



NEWS RELEASE

Comptroller of the Currency
Administrator of National Banks

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**Remarks by
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Comptroller of the Currency
Before the
Subcommittee on Financial Institutions
and Consumer Credit
of the
Committee on Financial Services
of the United States House of Representatives
June 19, 2003**

Chairman Bachus, Congressman Sanders, and members of the Subcommittee, thank you for inviting the Office of the Comptroller of the Currency (OCC) to participate in this hearing on proposed revisions to the 1988 Capital Accord developed by the Basel Committee on Banking Supervision.

I want to assure the Subcommittee that the OCC, which has the sole statutory responsibility for promulgating capital regulations for national banks, will not endorse a final Basel II framework for U.S. banks until we have determined through our domestic rulemaking process that any changes to our domestic capital regulations are practical, effective, and in the best interests of the U.S. public and our banking system.

My written testimony provides a detailed discussion of the background and content of Basel II and the important issues with which this Subcommittee is properly concerned. I would like to use this time to make three important points that may help to put today's testimony into proper focus.

First, all of the U.S. banking agencies share a concern about the potential effect of Basel II on the capital levels of large U.S. banks. Our banking system has performed remarkably well in difficult economic conditions in recent years, and I believe that is due in significant part to the strong capital position our banks have maintained. While a more risk sensitive system of capital calculation might be expected to have the effect of reducing the capital of some banks, we would not be comfortable if the consequence of Basel II were to bring about very large decreases in required minimum capital levels. By the same token, if Basel II were to threaten significant increases in the capital of some banks it could undermine support for the proposal and might threaten the competitiveness of those banks. As things stand today, we simply do not have sufficiently reliable information on the effect of these proposals on individual

institutions or on the banking industry as a whole. Before we can make a valid assessment of whether the results are appropriate and acceptable, we have to know, to a much greater degree of reliability than we now have, just what the results of Basel II will be.

The OCC shares the view of the Subcommittee that significant additional quantitative impact analyses will be necessary. Ideally, this should take the form of another study by the Basel Committee itself. However, even if the Basel Committee does not undertake such a study, I believe that it is absolutely essential that the U.S. agencies make such an assessment prior to the adoption of final implementing regulations. I strongly believe that we cannot responsibly adopt final rules implementing Basel II until we have not only determined with a high degree of reliability what the impact will be on the capital of our banks, but have made the judgment that the impact is acceptable and conducive to the maintenance of a safe and sound banking system in the U.S.

Second, some have perceived there to be significant differences among the U.S. banking agencies. Mr. Chairman, you and some of your colleagues have introduced H.R. 2043, a bill that would establish an interagency committee whose purpose would be to resolve such differences. While I am sympathetic to the concerns that underlie this legislation, I respectfully suggest that it is not necessary at this time.

I believe the agencies have worked exceedingly well together on the Basel II project for the past four years, and I am confident that we will continue to do so. To be sure, we have not always agreed on every one of the multitude of complex issues that Basel II has presented, but where there have been differences, we have worked our way through them in a highly professional and collaborative manner. The forthcoming Advance Notice of Proposed Rulemaking for implementation of Basel II in the U.S. is an example of the collegial and collaborative manner in which the agency staffs have worked. In addition, we are now in the final stages of internal review on draft interagency guidance that we will jointly issue concurrently with the ANPR to clarify and elaborate our expectations for those of our banks that will be subject to Basel II, and that guidance has been developed in a process in which every agency had substantial input.

Finally, as I said earlier, I believe we are all committed to a process that has real integrity to it. The current Basel Committee timeline presents a daunting challenge to both the U.S. banking agencies and the banking industry. While it is clearly necessary to address the acknowledged deficiencies in the current Basel Capital Accord, the banking agencies must better understand the full range and scale of likely consequences before finalizing any proposal. We have identified in our written testimony a lengthy and formidable list of critical milestones that the agencies must meet under the current Basel II timeline.

[Optional material: They include: Basel Committee consideration of comments received by it on its latest consultative paper; the issuance of an ANPR and draft supervisory guidance in the U.S. with a 90-day period for comments; full consideration of those comments; the issuance of a definitive paper by the Basel Committee; the drafting and issuance for comment in the U.S. of a proposed regulation implementing Basel II; the conduct of a further quantitative impact study; consideration of the comments received on the NPR; and finally the issuance of a definitive U.S. implementing regulation.]

If we find that our current target implementation of January 1, 2007, is simply not doable – and my personal opinion is that realization of that target may be very difficult - - we will take additional time. But it is too early to draw that conclusion yet. The important point is that we will take great care not to let the time frame shape the debate. If we determine that changes to the proposal are necessary, we will make those views known to the Basel Committee, and we will not implement proposed revisions until those changes are made.

[Optional Material: I'd like to make one more point. Some have viewed the new Basel II approach as leaving it up to the banks to determine their own minimum capital – putting the fox in charge of the chicken coop. This is categorically not the case. While a bank's internal models and risk assessment systems will be the starting point for the calculation of capital, bank supervisors will be heavily involved at every stage of the process. We will publish extensive guidance and standards that the banks will have to observe. We will not only validate the models and systems, but will assure that they are being applied with integrity. In my view the bank supervisory system that we have in the U.S is unsurpassed anywhere in the world in both its quality and in the intensity with which it is applied, and we are not going to allow Basel II to change that. In fact, if we don't believe at the end of the day that Basel II will enhance the quality and effectiveness of our supervision we should have serious reservations about proceeding in this direction.

Moreover, while Basel II has largely been designed by economists and mathematicians, and while these “quants” will play an important role in our oversight of the implementation of Basel II, the role of our traditional bank examiners will continue to be of enormous importance. Such values as asset quality, credit culture, managerial competence, and the adequacy of internal controls cannot be determined by mathematical models or formulas. Nor can many of the risks that banks face be properly evaluated except by the application of seasoned and expert judgment. I can assure you that those national banks covered by Basel II will continue to be closely monitored and supervised by highly qualified and experienced national bank examiners, who will continue to have a full-time on-site presence.]

I am pleased to have had this opportunity to provide our views on this important initiative, and I would be happy to answer any questions you may have.

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