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31 May, 2001

Basil Committee on Banking Supervision
Bank of International Settlements
CH-4002 Basel
Switzerland

Dear Sir,

COMMENTS ON BASEL CONSULTATIVE PAPER JANUARY 2001

MBIA Assurance SA, the European subsidiary of MBIA Insurance Corporation, appreciates the opportunity to comment on The Basel Committee on Banking Supervisions' Consultative Paper. MBIA Assurance is a wholly owned subsidiary of MBIA Insurance Corporation, which is the largest financial guarantee insurance company in the world and is rated triple-A by Moody's Investors Service, Inc., Standard & Poor's Corporation ("Standard & Poor's) and Fitch IBCA, Inc. MBIA has been providing triple-A credit enhancement for municipal and structured debt obligations since 1974. Over the last 25 years, we have guaranteed over $1.4 trillion of net par for over 34,000 municipal and asset-backed transactions.

MBIA is broadly pleased with the contents of the latest Basel consultative paper, which it feels go a long way to encourage enhanced credit standards in the market. As a long term investor in credit risk, MBIA Insurance Corporation has developed sophisticated models to analyze its credit risk portfolio and it would welcome the opportunity to present these to representatives of the Basel Committee to help further their understanding of market practice in this area.

MBIA Insurance Corporation is particularly pleased to see more detailed discussion of the risks associated with securitisation and believes that the Committee has come a long way in designing a realistic package of proposals that reflect the risks in this market. It is particularly pleasing to see the risks of synthetic securitisation separately addressed. The Committee makes it clear that there remains some work to do in preparing final proposals on the regulatory treatment of securitisation and MBIA would be very willing to meet with members

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of the Committee or its working groups to discuss the issues involved in this market from the perspective of a monoline bond insurer in more depth.

The 'w' factor

Our initial view of the 'w' factor is that it represents an unnecessary double counting of capital. The proposals include a formal capital allocation for operational risk. However, they also include the 'w' factor for the first time, which appears to attempt to capture risks associated with both the nature of the hedge held against positions and also the documentation and system risks that are associated with the hedge. This would appear to overlap with the requirement to hold capital against operational risk. If certain banks are seen as being over-reliant on forms of credit hedging which carry significant operational risk, we believe that it would be better to address this via the capital charge for operational risk, rather than via the introduction of the 'w' factor.

If the Committee determines to retain the 'w' factor, MBIA Insurance Corporation believes that it should reconsider the boundary between those guarantee providers attracting a 0 factor and those attracting a factor of 0.15. As currently proposed, only sovereigns, public sector entities and banks attract a 0 'w' factor, whilst corporates, including insurance companies attract a 0.15 factor. We understand the Committee's intention that only certain designated professional providers of credit enhancement should attract a lower 'w' factor to reflect their relatively robust documentation and systems, which have been proved over a number of years. However, MBIA Insurance Corporation feels that the definition of guarantors attracting the 0 factor is too narrow. MBIA Insurance Corporation is the leading triple-A rated monoline bond insurer and feels that it should, along with the other triple-A monoline companies, be included in the group of professional guarantors attracting a 0 factor.

Although incorporated as insurance companies, monoline insurers are credit market professionals, whose sole business is to offer financial guarantees, structured as insurance policies. The activities of monoline financial guarantee insurers that are licensed the State of New York are only permitted by law to engage in the business of financial guarantee insurance. The companies offer a guarantee of timely repayment of principal and interest and have many years experience in structuring and documenting financial guarantee policies. The companies are globally major long term holders of credit risk and have credit expertise equivalent to that of the major banks. The policies issued by MBIA are unconditional and irrevocable and provide that MBIA waives any defense to payment. Therefore, a bank holding an instrument that is guaranteed by MBIA is assured of timely payment of principal and interest under all circumstances.

The more significant monolines are also very highly rated, typically AAA, and are expected by the rating agencies to maintain that rating in the longer term (see

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rating agency research attached). Given the need to maintain the triple-A ratings, the primary rating agencies maintain fairly close oversight over the business activities of the triple-A rated monolines. In order to maintain its triple-A ratings, MBIA (and other monoline financial guaranty companies) must follow the capital guidelines established by Standard & Poor's and the other rating agencies that rate MBIA. These capital models are designed to ensure that MBIA will have sufficient capital to pay any claims under its guarantees in a sustained stressed economic environment.

Given the unique nature of financial guarantee insurance provided by triple-A rated monoline financial guaranty insurance companies, we believe that the proposals should be amended to include triple-A rated monoline financial guarantee insurers in the 0 'w' factor category. We would suggest that this group of insurers would be best identified by a phrase such as "those monoline insurance companies which are licensed to writing business under Article 69 of the New York State Insurance Law, under Paragraphs 14, 15 and 16 of the European Union Third Non Life Assurance Directive, or equivalent legislation, and which possess a rating of triple-A from at least two major rating agencies."

Application of 'w' factor for credit derivatives

MBIA Insurance Corporation is a participant in the credit derivatives market, typically acting as a credit support provider to special purpose vehicles that sell credit protection. There is a concern that the proposal that all transactions in this market which are eligible for capital relief would be subject to the 'w factor is expected to stifle the growth of the market in the future. MBIA Insurance Corporation believes that, if the regulators intend to direct regulation to those parts of the financial market that represent the highest risk, the application of a 'w' factor to credit derivatives transacted between professional players in the wholesale markets is unnecessary and that the same criteria should be used in applying the 'w' factor in the credit derivatives market as in the cash market.

Ambiguity of requirements common to guarantees and credit derivatives

The proposals state that "a guarantee/credit derivative must represent a direct claim on the protection provider." It is unclear exactly what is intended here – for instance, as stated above, MBIA Insurance Corporation insures credit derivatives written by King Street Financial Products, a special purpose vehicle. We would welcome clarification that such vehicles attract a consistent capital treatment with the ultimate guarantor under these proposals.

Capital charge for liquidity providers

MBIA Insurance Corporation shares with the market the concern about the impact of the proposed 20% risk weight for providers of short term liquidity facilities, which could be detrimental to the operation of the asset-backed

commercial paper conduit market. There is already a developing shortage of banks that offer this type of product and the suggestion to introduce for the first time a capital charge for such facilities is likely to either reduce the number of banks wishing to participate in the market or will result banks being forced to offer uneconomic prices for these facilities. This will not just affect new deals, but will also affect the support mechanism for existing conduits when they come to renegotiate their liquidity facilities, thereby reducing access to the capital markets for certain corporates which currently raise money in this way. We would propose that, at a minimum, no capital charge be imposed for these types of facilities where the liquidity banks benefit from a third party triple-A rated guarantee with respect to the facility.

Yours faithfully,

John B Caouette
Vice Chairman