopting and using the new capital framework. For many institutions, the existing Basel I standard provides a prudent level of capital, and the regulatory and paperwork burden of adopting a new standard, even though it would result in lower capital, is not an efficient use of the institution's funds. The Roundtable thus believes that rather than establishing a size threshold, the agencies should permit all non-Basel II institutions the option of using the existing Basel I framework or the proposed Basel I-A.[18]

L. Floor

Under Basel II, banking organizations will be required to compute their capital charge under the existing standard and under the Basel II standard. The amount of capital reduction that is permitted under Basel II will be limited to a percentage of the existing requirement, a so-called "floor." The ANPR asks if the floor should be based on the existing Basel I framework or the new Basel I-A standard.

The Roundtable strongly objects to a mandatory requirement that Basel II institutions be required to compute capital under the Basel I-A framework. The Basel II standard is applicable to large and internationally active banking organizations. These companies currently compute capital charges on their international assets under Basel I, and will soon be required to make this computation under Basel II. Requiring these companies to make a third calculation, under Basel I-A (which will only be applicable in the United States) would create an expensive regulatory burden with little or no benefit. This problem is further exacerbated by the fact that the floor is likely to be temporary, and thus the cost of developing systems to complete a Basel I-A computation would have to be quickly amortized as the systems themselves would only be used for a few years. Additional burden would also be created by imposing new information that would be required to be included in financial and call reports.

Rather than require Basel II banking organizations to engage in this costly exercise, the Roundtable believes that these institutions be given the option of using the Basel I or Basel I-A framework when computing the floor, thus providing flexibility and reducing regulatory burden. Additionally, the Roundtable urges that Basel II banking organizations be given the option of using Basel I or Basel I-A standards when computing capital requirements for assets that will be exempt from the Basel II framework.

---

[18] If a size threshold is established, it would be important to also consider whether the bank is part of a multi-bank holding company, as well as the number and location of markets in which the bank is doing business, and the range of products offered by the bank.

The Roundtable appreciates the opportunity to comment on the joint ANPR and supports your efforts to provide for a more risk sensitive capital framework and a reduced regulatory and paperwork burden for our financial institutions. If you have any questions please contact me at the Roundtable (202 589-2413).

Sincerely,

Richard M. Whiting

Richard M. Whiting
Executive Director and General Counsel.