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Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
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Re: *Strengthening the resilience of the banking sector*

Ladies and Gentlemen:

General Electric Capital Corporation ("*GE Capital*") appreciates the opportunity to provide our comments on the Basel Committee's recent Consultative Document *Strengthening the resilience of the banking sector* (the "*Capital Proposals*").[1] We hope that the Committee will find these comments useful as it seeks to produce a thoughtful evolution to the current regulatory capital requirements.

GE Capital is a subsidiary of General Electric Company ("*GE*"), a diversified holding company that employs approximately 320,000 people and operates in approximately 160 countries worldwide. GE's businesses include energy, technology infrastructure, media and consumer products, as well as financial services. GE Capital provides a broad range of financial services, with a focus on providing credit and banking products to consumers and small- to medium-sized businesses.

GE Capital is committed to the careful management of our risk profile, capital and liquidity needs. We realize that capital is a key component of institutional stability, and

[1] GE Capital is submitting separately a comment letter on the Committee's Consultative Document *International framework for liquidity risk measurement, standards and monitoring* (the "*Liquidity Proposals*").

that a reassessment of regulatory capital requirements is appropriate in light of the events of the past few years. We operate several regulated institutions in the U.S., the E.U. and elsewhere in the world, giving us a vested interest in the outcome of the Capital Proposals. In addition, although many of our entities are not subject to direct regulation by financial regulators of a particular jurisdiction, we expect that the final rules resulting from the Capital Proposals will influence international business practices and will affect the ways that investors, analysts and rating agencies evaluate banks and other financial services providers. Accordingly, we are keenly interested in final regulations that will help companies develop and maintain strong capital levels based on sound metrics and at the same time maintain competitive equality without overly restricting the capacity of financial institutions to serve their customers.

In broad terms, we support the move to strengthen regulatory capital standards and to heighten the focus on common equity, which provides the most loss absorption and, as recent events suggest, is of particular concern to market participants in times of stress. We agree with the Capital Proposals' approach of looking critically at whether instruments truly have the characteristics of common equity, requiring a predominance of common equity in the capital base and, in some cases, applying deductions from capital more directly to the common equity component of Tier 1 Capital than under current capital regulations (on the theory that common equity is the first component of capital to be depleted). We also believe that it makes sense to update and improve the regulatory framework for determining risk weighting of certain assets.

However, we also are concerned that the Capital Proposals are in many respects overly conservative and that, especially when considered cumulatively and in conjunction with the Liquidity Proposals, they are so restrictive that they actually could harm the banking sector – and, by extension, the global economy. In Part I of this letter, we expand on this idea and offer our thoughts on the broad concepts contained in the Capital Proposals, the balance they seek to strike between rules-based regulation and prudential supervision of institutions and the timing and process for revising and implementing the Capital Proposals. In Part II of this letter we focus on more specific comments to sections of the Capital Proposals, pointing out when elements of the proposals might inadvertently encourage procyclicality or have other unintended consequences.

I. General Comments

The financial services industry may, on the whole, be well advised to hold more capital than it did at the onset of the financial crisis. However, we also believe that if the final Capital rules opt for the most limited definitions of capital, the broadest set of

deductions from capital and the most pessimistic assumptions about counterparty exposures, the result will be that the rules will drive away the very capital that they seek to require as institutions returns would be dramatically diminished. This in turn could hurt access to additional capital when needed, depress lending and have other unintended and harmful macroeconomic effects.

The Capital Proposals contain a set of proposed rules for calculating ratios that have not been "calibrated" yet – that is, the Committee has not suggested what the required minimum capital ratios should be. These are to be developed and proposed at a later date, informed by further study and input from the Committee's concurrent Quantitative Impact Study ("*QIS*"). It is difficult, if not impossible, to evaluate or comment on the Capital Proposals on an informed basis without knowing the levels of capital that institutions will be required to hold. This in itself leads us to advocate for at least one additional round of review and comment and that the Committee only then begin the process of a gradual, deliberate phase-in of the final rules that emerge from the Capital Proposals.

We are concerned that the Capital Proposals (and the Liquidity Proposals) are moving toward implementation without allowing for a truly meaningful review by the world financial services community. In the Capital Proposals there are at least three very significant "moving pieces": how capital is measured, how assets are risk-weighted and off-balance sheet exposures converted to on-balance sheet equivalents, and how those measurements should compare to required capital levels. We recommend an extension of time that will allow the Committee to receive sufficient feedback on the first version of the Capital Proposals, fully evaluate and publish the results of the QIS and then re-circulate revised, preliminarily "calibrated" Capital Proposals for further review and comment. We believe that a second round of review will be extremely valuable and is likely to give the Committee, as well as institutions and their regulators around the world, confidence that the final Capital Proposals have been analyzed rigorously.

After the Capital Proposals have been fully vetted and the resulting rules completed, we believe that they should be phased in gradually – with particular attention to the grandfathering of existing capital instruments that may not qualify for their current treatment going forward. This will reduce the likelihood of any adverse and unintended consequences to the markets. Market disruption could occur if, for instance, a large number of institutions in the same region find themselves needing to raise capital simultaneously to meet higher capital requirements without an adequate transition period. Institutions also might be forced to reduce or even halt lending and other

methods of providing needed credit to the world economy if increased capital requirements are implemented abruptly.

If the final rules resulting from the Capital Proposals take into account appropriate comments and become effective over a number of years, and existing capital instruments generally are allowed to retain their current regulatory capital treatment, the shock to the market could be mitigated. We believe that the urge to reform regulatory capital quickly should not outweigh the need for gradual and orderly implementation.

II. Recommendations Regarding Specific Elements of Proposals

In this section of the letter, we comment in more detail on the Capital Proposals. Our comments follow the structure of the Consultative Document, focusing on: (A) the definition of capital; (B) counterparty credit risk; (C) the proposed leverage ratio; and (D) the role of the Capital Proposals in preventing procyclical practices.

A. Definition of Capital

1. Inclusion of Hybrid Securities in Tier 1 Capital. Under the Capital Proposals, the definition of Tier 1 Additional Going Concern Capital would completely exclude U.S.-style trust preferred securities,[2] the principal type of tax-deductible capital issued by U.S. banking organizations, from inclusion in Tier 1 Capital. We believe that this is the wrong result from a perspective of focusing on capital's contribution to a "going concern." Current U.S. trust preferred securities typically allow for interest deferral for up to 10 years. From a practical standpoint, this provides the same downturn protection as permanent deferrals (i.e., non-cumulative dividends), because credit and business cycles tend to last less than 10 years even in the most adverse circumstances, and thus the 10 year deferral allows institutions to continue to operate without triggering nonpayment defaults or becoming subject to undue influence by creditors.

Additionally, to have a level playing field we believe that it is important that domestic and international treatment of hybrids be consistent across jurisdictions. Although we appreciate that Tier 1 Additional Going Concern Capital plays a secondary role in the

[2] By "U.S.-style trust preferred securities" we mean trust preferred securities for which the issuer can defer, but not cancel, dividends, making them effectively cumulative. Such securities are treated as debt for many purposes in the U.S. and therefore currently are tax-advantaged compared to other equity instruments. "European-style trust preferred securities" generally are not cumulative, but enjoy similar tax-advantaged treatment in many EU jurisdictions.

Capital Proposals and is not intended to be the predominant form of capital, to the extent that it is recognized and factored into capital ratios, its definition must reflect due concern for competitive equality. Consistent treatment of hybrid instruments across jurisdictions is critical, including the definition of Tier 1 qualifying hybrid capital, the limits on hybrid capital as a percent of available capital and the tax treatment of hybrids.

Nonetheless, if the proposal with respect to Tier 1 Additional Going Concern Capital is to become effective in its current form, it is essential that the grandfathering rule proposed by the Committee be clarified so that it grandfathers securities issued prior to the finalization of the rule. We propose that any transition be phased in over time to minimize disruption of broader economic recovery.

2. Inclusion of Unrealized Gains and Losses in Tier 1 Capital. Paragraph 96 of the Capital Proposals states that no adjustment should be made to capital to "remove from the Common Equity component of Tier 1 Capital unrealized gains or losses recognized on the balance sheet." We are concerned that this proposal would make capital highly volatile and would actually promote procyclicality because institutions would be forced to raise capital when markets are inherently weak. In addition, the proposed treatment of unrealized gains and losses on Available for Sale *("AFS")* securities is also inconsistent with the Proposals' treatment of unrealized gains and losses on cash flow hedges. The Committee proposes to disregard, for purposes of determining capital, the unrealized gains and losses on cash flow hedges on the basis that this treatment will remove "artificial volatility in common equity" (Paragraph 104). We believe that the Committee should apply this same logic and exclude the unrealized gains and losses on AFS from capital. This treatment would promote harmony within the Proposals, while remaining consistent with the current regulatory treatment in the U.S..

Additionally, the U.S. Financial Accounting Standards Board (FASB) may introduce changes to the accounting treatment for some types of assets (including most loan assets) to require marking such assets to market and therefore subjecting shareholders' equity to greater volatility from unrealized gains and losses adjustments. Under the current version of the Capital Proposals, this too would result in additional volatility in capital. These potential accounting changes would significantly increase the importance of retaining the current treatment of unrealized gains and losses in capital under US guidelines.

3. Deductions from Capital. The Capital Proposals explicitly call for several deductions from regulatory capital for items that generally would qualify for inclusion under current regulations. In several cases, we view these deductions as unwarranted.

Shortfall of Provisions. Under the Capital Proposals, a shortfall of reserves to expected losses would be deducted 100% from Tier 1 Common (Paragraphs 102-103). While this idea is conceptually consistent with the expected loss ("*EL*") modeling required under the advanced internal ratings-based ("*IRB*") approach of "Basel II," the treatment of reserve shortfalls or surpluses should be symmetric. If all shortfalls of reserves against expected losses are to be deducted from Tier 1, then all surpluses should be added to Tier 1.

Equity Investments in Financial Companies. The proposed requirement to deduct from capital the full amount of any investment in a financial institution that exceeds 10% of the institution's common stock (Paragraph 101) is sweeping and, we believe, cannot be justified because every investment has different risk characteristics. We understand the Committee's concern with the availability of capital to absorb losses at an institution if significant resources are committed to unconsolidated minority investments, and the Committee's intention to reduce what it considers the "double counting" of capital. However, as applied beyond the context of reciprocal cross holding agreements (which we agree should continue to be deducted), we feel strongly that this initiative is misdirected. We recommend continuing to give an institution's primary regulators discretion to determine deductions from capital based on the facts and circumstances of the investment, taking into account control relationships and the availability of the capital to other group members, among other considerations. Additionally, the proposed deduction discourages investments in emerging markets and other jurisdictions where foreign institutions are restricted to minority stakes. These investments in financial companies support the stability and portfolio diversification of global financial institutions.

At a minimum, existing investments should be grandfathered in order to prevent institutions from simultaneously attempting to divest these types of investments on a global basis.

In addition, the proposed treatment of investments in financial firms should be adjusted to ensure that it is consistent with the proposed treatment of minority interests. Under the Capital Proposals, an institution that owns a majority stake in a financial subsidiary

would have to include 100% of the subsidiary's risk-weighted assets but would not be able to include the minority interest in its Tier 1 Common. Additionally, the institution holding the minority stake in the same subsidiary would have to deduct the entire investment from its Tier 1 common equity. This results in double-counting the capital required across the industry. To avoid this double counting, a treatment of equity investments in financial institutions should not result in a 100% capital deduction from Tier 1 Common Equity and should therefore reflect the current US practices under Basel I and Basel II.

B. Counterparty Credit Risk

1. Use of 1.25x Asset Value Correlation ("AVC") Multiplier for Large Financial Counterparty Exposures. The Committee has proposed, applying a multiplier of 1.25 to AVCs of financial firms with assets of $25 billion or more for purposes of modeling counterparty credit risk on the basis that AVCs among financial firms are higher than among non-financial firms (Paragraphs 135-136). Assuming the AVC multiplier applies to deposits of cash, other safe, liquid assets or traditional loans to financial institutions, the capital proposals would inadvertently penalize the holding of safe, liquid assets. We do not believe that it would be appropriate to discourage the holding of these types of assets, given the overall focus of the Capital and Liquidity Proposals on balance sheet strength and management of liquidity risk. This multiplier would be particularly problematic for financial institutions and their holding companies that do not have large banking operations themselves and therefore may rely on other institutions for deposit and other cash management services. We believe that it would be particularly inappropriate in these scenarios to apply the blanket 1.25x AVC multiplier.

2. Incentives to Use Central Counterparties for OTC Derivatives. The Capital Proposals generally would provide incentives to clear OTC derivatives through central counterparties ("*CCPs*") by assigning such derivatives a zero risk weight in determining exposure (Paragraphs 165-167). As an end user who utilizes derivatives for risk hedging purposes only, we disagree with the aggregate punitive impact of the Capital Proposals for firms not using CCPs. First, CCPs may not exist for many types of trades, such as currency forwards, currency swaps, certain interest rate swaps and amortizing trades. If exposures to counterparties for these trades are risk-weighted more heavily than CCPs even though CCPs are not available, it effectively would unfairly discriminate among institutions based on the types of instruments they use for hedging. Moreover, since the use of Credit Support Annexes *("CSA")* are widespread today,

counterparties already control exposure and mitigate risk based upon the creditworthiness of institutions and collateral posting requirements. Finally, CCPs typically impose margin requirements irrespective of the creditworthiness of an institution that can require a significant amount of an institution's liquidity to be posted to the CCP, which can be a disadvantage compared to directly dealing with other counterparties.

C. Leverage Ratio

1. Measure of Capital for Purposes of Leverage Ratio. For the newly required leverage ratio, the Committee has indicated that it is considering which measure of capital should constitute the numerator of the ratio: total Tier 1 Capital, or the "predominant form" of Tier 1 Capital, which under the Capital Proposals would be Tier 1 Common (Paragraph 208). We recommend that the measure of capital for purposes of the leverage ratio be Tier 1 Common.

We believe that Tier 1 Common is the "purest" measure of loss-absorbing capital and, consistent with the rest of the Capital Proposals, should be the predominant component of capital. Because other forms of capital are secondary – Tier 1 Additional Going Concern Capital as well as Tier 2 or so called "Gone Concern" capital – incorporating these forms into the leverage ratio would give a less accurate picture of the leverage ratio's intended "backstop" measure for an operating institution than Tier 1 Common alone.

Furthermore, defining the measure of capital for purposes of the leverage ratio to be Tier 1 Common would minimize cross-jurisdictional differences because these are likely to be less relevant in the calculation of Tier 1 Common than in other forms of capital.

2. Inclusion of Derivatives. The Capital Proposals include several suggestions on the scope of assets to be included in the total exposure measure (Paragraphs 217-231). We generally agree with many of the Committee's suggestions. However, we also believe that the Capital Proposals do not appropriately recognize the different ways in which institutions may use derivatives and the different effects that those different uses can have on an institution's risk profile. In particular, the Capital Proposals should distinguish between the use of derivatives to hedge economic exposures and the use of derivatives for trading or leveraging a position so as to increase risk exposures.

As one example, the Committee has explained that it is considering whether to include regulatory netting in the measure of derivatives exposure (Paragraphs 226-229). We believe that netting of derivatives should be recognized for purposes of the leverage ratio to the extent that the netting is legally enforceable. Legally enforceable netting arrangements represent a market practice that adds efficiency to the industry, can reduce risk and should not be implicitly discouraged by the Capital Proposals by requiring institutions to use gross exposures notwithstanding that a gross exposure has been reduced through legally enforceable netting arrangements.

Derivatives held for the purpose of hedging exposures (interest rates, foreign exchange rates and commodity prices) generally will reduce the overall risk for an institution. We believe that the Capital Proposals should not discourage this use of derivatives, which contributes to a stable market environment, and instead should reflect a more sophisticated approach to derivatives that considers their real relation to an institution's risk profile.

3. Inclusion of Off-Balance Sheet Items. We appreciate that off-balance sheet items can be "a source of potentially significant leverage" (Paragraph 233). As a result, we generally support the inclusion of off-balance sheet items in the measure of total exposure. However, we disagree with using a blanket 100% credit conversion factor ("*CCF*"). The 100% CCF creates an unrealistic measure of exposure that will distort the leverage ratio and lessen its value as a benchmark of true capital strength. Reasonable CCFs must be applied to make the leverage ratio meaningful and credible. Certain commitments that generally are unconditionally revocable by an institution and unlikely to be drawn down and converted into an on-balance-sheet asset– such as consumer credit lines – should be excluded, and other credit instruments should receive appropriate CCFs (which could be non-zero and could range up to 100% depending on the character of the commitment). For example, we would support the Committee's alternative proposal of using CCFs from the Basel II standardized approach, which range from 0% for consumer credit lines to 100% for direct credit substitutes.

D. Procyclicality

We understand the Committee's recommendations regarding procyclicality are preliminary and will be discussed further at its July 2010 meeting. As a result, we note that our comments necessarily are preliminary as well and lack the specificity of our comments on more fully developed proposals. Nonetheless, we believe that the Committee's recommendations on procyclicality appear to be excessive, especially

when considered in addition to the other increased capital requirements of the Capital Proposals. Again, it is the compound impact of these proposals that could so adversely affect the ability of institutions to raise capital and provide credit to the economy.

In general, we recommend that procyclicality-related initiatives be handled within the context of prudential supervision (so called Pillar 2 regulation) leveraging internal capital models developed by individual institutions. For example, supervisors in a particular jurisdiction could be encouraged to issue more specific guidelines on how institutions should conduct consistent “stress testing” and incorporate the results into capital requirements. Furthermore, we believe that any new procyclicality-related rules should be subject to an additional round of review and comment period and a phased multi-year implementation.

1. Proposal to Use “Downturn” PD in Calculating Capital Requirements. The Capital Proposals note that the Committee is conducting an impact study on a proposal to use the “highest average PD estimate applied by an institution historically to each of its exposure classes as a proxy for a downturn PD” to be used in modeling capital requirements (Paragraph 242). We have two fundamental concerns with this approach. First, this proposal should not apply to institutions that are not using the IRB advanced approach of Basel II, because they will not have the validated credit models necessary to provide the required inputs. Second, using a “stressed” PD would be theoretically inconsistent with the Asymptotic Single Risk Factor model which itself “stresses” PD and therefore requires a “through-the-cycle” PD as an input, not a “downturn” PD. We suggest that if the goal is to reduce the procyclicality potentially encouraged by capital calculations, then adopting a “stress testing” approach as provided in Basel II might be the most effective approach.

2. Capital Buffers. We strongly believe that any blanket capital “buffer” policy will be translated by the market into *de facto* minimum capital requirements. In any case, we also feel strongly that capital buffers should be institution-specific – that is, determined through the institution’s internal capital adequacy modeling process and reviewed by its regulator as part of the supervisory process. Furthermore, if the internal modeling and supervisory processes were adequate, then a proposal to impose restrictions on an institution’s expenditures and capital distributions to build up capital would, in our view, be duplicative of the supervisory role and overly prescriptive.

Again, we appreciate the opportunity to provide our comments and hope that the Committee will find them constructive.

Very truly yours,

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