

INSTITUTE OF INTERNATIONAL BANKERS

299 PARK AVENUE, 17TH FLOOR, NEW YORK, N.Y. 10171
TELEPHONE: (212) 421-1611 FACSIMILE: (212) 421-1119
HTTP://WWW.IIB.ORG

LAWRENCE R. UHLICK
EXECUTIVE DIRECTOR AND GENERAL COUNSEL
DIRECT E-MAIL: LUHLICK@IIB.ORG

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Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve
System
20th Street & Constitution Avenue, NW
Washington, DC 20551
regs.comments@federalreserve.com

Office of the Comptroller of the Currency
250 E Street, SW
Public Information Room, Mailstop 1-5
Washington, DC 20219
regs.comments@occ.treas.gov

Robert E. Feldman
Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
comments@fdic.gov

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
regs.comments@ots.treas.gov

Re: Joint Advance Notice of Proposed Rulemaking: Possible
Modifications To Risk-Based Capital Guidelines (Docket
Nos. R-1238 (Federal Reserve Board), 05-16 (OCC), 2005-40 (OTS))

Ladies and Gentlemen:

The Institute of International Bankers (the "Institute") appreciates this opportunity to comment on the advance notice of proposed rulemaking (the "ANPR") published by the U.S. federal banking agencies relating to their consideration of various possible revisions to their existing Basel I risk-based capital standards that would facilitate development of fuller proposals for what is known as Basel I-A. The Institute represents internationally headquartered banking/financial institutions that conduct banking operations in the United States through branches, agencies, commercial lending company subsidiaries, Edge corporations and/or U.S. bank subsidiaries.

The Institute commends the decision by the U.S. banking agencies to solicit public comments early in the rulemaking process on all aspects of the ANPR, including as to the possibility of permitting some banking organizations to elect to continue to use the existing Basel I risk-based capital framework. As we indicated in our November 3, 2003 comments on the Basel II implementation ANPR, we are appreciative of the transparency that has

The Institute's mission is to help resolve the many special legislative, regulatory and tax issues confronting **internationally headquartered** financial institutions that engage in banking, securities and/or insurance activities in the United States.

INSTITUTE OF INTERNATIONAL BANKERS

characterized the agencies' implementation efforts and the ongoing dialogue between the industry and bank supervisory authorities regarding Basel II. One of the core principles underlying Basel I and Basel II is the importance of having harmonized capital standards for internationally active banking institutions. We applaud the efforts underway among banking regulators globally to improve cross-border coordination. Only through coordination and harmonization can the heavy burden and expense of duplicative systems be avoided.

Application of Basel I-A to International Banks with U.S. Bank Subsidiaries

The ANPR recognizes that some banking organizations may prefer to remain under the existing risk-based capital framework without revision and, moreover, indicates that the agencies are considering the possibility of permitting some banking organizations to elect to continue use of the existing system. In addition to contemplating the availability of such an election for smaller banks, we believe that the agencies should similarly consider such an election for U.S. bank subsidiaries of international banks that are subject to implementation of Basel II on a global basis.

International banks are undertaking very substantial system modifications globally in preparation for the full implementation of Basel II by the end of 2007. This is, of course, a massive undertaking requiring an enormous commitment of economic resources and personnel over a sustained period continuing beyond initial implementation in order to convert their existing databases, models, and other operational and capital compliance systems to conform to their home country implementation of the requirements of Basel II. These conversions must be implemented on a consolidated global basis by international banks and therefore directly affect the operations and systems of their U.S. subsidiary banks. Under these circumstances, we believe that international banks with U.S. bank subsidiaries should not be obligated to make new and different modifications to their existing systems for compliance with Basel I guidelines in the United States.

Many international banks are concerned that the possible modifications to the existing Basel I framework under consideration for U.S. banks as reflected in the ANPR could impose additional and duplicative burdens on their U.S. bank subsidiaries that would be excessive and counter-productive, particularly during this period of extensive conversion of operations. For example, many U.S. subsidiaries of international banks do not collect data in the categories that would be necessary for application of Basel I-A as proposed in the ANPR and any such system modifications would be extremely difficult given the different and extensive system modifications that they are already required to undertake as part of their global Basel II compliance. We therefore urge simplification and flexibility in the standards for Basel I-A to reduce or eliminate any need to change existing data systems to meet their requirements, so that it could be a more practical alternative (assuming our request that it be elective is accepted) for possible implementation by U.S. bank subsidiaries of international banks already burdened with extensive Basel II system changes.

This exposure of international banks to the burdens of duplicative system modifications as a result of the ANPR would be unlike that of other institutions. As far as we are aware, no country under the Basel framework other than the United States plans to implement Basel II only for some institutions and retain Basel I for others. U.S. banks will be subject either to Basel II if they are internationally active large institutions (or elect to apply Basel II voluntarily) or

INSTITUTE OF INTERNATIONAL BANKERS

otherwise would be subject to Basel I or Basel I-A. This would pose a serious burden, for example, for international banks headquartered in the European Union (EU), all of which are subject to the new Basel II-based EU-Capital Adequacy Directive (CAD). The provisions of the EU-CAD allow international banks headquartered in the EU to choose from the Basel II-menu of available options the most suitable approach to calculate their required regulatory capital in compliance with their home country requirements for consolidated global supervision purposes. As a result, these methodologies will also apply to the U.S. subsidiaries of the international banks headquartered in the EU in computing global consolidated capital requirements.

While certain U.S. bank subsidiaries of international banks may be able to integrate a second contemporaneous system conversion into their global implementation of Basel II, and may prefer to do so to better reflect risk factors applicable to their business, for others the added burden of developing a second set of different new systems to address possible Basel I-A would be extremely onerous. Indeed, for many institutions the same personnel would be necessary to undertake any Basel I-A modifications as are already necessary and committed to the implementation of Basel II in compliance with the home country requirements of their consolidated global supervisor.

For all of these reasons, we urge that any implementation of Basel I-A be elective as regards U.S. bank subsidiaries of international banks that are subject to Basel II implementation globally. No other institutions would be subject to both Basel II and to Basel I-A, and making Basel I-A permissive rather than obligatory will help assure that it does not result in any unreasonable burdens for such subsidiaries. This will permit international banks to take into account the benefits of enhanced risk-factor elements that would result from the proposed modifications in the context of their existing burden of developing systems to comply with home country Basel II in determining whether to undertake the additional burden of developing the different data systems that would be necessary to implement Basel I-A in their U.S. bank subsidiaries.

Moreover, as we expressed in our November 3, 2003 comment, we believe that international banks that implement home country Basel II standards globally with host country coordination should be permitted to utilize these Basel II standards for capital compliance also in their U.S. bank subsidiaries no later than when domestic U.S. banks begin to utilize Basel II. We expect that a number of international banks may seek to apply the advanced methodology Basel II standards for determining capital compliance of their U.S. bank subsidiaries once that is permissible.

The Financial Services Authority (“FSA”) has provided specific guidance for the use of non-EEA regulators’ requirements for group capital calculations addressing the implications of the U.S. delay in Basel II implementation and the non-equivalence of Basel I for inclusion in Basel II calculations. The FSA guidance permits U.S. banking groups with U.K. subsidiary banks to apply to use advanced U.S. Basel II approaches in the U.K. and expresses readiness to collaborate with U.S. home country regulators on waiver applications and not to duplicate their work. We understand that U.S. banking regulators of U.S. bank subsidiaries of international banks have expressed their intention to accord deference to home country Basel II capital standards and urge that they similarly permit utilization of qualified home country determinations (with any U.S. specific add-ons) for the supervision of these U.S. bank subsidiaries.

INSTITUTE OF INTERNATIONAL BANKERS

Finally, since certain international banks may elect to apply the advanced Basel II methodology for determining capital compliance requirements in their U.S. bank subsidiaries, we strongly urge that there be no requirement on them to implement Basel I-A to calculate capital floors during the transition period. These international banks already face serious burdens in developing systems necessary for Basel II compliance globally and in their U.S. bank subsidiaries and should not face the added burden of being required to create a temporary system for Basel I-A in the interim transition period to Basel II. Instead, for the reasons described above, we believe that it should be permissible for such floors to be based on existing Basel I capital standards.

Conclusion

The Institute strongly supports making the application of Basel I-A elective rather than mandatory for U.S. bank subsidiaries of international banks that are subject to Basel II in their global operations.

Please contact the Institute if we can provide any further assistance.

Very truly yours,



Lawrence R. Uhlick
Executive Director and
General Counsel