
Ladies and Gentlemen:

The banking organizations listed on Schedule I (the “Commenting Banks” or “we”) wish to thank the Basel Committee on Banking Supervision (the “Committee”) for this opportunity to comment on its January 2001 Consultative Document (the “Consultative Paper”) on the New Basel Capital Accord (the “Accord”). We are submitting our comments to the Consultative Paper in two separate letters. A comment letter on the standardized approach set forth in the Consultative Paper is being submitted concurrently herewith (our “Standardized Approach Comment”). In this letter we comment on:

• the application of an internal ratings based approach (“IRB”); and

• appropriate capital requirements for securitizations.

Like our Standardized Approach Comment, this comment letter relates solely to the Commenting Banks’ participation in an important segment of the international capital markets: the asset-backed commercial paper (“ABCP”) markets. Many of the Commenting Banks also intend to submit one or more additional comment letters addressing other aspects of the Consultative Paper.

Although we have not seen an official statement from the Committee confirming this point, we understand that the Committee intends to formally publish a securitization IRB for public comment this summer. We strongly encourage the Committee to do so. The ABCP and other securitization markets are very important to internationally active banks and to their corporate customers. 1 Given the central role envisioned for the IRB in the new Accord, it is important that the securitization IRB receive full public review and comment and that the Committee and its staff have time to take those comments into consideration.

1 As to ABCP in particular, we refer you to the statistical information that we provided in our Standardized Approach Comment about the size of this market and the breadth of international participation in it.
We do not believe that the use of conservative placeholders in a final Accord is appropriate for the large, well-established securitization market. The uncertainty during the period prior to the replacement of these conservative placeholders with more finely tuned capital requirements could unnecessarily threaten the attractiveness of this efficient funding source for our clients and irreparably damage our competitive position vis-à-vis unregulated institutions.

Securitization IRB

We are commenting on the securitization IRB prior to a formal publication by the Committee that describes a proposal in detail. We are doing this on the basis of various discussions we have had with the Committee and its staff and in the hope that a few of our fundamental concerns about the IRB can be addressed in the draft that is exposed for public comment. Based on information that we have received to date, our initial concerns are as follows:

1. The goal of the IRB, and of the new Accord generally, should be to match capital requirements appropriately with risk, regardless of what entity holds a particular position. The risk-based capital rules should not give banks incentives to choose one transaction or activity over another if both involve equivalent risk.

2. Securitizations should be treated separately from other forms of what the Committee has referred to as “asset-based lending.” The line between the two should be based upon granularity: if the underlying collateral is sufficiently granular in credit risk so that a prudent credit analysis can be conducted at the pool level, rather than at the level of each individual obligor, then the transaction should be treated under the securitization IRB, rather than the general asset-based lending IRB. The pool vs. individual credit level of analysis is a material difference between securitization, on one hand, and the rest of asset-based lending, on the other. The IRB should appropriately recognize that difference.

3. Besides the treatment of originating banks and investors contemplated by the Consultative Document, the securitization IRB must also provide an appropriate treatment for banks acting as sponsors of securitization conduits. One of the key elements of the IRB as applied to sponsors will be the treatment of liquidity. In particular, capital requirements for liquidity commitments under an IRB should be calculated in a way that gives appropriate credit for the structure and purpose of these commitments, which (i) reduce substantially the risk that the commitments will be drawn in a particular transaction and (ii) protect the banks that issue these commitments from funding against non-performing assets. We believe that the effect

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2 We fully discuss these structural features and performance data that supports our beliefs in Section 2.2.B. of our Standardized Approach Comment.
of these features is to cause the PD and LGD for liquidity commitments to be lower than that for the underlying funded positions. The IRB should provide some means for banks to take this into account.

4. If the securitization IRB has both foundation and advanced levels, then the foundation level should be crafted so that it is usable by banks in each of the capacities identified by the Committee: as originators, as investors and as sponsors of securitization conduits. Among other things, this means that there should be some way to determine capital under the foundation IRB (at least for investing banks and sponsors) that does not require a bottom-up analysis based upon individualized internal risk ratings for every obligor in a securitized pool.

5. The best way to accomplish the goal above is to base regulatory capital on a bank’s internal risk analysis, subject to regulatory approval of the bank’s rating system and of the relationship between various rating levels and specific risk weights. Our preference would be for the IRB to permit capital to be determined from internal ratings, without any requirement to map the internal ratings to an external rating system. We believe each bank should be permitted to link its internal risk rating levels to estimates of PD and LGD, which would then be tied to specific risk weights. If the Committee nevertheless requires mapping to external ratings, the mapping should require only that a satisfactory level of correlation be demonstrated between internal and external ratings. Banks should not be required to actually adopt the criteria of external rating agencies.

6. The qualification standards for both the foundation and advanced IRBs should be reasonable. Most banks that are active in the ABCP market have developed sophisticated internal systems for assessing the risk of securitizations. In conduit transactions in particular, the sponsor bank will have detailed pool information for each transaction enabling it to make an informed credit decision. In fact, rating agencies have long relied on sponsor banks to structure and map transactions to particular credit rating requirements. Rating agencies allow many multi-seller conduits to enter into transactions without prior agency review. This procedure has been successful precisely because of the ability of the sponsor bank to structure its transactions in accordance with standards necessary to maintain a desired rating. Furthermore, rating agencies have consistently used internal bank risk scores as proxies for ratings of otherwise unrated borrowers in collateralized loan obligation transactions. For these reasons, we believe that most banks currently active in the ABCP markets should be able to qualify for an advanced IRB approach and that the qualifying standards should be drafted accordingly.

7. At a more detailed and technical level, we have the following suggestions for the securitization IRB:
• The definition of “default”: A 90 day past due concept is not meaningful for securitizations (as opposed to individual underlying receivables). Rather, a default at the securitization level should be deemed to occur only upon either (i) failure of an issuer to make required payments when due or (ii) a determination that there are insufficient assets to provide for payment of all or a portion of outstandings in a transaction. Furthermore, we note that the restructuring of a securitization can actually enhance the full collectibility of an obligation. For that reason, a restructuring in and of itself should not be considered a default.

• Maturity: A contractual maturity is inappropriate in securitization transactions because of the common occurrence of “tails” in the ultimate liquidation of term assets. An average life concept is much more relevant than the legal final maturity for a transaction. Also, a uniform three year average maturity (which we believe has been discussed by the Committee) will overcapitalize short term assets, such as trade receivables, while undercapitalizing long term assets, such as collateralized debt obligations, thereby creating capital arbitrage opportunities.

• Borrower vs. facility ratings: We strongly disagree with the notion that a borrower rating should not be “tainted” by consideration of structure. Structure is the major determinant of what level of risk is being taken by a bank in any securitization position and a bank would be unable to accurately assess the risk of a securitization position if it were not able to take into consideration the structural features supporting a position.

• 30% limit: The 30% limit for exposures in any one risk grade would not work at the securitization level as conduit transactions are typically structured to the same narrow (and relatively high) ratings range.

**Appropriate Capital Levels**

We believe that the proposed capital requirements for securitizations under the standardized approach substantially exceed on average the amount of capital that is justified by the credit risk inherent in these positions. We hope that the IRB will lead to lower capital requirements that (a) recognize what we believe to be the relatively low risk of securitizations and (b) give banks an incentive to move from the standardized approach to an IRB.

Even within the standardized approach, we believe that capital treatment should recognize finer distinctions between ratings levels than those proposed in the Consultative Paper. This will avoid anomalies where a small distinction between ratings creates a large difference in risk-based capital requirements and reduce the incentives to game the system that are created by such anomalies.
In general, we believe the risk weight for securitization positions at a given rating level should be lower than the risk weight for an identically rated conventional corporate exposure. First, we believe that as secured positions, securitizations have a lower PD than similarly rated unsecured corporate loans. Second, we believe that the LGD for a securitization position will be less than a comparably rated unsecured corporate credit. We note that secured credits have higher recovery rates in bankruptcy scenarios than unsecured credits. In addition to the presence of collateral supporting a position, securitizations typically benefit from additional structural protections (e.g., isolation of assets from the bankruptcy estate of an originator). We believe that these additional structural features of securitizations would result in even higher recovery rates (and lower LGD) than those experienced with secured credits.

Recent statistics published by the rating agencies support our request for more favorable treatment of securitizations:

- Moody’s shows no defaults for ABS in its historical database from 1985 to the present, regardless of rating.
- S&P shows a single investment grade default, but this was the result of fraud.
- S&P shows some BB defaults but at a rate approximately 1/2 that of corporate BB exposures. S&P shows no defaults at the B level.
- Investment grade ABS transactions show approximately 1/3 the downgrade risk of corporate transactions over a five-year timeframe, and subinvestment grade transactions show approximately 80% of the corresponding corporate downgrade risk.

In this connection, we note that the 150 percent risk weight proposed by the Committee for securitization exposures rated in the first rating category below investment grade is lower than the risk weight proposed by U.S. Federal bank regulators last year (200%). We support that reduction. However, the 150% risk weight for securitization positions begins at a higher rating level (BB+) than the corresponding risk weight for corporate exposures (BB-). We strongly oppose that discrimination against securitization positions.

We understand that one reason the Committee is considering applying greater regulatory capital to BB-rated ABS than for BB-rated corporate obligations is the Committee's belief that the major rating agencies would require more subordination to achieve a given rating level in an asset-backed transaction where the underlying assets were BB-rated ABS than they would in an otherwise identical transaction where the underlying assets were BB-rated corporate obligations.

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We do not believe this is true, and we encourage the Committee to review the analysis on this point that is being provided by the European Securitisaton Forum in Section 3.5 of their comment letter on the IRB approach and appropriate capital risk weightings for securitizations.

Conclusion

The Commenting Banks support the Committee’s continuing efforts to modify capital requirements to truly reflect the relative risk associated with various assets. We look forward to continuing to work with the Committee and its staff on the securitization IRB.

With your permission, we would appreciate the opportunity to add to the institutions included as Commenting Banks as additional institutions have an opportunity to obtain internal approval for support of the positions discussed in this letter.

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Respectfully submitted.
List of Commenting Banks

ABN AMRO BANK N.V.
BANK OF AMERICA, NATIONAL ASSOCIATION
BANK OF MONTREAL
BANK ONE CORPORATION
BARCLAYS BANK PLC
BNP PARIBAS
CIBC WORLD MARKETS CORP.
CITIBANK, N.A.
COMMERZBANK AG
DRESDNER BANK AG
FIRST UNION NATIONAL BANK
FLEET NATIONAL BANK
JP MORGAN CHASE & CO.
MBNA AMERICA BANK, NA
PNC BANK, NATIONAL ASSOCIATION
RABOBANK NEDERLAND
SOCIÉTÉ GÉNÉRALE
STATE STREET CAPITAL MARKETS, LLC
WACHOVIA BANK, N.A.
WESTDEUTSCHE LANDESBANK GIROZENTRALE