NEWS RELEASE

Comptroller of the Currency
Administrator of National Banks

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Contact: Robert M. Garsson
(202) 874-5770

Comptroller Hawke Discusses Basle Capital Framework in House Testimony

WASHINGTON -- Comptroller of the Currency John D. Hawke, Jr., told a congressional panel today that while the OCC supports the objectives of the proposed Basle II capital framework, it is important that regulators carefully consider industry comments before moving forward.

“The OCC, which has the sole statutory responsibility for promulgating capital regulations for national banks, will not sign-off on a final Basel II framework until we have determined through this notice and comment process that any changes to our domestic capital regulations are reasonable, practical and effective,” Mr. Hawke said in testimony before the Subcommittee on Domestic and International Monetary Policy, Trade and Technology of the House Committee on Financial Services.

The Comptroller expressed concern that the level of detail and specificity in the current proposal could lead to excessive complexity.

“This has led to a proposal of immense complexity—greater complexity, in my view, than is reasonably needed to implement sensible capital regulation,” Comptroller Hawke added. “I believe we must avoid the tendency to develop encyclopedic standards for banks, which minimize the role of judgement or discretion by banks applying the new rules and of supervisors overseeing the new rules.”

Excessive complexity could also increase the cost of implementing new capital rules, Mr. Hawke said. In addition, he added, “Basel II must be written in a manner that is understandable to the institutions that are expected to implement it, as well as to third parties.”

Mr. Hawke told the congressional panel that regulators need to think carefully about the impact of Basel on competitive equality, not just between foreign and domestic banks, but also between large and small institutions and between banks and non-banks.

The U.S. has a highly developed bank regulatory system, with up to 30 examiners resident year-round at the largest banks. Other countries, by contrast, may rely more on outside auditors.

“Given such disparities in the methods of supervision, it seems to us inevitable that an enormously complex set of rules will be applied much more robustly under our system

than in many others," Mr. Hawke added.

The Comptroller also warned that regulators must take account of the needs of small banks, which would continue to operate under the current capital system after the new Basel standards were implemented for large institutions.

"There is also a concern about the potential effect of Basel II on the competitive balance between large and small banks," Mr. Hawke said. "As it is likely to be implemented in the U.S., Basel II would result in a bifurcated regulatory capital regime, with the largest banks subject to Basel II-based requirements and all other banks subject to the current capital regime."

Mr. Hawke underscored that the OCC supports the view that there should be an appropriate charge for operational risk.

"But I have also consistently argued before the Basel Committee that the determination of an appropriate charge for operational risk should be the responsibility of bank supervisors, under Pillar 2, rather than being calculated using a formulaic approach under Pillar 1," he said. "I regret to say that I have not been able to persuade the Committee to adopt this approach."

The three pillars of the Basel II capital framework focus on minimum regulatory capital, enhanced supervision and market discipline, respectively.

The Comptroller noted that the addition of an option to use the Advanced Measurement Approach, which the OCC helped develop, is a significant improvement to the operational risk measurement. However, he said, the OCC remains receptive to comments on this aspect of Basel II.

Mr. Hawke said that while the OCC supports a temporary capital floor, as proposed by the Basel committee, the agency does not believe that a reduction in minimum regulatory capital requirements for certain institutions is a problem if the reduction is based on a regulatory capital regime that reflects the degree of risk in that bank's positions and activities.

"But we are not yet at the point where we can make a really confident judgment about the impact of Basel II on capital levels," he added. "QIS-3, the latest qualitative impact study, was based on an incomplete proposal and was applied by the banks without any of the validation or control that would be present when the new regime is in full force. Thus any effort to calibrate new capital requirements based on QIS-3, must confront great uncertainty. This uncertainty further illustrates the importance of moving cautiously before we incorporate Basel II into our domestic capital rules."

"If we determine through our rulemaking process that changes to the Basel proposal are necessary, we will press the Basel Committee to make changes," Mr. Hawke concluded. "And we further reserve our right to assure that any final U.S. regulation applicable to national banks reflect any necessary modifications. Given the importance of this proposal, we need to take whatever time is necessary to develop and implement a revised risk-based capital regime that achieves the state objectives of the Basel Committee both in theory as well as in practice."

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The OCC charters, regulates and examines approximately 2,100 national banks and 52 federal branches of foreign banks in the U.S., accounting for more than 55 percent of the nation's banking assets. Its mission is to ensure a safe and sound and competitive national banking system that supports the citizens, communities and economy of the United States.

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