JUNIPER

EXTRAORDINARY partnerships.

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Attn: Docket No. 03-14

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Ladies and Gentlemen:

Juniper Financial Corp. and its wholly owned subsidiary Juniper Bank (hereinafter collectively referred to as "Juniper") appreciate the opportunity to comment on the Advance Notice of Proposed Rulemaking ("ANPR") regarding the "Risk-Based Capital Guidelines; Implementation of New Basel Capital Accord".

Juniper Bank is a partnership focused issuer of credit cards, with over $1.2 billion in managed credit card receivables, approximately $500 million of on book assets, and approximately 700,000 credit card accounts. Founded in 2001 it is one of the fastest growing credit card issuers in the United States; yet it is also one of the smallest banks issuing credit cards nationwide. Juniper is an 89% owned subsidiary of the Canadian Imperial Bank of Commerce, a United States Financial Holding Company, with approximately $285 billion (Canadian) of on book assets and $688 billion (Canadian) of managed assets.

At the outset, Juniper would like to emphasize that it supports the Basel Committee on Banking Supervision's ("Committee") goal of more precisely assessing regulatory capital requirements in relation to risk. Any process that more accurately aligns regulatory capital to risk improves the safety and soundness of the banking system. At the same time, Juniper believes that any new capital regime should be employed in a manner that does not create competitive inequities or undue regulatory burden--especially if the new regime does not more accurately align regulatory capital to risk. Banking organizations should not be accorded a competitive handicap vis a vis their competitors because they are forced to comply with the Advanced Internal Rating Based ("IRB") approach to credit risk in the New Accord or because they continue to apply the current general risk based capital rules. Moreover, any new regulatory capital regime should be structured so that banks that are engaged in certain lines of business, such as credit cards, are not unduly disadvantaged vis a vis their non-bank competitors or vis a vis banks engaged in other lines of banking business. Unfortunately, we at Juniper are concerned that the New Basel Capital Accord ("New Accord") might do just that.

Juniper believes that, as presently constituted, the New Accord would require all credit card issuers to hold more regulatory capital against their credit card assets than presently required. This would cause banking organizations that issue credit cards to be competitively disadvantaged vis a vis their non banking competitors and could result in banking organizations shifting investments away from credit cards to other banking product lines that require less regulatory capital. Juniper itself would be negatively impacted, either as a subsidiary of a large internationally active bank that will be required to comply with the New Accord, or as a small independent issuer of credit cards in the United States. Moreover, Juniper believes much of this imbalance is caused by a misunderstanding of the risks posed by credit cards and that a few relatively simple modifications to the New Accord would go a long way in mitigating these competitive inequities and would not cause incremental risk to the safety and soundness of credit card banking.

Juniper notes that on October 11, 2003 the Committee issued a news release which declared that it has "identified opportunities to improve the framework" of the New Accord. Juniper further notes that the proposed areas identified for improvement include the proposed allocation of regulatory capital for expected losses, as opposed to unexpected losses, and the regulatory capital treatment of "credit card commitments" and securitized assets. Juniper strongly supports the direction in which the Committee seems to be heading. It is consistent with many of the points we make below. At the same time, since we have not seen the Committee's actual proposed amendments to the New Accord, we will comment on the ANPR as it is presently drafted. Hopefully our comments will assist the Agencies in their ongoing deliberations with the Committee regarding the drafting of actual amendments.

Juniper has the following recommendations regarding the New Accord:

<u>Summary</u>

1) Regulatory capital should not be allocated for Expected Losses ("EL"), especially for Qualified Retail Exposures ("QREs"), due to fact that the EL is incorporated into the interest rate and pricing spread of QREs; 2) In any event, the proposed future margin income ("FMI") offset to EL should be increased from 75% to 100% as consistent with economic pricing reality; 3) Banks should not be required to incorporate undrawn lines of credit into their calculation of the

estimate of default ("EAD") or loss given default ("LGD"); 4) Just as important, the requirement to hold capital against undrawn lines of credit card accounts that have been securitized should be eliminated; 5) Banks should not need to deduct dollar for dollar capital from retained positions in securitizations between zero and KIRB if the retained position has been rated by an independent debt rating agency; 6) The asset value correlation ("AVC") to probability of default ("PD") does not reflect economic reality, 7) The dollar for dollar reduction to Tier 1 Capital for capitalized FMI should be modified to apply only to amounts of capitalized FMI greater than 25% of Tier 1 Capital; 8) Operational risk regulatory capital considerations should incent investment in risk mitigation and contingency planning; 9) While greater transparency is a laudable concept, care must be taken to ensure that Pillar 3 does not require the public disclosure of proprietary and competitive information; 10) An additional overarching concern is that the New Accord is incredibly complex and costly to implement.

1. <u>Regulatory Capital should not be allocated for EL</u>.

As stated in the ANPR (p. 23), the EL is incorporated into the interest rate and pricing spreads of all retail banking products. It is simply one of the costs that retail lenders take into consideration when pricing their products (along with costs for acquiring the account, costs for servicing the account, etc.) with the expectation that the price will more than cover all expected costs (i.e., the profit margin). Assuming the retail lender is appropriately pricing its product, the FMI associated with that product should be more than sufficient to cover EL. Requiring regulatory capital to be set aside for EL adversely impacts products with higher ELs (and higher pricing to cover those higher ELs) – without any showing that it is needed to cover increased risk. Credit cards especially would be adversely impacted as they generally have higher ELs than most other banking products; they also are generally priced higher to absorb the higher ELs.

While it is entirely appropriate and prudent to require regulatory capital to cover unexpected losses ("UL"), given the fact that EL is baked into the price of retail banking products, regulatory capital should not be assessed for EL. We note that the Committee, in its October 11th communiqué, seems to agree with this proposition. We also note, however, that the Committee seems to have substituted reserves for regulatory capital and to have required that reserves must equal EL. We are concerned that this also might constitute a "one size fits all" approach that is not appropriate for all banking products and that regulators may require credit card issuers to beef up reserves to a greater degree than for other banking products. This could create many of the same issues that would be created by requiring that regulatory capital be allocated for EL. We at Juniper submit that it would be more appropriate for the supervisory function to review, as they do today, the retail bank's estimate of EL, provisioning policies <u>and</u> the adequacy of reserves as part of the supervisory review. If they find that the estimate of EL, provisioning policies or reserves are inadequate, they can require additional reserves or additional regulatory capital as they do now. If the retail bank does a good job of estimating EL (versus actual performance) and prices its products accordingly <u>and</u> adequately provides for reserves, it should not be penalized simply because the amount of EL is high.

2. <u>The FMI Offset to EL for QREs should be increased from 75% to 100%.</u>

As a partial acknowledgement of the above argument, the ANPR proposes that the total capital held against EL be reduced by 75% of eligible FMI. We note that the proposed 75% offset is itself reduced from a proposed 90% in the Quantitative Impact Study. At the very least, should regulatory capital be allocated for EL, Juniper believes that the appropriate offset number should be 100%.

As stated previously, banks price their products by incorporating EL into their pricing. Not allowing a 100% FMI offset clearly results in a regulatory capital charge that is higher for higher priced products than for lower priced products regardless of any increase in actual risk to the banking system. Moreover, the proposed definition of eligible FMI for QREs is limited to the amount of income the QRE accounts can be expected to generate over the next 12 months. Anticipated income for new accounts can not be included. In order to use FMI as an offset, the banking organization must be able to support their estimate of eligible FMI on the basis of historical data. These appear to be conservative and appropriate limitations. These limitations further underscore the proposition that FMI should be allowed to offset up to 100% of EL since FMI is conservatively defined. If the realistic amount of FMI more than covers EL over the next year – it should be allowed to be a total offset to EL-- again, with the caveat that the supervisory process has the authority to disallow any portion of FMI that the banking organization's primary regulator believes does not comport with safe and sound banking practice.

3. <u>Banking organizations should not be required to incorporate undrawn lines of credit into their calculations of the EAD or LGD</u>

There should be no requirement to hold regulatory capital against undrawn lines of credit where the undrawn line can be terminated at will. On page 40 of the ANPR, it is acknowledged that there is a substantial difference between credit card undrawn lines of credit and undrawn wholesale lines of credit – "not only in degree but also in kind." The big difference is that banking organizations have much more control over the credit risk imposed by undrawn credit card lines than undrawn corporate lines. Unlike a committed corporate line of credit, there are no limits to a credit card lender's ability to reduce its line exposure. Credit card banks can and do actively manage their credit risk exposure by constantly reviewing credit card accounts and their associated credit lines and by reducing the lines on those accounts that are identified as high risk. It is one of their primary methods of managing credit risk exposure and is substantially different from corporate lines of credit. Requiring regulatory capital to be set aside for undrawn corporate lines of credit in the same manner as undrawn credit card lines is tantamount to favoring corporate over credit card lending and creates competitive inequality without consideration of the amount of actual credit risk involved. It is our hope that the Committee's reference in its October 11th communiqué to revisiting provisions regarding "credit card commitments" represents an undertaking to address this issue.

4. <u>The Requirement to hold capital against undrawn lines of credit card accounts that have been securitized should be eliminated</u>.

The proposal that banking organizations be required to hold capital against the full amount of undrawn lines on accounts that have been securitized (ANPR, p. 41) is inconsistent with the inherent risk posed by these lines. As stated above credit card lines on credit card accounts are uncommitted lines; credit card issuers can and do reduce and/or terminate unused lines at will in order to manage their credit card risk. Just as important, in a typical securitization, both drawn balances and undrawn balances are securitized; third party investors are obligated to purchase at par newly originated receivables on securitized accounts in order to maintain their investor interest during the securitization's revolving period. Investors are required to purchase the receivables on a pro-rata basis from all accounts in the Master Trust, including those in high risk or high EL segments. There should not be a requirement to hold regulatory capital against those undrawn lines of credit that may or may not be accessed, when at the time those lines are accessed, the newly created receivables are securitized. These are receivables that never make it to the banking organization's books – holding regulatory capital against them makes no sense. At the very least, the requirement to assess regulatory capital against undrawn lines of credit card accounts should be limited to those securitizations that do not sell new loan originations.

5. <u>Banks should not be required to deduct dollar for dollar capital from all retained positions in securitizations between zero and KIRB if the retained position has been rated by a rating agency</u>.

The requirement to deduct dollar for dollar capital for all retained positions in securitizations between zero and KIRB (ANPR, p. 78) does not provide equitable relief if the retained position is rated by a independent debt rating agency. The purpose of the external rating is to evaluate the level of retained risk. The requirement to deduct dollar for dollar capital for retained positions is not consistent with the risk the retained position actually poses since it gives no credit to the rating assigned by an independent agency. Moreover, this proposed dollar for dollar treatment is inconsistent with the risk weighted capital approach required for investors in securitizations. It also is inconsistent with the standardized approach to calculating regulatory capital. We suggest that the appropriate position would be to risk weight the retained position based on the rating assigned by the debt rating agency – thereby aligning the regulatory capital requirement with the risk the retained position actually poses.

6. The proposed AVC to PD does not reflect economic reality.

The ANPR assumes that AVC for QREs declines as PD rises; that higher credit quality borrowers are more likely to experience simultaneous defaults (on a proportionate basis) than pools of lower quality borrowers because higher wealth individuals are more sensitive to macroeconomic events (see ANPR p.44). This does not comport with the experience of our industry. Historically, the credit card industry has not shown a higher correlation of losses from lower risk individuals during macroeconomic shocks – and any correlation that might exist is significantly lower than the threshold used in the PD calculation – that the AVC curve should be significantly flatter. The result of the proposed curve is that companies originating less risky accounts are being penalized with a higher correlation factor than is warranted and ultimately a higher capital requirement.

7. The dollar for dollar reduction to Tier 1 capital for certain securitization exposures should be modified.

The proposed requirement that banking organizations deduct capitalized FMI from Tier 1 capital should be limited only to amounts of capitalized FMI greater than 25% of Tier 1 Capital. Other capital deductions should be deducted from total capital, not 50% from Tier 1 and 50% from Tier 2. Both recommendations are consistent with current FFIEC guidelines.

8. Operational Risk Rules should incent the establishment of preventative controls.

Juniper agrees that a systemic and rigorous analysis of Operational Risk is to be encouraged – especially if it leads to taking measures to mitigate or reduce operational risk. To the extent that the New Accord's emphasis on operation risk achieves that goal, it is to be lauded. Juniper believes that the most effective way to manage operational risk is the establishment and maintenance of a strong control and compliance environment; yet the New Accord gives no weight or incentive for preventative controls. Banks are given no credit for the investment in risk management and contingency planning. At the very least, more weight must be given to the establishment of a strong control and compliance environment and some sort of reduced capital requirement be accorded for investments which directly lead to reduced operational risk. This is best done through the supervisory process.

9. Pillar 3 should be reworded to ensure it does not require public disclosure of proprietary and confidential information.

Increased transparency is a laudable concept and ensuring public disclosure as to how an institution calculates its regulatory capital requirements could enhance market discipline. However, any disclosure requirements contained in Pillar 3 need to be balanced against the concern of regulatory burden, complexity and more importantly, the need to protect proprietary and confidential information.

Mandating disclosures beyond those currently mandated by debt rating agencies, accounting and securities authorities could result in the disclosure of information that non-regulated competitors are not required to disclose. It will also add significant costs. Moreover, a banking organization's disclosure of various components of credit risk (type of credit exposure, geographic distribution of loans, etc., see ANPR p. 100) could result in the disclosure of highly confidential and proprietary information that could be accessed and used by a banking organization's competitors. Significantly, this would impact relatively small competitors with a limited product set such as Juniper to a greater degree than it would larger institutions (with a more diverse set of product lines) by revealing far more competitive information about its sole product line – credit cards.

We recommend that the agencies work closely with accounting and securities authorities to implement a cohesive and consistent disclosure scheme.

10. The New Accord is incredibly complex and will impose substantial regulatory burden and implementation costs on those banking organizations adopting it; time will be needed to comply with it.

An overarching concern regarding the New Accord is that it is too complex and the corresponding increase the regulatory burden imposed on those attempting to comply with it is too great. It has been estimated that the costs to even small banks for complying with the New Accord will be at least $10 million* (it might not be that much for Juniper, but it will be significant). Moreover, given the overall complexity of the New Accord, banking organizations are going to need to develop the systems, infrastructure and expertise to support the New Accord. Time will be needed for implementation if implementation is to be done well – at a minimum four years (regulators themselves will require time to develop and coordinate their approach for all institutions). Juniper appreciates the recent six month extension for drafting the rule; it proposes that at least another year extension be provided for implementation and compliance.

Conclusion – The net effect of the above is that as presently constituted, the New Accord could cause significant competitive harm to banks (versus their unregulated competitors) and particularly to US banks focused on issuing credit cards. Hopefully, the October 11^{th} communiqué signals a willingness to address the concerns. However, the New Accord as presently drafted, would require credit card issuers to increase the amount of regulatory capital to be held against credit card receivables; favor other forms of retail lending over credit card lending, and would impose enormous compliance costs and burdens. Juniper as a subsidiary of a large international bank will be required to comply. Moreover, even were Juniper to be spun off from CIBC, (as an independent relatively small bank) Basel II would adversely impact Juniper. The compliance costs and extra

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* Petrou, Karen Shaw, "Policy Issues in Complex Proposals Warrant Congressional Scrutiny", Testimony before the Domestic and International Monetary Policy, Trade and Technology Subcommittee on Financial Services, U.S. House of Representatives, February 27, 2003.

regulatory capital requirements could reduce its valuation in an IPO. Even were it not required to adopt the Advance IRB approach ("AIA") to calculating regulatory capital and the Advance Measurement Approach ("AMA") to calculating operational risk, it is likely that its supervisory regulators would impose additional regulatory capital requirements on Juniper so as not to give it a competitive advantage versus its larger credit card competitors who would be required to adopt the Advanced IRB and AMA approaches to calculating regulatory capital. While maybe not inevitable, there would clearly be some pressure to place all credit card issuers on a so called "even playing field" and it is certain that the pressure would be to require all issuers to increase their levels of regulatory capital, not decrease them. Yet, unlike its larger competitors, Juniper is not large enough to absorb easily additional regulatory and compliance costs. Juniper and other small issuers would clearly be more adversely impacted by any requirement to increase regulatory capital than its competitors. Care should be taken to ensure smaller credit card issuers are not unduly implaced.

Accordingly, we urge the Agencies to consider seriously these suggestions and recommendations set forth above. They would go a long way in ameliorating any competitive inequities that the new Accord, as presently drafted, might cause. Again, thank you for the opportunity to submit our comments to the ADPR. Should anyone desire, we at Juniper would be delighted to discuss our concerns further.

Sincerely,

Clinton W. Walker

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