May 31, 2001

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

Re: Comments on The New Basel Capital Accord

Dear Committee Members:

This letter is submitted on behalf of Wachovia Corporation and Wachovia Bank, N.A. (hereinafter collectively referred to as "Wachovia"). Wachovia Corporation is an interstate financial holding company with dual headquarters in Atlanta, Georgia and Winston-Salem, North Carolina, with total assets of $75.6 billion as of March 31, 2001. Wachovia's member companies offer consumer and commercial banking, community development finance, bank card, asset and wealth management, capital markets and investment banking, brokerage and insurance services. Wachovia Bank, N.A., the principal subsidiary of Wachovia Corporation, has more than 650 offices and 1,350 ATMs in Florida, Georgia, North Carolina, South Carolina, Tennessee and Virginia.

Wachovia has reviewed the consultative document "The New Basel Capital Accord" (the "Accord") issued by the Basel Committee on Banking Supervision (the "Committee") in January, 2001. We also have reviewed several comments made by various industry groups and have participated in discussions with peer banks and regulators. Wachovia appreciates this opportunity to comment on the proposed Accord and we hope this letter will help to clarify the proposal and answer questions raised therein. This letter will provide general comments that address the major issues and also provide specific comments on several items of interest to Wachovia. Because of the complexity of the Accord, Wachovia will rely on various industry comment letters to provide more specific comments. Where appropriate, we will make reference to specific industry comment letters to show Wachovia's support for the points set forth in those letters.

Overall, Wachovia supports the Committee's goal to align regulatory capital more closely with the true economic risks in banking organizations and to provide incentives to reduce risk. Also, we support the use of internal models in allocating economic and regulatory capital and commend the Committee's efforts to include the use of internal models in the Accord. However, Wachovia does not believe that sufficient work has been completed to ensure that the Accord will meet the Committee's goals to maintain the same amount of capital in the banking system and to improve the allocation of capital to more closely reflect differences in risk. Wachovia recommends that the Committee allow sufficient time for testing and modification of the Accord so that it will reflect more accurately the proper amount of regulatory capital and provide the proper incentives to improve capital allocation and reduce risk.

## Pillar 1: Minimum Capital Requirements

### *Credit Risk*

Wachovia commends the Committee's efforts to move toward a measure of credit risk that is more closely aligned with the internal models used by banks to measure and/or allocate economic capital. The Internal Ratings-Based ("IRB") approaches represent significant progress toward an ideal goal of determining regulatory capital using the banks' internal models. While we appreciate the supervisory hurdles in allowing banks to adopt the full IRB-Advanced approach, we are concerned that banks will not be incented to make the progression from "Standardized" through "IRB-Foundation" to "IRB-Advanced", due to the potential for a significant increase in capital called for under the IRB-Foundation approach. As reducing regulatory capital arbitrage is a goal of the New Accord, banks should not be discouraged from leaving the Standardised approach. These issues are discussed more thoroughly in the RMA Working Group comment letter, which Wachovia endorses. The following bullet points provide additional comments regarding the Minimum Capital Requirements:

- The Committee has said that their expectation is that there would not be a system wide increase in regulatory capital. Based upon our calculations, regulatory capital to support credit risk would in fact increase under the Standardised and IRB-Foundation approaches over the level required under the 1988 Accord. This increase would occur before any additions to capital for Operational Risk. Regulatory capital would also be higher under the IRB-Advanced approach when Operational Risk is included. Separately, the requirements for the IRB-Advanced approach appear onerous and therefore difficult to achieve for most banks (at least within the contemplated transition periods).

- Wachovia appreciates the additional risk weighting categories that the Committee has included under the Standardized approach, but still there are an insufficient number of categories to capture the differences in risk. This shortcoming is apparent whether one measures risk by historical bond default rates or market pricing practices. Wachovia urges the Committee to differentiate risk by expanding the various risk categories beyond those suggested in the current proposal. We note that banks are adding granularity to their internal risk ratings; therefore, the new Accord should be consistent with this approach.

- The 150% risk weighting for corporate loans rated below BB- is not sufficient to capture the true risk in these assets. This relatively low capital requirement could be an incentive for banks holding high risk assets to utilize the Standardised approach versus developing more sophisticated models. We believe banks should be incented to move to the use of models, as over time the expanded use of these models will lead to greater knowledge and understanding of credit risk in the banking system.

- Wachovia disagrees with the 150% risk weighting for asset-backed securities rated BB- as compared to 100% for corporate loans rated BB-. The ratings assigned by the rating agencies are designed to represent the same risk of default across asset categories, and we believe that the rating agencies have been very conservative in assigning ratings for asset-backed securities.

- Wachovia agrees that the maturity of assets is an important factor in the riskiness of an asset. We recommend that the "term factor" be used on a consistent basis in both the IRB-

Foundation and IRB-Advanced approaches. We do not feel that it would impose an undue burden on banks to include the term factor in their calculations.

- While the benefits of diversification are partially captured in the granularity adjustment, we would recommend developing measures (including the use of banks' own models) that measure the impact of the correlation of default probabilities more explicitly.

- Wachovia understands that the 90% floor on the IRB-Advanced approach will provide protection against overly aggressive IRB models, but we are concerned that the factors supplied under the IRB-Foundation approach need to be more closely calibrated with the values that will ultimately be used under IRB-Advanced. Specifically, we believe the use of a fixed LGD (including collateral benefits from the Standardised approach) should be replaced with a schedule of LGD factors that reflect broad industry experience for a wide range of collateral types.

***Operational Risk***

Wachovia agrees with the concept of including a capital charge for operational risk and commends the Committee for its efforts in developing the Standardized Approach and Internal Measurement Approach. However, this heretofore uncharted category of capital deserves more dialogue with the supervisory community before standards are set and communicated to the banking industry. Toward this end, we encourage the Committee to review the work of the Working Group on Operational Risk (WGOR). Wachovia generally supports the positions taken by the WGOR and specially endorses the following recommendations:

- Modify the suggested definition of operational risk to eliminate the words "direct or indirect". Wachovia agrees with the WGOR that losses covered by the regulatory capital framework should be defined in terms of immediacy and measurability of the losses resulting from an operational risk event and not with the terms "direct or indirect".

- Use the loss types specified by the WGOR These loss types include:

    1. An **operational risk loss** is the **amount charged net of recoveries** to the P&L account in **resolution** of an operational risk event.
    2. **Amount charged net of receivables** is determined by generally accepted accounting principals (GAAP).
    3. **Resolution** is a correction of an individual event that results in a return to a position and standard comparable to the original.

- Internal controls and procedures are a very important part of the capital charge for operational risk. Therefore, the regulators should have the ability to increase or decrease regulatory capital based on their supervisory review of the controls and procedures used in a banking organization. This supervisory review should be based upon standards that are uniform across banking jurisdictions.

- The Committee should consider providing capital relief for the risk reduction that is provided by various insurance products.

- The proposal suggests basing a capital charge for the Asset Management Business upon assets under management. This approach will produce capital charges that are well out of proportion to the risk in the business.

- The capital charge for operational risk should represent unexpected losses, but not expected losses. Expected losses are covered by the pricing for services provided; therefore, an additional capital charge for expected losses is more than is necessary.

Wachovia believes there is currently insufficient data available in the banking system regarding operational risk to provide accurate quantitative measures for either the Standardized or Internal Measurement Approaches. This lack of data may cause regulators to create unrealistic hurdles in order to maintain a capital charge of 20% for operational risk. Also, we note the uncertainty as to whether the proposed 20% capital charge for operational risk is appropriate (i.e., the proposed capital charge may be too conservative). Wachovia recommends that additional research, as outlined in the report by the WGOR, be undertaken before issuing a final rule on operational risk in order to resolve the current uncertainty.

***Asset Securitization***
Wachovia commends the Committee for its work in using external ratings to assign asset-backed securities to the appropriate risk category and for its continuing work to implement a more risk sensitive IRB approach. Since the issues regarding asset securitization are too numerous and complex to cover in this general comment letter, Wachovia provides its endorsement to the comment letters that are being provided to the Committee by the FASB Issues Working Group and by the Commenting Banks for the Multi-Seller Conduit Comments (the “Commenting Groups”). A few of the more important items are outlined in the following bullet points:

- Wachovia believes that the proposed 100% loss severity for asset-backed securities is much too conservative as compared to the 50% loss severity for sovereign and corporate bonds. As compared to corporate bonds, asset-backed securities may represent even less risk since the securities represent a pool of exposures instead of single name exposure.

- Wachovia believes that the proposed 20% conversion factor is too high for liquidity facilities that are provided to conduits since the purpose of the liquidity facilities is to provide liquidity management instead of credit enhancement. We recommend a conversion factor of 10%, which will represent more accurately the true risk in these liquidity facilities.

- Wachovia believes that the proposed 10% conversion factor for revolving securitizations that contain an early amortization provision (or “managed assets approach”) is not necessary. Typically, early amortization features do not constitute credit recourse. In addition, the liquidity management concerns raised by the managed assets approach are not so different from those of other funding sources as to justify an additional capital charge. Therefore, requiring additional minimal capital under the managed assets approach would be duplicative of capital currently required for sales with recourse under bank regulations in most countries.

- Wachovia supports limiting the capital charge for retained interests to dollar for dollar coverage up to the on-balance sheet requirement for the pool of securitized assets. In addition, capital relief should be provided when an originating bank retains a second loss position in the form of a rated security, even when the holder of the retained interest also holds the first loss position. This recommendation is based on the concept that the risk in a junior rated security is the same no matter who holds the first loss position.

- Wachovia opposes the imposition of capital requirements on banks having servicer advance obligations where those obligations are purely discretionary. In addition, Wachovia believes a 0% credit conversion factor should apply in cases where the reimbursement of servicer advances is senior to all other payments and the servicer can refuse to advance funds if repayment is determined to be unrecoverable. The 0% conversion factor should also apply in those cases where the servicer does not sponsor the securitization in which the serviced assets are held.

- Finally, Wachovia supports the important technical comments made by the Commenting Groups concerning the "clean break" and "implicit recourse" requirements.

***Credit Risk Mitigation***

Wachovia commends the Committee for recognizing the benefits of various types of credit risk mitigation including collateral, guarantees, credit derivatives and on-balance sheet netting. We agree that certain haircut parameters ("H") are appropriate for reducing the amount of collateral coverage and that the value of H should vary for specific types of collateral based on the volatility of the collateral over a ten day holding period. We disagree with the "w" parameter that sets a floor below which the risk weight will not fall (to cover unavoidable risks). Wachovia believes the uncertainty that the w parameter is intended to cover is already covered by the capital charge for operational risk; therefore, the w parameter represents double counting of operational risk. The following bullet points will outline our additional comments:

- Regarding the two-party protection that is provided under guarantees and credit derivatives, Wachovia recommends that the Committee consider providing capital relief for the diversification and risk reduction that is provided by the "double default effect".

- Wachovia recommends that the Committee consider recognizing the benefits provided by diversification and obligor limits.

- Wachovia agrees with the concept that proportional adjustments should be made to the capital relief provided by credit mitigation when there is a mismatch between the maturity of the risk mitigation and the underlying credit exposure.

***Interest Rate Risk***

Many of the principles for the management and supervision of interest rate risk (IRR) represent a solid foundation for banks to follow to establish an effective interest rate risk management process. We agree with the Committee that the proper placement for the regulatory assessment of capital adequacy for interest rate risk in is Pillar 2, which is supervisory review. We also agree that there should be clear lines of authority for the management of IRR and that the sophistication of the technology and modeling process should be commensurate with the complexity of the balance sheet. However, there are three areas of concern in the proposal.

- There are risk based capital guidelines currently in place for trading risk. These have been well vetted and accepted as a positive move for using internal models for IRR in the trading book. Wachovia agrees that management should have an understanding of IRR across the full scope of a bank's activities, but we also believe that trading risk has been effectively covered in the existing risk-based capital guidelines and therefore should not be included in the current proposal.

- Many banks use a combination of an earnings simulation approach and an economic value approach for measuring and managing IRR, as has been pointed out in the proposal. However, the current proposal imposes an economic value perspective for regulatory review as the primary management tool. This approach is in direct conflict with what is widely considered to be best practice, which is a balanced approach with different weightings toward earnings simulation or economic value depending upon the institution.

- The imposition of an economic value approach to determine so-called "outliers" also leads to the third problem which is a highly standardized approach for regulators to determine economic value risk. We strongly believe that forcing banks' positions into standardized time bands with standardized durations will provide misleading information and will create substantial unproductive efforts to reconcile the results back to more sophisticated valuation techniques used by many banks. This standardized approach was shown to be inappropriate, misleading and burdensome when it was originally proposed in FDICIA 305. Wachovia's recommendation is to use an internal models approach for the calculation of capital for IRR.

**Pillar 2: Supervisory Review Process**

Wachovia is in full agreement with the concepts outlined in Pillar 2, which provide banking regulators with the ability to require more capital based upon the level of risk in a bank. We also agree with the concept that banking regulators will place an emphasis on the review of internal processes and capital management. Our principal comment is that the banking regulators must have sufficient resources in place to evaluate the banks' internal models in a timely fashion in order to allow banks to utilize either IRB approach. These supervisory resources should also include adequate staff to provide ongoing monitoring of the IRB models and the resulting capital adequacy under the new Accord. Finally, it will be very important for the regulators to be consistent across the various banking jurisdictions in order to provide a level playing field for the entire banking industry.

**Pillar 3: Market Discipline**

Wachovia agrees that enhanced transparency will promote greater discipline in the management of capital and in the reduction of risk. However, we are concerned about the massive volume of information that is proposed for disclosure. Not only will the cost of such disclosure be high, but the amount of information to be disclosed is far too extensive to provide an understandable picture of the bank. While it makes sense for a bank using the IRB approach to provide additional information about its models, an overdose of information could easily lead to incorrect conclusions being made about the bank.

Wachovia has received some feedback that the list of disclosures in the Accord represents an all encompassing list that will be scaled back in the final rule. We encourage the Committee to try to find the appropriate balance between meaningful disclosures that will enhance market discipline versus a "kitchen sink" approach that will burden both the banking industry and readers of the disclosures. We encourage the use of more specific parameters for market disclosure so that the disclosures will be consistent across the industry. Finally, we caution the Committee to be mindful of requiring the disclosure of proprietary information that would place banks at a competitive disadvantage versus non-bank competitors.

**Transitional Arrangements**
Wachovia appreciates the Committee's concern about providing sufficient time to implement the new Accord. While 2004 appears to provide a sufficient amount of time, we do not believe that May 31, 2001 represents adequate time for the banking industry to digest the entire Accord, research the implications of the Accord and provide meaningful comments to the Committee. Furthermore, we believe that the Committee's goal of issuing a final rule by the end of 2001 appears to be very aggressive considering the complexity of the Accord and the large amount of issues that remain unresolved. Wachovia recommends that the Committee encourage further consultation beyond the comment period and gain a complete knowledge of the effect of the Accord on regulatory capital prior to implementing a final rule. The new Accord represents one of the most important steps that the banking industry will take in the coming decade; therefore, it is imperative that the Accord be thoroughly reviewed prior to issuing a final rule.

**Summary Comments**
In summary, Wachovia remains supportive of the Committee's efforts to implement new risk-based capital rules that more accurately reflect the risk in the banking industry and provide incentives to reduce risk. We also believe that the proposed Accord will provide management with new tools that will improve the management of risk in their respective banks. However, we caution the Committee against implementing the Accord too quickly considering its complexity, the amount of work that still is in progress and the uncertainty regarding the effect that the Accord will have on the amount of capital in the banking system.

Thank you for your consideration of these comments. We shall look forward to seeing the Committee's revisions to the current proposal.

Sincerely Yours,

Robert S. McCoy, Jr.
Vice Chairman and Chief Financial Officer

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