NEWS RELEASE

Comptroller of the Currency
Administrator of National Banks

NR 2003-50

FOR IMMEDIATE RELEASE
June 18, 2003

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Remarks by
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Before the Committee on Banking, Housing, and Urban Affairs
United States Senate
June 18, 2003

Chairman Shelby, Senator Sarbanes, and members of the Committee, 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 Committee that 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 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. banking system.

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

I believe all of the U.S. banking agencies share that objective, and we expect to work closely together to resolve any open issues.

Second, some have perceived there to be significant differences among the U.S. banking agencies, and have suggested that some external mechanism is needed to resolve such differences. I believe that is an erroneous conclusion.

On the contrary, I believe the agencies have worked exceedingly well together on this project for the past four years and 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 that is no more than one would reasonably expect when a group of experts have brought their individual perspectives to bear on difficult issues. Where there have been differences, we have worked our way through them in a highly professional and collaborative manner.

The Advance Notice of Proposed Rulemaking for implementation of Basel II in the U.S. that the agencies will soon jointly issue is another example of a highly collegial and collaborative process. Our staffs have been laboring together diligently to get us prepared for this first round of rulemaking. 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 on 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. While reaching agreement on some of the proposed requirements was no small feat, I believe that every agency will concur with the outcome.

Considerable consultation and deliberation still lie ahead before we can even consider final adoption of implementing regulations. But I have every confidence that the agencies will continue to approach the issues in the same constructive spirit that has prevailed to this point.

Third, 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 the milestones that the agencies must meet under the current Basel II timeline. 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. Each of these steps is critical in a prudential consideration of Basel II in the U.S., and the agencies will be working closely together at every step.

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 more 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. Equally important is that the time frame will be secondary to our responsibility to fully consider all comments received during our notice and comment process. If we determine through this process 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.

Finally, 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. The new process will not replace them; it will simply give them even better tools to assess the true nature and measure of the risks confronting the banks for which they are responsible.

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.