THE FINANCIAL SERVICES ROUNDTABLE

May 31, 2001

Basel Committee Secretariat
Basel Committee on Bank Supervision
Bank for International Settlements
CH-4002
Basel, Switzerland
BCBS.Capital@bis.org

Re: The New Basel Capital Accord: January 2001 Consultative Papers

Dear Sir or Madam:

The Financial Services Roundtable ("Roundtable") is pleased to have the opportunity to comment on the January 2001 proposed revisions to the Basel Committee's risk-based capital accord ("Basel 2 Accord"). The Roundtable represents 100 of the United States' largest diversified financial institutions, providing banking, insurance, and investment products and services to American and international consumers and corporations.

The Roundtable is uniquely situated to comment on this proposal. We are comprised of firms active in all major financial services sectors. As such, our members are those for which the internal ratings-based approach is intended, and Roundtable members will be significantly affected by the proposed imposition of risk-based capital at the holding company level.

We view these comments as a starting point, and look forward to providing additional views to our home-country regulators, as well as to the Basel Committee on Bank Supervision ("Committee"). We would be pleased to expand on the views expressed below and to provide additional data that may be of assistance as the rules advance.

I. Overview and Summary of Recommendations

Although we share the Committee's goal of refining the international risk-based capital ("RBC") framework to more accurately measure risk and assess capital, particularly through reliance on external and internal risk ratings, we have significant concerns about key aspects of the proposed credit and operational risk-based capital proposals. Ideally, by moving regulatory capital requirements closer toward market assessments of risks, the

Committee intends that the framework would have a neutral impact on financial services providers, regardless of their charter type. The Committee also intends that implementation of the Basel 2 Accord will be neutral, on average, with respect to overall capital levels.

However, as with the implementation of the 1988 Basel Accord, the risks of unintended consequences are quite high and, in fact, are magnified by the sheer complexity of the latest proposal. A review of the proposal by Roundtable member companies indicates that several aspects of the proposed framework could have a dramatic impact on the landscape of the financial services industry, potentially altering the competitive balance between industries and between countries, as well as inflicting a significant adverse macroeconomic impact. Our primary concerns stem from the new operational risk-based capital charge that is based on faulty assumptions about the nature of such risk, and from the implementation of an internal models approach to credit risk that is simply not ready for use as a regulatory capital standard.

The Roundtable is also concerned about the emphasis in the new accord on setting regulatory capital to cover both expected and unexpected losses. Economic capital is typically intended to cover unexpected losses — *i.e.*, the prospect that actual losses could exceed the expected level — while expected credit losses are generally covered by loan loss reserves. However, the new accord, like the current one, continues to limit the amount of reserves that count toward capital. Defining regulatory capital to cover both expected and unexpected losses, and then limiting the amount of reserves that count toward capital, results in a systematic overstatement of risk and an undercount of the resources available to absorb it. This imbalance can be particularly punitive for business lines that have high, but stable, expected losses, such as credit cards. To address this imbalance, the Roundtable recommends that the purpose of regulatory capital be clarified to cover only unexpected losses, which would require significant conforming changes throughout the accord. As an alternative, total regulatory capital should include the full amount of loan loss reserves.

A. Operational Risk

First and foremost, the Roundtable is deeply concerned with the proposed operational risk-based capital requirement. We believe that this could increase significantly the net amount of capital imposed by the Basel rules, without any evidence that operational risk is a significant cause of bank failures, or that a supervisory approach to addressing operational risk has proved unsatisfactory. The proposal also erroneously assumes that operational risk is positively correlated with transaction volumes, although for many lines of business this does not hold. Because asset management, custody services and many other activities are often conducted outside a banking charter, especially in the U.S., imposition of the operational capital charge could exacerbate the competitive balance between bank and non-bank firms, and contribute to systemic risk by moving these activities into the less well-regulated non-bank sector.

Financial Services Roundtable Recommendations

The Roundtable urges the Committee to

- eliminate imposition of a separate capital charge for operations risk; and
- adopt a supervisory approach to operational risk that relies on industry best practices.

B. Capital Neutrality

The Roundtable supports the Committee's efforts to ensure that the new framework will be neutral "on average" with respect to the minimum level of regulatory capital in the banking system. However, detailed reviews of both the standardized and internal ratings based ("IRB") approaches by Roundtable members clearly suggest that the Basel 2 Accord does not achieve this objective. Imposition of operational RBC, new capital charges on assets previously outside the framework, and miscalibration of risk weights and conversion factors combine to tilt the accord toward significantly higher capital levels. *Moreover, Roundtable members have found that in many cases the IRB approaches for sophisticated banks actually result in* ***higher*** *capital relative to the standardized model, directly contrary to the significant reduction intended by the Committee in order to provide incentives for adoption of the IRB.* These reviews by Roundtable members highlight serious problems with the calibration of the Basel 2 Accord. We anticipate that the results of the Committee's Quantitative Impact Study ("QIS") and QIS 2 will bear out these conclusions. However, we are concerned that the cost, complexity, and short time frame of the QIS may limit the value of these results.

Financial Services Roundtable Recommendations

Research on the implementation of the 1988 Basel Accord clearly suggests the potential for significant unintended consequences — both sectoral and macroeconomic — that an improperly calibrated new regulatory capital regime can inflict.[1] The Roundtable strongly urges the Committee to conduct additional research on the impact of the proposed accord in order to

- assess more accurately the extent to which the proposed accord is capital neutral, as intended;
- ensure that the variances around average capital level are not so broad as to arbitrarily create big winners and losers;
- evaluate the impact of the accord on the global economy; and

[1] See, for example, Hal S. Scott and Shinsaku Iwahara, "In Search of a Level Playing Field: Implementation of the Basel Capital Accord in Japan and the U.S," Occasional Paper 46, Group of 30, 1994, and Hal S. Scott, "The Competitive Implications of the Basel Capital Accord," St. Louis L.J. (1995). Scott found that the 1988 Accord did not level the playing field and, in some cases, created competitive distortions. See also Robert Litan, "Nightmare in Basel," The International Economy, 1992, which documented the initial impact of the 1998 Accord that forced banks to withdraw credit from the market in favor of riskless assets such as government bonds. Other research (Haubrich and Wachtell 1993, Berger and Udell 1994, Hancock and Wilcox 1994, and Wagster 1999) suggests that the 1988 Accord played a contributory role in the early-1990s credit crunch, a finding echoed in the Basel Committee's own research (Capital Requirements and Bank Behaviour, The Impact of the Basel Accord, Working Paper No. 1, April 1999).

- provide opportunity for continued industry comment on additional changes to the accord necessary to mitigate the macroeconomic concerns, and the potentially arbitrary impact on competitiveness within the financial sector.

C. IRB Concerns

While the Roundtable supports efforts to move toward a more sensitive, institution-based approach, our members' reviews of the proposed IRB foundation and advanced approaches clearly indicate that these regulatory models are not yet sufficiently evolved to avoid unintended or anomalous outcomes, with potentially serious repercussions for some institutions. As noted, for many Roundtable members, the IRB models resulted in higher capital levels than the standardized approach. We also are concerned about the requirement that would make adoption of the IRB approach contingent on using these models as the primary driver of management decision-making. Given the serious problems with the calibration of the IRB, this requirement could drive management decisions that would undermine both competitiveness and safety and soundness.

Financial Services Roundtable Recommendations

The Roundtable urges the Committee to

- drop the IRB foundation and advanced models;
- permit reliance on internal models from companies that have demonstrated advanced and reliable systems, without superimposing regulatory formulas on such models; and
- loosen the tie-in between the IRB model and management decision making.

D. Functional Regulation and Holding Company Capital

The Roundtable is concerned that the new framework could create differences among the capital regimes that govern companies with different charters in the same functional line of business. The Committee's broad interpretation of the "predominantly engaged" in banking activities standard could result in a new form of capital arbitrage that could be even more destructive than the arbitrage that the new proposal aims to curb. An over-reaching interpretation could create incentives for companies to select a less regulated charter over that of a bank, pushing large amounts of assets outside the banking system. This could significantly increase systemic risk. Similarly, an overreaching standard could end up driving merger or divestiture activities based on regulatory concerns rather than economic ones.

Financial Services Roundtable Recommendations

The Roundtable encourages the Basel Committee on Bank Supervision to

- avoid an over-reaching standard for defining what activities would determine whether an institution is predominantly engaged in banking activities; and
- rely on functional regulation of capital levels for non-banking activities that are only remotely connected to a bank.

II. Specific Comments on the Proposed Basel 2 Accord

The comments provided below address the broad parameters of the Basal 2 accord. We expect many Roundtable members will respond to the Committee's Quantitative Impact Study, the results of which we anticipate will confirm many of the concerns we raise here. The survey results also will guide our future comments to the Committee and U.S. regulators on the impact of the Basal 2 accord, and help us to provide more specific recommendations to improve the accord.

A. Operational Risk-Based Capital

Under current rules, operational risk has been subsumed in the current eight percent standard. However, under the proposed revision, operational risk would be subject to a separate charge. The Roundtable believes that the proposed operational RBC requirements could significantly raise the cost of doing business for all banks. As we noted earlier, should the credit RBC provisions in the Basal 2 accord result in neutral or, more likely, significantly higher capital for many institutions, the additional operational RBC could sharply boost overall capital requirements.

In addition to our concerns about the overall capital implications of the operational risk rules, we also have serious reservations about the underlying assumptions, benchmarks, and methodologies used to set operational risk capital. While there have been improvements in operational risk management capabilities, the Roundtable strongly believes that these models remain too rudimentary to be incorporated into the new accord at this time.

Under the basic indicator approach, the Committee proposes that institutions hold 30 percent of gross income as capital. While this is intended for smaller institutions, some larger ones with simple, low credit risk balance sheets could find the 30 percent operational risk requirement to be extremely steep. The standardized and internal measurement approaches are intended to permit operational risk capital charges below the 30 percent of gross income threshold.

However, our review of the estimated beta factors for the various lines of business in the standardized model suggest that capital levels for some types of institutions could be extraordinarily high, even when the low end of the beta ranges are used. This largely stems from the erroneous assumption embedded in the beta factors that operational risk has a highly positive correlation with asset size or transaction volume. However, the research from many Roundtable companies for many lines of business shows very low correlations.

This assumption can result in anomalous results, especially for specialty institutions involved in businesses with large asset bases or high transaction volumes. However, it will vary with very little credit risk, such as asset management, custody services, and payment systems. Banking organizations that have made large investments in risk management systems, insurance, and other risk mitigators in order to build market share will be punished for doing so, because of the erroneous assumption of linearity between asset base and operational risk, and the fact that risk management investments are not recognized. Institutions with a significant presence in these lines of business could face extremely steep new capital charges. In many cases, our estimates suggest that these would significantly exceed the 30 percent of gross income threshold under the basic indicator approach.

The imposition of a stiff new operations risk capital charge on these institutions would have a significant impact on their relative competitiveness. Specialty institutions competitively disadvantaged by the operational risk rules could be forced to explore alternative charters not covered by the Basel framework. As noted, this would push these services into less regulated markets and increase systemic risk.

The cost of the operational RBC charge will also be high in relation to risk because the proposal does not recognize the value of insurance or other forms of operational risk mitigation. This is in sharp contrast to the approach in the credit RBC rules, which rightly increases recognition of credit risk mitigation to create a positive incentive to reduce this risk. If an operational RBC charge is imposed without providing credit for risk mitigation, institutions will have an incentive to eliminate costly insurance policies or other prudent operational risk mitigation activities. This is a perverse result, of course, but it is the likely effect of the Committee's proposal.

We would note that the Committee has decided in its current proposal not to reflect the value of operational risk mitigation because of its concerns about liquidity or counterparty risk. These are, however, precisely the factors that the operational RBC charge is meant to capture. We believe that the current proposal, therefore, includes an internal contradiction that exacerbates its flaws.

The Committee also notes in its proposal that many institutions maintain reserves to protect against operational risk. In the U.S., these are often specific reserves to address specific issues, such as the anticipated cost of a legal settlement. There is no evidence that these reserves have proved inadequate to address operational risk, especially given the role insurance plays in reducing the cost of contingent risks such as natural disasters or systems failures.

We note that the Committee has decided to adopt a supervisory approach through its Pillar 2 for interest-rate risk ("IRR"), even though financial models and industry understanding of IRR is far more advanced than that for operational risk. The same is

true for regulatory understanding of IRR. In the U.S. and many other nations, examiners have models of IRR that they apply to institutions to determine which banks require additional IRR-related risk-based capital.

The Roundtable is puzzled by the Committee's decision to adopt a supervisory approach for interest-rate risk, which is far better understood than operational risk. We strongly urge the Committee to do the same for operational risk until such time as there is additional direct evidence that operational risk requires explicit capitalization, and then only using operational risk models that are better developed than those contained in the proposal. While a consensus on modeling approaches appears a long way off, the Roundtable believes that an industry and supervisory consensus on best practices for operations risk management could be achieved and incorporated into the accord on the current implementation schedule.

B. Credit Risk-Based Capital Standards

As noted, the Roundtable supports the Committee's efforts to implement a more risk sensitive framework that, on average, will neither increase nor decrease capital among internationally active institutions. However, the Roundtable strongly believes that several factors in the revised accord will demand significantly higher credit RBC from many institutions, resulting in higher overall capital levels in the industry and potentially serious economic side effects. Of course, the impact of higher credit RBC is compounded by the additional charge for operational risk — a charge that was predicated on the assumption that the credit component would be lower.

1. Capital Neutrality

The Roundtable recognizes that the Basel Committee shares our concerns about capital neutrality and we commend the Committee for asking internationally active banks to provide statistical data on the impact of the proposal. However, our review of the request for data compounds our concern about the as-yet unknown implications of the credit RBC proposal. The Committee has asked banks to provide their best estimates for many crucial data points, and many institutions will have difficulty providing even tentative responses to the questions related to the impact of the approaches. Even for the standardized model, it will be difficult to calculate the impact of credit risk mitigation, and many banks therefore may present a distorted picture of the impact of the simplest of the proposed capital frameworks.

One reason we believe that the credit RBC requirement will be far from neutral stems from the impact of the current accord on bank asset management policies over the past decade. Although there is little reliable data on overall U.S. bank credit risk, a 1998 Federal Reserve Board study[2] found that many large banks have moved well down the

[2] Credit Risk at Large U.S. Banks, Federal Reserve Bulletin, November 1998. The study of 26 of the 50 largest banks found that more than half of these institutions' internally rated loans on their balance sheets mapped into rating agency categories that were below investment grade.

credit risk spectrum in recent years — largely because of the arbitrage opportunities created by the current capital accord. Thus, the Committee's expectation that a bank with an "average" or BBB-rated profile would have no new net capital demands may prove incorrect because many large banks in fact have portfolios with riskier aggregate exposure.

In addition, several risks not previously captured by the RBC framework — such as routine servicer cash advances provided in asset-backed securitizations ("ABS") — are now included in the framework, and could significantly boost overall RBC levels. With a 20 percent credit conversion factor and a 100 percent weighting, the treatment of servicer cash advances could impose significantly higher capital at many U.S. institutions, where ABS issuance runs high. However, in most cases, these advances are structured so that the servicer has a senior claim on asset collections in order to recover any uncollected advances from the securitization trust, making the risk of non-reimbursement of securitization close to zero.

Similarly, the new capital requirements associated with short-term commitments and unused portions of home-equity loans also will push overall RBC levels higher under the proposed framework than under current rules. As with servicer advances, some of these commitments have very little risk associated with them, but all are subject to the same conversion factor under the standardized model and foundation IRB. The use of the "w" factor in securities lending activities also will contribute to overall higher capital levels by sharply limiting the value of collateral, particularly when imposed in conjunction with the proposed collateral haircuts.

The Roundtable believes that substantial additional research needs to be conducted to assess the impact of the accord on overall credit RBC levels in the banking system, and to ensure that it is, in fact, capital neutral for much of the industry. Coverage of certain new on- and off-balance sheet risks should be reassessed to determine if the conversion factors, haircuts, risk floors, and capital charges are necessary and accurately reflect risk. We expect that many of our member companies will provide additional technical input that will help the Committee to better calibrate credit RBC levels. We also urge the Committee to allow the industry additional opportunities to comment on any revisions to the framework that will be necessary to ensure that it is truly capital neutral.

2. Impact on Global Economy

The Roundtable is concerned that implementation of the credit RBC standards without a clear idea of their bottom-line impact could have pro-cyclical implications for the U.S. economy, as well as for other major nations. Specifically, the Roundtable is concerned that imposition of net higher capital ratios could lead banks to reduce credit availability precisely at the point in the economic cycle when central banks are seeking to boost liquidity to promote national recoveries.

As noted above, there is substantial research indicating that implementation of the 1988 Basel Accord had precisely this effect. The timing of the implementation of the Basal 2 Accord — and its anticipated demand for significant amounts of additional capital from the banking industry — is strikingly similar to 1988. With several major global economies approaching a turning point in the economic cycle, the Basel 2 Accord could be implemented just as banks are dealing with expected higher levels of non-performing assets. If the Basel 2 Accord is implemented without modifications that provide greater assurance that it is, indeed, capital neutral for most institutions, we face the real prospect of a repeat of the 1988 credit crunch.

We fear this impact could be particularly severe in Japan, where many banks are significantly under-capitalized under the current regime and likely would be even more so under the new one. Putting further pressure on the Japanese banking system while its economy remains vulnerable could have adverse implications for the international economy.

3. Impact on Individual Institutions

The Roundtable is also concerned that the standardized and IRB approaches could have vastly different implications on individual institutions that may not comport with their actual risk profile. Institutions that, for example, have emphasized subprime lending but that have very substantial reserves and significant internal risk-management capability could find themselves subject to a significant increase in capital that does not, in fact, relate to their actual risk. Some financial services firms with high external ratings could still find themselves subject to punitive capital intended for institutions with far lower external ratings. Care must also be taken that the variance of capital requirements around the mean is not so wide as to result in a regulatory capital standard that creates big winners and big losers, with very few institutions facing a modest or neutral impact.

4. IRB Framework Not Ready

The Roundtable applauds the Committee's significant efforts to move toward a more sensitive, institution-based approach. However, as noted previously, Roundtable member reviews of the IRB foundation and advanced approaches clearly indicate that these regulatory models are not yet sufficiently evolved to avoid unintended or anomalous outcomes, with potentially serious repercussions for some institutions and market sectors.

As noted, the Roundtable believes that the Committee's proposal will not achieve its desired objective of having users of the IRB approaches realize a total reduction in the amount of credit RBC they must hold. Moreover, the 90 percent floor on any capital reduction that might result from using the IRB also serves as a significant disincentive to its adoption.

Many of our members have, in fact, determined that the foundation IRB — and in many cases the advanced IRB, as well — will require more capital than the standardized model.

This stems from both models' reliance on regulatory determinants for many of the risk factors that are not accurately calibrated. This is particularly true for the foundation IRB, where only probability of default is bank-determined. In addition, the foundation treatment for collateral, credit risk mitigation, ABS holdings, and conversion factors for off-balance sheet items generally flows from the standardized model, which may limit the amount of any reduction in credit RBC from adopting the foundation model. The lack of a consistent, rich data set on which to calibrate the regulatory determinants of loss given default, exposure at default, and other factors in the IRB approaches results in misspecification of many risk factors in the models, and severely limits the viability of regulator-developed internal models.

Finally, the Roundtable is concerned about the requirement that banks restructure their internal loan grading, pricing, credit administration, and compensation systems to reflect the categories and risk assumptions on which the IRB capital models rely. While well-developed internal models should be a factor in these management decisions, the Roundtable strongly believes they should not be used as the sole or primary driver of management decisions in these areas. Financial services companies today must respond to an extraordinarily complex set of economic factors in managing their activities. Some of these factors may be temporary local market conditions, such as tight labor markets for certain management talent, or competitive ones resulting from new entrants to a particular line of business.

A too-tight nexus between the IRB model and day-to-day management will force senior management to discount certain market signals that drive pricing, underwriting, and compensation practices, but are not captured by the models themselves. This will result in business decisions that may be rational from a regulatory perspective, but not an economic one. The Roundtable believes that the proposed IRB approach would force an over-reliance on internal models to drive complex business decisions that could result in tactical or strategic errors by management. This is particularly true when the internal model contains the kind of calibration problems contained in the current IRB. We urge the Committee to reconsider the strength of the tie-in between the IRB model and management decision making to ensure that the model is an important, but not a primary driver.

C. Holding Company Capital

Under the revised framework, the risk-based capital rules will apply at the holding company level to "banking groups…that engage predominantly in banking activities."[3] The proposal does not define when this threshold would be reached, but it does make it clear that many non-bank financial activities — *e.g.*, equipment leasing and finance companies — would be aggregated with traditional banking activities to determine when a company is predominantly engaged in banking and thus subject to the Basel rules.

[3] Basel Committee on Bank Supervision, Consultative Document, The New Basel Capital Accord, January 2001, p. 1.

Thus, financial services companies that may not necessarily be registered as banks or engage in extensive non-bank financial activities may fall under it.

However, an over-broad application of the “predominantly engaged in banking” test in order to extend the reach of the Basel standards raises complex statutory issues, especially in the United States. While the recently passed Gramm-Leach-Bliley Act permits the Federal Reserve Board to impose capital on a consolidated basis on financial holding companies (“FHCs”), it did not give the Fed the power to do so in other circumstances. Commercial firms with large non-bank financial services operations are barred from becoming FHCs, even if the Basel framework might consider them banking groups. In addition, although the U.S. Office of Thrift Supervision (“OTS”) recently issued a proposal indicating that it might impose capital on thrift holding companies, it has been withdrawn because it proved too controversial. It is thus unclear how U.S. regulators could even comply with the holding company standard for some large diversified financial services firms with insured depository affiliates. Attempts by non-U.S. regulators to impose such capital standards through their own authority would raise complex questions about extraterritorial application of banking rules, and it could result in companies moving charters into different countries depending on the statutory capital framework that might be applicable.

Although the imposition of capital at the holding company level is an effort to enhance competitive equality among financial services firms, different home country legal structures and interpretations of the “banking group” concept will limit its effectiveness in leveling the playing field. Similarly, differences in accounting standards also will create problems for competitive equity. In the U.S., for example, the Securities and Exchange Commission and banking regulators have been at odds over loan loss reserve practices, which will be exacerbated by the new accord’s focus on covering both expected and unexpected losses in regulatory capital. Finally, differences in implementation by banking supervisors will have a major impact on individual firms, with some being competitively advantaged, while others are disadvantaged. The end result will be a regulator-induced shuffling of the deck with little or no net benefit in competitive equality or safety and soundness.

The Roundtable strongly urges the Committee to adopt a narrow approach to the definition of “banking group” and avoid imposition of consolidated capital too far upstream in the holding company structure. The Committee should instead rely on functional regulation of capital levels for non-banking activities not conducted within the bank. This is analogous to the “building block” model of capital previously considered by the Basel Committee, and we urge consideration of that model as a more appropriate way to avoid capital arbitrage among financial services charters and different chartering nations.

D. Asset Securitization

The Roundtable generally supports the Committee's proposed external ratings approach to asset-backed securities holdings under the standardized and foundation IRB approach. This approach generally mirrors the one pursued by U.S. regulators over the past several years to address the more complex risks associated with asset securitizations.[4] Given the widespread availability of external ratings in the ABS market, most investors in this market should adapt readily to the new standards. In particular, the Roundtable supports the 20 percent risk weight for the highest rated private ABS, which will give these instruments the appropriate parity with similarly rated ABS issued by U.S. government-sponsored enterprises ("GSEs"). The external ratings-based approach not only levels the playing field between issuers, but it also correctly does so between asset types (mortgages *vs.* small business loans *vs.* credit cards).

The ABS issuer treatment and clean break rules are also generally consistent with the approaches used by U.S. regulators and under U.S. generally accepted accounting principles. However, the Basal 2 Accord would require retained first-loss tranches used as credit enhancement to be deducted from capital. The Roundtable disagrees with this treatment and believes that external ratings, where present, should be used to determine capital on these assets. For many commonly securitized assets in the U.S., first-loss tranches are often rated investment grade. If a bank sold a rated first-loss tranche, the buying institution would receive preferential capital treatment. If retained by the issuer, however, that same asset would receive punitive capital deduction treatment. The Roundtable recommends that the final rules allow issuers to rely on external ratings for retained first-loss tranches.

As noted previously, the Roundtable is concerned that pulling certain servicer advances within the ambit of the credit RBC rules will impose unnecessary capital burdens on institutions with large servicing portfolios of asset- and mortgage-backed securities ("MBS"). The Committee proposes placing an explicit capital charge on a variety of ABS features that currently are not covered. As noted, in most cases, such as servicer advances on private label and GSE mortgage backed securities, these facilities provide very short-term advances, pose little risk to the servicer, and account for only a fraction of the overall servicing portfolio. As noted above, in the case of most MBS and some ABS, servicer advances not recovered from those borrowers that ultimately default are covered by private mortgage insurance proceeds, government guarantees, or other loan liquidation proceeds, and the servicer also has a senior claim on all asset pool collections for the reimbursements of its advances. The risk of non-reimbursement from these advances is close to zero.

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[4] While the Roundtable generally supports the Committee's approach, we have concerns that exclusive reliance on external ratings for weighting securitization holdings could penalize some monoline issuers of asset-backed securities because of the ratings agencies' approach to assessing these assets. We urge the Committee to carefully evaluate these concerns, as articulated in separate comments to be filed by several monoline issuers, and to provide home country regulators some flexibility in implementing the external ratings approach.

The Roundtable urges the Committee to provide regulators the flexibility to determine when certain ABS servicing features pose only *de minimus* risk to the servicer, and exempt these from the RBC conversion. Failure to carve out these low-level exposures could disrupt the level playing field that now exists between bank and non-bank ABS and MBS servicers, and between securitizers and portfolio lenders. Again, this runs counter to the Committee's efforts in the revised accord to maintain competitive equality.

E. Disclosure Issues

The Roundtable has a long-standing policy in support of strong disclosure standards to improve transparency and market discipline. Such disclosures help alleviate the need for regulators to impose excessive capital standards or engage in intrusive supervision. However, we are concerned that many of the disclosure standards dictated under Pillar 3, particularly those that are prerequisites for use of the IRB models, are excessive or have an unclear target audience. Moreover, these additional disclosures do not come with lower capital standards, full reliance on a bank's own validated models, or the promise of less intrusive supervision. We urge the Committee to reevaluate the disclosure standards and narrow them to only those that have clear and recognizable benefits for shareholders, depositors, and other bank counterparties that will allow them to exercise market discipline.

III. Conclusion

The Financial Services Roundtable commends the efforts of the Committee to develop a new capital framework that relies on market indicators and individual institution experience, rather than crudely drawn risk baskets, to measure risk and allocate regulatory capital. Given the rapid pace of development in financial products and risk management techniques, it is a tremendously difficult undertaking.

However, as we have outlined above, several aspects of the proposal are not yet developed fully enough to serve as reliable tools for setting regulatory capital. As the Committee moves forward, we urge caution on those elements of the proposal — most notably holding company capital, IRB, and operational risk — that have the potential to cause significant market dislocations. The Roundtable strongly urges the Committee to ensure that the final accord adheres to the Committee's initial objectives — to maintain competitive equality and preserve overall capital at a level that, on average, neither raises nor lowers capital for internationally active banks.

We look forward to providing ongoing comments to the Committee directly and through U.S. regulators as the process moves forward. We also look forward to the results of the Qualitative Impact Study, and anticipate that many of the concerns raised by the Roundtable and other interested parties will be confirmed. This should provide

additional opportunities for comment as the Committee and home country regulators move forward.

Thank you for considering the views of The Financial Services Roundtable on these important issues. If you have any further questions or comments on this matter, please do not hesitate to contact me, Lisa McGreevy, or Maura Solomon of the Roundtable staff at (202) 289-4322.

Sincerely,

Richard M. Whiting

Richard M. Whiting
Executive Director and General Counsel

cc: Federal Reserve Board
Basel 2001 Capital Proposal
Mailstop 179, 21st and C Streets, NW
Washington, DC 20051

Basel 2001 Capital Proposal
Office of the Comptroller of the Currency, Mail Stop 3-6
250 E Street, SW
Washington, DC 20019

Comments/OES
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Ms. Kim Olson
Federal Reserve Bank of New York
33 Maiden Lane
24th Floor
New York, New York 10045