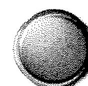
THE FINANCIAL SERVICES ROUNDTABLE 

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January 23, 2007

Communications Division
Public Information Room, Mail Stop 1-5
Office of the Comptroller of the Currency
250 E Street, S.W.
Washington, DC 20219 — Re: Docket No. 06-10

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, N.W.
Washington, DC 20552 — Re: No. 2006-34

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal
Reserve System
20th Street and Constitution Ave., N.W.
Washington, DC 20551 — Re: Docket No. R-1265

Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corp.
550 17th Street, N.W.
Washington, DC 20429 — Re: RIN No. 3064-AD10

Dear Sir or Madam:

The Financial Services Roundtable[1] (the "Roundtable") appreciates the opportunity to comment to the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Office of Thrift Supervision, and the Federal Deposit Insurance Corporation (collectively, the

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[1] The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and 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.

"Agencies") on the Market Risk Joint Notice of Proposed Rulemaking ("NPRM").[2]

I. General Comments

The Roundtable appreciates the Agencies' goals, expressed through the Market Risk NPRM, to increase the risk sensitivity, and broaden the scope of the current Market Risk rule. The inclusion of risks not adequately captured in the required methodologies of the current Market risk rule and the refinement of the specific risk charge will reflect more accurately current market practice and align regulatory capital with it. The Roundtable also acknowledges that the use of sophisticated models to capture and evaluate risk necessitates sophisticated risk management procedures. However, in its desire to comprehensively capture and address all trading book risks, the Agencies may have underestimated the burden and costs for smaller institutions, given that certain simplified trading activities that still exist in some segments of the industry. Further, for all institutions, the proposal will require the production of excessive paperwork and documentation that will do little but add unnecessary costs.

II. Implementation Date of Market Risk Rule

The Roundtable is strongly opposed to the implementation of the Market Risk rule prior to the implementation of the Basel II credit risk framework. Failure to coordinate these two rules creates numerous problems for institutions. Due to the proposed distinction between covered and non-covered transactions, a discrepancy in the treatment of trading book assets will be created without the corresponding Basel II banking book treatment being in effect to address them. This timing mismatch will also result in competitive inequalities between U.S. and European banking institutions since European institutions will be able to take advantage of Basel II banking book rules simultaneously with the adoption of market risk capital rules. Finally, the timing difference also distorts the calculation of the risk-weighted assets (RWA) benchmark ("floor") that will be used during the 2009 – 2011 transition period.[3]

[2] Some members of the Roundtable may have different views on some of the points expressed herein and may submit individual company comments to the agencies.

[3] It is also important to leave sufficient time for institutions to comply with the final version of the Market Risk rule before it becomes effective. In the best case scenario, the final version of the Market Risk rule will not be ready before the summer of 2007, which would not leave sufficient time for implementation in January of 2008.

III. Modification of the Definition of Covered Position

The Roundtable is also concerned with the bifurcation of the trading book into "covered" and "non-covered" positions. Trading book assets are categorized for accounting and management purposes according to GAAP. However, the NPR would require an alternate categorization of those same trading book assets for purposes of calculating regulatory capital. Doing so is burdensome and inefficient.

The Roundtable is also troubled with the treatment of hedging strategies. In particular, the requirement that "the hedging strategy must clearly articulate which positions are being hedged and which positions serve as hedging instruments" within the trading book is unrealistic given industry practice.

Hedging strategies are often used in the management of banking book assets. However, the same strategies are not employed in management of the trading book. Within the trading book, the purchase of derivatives is not characterized as an investment or a hedge. Traders trade to maximize profit and loss, and a position could be, at the same time, either an investment or a hedge. As such, traders are given limits on the amount of net risk to which they can expose the institution. But, they are not told when, or how, to employ a hedge in the course of daily trading. In fact, it would not be meaningful for a trading desk to specify which are the hedged and which are the hedging instruments because an essential purpose of the desk is taking and managing its particular risk. In contrast, however, it is easier to make a distinction between hedged and hedging contracts for a desk that trades relatively illiquid contracts and hedges them with more liquid contracts.

Finally, the Roundtable supports the exclusion of interest rate swaps that are direct hedges of non-covered positions from the definition of "covered position." Doing so will eliminate the potential distortion in the VaR model that would arise from the modeling of only one side of a hedged transaction, again provided that there are no material residual risks.

IV. Specific Risk

The NPRM proposes to eliminate partial modeling of specific risk effective January 1, 2010. Those institutions that cannot fully model specific risk will be subject to the standard specific risk charge for all portfolios. Modeling of specific risk is a more risk sensitive and sophisticated way to manage market risk, and the 2010 date is realistic for many of our larger institutions. However, for smaller institutions, the agencies should consider permitting partial modeling after 2010 as long as progress is being made to a full modeling system.

The Agencies also requested comment on whether a specific risk capital charge should be applied to foreign exchange and commodities positions. The Roundtable is strongly against this potential application. Foreign exchange and commodities contracts do not have issuer risk similar to other types of positions. The VaR models for these instruments do not assume away any risks, since there are no specific issuers or unique characteristics that are not already captured in the market pricing of the underlying instruments. Any questions regarding market risk of foreign exchange and commodities positions is better addressed through the validation of the VaR, rather than through inclusion of it as a specific risk.

V. Disclosure

The NPRM proposes detailed disclosure of the qualitative and quantitative aspects of a bank's internal models. We understand the importance of adequate disclosures under the Market Risk framework, including disclosures relating to policies and the qualitative and quantitative aspects of models. However, the Roundtable believes that the extent of the disclosures required under the NPR is excessive and should be streamlined to avoid unnecessary regulatory burden. For example, the Roundtable feels that disclosing "procedures" as the NPRM demands is of little value. Procedures -- such as what files to open and how to launch batch process jobs, etc.-- are proprietary, far too detailed, and of no use to anyone other than the institution itself.

VII. Board of Director and Senior Management Certification

The NPR requires that a bank's board of directors and senior management verify that the bank has made all necessary disclosures and maintains effective internal controls and disclosure controls and procedures. The Chief Financial Officer would be required to certify that all required disclosures are appropriate and the board of directors and senior management are responsible for establishing and maintaining an effective internal control structure over financial reporting, including the information required by this proposal.

These provisions would create yet another certification requirement relating to internal controls in addition to the requirements found in FDICIA and Sarbanes-Oxley. To the extent it is duplicative of these provisions, it is unnecessary to include in this regulation, and worse, may be interpreted as requiring a separate and additional independent auditor attestation.

Further, specifically requiring the board of directors to verify that all necessary disclosures have been made is inappropriate, in light of the fact that this function is the responsibility of management, and beyond the knowledge or

expertise of the typical board of directors. It would unnecessarily expose a bank's board of directors to financial risk without an offsetting gain, and would add to the difficulty many banks currently have in recruiting talented individuals to serve on their boards.

Thank you for the opportunity to comment on the Market risk NPRM. If you have any questions, please feel free to contact to contact me.

Sincerely,

Richard M. Whiting
Executive Director
and General Counsel