Massachusetts Bankers Association

August 4, 2003

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

Regs.comments@federalreserve.gov
Basel 2003 Capital Proposal
Board of Governors of the Federal Reserve Sys.
Mail Stop 155
20th Street and Constitution Avenue, NW
Washington, DC 20551

Comments@FDIC.gov
Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Basel.Comments@occ.treas.gov
Basel 2003 Capital Proposal
Office of the Comptroller of the Currency
Mail Stop 3-6
250 E Street, SW
Washington, DC 20219

Re: Basel II Accord

To Whom It May Concern:

On behalf of the 230 commercial, savings, co-operative bank and federal savings institution members of the Massachusetts Bankers Association located throughout Massachusetts and New England, we would like to express our serious concerns with respect to the competitive threat posed by the Basel II Accord ("Accord") to most, if not all, of our member banks. The overwhelming majority of our members are regional and community banks with a strong market presence in retail, business, and residential mortgage lending.

The Accord is an extremely comprehensive framework created originally for large European banks to determine capital adequacy. Unlike the U.S. market, however, there are few regional or community banks serving as viable retail lenders in Europe. Therefore, the competitive threat caused by this regulatory proposal will only destabilize U.S. markets.

Before we review this negative influence of the Accord, however, we would add that the Accord is both unduly burdensome and costly for regional and community banks, and for banks which have been dubbed "second-tier" (i.e. under $250 billion in assets). For this reason, we support the federal regulators' decision to apply the Accord to the 10 largest institutions in the country only with the expectation that the next 11 – 20 largest institutions could, for competitive reasons, voluntarily choose to comply with the Accord's requirements as well. For all but the largest banks, there is no offsetting benefit from a public policy perspective or for the banks themselves, for complying with the provisions of Basel II as opposed to maintaining compliance with Basel I. Basel I was adopted in 1988 and is currently the capital accord under which all banks operate.

Our major concern, however, is the unintended consequence which provides the top few banks a significant competitive advantage – through lower capital requirements. Without oversimplifying the complexities of the Accord, this proposal will allow impacted banks to create a statistical model predicting the actual risks of certain investments/assets. While the modeling concept is not inexpensive, once created, it is evident that modeled banks could significantly lower the amount of capital required for certain asset categories.

For example, if a bank can verify a lower risk weight and justify only 15-25 b.p. capital for its residential mortgage portfolio, there is no question that it will have a major pricing advantage over its Basel I competitors retaining 400 b.p. capital for residential loans. While some financial pundits have downplayed the impact of this disparity, we would assert that no amount of high quality service can outweigh such a gap in the "cost" of carrying these assets for smaller regional and community banks.

Perhaps the most pernicious aspect of the Accord is the potential "purchasing power" it provides to acquiring banks. For example, a bank under Basel II could now afford to bid for competitors with sizeable retail portfolios, and even pay a premium to consummate the deal. This can occur because, once the merger is complete, the acquired loan portfolio only requires 15-25 b.p. capital, in our example, and not the 400 b.p. required for the recently acquired residential lending bank. While consolidation in the banking industry is expected to continue for the foreseeable future, the proposed European Accord cannot be implemented in the U.S. without eliminating the strong competitive presence of local regional and community bank lenders.

Our concern is not only for the regional and community banks that will suffer but also for their customers and the community they serve. If a Basel II bank wants to "own" a market, the Accord provides the tools to undermine any financial institution it chooses in any community through either its anti-competitive pricing advantage or by simply buying out the competition.

We believe Basel II to be inherently unfair in this regard and would strongly urge the Federal Reserve, the FDIC, and the OCC to "re-think" this issue before implementing any aspect of the Accord.

On behalf of the membership of the Massachusetts Bankers Association, I thank you for your consideration of our views.

Sincerely,
Daniel J. Forte
President

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