May 31, 2001
Via E-mail [to BCBS.Capital@bis.org]
Basel Committee on Banking Supervision
Attn: Secretary General Nouy
Bank for International Settlements
CH-4002
Basel, Switzerland

RE: Timely comment on the BCBS's proposed new Capital Accord

Dear Secretary General Nouy, others:

On behalf of Inner City Press / Community on the Move ("ICP") and the Fair Finance Watch (the "FFW"), non-governmental organizations headquartered in New York' South Bronx in the United States, this is a timely comment on the Basel Committee on Banking Supervision's ("BCBS's") proposed New Basel Capital Accord (the "New Accord").

While many of the comments the BCBS receives may be from financial institutions, urging ever-lower (or even self-determined) capital levels, ICP and the FFW wish to highlighting the need for more, rather than less, on-site supervision of banking institutions, and the dangers posed by the apparent regulatory capture of national bank-supervisory agencies by the largest institutions and by the lack of transparency in the bank regulatory process.

Among the New Accord's three "pillars," these comments are directed primarily at the second and third: supervisory review and disclosure (also referred to more narrowly as "market discipline"). ICP, based on the experiences summarized below, is concerned by the dangers posed by granting national bank-regulatory agencies the discretion to essentially negotiate with banks their required capital levels. The ambit of the third pillar, disclosure, should be extended to the regulatory agencies themselves. As the trend toward global consolidation continues, FFW urges the BCBS to consider whether the increased concentration of risk in a dwindling number of mega-institutions does not militate for a cap on any one bank's size, akin to U.S. law's cap of 10% of nationwide deposits, and 30% in most subdivisions (states) in the U.S.. Technically beyond the scope of the New Accord, but as a matter of urgency, FFW urges the BCBS to more explicitly consider, and promulgate principles concerning, so-called "reputational risk," and, relatedly, social, environmental and human rights standards for the emerging, and unprecedentedly global and diversified, mega-banks. The BCBS, because it does not directly supervise these mega-banks, and because of its supranational charter and mission, is uniquely positioned, and has a duty, to begin addressing these issues, in connection with the New Accords and otherwise. Some background (in order to escape the realm of generality, to the degree possible in this brief comment, the discussion below gives institution- and agency-specific examples):

For the past decade, ICP has engaged in advocacy before U.S. bank regulatory agencies, most notably the U.S. Federal Reserve System and its Board of Governors (the "FRB"). Under U.S. law, the FRB's duties are not limited to monetary policy and assessing and maintaining the safety-and-soundness of the banking system: the FRB is also charged with enforcing a number of consumer- and community-protection statutes, including the Community Reinvestment Act ("CRA"), the Truth in Lending Act ("TILA") and the fair lending laws more generally. In the course of petitioning the FRB to enforce these laws, ICP has concluded in several instances that the FRB lacks the necessary distance and independence from the largest U.S. banks to fulfill its consumer protection duties; this leads ICP to question, and hereby raise, the danger of establishing a capital regime in which sometimes "captured" supervisory agencies can defer to banks' own self-described risk-assessment systems in setting minimum capital levels. Some examples:

In 1998, Citicorp and Travelers Insurance announced their intention to merge. Many industry observers noted that such a combination would run afoul of U.S. banking law, specifically, the Glass-Steagall Act of 1933. Travelers' chief executive stated that prior to announcing the proposed merger, he had conferred with the FRB; he implied that the FRB had intimated that it would approve the merger. In fact, the FRB did approve the merger, granting Citigroup a two year "grace period" in which to either divest Travelers, otherwise conform to the Glass-Steagall Act -- or have the Glass-Steagall Act repealed. In 1999, after extensive lobbying and political campaign contributions by Citigroup (and other institutions), the Glass-Steagall Act was repealed. Since then, Citigroup has acquired a controversial, high interest rate consumer finance lender, Associates First Capital Corporation. The FRB explicitly disallowed, and disregarded, public comment on Citigroup's applications to acquire Associates' banks in the United Kingdom and Hong Kong, and approved both applications without conditions. Barely three months later, the U.S. Federal Trade Commission sued Citigroup and Associates for "predatory lending" (see above, regarding "reputational risk"). In this instance, a government agency that is not a bank supervisory agency stepped into the breach and filed an enforcement action against a bank holding company and its subsidiaries. The question remains: with the FRB's hands-off policy, how wise would it be to grant even greater discretion to the FRB in negotiating Citigroup's required capital level with the institution, in a process neither open nor transparent to the public? For more, see "Federal Reserve: Big Talk, Little Action," by Matthew Lee, U.S. Banker, May 2001, <http://www.us-banker.com/usb/articles/usbmay01-6.shtml>.

As the BCBS is aware, in 1998 the hedge fund Long Term Capital Management ("LTCM") nearly failed; this was averted only after the FRB convened, and essentially strong-armed, LTCM's counter-parties, many of them bank holding companies "supervised" by the FRB. While it is impossible for the public to know what understandings were reached between the FRB and these institutions, the lack of transparency leads inevitably to a questioning of how objectively and independently the FRB would assess these institutions' self-described risk-assessment systems, in determining their required level of regulatory capital.

While the majority of ICP's work has been in the U.S., earlier this year the FFW sought to petition Canada's Office of the Superintendent of Financial Institutions ("OSFI") to inquire into the consumer impacts of, and risks presented by, two high-rate lenders that Royal Bank of Canada had applied to OSFI to acquire in the United States, along with Centura Banks, Inc.. OSFI replied, in an April 5, 2001, letter, that the entirety of banks' applications to OSFI are confidential, that the Bank Act (Canada) has "no criteria... regarding the factors that the Minister must take into account with respect to transactions such as this one," and that OSFI would defer, on "concerns about compliance of a company to be acquired," to the "responsible regulatory authorities in the [company's] home jurisdiction." For the reasons set forth above (among others), it is not certain that the U.S. FRB is appropriately assessing the risks presented by high interest rate consumer finance companies. But FFW also questions whether the primary regulatory of an institution the size of Royal Bank of Canada should, or legitimately can, defer entirely to authorities in the home jurisdiction of a company being acquired. As folk wisdom, particularly pertinent here, has it, the buck must stop somewhere. Under the proposed New Accord, an institution's primary regulator could essentially negotiate with the institution its required level of capital. This unprecedented level of discretion, and this diminishment of even the 1988 Accord's level of transparency, poses even greater dangers if the primary regulator refuses to independently assess the risks posed by acquisitions.

The lack of transparency of the bank regulatory process appears pervasive. Earlier this month, FFW wrote to the Mexican regulator, the Comision Nacional Bancaria y de Valores, to request information concerning the procedures, including procedures for public participation, that will obtain to Citigroup's recently-announced proposal to acquire Banacci / Banamex. FFW has received no response. In a May 17 teleconference call with investment

analysts, Citigroup's chief executive bragged that Citigroup had already presented the proposal to the U.S. FRB and Treasury Department, and that he believes the proposal will be "favorably [re-] viewed." See, e.g., Agence France Presse of May 17, 2001: the "chairman and chief executive of New York-based Citigroup... said he discussed the merger with... Federal Reserve Chairman Alan Greenspan. 'They had a very favorable reaction,' [he] said at a news conference in Mexico City." ICP has requested from the FRB a summary of these ex parte discussions, as well as related documents, under the U.S. Freedom of Information Act. To date, ICP has received neither. Again, the third pillar, disclosure, must be applied to the regulatory agencies themselves.

The Citigroup - Banamex proposal would, if consummated, result in Citigroup controlling over 25% of the banking system in Mexico. U.S. law caps any one bank's share of U.S. deposits at 10%, for a variety of reasons. But each nation regulates... primarily for itself, or, even more narrowly, for certain segments of its society. This is a reality, the flip-side to the so-called "race to the bottom," that the proposed New Accord, and the BCBS more generally, has not sufficiently considered. FFW's understanding is that the BCBS and the BIS attempt, among other things, to promulgate standards and "best practices" that will harmonize banking supervision in different nations. But the New Accord's granting of increased discretion to national bank supervisory agencies to negotiate with "their" banks the required levels of capitalization present the danger that, supervisory agencies will grant favorable treatment to their own banks, in the name of national pride, or the ability to compete, etc.. While we anticipate that many comments that the BCBS receives on the New Accord will call for increased "customization," fewer bright-line tests, and, essentially, more deregulation / "self-regulation," there is in fact a need for greater standardization, and more transparency to the public, in the setting of capital standards and otherwise.

Going forward, the BCBS should step into the 21st century, and understand that it must use its important supranational position to address not only issues like capitalization, but also global banks' responsibilities to serve the communities from which they collect deposits, and on which their decisions impact. As a first step, in connection with the proposed New Accord, this could and should be done under the rubric of "reputational risk." Another example, from The Times of London, November 27, 1999, "Japanese lender orders debtors to sell their kidneys:" "A former employee of Nichiei Co, Japan's leading lender to small companies, was arrested yesterday after being accused of telling a borrower and his wife to sell their kidneys to repay their debt.... Police arrested Yukihiro Wada, 45, now employed by a Nichiei subsidiary, on suspicion of using intimidation to recover a 7.2 million yen (Pounds 40,400) loan. 'Make money by selling your kidneys. You can sell them for three million yen,' he was quoted by a police official as telling the borrower and his wife, who was the guarantor... Japanese regulators have begun questioning 13 Japanese and foreign banks that provided funds to Nichiei, including Merrill Lynch and Citibank. Chase Manhattan has a 4.7 per cent shareholding."

See also The Guardian (London), November 6, 1999, "Banks bitten by Japanese loan sharks scandal:" "The scandal is also embarrassing to foreign investors, who own 31% of Nichiei. These investors, led by Chase Manhattan Bank, have enjoyed healthy dividends from the company in recent years."

That the BCBS needs to account for the loopholes created by the national regulation of banks which operate transnationally, in the New Accord and otherwise, is further demonstrated by the U.S. FRB's response to the above-quoted, which ICP submitted into evidence before the FRB in connection with Chase's applications to merge with J.P. Morgan and Co.. The FRB was satisfied with Chase's answer, that it held this 4.7% shareholding for some other, undisclosed investor. On other environmental matters, the FRB's final Chase-Morgan Order in late 2000 noted that if the incidents or investments occurred in the United

States, they fell within the jurisdiction of the U.S. Environmental Protection Agency. Matters outside the United States -- were not addressed. But reputational harm knows no borders...

The exposure of major banks' handling of funds of, for example, Nigeria's ex-dictator Sani Abacha (i.e., Citigroup, Credit Suisse First Boston, among others), Raul Salinas (Citigroup), etc. -- raises this issue of reputational risk, as does banks' acquisition of, lending to and/or underwriting for, high interest rate lenders widely alleged to be predatory, or sweatshops, or projects so environmentally destructive that even the World Bank and IMF will not fund them. The BCBS should answer, in connection with the New Accord and beyond: what level of capital should have to be held in reserve, if a bank has not adopted sufficient standards on these matters?

The BCBS, because it does not directly supervise the above-referenced mega-banks and their peers, and because of its supranational charter and mission, is uniquely positioned to begin addressing these issues, in connection with the New Accords and otherwise. For reasons not only humanitarian, and also for the stability and credibility of the banking industry and the bank supervisory systems, we urge you to do so. We will be amplifying upon these comments and suggestions in the future, but wished to raise them in a timely comment on the proposed New Accord. Thank you for your attention.

Very Truly Yours,

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