Capital One Financial Corporation
1680 Capital One Drive
McLean, VA 22102

April 16, 2010

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

Re: Consultative Document: *International framework for liquidity risk measurement, standards and monitoring*

Dear Ladies and Gentlemen:

Capital One Financial Corporation ("Capital One")[1] is pleased to submit comments to the Basel Committee on Banking Supervision ("Committee") on the consultative document *International framework for liquidity risk measurement, standards and monitoring* ("CD" or "liquidity proposal").[2]

We support the Committee's goal, as outlined in the CD, to enhance the resilience of the financial system to liquidity stresses. The recent financial crisis has clearly demonstrated the need for the global banking industry to reduce liquidity risk exposure and develop a more effective regulatory assessment of exposure to liquidity stresses. As a U.S. bank that did not rely on the government liquidity programs during the recent crisis, we

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[1] Capital One Financial Corporation (www.capitalone.com) is an international financial services company, whose subsidiaries, which include Capital One Bank (Europe) plc., Capital One Bank (Canada Branch), Capital One, N.A., and Capital One Bank (USA), N. A., collectively had $115.8 billion in deposits and $212.0 billion in total managed assets outstanding as of December 31, 2009. Headquartered in McLean, Virginia, USA, Capital One offers a broad spectrum of financial products and services to consumers, small businesses and commercial clients in the U.S., Canada and the UK. A top ten credit card issuer in the UK, Canada and United States and a Fortune 500 company, Capital One trades on the New York Stock Exchange under the symbol "COF" and is included in the S&P 100 index.

[2] Capital One has also submitted a letter dated April 16, 2010 regarding the Committee's consultative document entitled *Strengthening the resilience of the banking sector*.

support the effort to require banks to ensure sufficient access to stable funding under a variety of market conditions and to develop improved measurement metrics.[3]

We do, however, have serious reservations about some of the conceptual underpinnings of the CD and suggest a modified approach to evaluating banks' liquidity risk positions. In this letter, we will outline our key conceptual concerns with the CD, suggest a modified approach, and provide suggestions for how several specific issues could be addressed more effectively.

Overview

Both the liquidity proposal and capital proposal in the Committee's consultative document entitled *Strengthening the resilience of the banking sector* ("capital proposal") appear to have been developed to prevent a once-in-a-generation financial crisis. While elements of these proposals could theoretically each work individually to reduce risk without harming the broader economy, in reality they must function together as part of a cohesive system. Additionally, they have not been proposed in isolation. Several regulatory and legislative proposals currently circulating, together with the Basel amendments, could have a substantial cumulative impact on the global economy, including a significant contraction in credit.

We agree with the Committee's concerns that recent events were "preceded by several years of ample liquidity in the financial system, during which liquidity risk and its management did not receive the same level of scrutiny and priority as other risk areas."[4] We are concerned, however, that the imposition of rigid requirements driven by market shock assumptions would force banks to self-insure against highly unlikely events, thus introducing inefficiency into the markets and resulting in significantly reduced and more expensive credit.

This proposal has also set forth requirements without regard to the characteristics of a specific institution or jurisdiction. In particular, it appears to disregard standards and customs particular to individual countries, developed over time to enable efficient local commerce. Cross-border differences in public policy goals and tax, accounting, and legal standards could result in an uneven, and potentially harmful, global application of the Basel amendments if they are implemented in their current form. Instead, we urge the Committee to allow sufficient discretion by national regulators when interpreting and implementing these rules for their specific jurisdictions.

We believe that an assessment of an institution's liquidity position needs to be broader than the two regulatory standards for liquidity risk proposed in the CD, which may not accurately capture its business model or funding landscape.[5] Baseline ratios may provide regulators with a reasonable starting point, but should be used with scenario-based stress

[3] U.S. government funding programs include the Temporary Liquidity Guarantee Program (to issue long-term debt), Term Asset-Backed Securities Loan Facility, and Term Auction Facility.

[4] CD, paragraph 1.

[5] We will discuss the Liquidity Coverage Ratio and the Net Stable Funding Ratio in greater detail in the Specific Comments section.

tests, which together would allow for a more extensive and nuanced perspective of an institution's overall health and sustainability. Stress tests can also effectively capture the relationship between liquidity and capital and take into account institution-specific variables, such as mix of business activities and liquidity access.

We believe that the 2009 Supervisory Capital Assessment Process ("SCAP") in the U.S., while not a liquidity analysis, is a good example of how dynamic supervisory processes can help market participants, including regulators, understand banks' capital and liquidity positions. Given continued financial innovation, constantly evolving accounting, tax, and legal standards, and important differences among financial institutions, we believe that scenario-based stress tests would provide a better perspective of an institution's overall sustainability than would static regulatory requirements.

Liquidity "Market Shock" Assumptions Leads to Bank Self-Insurance

The liquidity proposal would appear to require banks to continuously manage liquidity under "market shock" assumptions that represent a once-in-a-lifetime financial crisis. For example, recent experience demonstrates that assumptions such as 7.5% or 15% deposit run-off rates within a thirty-day timeframe are, in the aggregate, unrealistic in a closed banking system, since any deposits that are withdrawn from one bank would likely be deposited in another.[6] Managing liquidity in this context would force banks to self-insure against highly unlikely scenarios, injecting significant inefficiency into the markets that would likely result in reduced and more expensive credit.

In developing this liquidity proposal, the Committee appears also to have ignored some of the fundamental structural elements of the U.S. economy and financial system. Following the Great Depression, rather than extending loans that could be called at any time, U.S. bank policy shifted towards providing borrowers with fixed terms on their loans, even as many deposits remained available on demand. This arrangement provided customers with a high degree of flexibility but created liquidity risk for the banks. Liquidity backstop mechanisms were developed by the Federal Reserve and other governmental agencies to ensure that banks had access to the necessary liquidity to support this gap, thereby establishing effective and low-cost funding for both consumers and businesses.

The requirements and assumptions detailed in the CD would attempt to eliminate this liquidity risk by requiring banks to adopt a much more conservative and costly approach to liquidity risk management. The changes proposed in the CD would create a system in which banks essentially fully insure against this liquidity risk themselves instead of relying on the support of central banks or other governmental entities during a once-in-a-lifetime liquidity crisis. <u>The burden and high cost of such a framework would introduce undue inefficiency into the financial system and result in the retrenchment of banks from</u>

[6] Note that we also believe that such assumptions are particularly conservative with respect to banks in specific jurisdictions, such as the U.S., with a robust deposit insurance system.

some of their key intermediation activities, likely resulting in reduced liquidity and an increased cost of credit.[7]

We agree, of course, that banks must manage liquidity risk prudently to ensure that the government intervenes only as a last resort. We therefore support many of the key provisions outlined in the CD. Capital One has employed a rigorous program of forward-looking liquidity stress tests for many years, the success of which was proven during the recent financial crisis, and would welcome the implementation of such procedures at all banks. We believe, however, that the Committee should avoid utilizing overly conservative assumptions that do not take into account important jurisdiction- and bank-specific factors. We discuss our reservations in more detail below.

Cumulative Impact of Basel and Other Regulatory & Legislative Proposals

We agree with the Committee that both capital and liquidity standards must be strengthened across the international banking industry. However, while elements of these proposals could theoretically each work individually to reduce risk without harming the broader economy, we are concerned that the interface between the two could have significant negative macroeconomic consequences.

For example, the liquidity proposal may force banks to hold more liquidity on their balance sheet or shift much of their investment portfolios from consumer, mortgage, and business loans into lower-yielding assets including cash, central bank reserves, and government securities. These strategic shifts would result in a decline in earnings that limits the natural accretion of capital, and could limit banks' ability to use investment portfolios in the management of interest rate risk. We are concerned that allocating more capital against liquidity at the same time that required capital levels are increasing will result in more expensive and less available credit and stall economic recovery. We urge the Committee to consider these potential impacts carefully.

While the impacts of the Basel proposals alone are significant, they have not been proposed in isolation. In the U.S. alone, there are ongoing legislative and regulatory efforts to overhaul oversight of the banking system, increase consumer protection requirements, impose new assessments and taxes on financial institutions, and reform securitizations, among other things. If all of these items are implemented as currently contemplated, it is likely that there will be an increase in the cost and decline in the availability of credit.

Therefore, we advocate greater coordination and harmonization not only across the various international regulatory and legislative proposals, but also between the liquidity and capital proposals in order to prevent detrimental and unintended impacts to capital and liquidity within the global financial system. Only by studying this cumulative impact

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[7] As The Clearing House letter in response to the liquidity letter ("Clearing House letter"), dated April 16, 2010, p.21, states: "For centuries, maturity transformation – that is, intermediating the imbalances between short-term and long-term needs of borrowers and the availability of credit – has been an essential economic and even societal function of banks."

will the Committee be able to coordinate regulatory reforms in an appropriate and effective manner.

Jurisdictional Differences and Need for Regulator Discretion

We understand the Committee's interest in creating uniform liquidity and capital rules across countries to prevent competitive inequality and achieve a sound global financial system. However, jurisdictional parity is not achieved by applying the same rules to countries with different policy goals, legal and accounting systems, and regulatory structures. Where real differences substantively impact liquidity characteristics, the Committee must consider the idiosyncrasies of a particular jurisdiction and provide national regulators with needed discretion.

As outlined in the Overview, one of our main jurisdictional concerns is that the Committee appears to have ignored key structural features of the U.S. financial system that were designed to reduce the cost of liquidity in the economy. For example, U.S. policymakers have historically focused on the promotion of homeownership, reflected, in part, by the development of a large and highly liquid mortgage-backed securities ("MBS") market. The current regulatory capital risk-weightings for MBS issued by government-sponsored enterprises ("Agency MBS") reflect the role that these instruments play in extending readily available and cost-effective liquidity to consumers.[8] As discussed in greater detail below, we believe that Agency MBS should be treated comparably to Treasuries due to their strong support from the U.S. government and highly liquid market.

Timing Considerations

Given the above considerations, we believe that the Committee should take more time to assess the wide-ranging impact of these proposals. The CD does not provide a specific date for the implementation of revised liquidity standards, but does quote the recommendation of the G20 that the Committee and national authorities should by 2010 agree upon a global framework for promoting stronger liquidity buffers at financial institutions.[9]

We request, however, that following the completion of the Quantitative Impact Study, the Committee publish a second document and provide banks, regulators, and other key market participants with enough time to evaluate and comment upon the updated proposal. Furthermore, as requested by the American Bankers Association ("ABA") in their letter dated April 15, 2010, we urge the Committee to publicize the research that supports the run-off rates, funding haircuts, available stable funding factors and required stable funding factors proposed in the CD.[10]

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[8] The concept of risk-weighted assets was originally developed by the Committee whereby assets are weighted according to their riskiness and potential for default. National regulators determine the appropriate risk-weightings for bank assets within their jurisdictions.
[9] CD, paragraph 4.
[10] ABA, p.2.

We also believe that the Committee should consider carefully the timing of the announcement and implementation of any new requirements, in light of a potentially massive disruption in capital markets driven by bank portfolio restructuring.

Suggested Approach – Scenario-Based Stress Tests

We do not believe that basing liquidity standards on extreme market shock assumptions, as laid out in the CD, would result in effective bank liquidity risk management. Continuously managing towards worst-case scenarios would introduce high costs and inefficiency into the banking system. Although reasonable minimum liquidity requirements are necessary, they should be used in conjunction with scenario-based, bank-specific stress tests, which together would better measure an institution's health than extremely conservative "one-size-fits-all" ratios.

An assessment of an institution's liquidity position needs to be more dynamic than two ratios driven by generic, industry-wide assumptions, as proposed in the CD, which may not accurately capture its business characteristics or funding environment. Relying only on specific ratios could also introduce a safety and soundness risk if banks start placing less emphasis on broader, more relevant liquidity measurement tools. While baseline ratios may provide regulators with a reasonable starting point, scenario-based stress tests would enhance supervisory ability since they provide a broader perspective of an institution's overall sustainability. Specifically, they can effectively capture the relationship between liquidity and capital and take into account bank-specific variables.

We believe that the SCAP in the U.S., while not a liquidity analysis, is a good example of how dynamic supervisory processes can help market participants understand banks' capital and liquidity positions and restore faith in the financial system. Through the SCAP, U.S. regulators applied stress scenarios across multiple banks and all lines of business within each bank, which "allowed a broader analysis of risks than is possible within the traditional supervisory focus on individual institutions."[11] Indeed, Chairman of the Board of Governors of the Federal Reserve System Ben Bernanke proclaimed that the SCAP "was an enlightening exercise that will improve the toolkit we use to help ensure the safety and soundness not just of individual firms, but of the financial system more broadly."[12]

Stress tests and a strong supervisory approach also provide a level of flexibility against changing economic conditions and constantly evolving accounting, tax, and legal standards that inflexible ratios do not. As Federal Reserve Governor Daniel Tarullo stated in a March 26, 2010 speech, "I believe that the most useful steps toward creating a practical, macroprudential supervisory perspective will be those that connect the firm-specific information and insight gained from traditional microprudential supervision to

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[11] Chairman of the Board of Governors of the Federal Reserve System Ben S. Bernanke, at the Federal Reserve Bank of Atlanta 2009 Financial Markets Conference, Jekyll Island, Georgia, May 11, 2009.
[12] *Ibid.*

analysis of systemwide developments and emerging stresses. Here, precisely, is where our SCAP experience has helped lead the way."[13]

Additionally, we believe a more dynamic process that continuously retests short- and medium-term liquidity as a crisis persists is a better assessment of liquidity strength. Capital One currently performs internal, dynamic liquidity stress tests, which have proven invaluable to our ability to weather the recent financial crisis without relying on the U.S. government liquidity programs, such as the Term Asset-Backed Securities Loan Facility, Term Auction Facility, and Temporary Liquidity Guarantee Program on long-term debt.

Finally, we believe that that the proposed liquidity tests should function only as a supervisory tool for regulators rather than metrics that are publicly disclosed. We believe that the disclosure of liquidity ratios would have a very different, and likely negative, impact from the disclosure of capital ratios. As stated in the Clearing House Association's ("Clearing House") letter, "Liquidity measures do not derive from financial statements and depend for a particular bank upon its interactions with the market. As a consequence, liquidity ratios are ...much less useful as a disclosure metric to be considered by depositors and market participants.[14]

We also agree with the Clearing House that "public disclosure may expose banks to market penalties for marginal differences in their own ratios as compared to peers, even where the differences do not reflect meaningful differences in the banks' respective liquidity strength."[15] Furthermore, we are concerned that publishing liquidity ratios could result in unnecessary panic and downward spirals for banks, even if they have plans in place with regulators to effectively manage the risk.

Specific Comments on the Liquidity Proposal

Definition of Liquid Assets

Jurisdictional Considerations

Our overarching concern with the CD's definition of highly liquid assets is that it seems to overlook critical features of the U.S. economy and financial system. The proposal states that only cash, central bank reserves, securities backed by sovereigns, central banks and certain international institutions, and government and central bank debt can be considered highly liquid for purposes of calculating the Liquidity Coverage Ratio ("LCR").[16] We believe this classification is excessively narrow and, in particular, does not reflect the fact that many types of assets in the U.S. are liquid even in times of severe market dislocation.

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[13] Federal Reserve Governor Daniel K. Tarullo, "Lessons from the Crisis Stress Tests", March 26, 2010.
[14] Clearing House Letter, p.10.
[15] Ibid, p.10.
[16] CD, paragraph 34. The Net Stable Funding Ratio ("NSFR") has similar requirements (Table 2).

For example, given the low risk and substantial liquidity of Agency MBS, they should be included in the Committee's definition of highly liquid assets, treated comparably to U.S. Treasuries. Agency MBS are a fundamental component of the U.S. economy and are low-risk, with the strong support of the U.S. government. The securities are readily accepted as collateral, not only in the repurchase markets, but also with both the Federal Reserve and the Federal Home Loan Bank ("FHLB") systems.[17] Additionally, the market for Agency MBS is both very large, with over $5 trillion outstanding,[18] and highly liquid, [19] with global investors benefiting from transparent pricing and tight bid / ask spreads.

If appropriate liquidity credit is not provided to Agency MBS, many U.S. financial institutions would likely fail the proposed liquidity tests as these securities comprise a large portion of their liquidity holdings. Excluding Agency MBS from the definition of highly liquid assets could force banks to sell these securities en masse, potentially disrupting the mortgage market, damaging the housing sector, and delaying U.S. economic recovery.[20]

Ability to Pledge through Government Liquidity Programs

The CD treats the ability to pledge assets to a central bank or other governmental entity as only a secondary indicator of asset liquidity and hinges its liquidity designations primarily on the ability to sell assets in the secondary markets. However, we believe that the ability to pledge assets to a central bank or similar institution is of critical importance, particularly during the type of market shock on which the Committee appears to be focused, and we see little logic in making significant distinctions among assets that are equally eligible to be pledged. As discussed in the Overview to this letter, we believe that the current financial system in which the government functions as a lender of last resort is far preferable to one in which banks self-insure to such an extent as to render the credit markets costly and inefficient.

With respect to the U.S., we believe that MBS, asset-backed securities, mortgage loans, and corporate bonds that can be pledged to government liquidity programs should receive appropriate liquidity credit in this proposal. We recommend using haircuts akin to those applied at the Federal Reserve discount window, where, for example, haircuts imposed on investment grade corporate bonds are a few percentage points higher than on

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[17] See section entitled "Ability to Pledge through Government Liquidity Programs." Note that Agency MBS are currently explicitly guaranteed by the U.S. government.

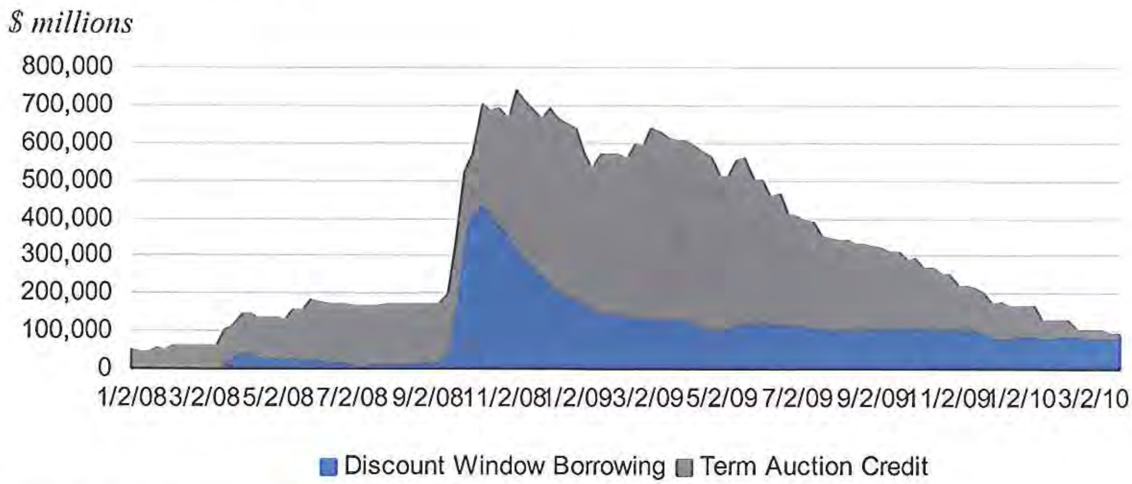
[18] www.federalreserve.gov/econresdata/releases/mortoutstand/current.htm

[19] In their *Interagency Policy Statement on Funding and Liquidity Risk Management*, the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of Thrift Supervision, and National Credit Union Administration state: "It is the intention of the agencies for institutions to maintain a buffer of liquid assets that are of such high quality that they can be easily and immediately converted into cash. Additionally, these assets should have little or no loss in value when converted into cash. In addition to the example used in the policy statement, **other examples of high-quality liquid assets may include government guaranteed debt, excess reserves at the Federal Reserve, and securities issued by U.S. government sponsored agencies.**" (Emphasis added)

[20] According to Barclays Capital, *2010 Fixed Income Outlook*: At Q3 2009, U.S. banks held more than 20% of outstanding Agency MBS.

Treasuries. At the very least, like the Clearing House, we believe that the Committee should disclose the reasoning it has used to design the proposed criteria and associated haircuts, and permit market participants to potentially suggest other ways of tailoring the weightings more closely to reflect economic reality and/or the risk profile of individual institutions.[21]

The Federal Reserve grew its balance sheet significantly during the financial crisis, extending to banks cash and term loans backed by the types of assets listed above. The below chart shows the increase in borrowings under the Federal Reserve discount window and Term Auction Facility ("TAF") during the crisis and the subsequent decline as the markets recovered.



Source: Federal Reserve H.4.1 report

In the depths of the recent financial turmoil, banks were also able to access the FHLB for advances on eligible collateral. Established by the U.S. Congress in 1932 to support mortgage lending, the FHLB System provides a stable source of funding to federally insured depository institutions. FHLB advances are backed by residential and commercial mortgage collateral and are available in a wide variety of terms to maturity. During the recent crisis, advances were provided to U.S. banks in increasing amounts: $640 billion at 6/30/2007, $875 billion at 12/31/2007, and $1.01 trillion at 9/30/2008.[22] Even troubled banks, including Washington Mutual and National City, were able to access FHLB funding in significant amounts. We understand that banks in many other jurisdictions have ready access to similar sources of funds in both business-as-usual and stressed conditions that should receive similar consideration.

Finally, classifying central bank (or similar) eligible assets as highly liquid could be conditioned on a bank having in place all contractual arrangements needed to allow for ready access to the funds.

Definition of Required Stable Funding for Assets

[21] Clearing House, p.17.

[22] http://www.fhlb-of.com/specialinterest/financialframe2.html

For the denominator (required amount of stable funding) of the Net Stable Funding Ratio, the CD proposes an RSF factor of 50% for loans to non-financial corporate clients having a residual maturity of less than one year, but an 85% RSF factor to retail loans with similar maturities. We understand, per Paragraph 88, that RSF factors assigned to various types of assets are "parameters intended to approximate the amount of a particular asset that could **not** be monetized through sale or use as collateral in a secured borrowing on an *extended* basis during a liquidity event lasting one year."[23]

Given recent historical experience, we believe that the proposed differences between corporate and retail loans are ungrounded, at least in the U.S. Here, institutions can pledge both corporate and retail loans to the Federal Reserve discount window at similar haircuts (and were able to do so under the TAF as well).[24] We would argue, therefore, that they possess similar liquidity characteristics that should be reflected by similar RSF factors.

Additionally, retail loans rarely have balloon payments or require refinancing in order to pay off balances remaining at maturity. In contrast, many commercial loans do require refinancing, which in times of stress may be more difficult to obtain. We therefore believe that the Committee should reconsider these RSF factors and conform the retail loan factors to the corporate loan factors.

Cash Outflows

The CD imposes cash outflow rates for the LCR that are very conservative given banks' experiences during the recent financial disruptions. We believe it is highly unlikely that the banking system as a whole would experience the proposed run-off rates since liquidity would have to be housed somewhere within the banking system. This outcome is also inconsistent with the assumption that bank liquidity facilities would be fully drawn since, if this were the case, the drawn funds would also have to be placed on deposit somewhere in the financial system.

As outlined earlier in this letter, we support a scenario-based approach that uses historical data from past crises to determine prudent run-off factors that could be adjusted over time to account for changes in both market conditions and jurisdiction- and institution-specific factors. Such an approach would have the benefit of greater accuracy, be more aligned with historical experience, and would contribute to more robust liquidity risk management practices.

Retail and Small Business Deposit Run-off

[23] CD, paragraph 88.

[24] Federal Reserve Discount Window & Payment System Risk Collateral Margins Table, updated December 7, 2009: for example, the haircut for normal risk-weighted commercial loans is 63%-95%, for normal risk-weighted commercial real estate loans 57%-95%, for unsecured consumer loans 60%-96%, and for private banking loans 90%-96%.

The CD currently proposes the following run-off assumptions for retail and small business deposits: 7.5% or higher for deposits that are, at a minimum, insured and 15% or higher for those that are uninsured, all within a thirty-day period. As indicated in the Overview to this letter, we believe that these assumptions are too conservative. At the height of the 2007-2009 financial crisis, deposit run-off rates at troubled banking institutions were typically lower than the rates assumed in this CD. According to the ABA, "deposit trends from 121 bank failures from 2008 and 2009 show that deposits actually increased at banks in the third and fourth quarters prior to failure, decreasing by 1.3 percent in the second quarter prior to failure and 2.1 percent in the last quarter prior to failure. The greatest decline in deposits – that is, the greatest rate of run-off – of any bank in the last quarter prior to failure was 17 percent."[25]

We agree with the Committee's statement that "Certain parameters...will need to be set by national supervisors to take account of jurisdiction-specific conditions. For example, the percentage of potential run-off of retail deposits is partially dependent on the structure of a jurisdiction's deposit insurance scheme."[26] We would propose that run-off rate assumptions be established by national regulators based on both historical experience (including recent data) and their assessment of individual banks' specific businesses and liquidity profiles.

For example, while we appreciate that different jurisdictions have different types of deposit insurance, we would urge the Committee to give due credit to the robust and historically proven protection provided by the Federal Deposit Insurance Corporation ("FDIC") in the U.S. We believe that the market's confidence in this protection, and its timely limit increase during the height of the crisis, justifies a reexamination of the 7.5% run-off assumption, at least in the U.S. Again, liquidity requirements should be appropriately conservative but not so draconian that banks must fully self-insure against once-in-a-generation liquidity crises.

Unfunded Commitments

We believe that the Committee should also revisit its stance on the liquidity risk of committed credit and liquidity facilities. Currently, the proposal requires banks to assume a 10% draw-down on committed credit facilities and a 100% draw-down on committed liquidity lines to non-financial corporate customers, as well as a 100% draw-down on both types of facilities to financial institutions. However, at the same time, banks must assume that they cannot draw on any liquidity or credit lines to which they have access.

This asymmetrical dynamic represents a flawed logic that is both onerous and unrealistic and should be tempered when determining an institution's liquidity position. During the recent financial crisis, there was very little evidence of either customers fully drawing down on facilities or banks refusing to honor their commitments anywhere near the extent suggested by the proposal. We have historically found, in fact, that the demand for credit declines in a recession. Additionally, these extreme assumptions must be

[25] ABA letter, p.9. (focused on banks failed by the FDIC)
[26] CD, paragraph 10.

considered in concert with the proposed deposit run-off scenarios. If bank liquidity and credit lines are being fully drawn, those funds have to be housed somewhere within the financial system. Assuming thirty-day 7.5%/15% run-off rates at the same time as full draws on committed facilities results in a banking system that in the aggregate must self-insure against the near-impossible to such an extent that it may no longer be able to execute its lending functions effectively.

Monitoring Tools

We believe monitoring tools can play a useful role in the ongoing assessment of bank liquidity positions. However, these tools should be a part of the overall analysis of a bank's strength as discussed under our Suggested Approach section. Additionally, where monitoring tools do not accurately capture a bank's risk management strategy, they can introduce an element of confusion. We discuss below our key concern with the proposed monitoring tools.

Contractual Maturity Mismatch

Through the use of a contractual maturity mismatch profile, the Committee seeks to identify gaps between the contractual inflows and outflows of liquidity for defined time bands.[27] The CD indicates that asset flows would have to be reported based on contractual maturities rather than behavioral assumptions and historical experience with prepayments. We believe that this approach would be highly misleading given that amortizing assets such as mortgage loans are normally analyzed based on modeled cash flows that consider the significant role of prepayments, rather than on contractual cash flows. Instead, we believe that the experience of the past few years would provide valuable data around liquidity movements, particularly the impact of consumer behavior, and should be used in the context of scenario-based stress tests.

Summary

We agree that the recent financial crisis has demonstrated the need for banking institutions to reduce liquidity risk exposure and enhance risk modeling capabilities. However, we fear that the overly conservative assumptions and classifications proposed in the CD would create a system in which banks fully self-insure against liquidity risk instead of relying on the support of governmental entities in a liquidity crisis. The high cost of such a framework would introduce undue inefficiency into the financial system and result in the retrenchment of banks from some of their key lending functions. Instead, more reasonable baseline requirements should be used in conjunction with scenario-based, bank-specific stress tests, which together would better measure an institution's health than extremely conservative "one-size-fits-all" ratios.

[27] CD, paragraph 95.

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Capital One appreciates the opportunity to comment on this Consultative Document. If you would like to discuss our comments, please contact me at (1)-703-720-1000.

Respectfully,

Gary L. Perlin
Chief Financial Officer