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Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel, Switzerland

Re: Basel Committee on Banking Supervision Consultative Documents - Capital floors: the design of a framework based on standarised approaches and Revisions to the Standardised Approach for credit risk

Dear Sirs:

Wells Fargo & Company (Wells Fargo) is a diversified financial services company with over $1.7 trillion in assets providing banking, insurance, trust and investments, mortgage banking, investment banking, retail banking, brokerage services and consumer and commercial financial services. We appreciate the opportunity to comment on the Basel Committee on Banking Supervision ("BCBS") Consultative Documents: *Capital floors: the design of a framework based on standarised approaches* ("CF Proposal") and *Revisions to the Standardised Approach for credit risk* ("SA Proposal") The Capital Floor Proposal and the SA Proposal are hereinafter referred to collectively as the "Proposals".

We agree with the BCBS's objectives to ensure that a minimum level of capital is held across the banking system and to mitigate risk of model error. Market participants must have confidence in the regulatory capital framework and we understand how significant differences in risk weights for similar credit quality exposures may reduce confidence in a bank's internal models and the overall capital framework. While we recognize the need for a capital floor within the regulatory framework and acknowledge a capital floor does not exist in all jurisdictions; we are concerned with the introduction of an additional capital measure amidst the myriad of additions and modifications that have been made to regulatory capital standards in the recent past. Many U.S. financial institutions are in the process of implementing Basel III, including both the U.S. Advanced Approach and the U.S. Standardized Approach[1], the latter of which already serves as a capital floor for U.S. institutions. We believe the BCBS's objectives can be achieved through a reasonably calibrated standardized approach similar to the current U.S. Standardized Approach.

Most large U.S. institutions will begin publically reporting capital under the U.S. Standardized Approach in the first quarter of 2015[2]. We believe it would be prudent for the BCBS to further assess and align where appropriate to the U.S. Standardized Approach. Likewise, we also acknowledge that it may be prudent for U.S. regulators to align with the final BCBS Standardized Approach. What should be avoided is a scenario where U.S. institutions become subject to two floors, a final BCBS Standardized Approach in addition to the current U.S. Standardized Approach. As a result, we believe it is essential that the

[1] 12 CFR parts 3, subpart D; 217, subpart D; 324, subpart D
[2] Eight U.S. financial institutions exited parallel and implemented the U.S. Standardized Approach in 2014.

BCBS provide sufficient national discretion such that substantial alignment in standardized approaches can be achieved across jurisdictions and U.S. institutions are not subjected to multiple capital floors.

In addition to implementing the Basel III capital rule, we are also subject to leverage and supplemental leverage, liquidity, capital buffers and total loss absorbing capital ("TLAC") requirements which are in various stages of implementation. Before the BCBS layers further onto this framework, we believe time should be provided to complete the implementation of the current requirements followed promptly by an effectiveness assessment study. In conjunction with assessing the effectiveness of the overall framework, the BCBS should consider the incentives created by the various requirements and impact of the SA Proposal on other regulatory ratios. For example, the proposed changes to credit conversion factors ("CCFs") would carry forward to leverage ratios. Similarly, the definition of high quality liquid assets ("HQLA") in the liquidity coverage ratio ("LCR") for certain asset classes (e.g. sovereigns) is dependent on risk weightings under the U.S. Standardized Approach. It is not clear whether the impact to other regulatory ratios was fully considered in the SA Proposal.

Beyond addressing the conceptual need for a floor within the overall regulatory capital framework, the CF Proposal addresses the design of the capital floor. One key aspect of the design is the level at which the capital floor is applied based on two alternatives, an aggregate floor or a risk-category based floor. We strongly recommend the aggregate approach as it is more intuitive and promotes comparability of capital ratios across institutions. Capital ratios based on a risk-category based floor would not provide insight into an institution's risk management strategy and would not represent a regulatory defined minimum, but rather some combination thereof. For example, it would be difficult to evaluate the overall capital ratios of different institutions if the institutions are subject to different risk-category floors. Capital ratios will lose their utility to investors unless they are able to assess bank capital uniformly.

We believe management's view of risk is relevant market information as it is a differentiating characteristic between institutions. For example, low risk-weights calculated under the Advanced Approach, regardless of jurisdiction, relative to other institutions may be driven by conservative risk management practices or conversely due to overly optimistic modelling assumptions. It would be difficult for market participants to ascertain such a distinction using publicly available information, such as Pillar 3 disclosures, based on a risk-category based approach. Moreover, narrowly focused floors, may create a disincentive for strong risk management practices due to overemphasis on the selected risk drivers resulting in increased systemic risk. We believe an aggregate floor consistent with the current U.S. Standardized Approach provides transparent information to market participants regarding an institution's risk management strategy as well as a regulatory minimum to determine published capital ratios.

Irrespective of the use of an aggregate floor or a risk-category based floor, the design of a capital floor must strike a balance between competing objectives of risk-sensitivity and pro-cyclicality. Flat risk weights are not pro-cyclical, but are also not very risk-sensitive. Conversely, a risk-driver approach is more risk-sensitive, but may also be pro-cyclical depending on the nature of the risk driver. The pro-cyclical nature of the SA Proposal is caused by a reliance on a limited set of risk drivers that are generally correlated to the overall credit cycle, which in turn reduces its effectiveness as a capital floor. In other words, the sensitivity of the risk drivers exacerbates volatility in risk-weights. As an example, the use of common equity tier 1 ("CET1") capital as a risk driver for bank exposures may be a reasonable measure of credit risk, but CET1 will be correlated to fluctuations in the credit cycle. However, a capital floor that relies on CET1 may not achieve an appropriate minimum level of capital during the peak of the credit cycle and likewise will not eliminate volatility throughout the credit cycle.

Rather than providing a capital floor, the Proposals appear to mimic a less sophisticated Advanced Approach. Risk drivers should not cause risk weights to vary excessively through the credit cycle and a capital floor should address overall system capital level, capital volatility and model risk. Because the Advanced Approach is inherently risk sensitive and pro-cyclical, we believe a capital floor should be less risk-sensitive and provide for relatively stable capital throughout the credit cycle. As a result, we believe a simpler approach that relies more heavily on flat risk weights as opposed to risk drivers is better aligned with the BCBS's objectives.

In order to determine appropriate risk weights, we encourage the BCBS to complete a thorough quantitative impact study ("QIS"). The QIS should consider how the selected drivers will perform through the credit cycle. If possible, a single risk driver should be used, as opposed to multiple drivers to promote simplicity. In addition, to the extent accounting based measures are used as risk drivers, jurisdictional differences in accounting should be accommodated through national discretion. The QIS process should also be used to address the calibration of risk-weights for all exposure types under the SA Proposal. While the BCBS does not intend to increase overall capital requirements, the majority of the changes to risk-weights in the proposal appear to have an upward bias. We noted increases for nearly every exposure type addressed in the SA Proposal. Although not separately addressed, the calibration should be specifically considered for exposures measured using look-through approaches, which will also be impacted by the SA Proposal. To ensure proper consideration of all relevant information, we encourage the BCBS to extend the proposed QIS timeline in order to assess the performance of the Proposals through a full credit cycle.

Lastly, it is difficult to assess the appropriate calibration of risk weights before the BCBS exposes the proposed rulemaking related to the remaining sections of the Standardized Approach. We will defer additional comments on the calibration of risk weights until the complete rulemaking framework is proposed, risk drivers have been finalized and supporting evidence is available. We encourage the BCBS to devote sufficient time to a QIS to justify changes to standardized risk weights with empirical evidence and overall calibration adjusted accordingly.

<u>Specific Comments on the Revisions to the SA Proposal</u>
We have included specific comments on the exposure types addressed in the SA Proposal for credit below. We will defer most of our comments regarding calibration upon completion of QIS.

Bank Exposures

- Under the SA Proposal, bank risk weights would be determined based on CET1 and non-performing asset (NPA) ratios. While we agree CET1 is a representative measure of credit risk, inclusion as a risk driver presents practical concerns. Specifically, CET1 may not be available for banks that have not adopted Basel III. As a result, those banks would be required to determine CET1 in order to obtain financing from institutions that are subject to Basel III. This is of particular relevance for small institutions in the U.S., securities firms and emerging market institutions in jurisdictions not subject to Basel III. As a result, we believe flexibility is needed to ensure that accurate risk-weights can be applied for banks in all jurisdictions. We believe that defaulting to the highest risk weight if a CET1 is not available is not appropriate. Use of a NPA ratio also presents practical concerns, such as jurisdictional differences in accounting that do not cause differences in risk exposure and therefore should not cause differences in risk-weights.

Corporate Exposures

- The risk drivers selected for corporate exposures are revenue and leverage. These risk drivers are also pro-cyclical and may not be appropriate measures of credit risk. Using leverage to differentiate risk weights for commercial borrowers would significantly penalize borrowers in stable industries where higher leverage is acceptable as part of the industry norm (e.g. utilities). If the BCBS pursues leverage as a risk driver, we recommend a separate calibration by industry type. We believe industry segmentation should be determined through a QIS as natural groupings of industries will likely emerge. Similarly, using revenue as a driver without consideration of the stability or maturity of the company or industry could produce risk weights that are inconsistent with the underlying credit risk exposure. In addition, jurisdictional accounting differences (e.g. accounting for leases, balance sheet offsetting) should be addressed either directly by the BCBS or through latitude given to local regulators. Unlike leverage, jurisdictional accounting differences related to revenue recognition may be less severe given the recent finalization of a joint FASB/ IASB revenue recognition standard; however, that standard has yet to be implemented.

Residential Real-Estate Exposures

- The Proposals recommend the use of loan-to-value ("LTV") and debt-service coverage ("DSC") ratios to determine the risk weights of residential real-estate exposures. We agree with the use of origination LTV, as opposed to current LTV. Current LTV would introduce unnecessary volatility to capital levels by linking risk weights to housing prices. Current LTV provides an accurate measure of credit risk because it provides insight into loss given default ("LGD"), but is does not provide an accurate measure of probability of default ("PD"). LTV at origination provides an indication of the strength of the borrower and underwriting risk taken by the bank. Because LTV is not an accurate measure of PD, we believe a second risk driver reflective of borrower performance, such as delinquency status, should be used in conjunction with original LTV. We also recommend that the BCBS permit the consideration of additional collateral/ guarantees in the determination of the risk weights (e.g. risk weight of the guarantor should be used instead of the risk weight of the borrower) as banks often grant higher LTV loans when other mitigating factors are in place. While this seems to be captured in the general principle for applying credit risk mitigation, including explicit language for residential real-estate exposures would be a useful clarification.

- We believe that the introduction of the DSC ratio as a risk driver will present considerable operational difficulties for many banks because, subsequent to the original underwriting of mortgages, many banks and mortgage servicers do not continuously receive information relating to a borrowers income and ability to repay. Another complexity is the use of pre-tax DSC, rather than post-tax DSC as a more comparable measure due to jurisdictional tax differences; however, we currently do not collect pre-tax DSC. As a result, pre-tax DSC will not be available for QIS, nor would it be appropriate to estimate pre-tax DSC. In addition to these operational complexities, a DSC ratio would represent a poor indicator of credit risk for certain high net worth borrowers with low incomes. As a result, we believe a delinquency status would be a better risk driver than DSC.

Commercial Real-Estate Exposures

- The Proposal presents two options for risk weighting commercial real-estate exposures. We support the second option, which uses a look-up table with risk weights that range from 75% to 120% on the basis of the LTV. We believe collateral value should be considered in determining the appropriate risk weight for commercial real estate exposures and therefore support the second option. The Proposals define commercial real estate exposures narrowly by including primarily owner occupied real estate and excluding loans repaid primarily though cash flows received for rents or sale of the property. Because of the narrow definition of commercial real estate, we encourage the BCBS to also permit the consideration of additional collateral (financial or non-financial) and parent company guarantees due to the credit risk reduction provided and prevalence of such arrangements in the market.

Off-Balance Sheet Exposures

- The Proposal introduces increases to CCFs without substantiation or consideration of the impacts to other regulatory ratios. The SA Proposal indicates CCFs will be more closely aligned with the Advanced Approach, but do not provide the rationale for the proposed increase to a 75% CCF from the existing CCFs of 20% and 50%. We believe historical drawdown rates are well below 75% and the combination of current levels of the CCF and the risk weight that will eventually be applied to any undrawn amount will adequately capture the underlying credit risk. Accordingly, we encourage the BCBS to retain the existing CCFs until a quantitative analysis is performed.

- We agree that maturity may not be the most appropriate factor in distinguishing CCFs for unused commitments; however, we cannot recommend an alternative at this time and suggest maturity be researched via QIS.

- We also note cascading effects to the supplemental leverage ratio in the U.S. as the CCFs under the U.S. Standardized Approach are also used in determining total leverage assets. The BCBS should consider the implication of changing CCFs on other aspects of the regulatory capital framework before implementing changes.

Conclusion

We encourage the BCBS to consider our comments and recommendations described in this letter as well and complete a thorough QIS prior to finalizing the guidance and calibration. We also believe sufficient national discretion should be provided, so as not to impose an additional capital floor on many large institutions with a U.S. presence. We believe that our recommendations are consistent with the project goals, to achieve a capital floor resulting in greater comparability and consistency of risk-weighted assets across financial institutions and provide more meaningful information to financial statement users.

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We appreciate the opportunity to comment on the issues contained the Proposal. If you have any questions, please contact me at 415-222-3119.

Sincerely,

/s/ Richard D. Levy

Richard D. Levy
Executive Vice President & Controller

cc:

Rusty Thompson – Office of the Comptroller of the Currency
Stephen Merriett – Federal Reserve Board
Robert Storch – Federal Deposit Insurance Corporation