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Basel Committee Secretariat
Basel Committee on Banking Supervision
Bank for International Settlements
Centralbahnplatz.2
CH-4022
Basel, Switzerland
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Re: Basel Capital Accord – Comments of Capital One Financial Corporation

Ladies and Gentlemen:

Thank you very much for providing us the opportunity to comment on the most recent package of consultative papers proposing revisions to the Basel Capital Accord (the "Proposal"). Capital One Financial Corporation, Falls Church, Virginia (together, with all of its subsidiaries and affiliates, "Capital One") is a holding company whose principal subsidiaries, Capital One Bank, Glen Allen, Virginia and Capital One, F.S.B., Falls Church, Virginia, offer consumer lending and deposit products, including credit cards, installment loans, and automobile financing.

Capital One had 36.5 million customers and $31.6 billion in managed loans outstanding, as of March 31, 2001. A Fortune 500 company, Capital One is one of the largest providers of MasterCard and Visa credit cards in the world. Capital One also issued $4.8 billion in asset-backed securities during the year ended December 31, 2000, and expects that it will be one of the world's largest issuers of asset-backed securities in 2001.

As a global provider of credit cards and one of the largest issuers of asset-backed securities in the United States, Capital One is particularly concerned about the Proposal's disparate impact on credit card companies and ABS issuers. As discussed in more detail below, credit card lenders and ABS issuers are particularly disadvantaged by the Accord as currently drafted, a result we believe to be inconsistent with the Proposal's goal of neutrality across asset classes. The 1988 Accord created incentives that produced unintended and wasteful results (e.g., the conduit funding structure for securitization), and we urge the Committee to avoid rules that create similar arbitrage opportunities in

this proposed revision. Capital One generally supports the comment letters on the Proposal submitted by the Financial Services Roundtable and by Mayer, Brown & Platt on behalf of several other issuers of asset-backed securities. We would like to make the following additional comments:

Consumer Lending

The Proposal takes the position that financial institutions must consider the likelihood of additional drawings on the unused portion of a credit card line when the bank determines its loss estimates. Under the IRB approaches, the bank must incorporate those risk assessments into the bank's calculation of EAD or LGD. We believe that this requirement could lead to a significant and unwarranted increase in the amount of capital that banks must hold against credit card accounts. As such, we strongly oppose this provision as we believe that it does not accurately reflect the true risk exposure faced by institutions engaged in this type of consumer lending.

Due to the nature of open-end credit, Capital One regularly re-underwrites its credit exposure to each customer. For instance, when a customer exhibits certain risk-indicating behaviors, Capital One has the contractual authority to deny specific charges, suspend charging privileges entirely, or reduce significantly an existing line of credit. Capital One can exercise these policing functions swiftly and effectively to address the risks posed by consumers it believes to be in danger of delinquency or charge-off. Unused credit lines on open-end accounts, therefore, present limited risk exposure, and indeed far less than the Proposal suggests because of the high degree of control that an issuer can exercise over any such account. In addition, for reasons that are readily ascertainable, credit card lenders typically reserve higher credit lines for lower risk consumers. Many of these consumers never intend to utilize the full amount of credit granted them. Furthermore, many consumers -- particularly these lower risk and, hence, higher line consumers -- are "convenience" users, paying off any outstanding balances each month, using the card exclusively as a payment mechanism.

In seeking to impose additional requirements resulting in unwarranted capital charges against the unused portion of these lines, the Proposal also fails to recognize the value and effectiveness of sophisticated management processes utilized by companies like Capital One to reduce risk and achieve a competitive advantage. Thus, the Proposal, in effect, creates a disincentive to further develop and improve such processes.

The Proposal also fails to properly consider that many credit card issuers maintain high reserve levels and achieve strong earnings that serve to mitigate significantly the risk posed by these assets. Imposing additional, and unnecessary, capital charges on such lenders will serve only to increase the cost and decrease the availability of credit to consumers. In sum, we oppose the Proposal's requirement that could lead to a significant increase in the capital required to be held against unused credit-card lines of credit.

Asset-Backed Securitization

Capital One concurs with the comments of the Financial Services Roundtable and Mayer, Brown & Platt regarding the Proposal's treatment of asset-back securitization. For the reasons set forth in those letters, Capital One particularly opposes the "managed assets" approach to securitization transactions with an early amortization feature. We also oppose the proposed capital treatment of servicer advance obligations as unnecessary in light of the limited risk these structured obligations present to the safety and soundness of the issuing bank. Finally, we oppose the imposition of any broadly applied capital charge for implicit or residual risks.

Capital One supports the Committee's use of external ratings on ABS debt to assess capital requirements for investors in ABS securities. ABS deals are structured so that most of the debt receives ratings that are well above investment-grade. The Proposal's reliance on external ratings on ABS debt should therefore accurately reflect the level of risk that those securities raise for our investors.

Although the use of external debt ratings may be appropriate with respect to asset-backed securitization, Capital One cautions the Committee against the use of external ratings in other situations. Capital One does not believe that the external ratings on certain debt issued by monoline credit card banks, as currently determined, accurately reflect the quality of that debt, particularly for lenders who obtain sizeable rates of return. The external debt ratings on unsecured debt typically assigned to monoline credit card issuers tend to be lower than for banks generally. However, no empirical data prove that the quality of monoline debt is lower than the quality of debt issued by diversified commercial banks. For this practical reason, reliance on ratings that are not necessarily objective for the purpose of determining regulatory capital would be flawed policy.

By way of illustration, comparatively higher ratings are typically assigned to lenders whose portfolios can be characterized as low risk and low return. As a result of the low risk profile, the lender generally holds less capital. The higher rating, in turn, results in lower capital requirements held against securities issued by the lender, which produces a lower cost of funds. In contrast, the lenders with higher risk portfolios have produced correspondingly higher returns; higher levels of capital are typically required and held. Logic would suggest that the higher level of capital should offset the higher risk, thereby producing a comparable rating to the lower risk institution. In reality, however, the lower rating is still assigned to the higher risk institution, in effect ignoring the benefits of higher capital and superior earnings coverage. Therefore, Capital One would oppose the use of external ratings on general unsecured debt to determine capital requirements or for other purposes where the impact on monoline credit card banks would be disproportionate.

Operational Risk

Concurring with the comments submitted by the Financial Services Roundtable, Capital One would like to re-emphasize that the Proposal's treatment of operational risk is overly conservative and will undermine the Committee's goal of capital neutrality. There is no empirical evidence that financial institutions need to hold capital against operational risk. Capital already serves as a bulwark against losses produced by unexpected risks, as does insurance, with the calculation being based on asset levels. Requiring banks to hold capital against operational risks would functionally turn banks into self-insurers, presumably at a higher cost than third-party insurance. It would also lead to wasteful overinsurance against expected losses, because national accounting standards would still require many banks to establish loan-loss reserves in anticipation of expected losses.

While the Proposal seems to indicate that any increase in capital to reflect operational risk would be offset by the reduction in capital made possible by the IRB approaches, the empirical research performed to date by larger American banks suggests otherwise. In the absence of more persuasive evidence, the capital requirement contained in the Proposal is unnecessarily burdensome, will tighten credit, and may produce adverse marginal economic effects, particularly in countries already facing a credit crunch. Furthermore, excessive regulatory capital requirements are likely to hurt banking industry earnings, thus driving investment capital out of this sector. Capital One therefore recommends that operational risk, like interest-rate risk, be addressed through the supervisory process, not through the imposition of potentially additive capital requirements.

Holding Company Capital Requirements

While Capital One is not opposed to the consolidated treatment of capital for holding companies that own multiple depository institutions, we oppose capital requirements based on the activities of nonbanking affiliates. The capital requirement standards contained in the Proposal could be extended to cover activities that are conducted by nonbanking affiliates, such as auto or other finance companies, thereby requiring bank holding companies and nonbank holding companies to hold capital against those affiliates' activities. As the letter submitted by the Financial Services Roundtable notes, a broad interpretation of the "predominantly engaged" standard not only would have unintended adverse consequences, but also bear little relation to the safety and soundness of the regulated entities.

In addition, this capital treatment of holding companies is unnecessary in the United States given the laws enacted by Congress and enforced by the Federal Reserve to address safety and soundness concerns posed by nonbank affiliates. In this regard, under Sections 23A and 23B of the Federal Reserve Act, and proposed Regulation W thereunder, U.S. banks and thrifts must adhere to strict affiliate transactions rules that, *inter alia*, (a) limit the transfer of low-quality assets between financial institutions and

their affiliates; (b) place quantitative limits on such transactions; and (c) ensure that any such transactions are conducted on market terms.

This capital treatment of holding companies may also produce unintended regulatory effects and needless legal entity restructuring efforts. Under the Proposal, a nonbank company affiliated with a depository institution would be placed at a competitive disadvantage relative to a nonbank company without such an affiliate. The Proposal would thus encourage "regulatory arbitrage" whereby companies seek to conduct their financial activities outside the banking system under less regulated charters. Such regulatory reshuffling would constitute not only a wasteful expenditure of resources, but also result in the movement of large amounts of assets outside the banking supervisory framework, thereby increasing systemic risk.

Disclosure Requirements (Third Pillar)

Capital One believes that current laws regarding bank disclosures are more than adequate, and as a result we urge the Committee to withdraw its proposed enhanced disclosure requirements. Financial institutions, particularly in the United States, already bear extensive disclosure burdens as the result of comprehensive banking regulations, consumer lending laws and securities laws. Additional disclosure burdens on lenders should be narrowly tailored to achieve a specific purpose. It is unclear from our review of the Proposal to whom the disclosures would be directed and for what specific purposes, and we therefore oppose such additional disclosures as unnecessary and wasteful.

In this regard, the Proposal does not identify the reasons that current disclosure requirements (particularly in the United States) provide insufficient market discipline. While disclosure frequently assists consumers and investors to make decisions regarding financial institutions, investors, depositors, regulators, and external ratings agencies already receive a wealth of information about the financial health of lending institutions. In particular, securities laws in the United States and other countries require that public companies release all "material information" to the public. "Material information" is generally defined as information that someone could reasonably use when making an investment decision. Therefore, the data contained in the proposed "enhanced disclosures" would provide information to investors that either (a) replicates material information that already must be disclosed to the market or (b) represents non-material information that will not provide any market discipline to the company's stock. Such disclosures would unfairly provide competitors with access to proprietary information and business insights that are not material to investor decision-making.

Not only would "enhanced disclosure" provide the market with information that will not discipline securities prices, the Proposal directs these enhanced disclosures to the wrong audience. Bank regulators, not investors, constitute the primary audience for disclosures regarding capital requirements, and enhanced public disclosure requirements that direct such information to the market would be unnecessary and potentially confusing to the market. Enhanced disclosure would be unnecessary, because there is no

evidence (i) that current disclosure requirements are insufficient; (ii) that the current health of our financial institutions requires this additional burden; or (iii) that public disclosure (rather than regulatory examinations) would improve the safety and soundness of financial institutions. It is therefore unclear what benefits these disclosure costs would produce.

Additional disclosure requirements also would heighten the risk of investor confusion. Such confusion could potentially cause market disruptions that diminish bank valuations – the opposite of the Committee's stated goal in this area. Domestic regulators currently have sufficient access to information needed to communicate to the market whether banks are safe and sound. Allowing the market to access this information unfiltered by experts would be unwise.

Based on the foregoing arguments, we respectfully request that the Committee withdraw its proposed disclosure requirements.

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In closing, we thank you again for allowing us the opportunity to comment on the Proposal. We appreciate the consideration given to our comments, and look forward to further opportunities to participate in this process as it moves ahead.

Respectfully submitted,

/s/ Frank R. Borchert, III

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Capital One Financial Corporation