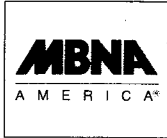

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July 31, 2003

The Bank for International Settlements
Basel Committee on Banking Supervision
Centralbahnplatz.2
4002 Basel
Switzerland

Re: Consultative Paper 3

Ladies and Gentlemen:

MBNA America Bank, N.A., having two additional banking subsidiaries, MBNA Europe Bank Limited and MBNA Canada Bank (together "MBNA") welcomes the opportunity to provide comment with respect to regulatory capital requirements under the proposed New Basel Capital Accord ("Basel II" or the "New Accord") and more specifically, Consultative Paper 3 ("CP 3"). MBNA America Bank, N.A. is the principal subsidiary of MBNA Corporation and focuses primarily on retail lending. In fact, MBNA is the largest independent credit card issuer in the world. At June 30, 2003, MBNA Corporation reported assets net of securitizations totaling $57 billion. MBNA Corporation's managed assets, including securitized loans were approximately $138 billion as of June 30, 2003.

At the outset, please understand that MBNA supports the Basel Committee on Banking Supervision's (the "Committee") primary goal of better differentiating risk and assigning appropriate capital to different risk exposures. Our comments are made to ensure that this goal is achieved without regulated institutions incurring needless costs, unnecessarily complex and burdensome regulation, or competitive harm.

Before commenting on CP 3, we note again the many concerns that MBNA has previously raised with respect to Basel II. MBNA has offered a series of comment letters addressing many aspects of Basel II, including but not limited to operational risk, retail credit risk, securitization and disclosure requirements. In addition, MBNA participated in Quantitative Impact Study 3 ("QIS 3") and the Operational Risk Loss Data Collection Exercise in order to help the Committee measure the regulatory capital impact of Basel II. Throughout the Basel II process, we have consistently expressed serious reservations with many aspects of Basel II, including its complexity and the capital distortions created by

the internal ratings-based ("IRB") approach for unsecured retail credit exposures. Most of these issues, which we view as serious issues, remain unresolved. Other than the creation of the qualifying revolving retail exposure ("QRE") formula, very little has changed in areas important to MBNA and other active credit card issuers and even the QRE formula does not achieve an appropriate capital/risk balance. MBNA has been a very diligent and active participant throughout the Basel II process, but many of our concerns have been largely ignored.

Provided below are our comments about CP 3 in general and specific comments on each of the three Pillars to Basel II.

I. GENERAL COMMENTS

A. Timing

Basel II in its current form is not ready for implementation. Too many open issues remain as to how the New Accord will be applied, especially in areas more recently developed such as retail credit, securitization and operational risk. Given the complexity and scope of Basel II, we remain very concerned that the aggressive time schedule for finalizing Basel II does not allow all stakeholders to consider fully and react to the proposed requirements. Good public policy requires that policy makers completely and objectively consider all of the comments received. The changes as proposed are far ranging and broad, they require careful and deliberate review, not necessarily consistent with the aggressive and seemingly arbitrary implementation schedule established by the Committee. We recognize the Committee's commitment to have the New Accord implemented as soon as possible, but we are deeply concerned that a well thought out proposal may be sacrificed in order to meet an arbitrary deadline for adoption.

The time frames for implementation of the proposal ultimately are also too short. Our understanding is that certain U.S. banks will be required to adopt the advanced IRB ("A-IRB") approach and advanced measurement approaches ("AMA") for operational risk. Some banks may not have the necessary infrastructure, systems, or personnel in place to meet the prescribed standards established by CP 3.

We also remain concerned that both the affected institutions and the home country regulatory agencies that supervise them will not have adequate time to develop the necessary expertise to implement the New Accord within the compressed timeframes envisioned by the Committee.

B. Complexity

Our principal regulator, the Comptroller of the Currency, who regulates 10 of the 25 largest banks in the United States, shares our concern about the undue complexity of the New Accord. Comptroller John Hawke has testified before a subcommittee of the U.S. Congress: "[W]e must be mindful of the risks of excessive complexity. . . . [T]he more complex Basel II is, the more difficult it will be to implement it consistently across

countries, especially in light of widely varying supervisory structures and approaches." [1] In remarks before the Institute of International Bankers, the Comptroller, in describing the New Accord, noted:

> "[T]he complexity we have generated goes far beyond what is reasonably needed to deal with the intricacies of sensible capital regulation. It reflects, rather, a compulsion to close every possible loophole, to dictate every detail, and to exclude to the maximum extent possible any opportunity for the exercise of judgment or discretion by those applying and overseeing the application of the new rules. In short, it reflects much more a commitment to prescriptiveness than a mere recognition of the complexity of today's banking business." [2]

In these remarks, Comptroller Hawke also observed:

> "The process has generated a product of vast complexity . . . . Thousands of pages of task force and working group papers, years in the making, have given rise to hundreds of rules, guidelines, and standards saturated with arcane mathematical formulae. They're not written by or for bankers – or for that matter, by or for conventional bank examiners. They're written for mathematicians and economists – 'quants.'"

He notes that this complexity will have a cost, "a cost in terms of credibility and public acceptance, for if legislators, customers, and market participants cannot penetrate the new rules, can we expect them nonetheless to love and respect them? . . . I think it would be well to consider whether we're not approaching that point of perfect impenetrability . . . that makes honest compliance difficult, if not impossible."

We agree with Comptroller Hawke's observations and with the fundamental premise that Basel II must "be written in a manner that is understandable to the institutions that are expected to implement it, and to third parties, without regard to the complexity of the subject matter." [3]

The current draft, although significantly improved, certainly does not achieve that. The general theme, which is part of each of MBNA's specific recommendations for change, is centered on the need to simplify Basel II without increasing regulatory burden or requiring additional unnecessary capital.

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1 Testimony of John D. Hawke, Jr., Comptroller of the Currency before the Subcommittee on Domestic and International Monetary Policy, Trade and Technology of the Committee on Financial Services of the U.S. House of Representatives, February 27, 2003 ("Hawke Testimony").

2 Remarks by John D. Hawke, Jr. Comptroller of the Currency, before the Institute of International Bankers, Washington, D.C., March 3, 2003 ("Hawke Remarks").

3. Hawke Testimony.

Given the overall complexity of Basel II and the need to develop the systems, infrastructure, and expertise to support the A-IRB and AMA elements of the New Accord, we believe that the envisioned timeframes for implementation are unsound and unrealistic. At a minimum, the Committee should allow four years after approval for implementation.

C. Regulatory Burden and Implementation Costs

In the current environment, we are witnessing both internationally and domestically an unprecedented number of changes to the regulatory, accounting, compliance and disclosure landscape. Many of these changes are made hurriedly and without understanding the true impact that each individual change or the combined set of changes will have on an institution or on an industry as a whole. We believe that the Committee should proceed carefully and should remain cognizant of the other changes occurring simultaneously and consider a phased implementation for each of the three Pillars in the New Accord. We support the Committee's plan to "maintain an ongoing relationship with accounting authorities and monitor developments in this area to provide consistency between the disclosure frameworks." Paragraph 762 (*Interaction with accounting disclosures*). We suggest that the Committee also apply this approach to securities and other agencies that participate in the supervision and regulation of financial institutions. Failure to proceed in this way may create even greater risk to affected institutions.

The costs to implement Basel II are significant by any standard and they fall only on regulated financial institutions. The cost to banks for implementing Basel II have been quoted in a range from $10 million for small banks to $150 million or more for large banks.[4] Although differences in regulatory requirements for banks and non-banks have always existed, the requirements of Basel II, specifically with respect to operational risk and disclosure, make these differences even more acute, placing a greater burden on regulated financial institutions. Again, Comptroller Hawke accurately explained that the complexity of the New Accord "has a price. Most obviously, it will impose a heavy cost burden on bankers, who have to design systems and educate staff to deal with the complex new rules." [5]

D. International Application

The global implementation of Basel II will need to be closely monitored by both the supervisors and the regulated institutions to ensure that different interpretations by home and host country supervisors will not create unnecessary additional compliance burden – the effect of which may contribute to a material competitive disadvantage. For example, as currently drafted, the standardized method actually generates a lower capital charge

4 Petrou, Karen Shaw, "Policy Issues in Complex Proposals Warrant Congressional Scrutiny", Testimony before the Domestic and International Monetary Policy, Trade and Technology Subcommittee on Financial Services, U.S. House of Representatives, February 27, 2003.

5 Hawke Testimony.

than the A-IRB approach for MBNA Europe's credit card business. The FSA has indicated that it will not impose the A-IRB approach on MBNA Europe, which is currently the third largest credit card issuer in the U.K. with total assets of £5.6 billion. Conversely, U.S. regulators have indicated that MBNA America will be required to move directly to the A-IRB approach on final implementation of the New Accord. This could have the following consequences:

- MBNA Europe will potentially have to maintain three sets of regulatory capital records, a standardized approach set for the FSA, the A-IRB for U.S. regulators and a general risk based capital rules set during the three-year transition period, at additional cost but with no additional benefit. We ask the Committee to imagine the confusion that this Hydra-headed approach will create for investors, analysts, funders and debt rating agencies.

- Alternatively, MBNA Europe may be required by the FSA to move to the A-IRB approach immediately (i.e. the U.K. regulator will fall in line with the U.S. regulators' lead, but other credit card issuers operating in the U.K. will be permitted to operate under the standardized approach, with a lower cost of compliance and potentially a lower capital charge). These other issuers could be either U.K. banks or affiliates of U.S. banks which are not themselves considered to be internationally active, or which are considered to be internationally active but which may not be required by U.S. regulators to move to the A-IRB approach across all asset classes and territories with immediate effect.

The threat of creating an uneven playing field can only be obviated if regulators (home and host) coordinate their approach for all institutions, not just those that are internationally active, in a rational, balanced, and transparent way. Moreover, home and host regulators must ensure that no single institution be subjected to more than one interpretation of Basel in any one jurisdiction.

E. Competitive Disadvantage

CP 3, if adopted, will cause significant competitive harm to banks, particularly U.S. banks that are internationally active in unsecured, revolving, retail lending ("U.S. banks with QREs"). When compared to non-banks, non-U.S. banks and institutions that primarily offer secured retail products, U.S. banks with QREs are burdened with excessive costs and capital requirements that are not justified when comparing risk profiles.

For example:

- Unlike U.S. banks with QREs, non-banks will not be burdened with the significant implementation and ongoing regulatory costs associated with Basel II.

- Non-U.S. banks, using the Basel II standardized approach will receive significantly more favorable capital treatment than U.S. banks with QREs that are required to apply the A-IRB approach.

- Institutions that offer primarily secured retail loans will receive favorable capital treatment, relative to the earnings performance of unsecured retail lenders.

CP 3's excessive capital requirements for U.S. banks with QREs are not based on a risk profile that is any greater than the retail lenders described above. CP 3's approach to U.S. banks with QREs will cause unnecessarily competitive imbalance by creating greater barriers for unsecured, revolving, retail lenders' (such as credit card banks) in the U.S. and threatens, their ability to effectively and efficiently offer customers convenient access to credit. For an industry with total loans of $560 billion in the U.S. market alone, this imbalance is significant and may dramatically change how consumers will be able to access credit in the future.

II. PILLAR 1 – MINIMUM CAPITAL REQUIREMENTS

The requirements of CP 3, Pillar 1 are exceptionally complex as they relate to the IRB approach to QREs. This is true particularly when the complexities of the securitization requirements are overlaid. The degree of complexity is so great that we question the ability of originators, investors, and the regulator to implement the requirements of CP 3 as they relate to QREs and to achieve the overall objectives of Basel II within the proposed schedule for implementation.

A. Retail Loan Exposures

1. Exposure to Additional Drawings Prior to Default

For retail exposures with uncertain future drawdowns, paragraph 307 (*Exposure at default ("EAD") for retail exposures*), requires banks to incorporate an estimate of expected additional drawings prior to default in the calibration of the loss estimates. We believe that this approach exaggerates both risk and capital requirements and is directly inconsistent with the approach taken for corporate lending.

Specifically, no charge for future drawdowns in the calibration of the loss estimates should apply where the lines represent uncommitted facilities that can be terminated at will. Unlike a committed corporate line facility, there are no limits on a lender's ability to reduce its line exposure. In other sections of CP 3, the Committee generally recognizes this distinction and does not require additional capital for uncommitted facilities. For example, paragraph 56 (*The standardized approach – general rules for off balance sheet items*) and paragraph 281 (*EAD under the foundation approach for bank, sovereign and corporate exposures*) are both credit facilities that are characterized as being, "unconditionally cancelable at any time by the bank without prior notice, or that provide for automatic cancellation due to deterioration in a borrower's creditworthiness." Paragraph 56.

These lines are correctly given a 0% credit conversion factor and no capital is charged. There is no material difference between these uncommitted off balance sheet lines and credit card lines and the treatments should be the same. Indeed, if there is a difference between these uncommitted lines and MBNA's uncommitted retail lines, it is that the latter involves an unfettered right to cancel the line while the former is subject to a borrower's claim that there has not been a material deterioration in its credit worthiness.

As the Committee has recognized, an important objective of Basel II is to prevent anomalies in its risk-based calculations that create competitive imbalances. Although the focus of this concern appears to have related to differences between countries and the differences between the standardized approach and the A-IRB approach, an equally important issue relates to banks with different types of lending. The capital requirements should not favor corporate over retail lending (or vice versa) to avoid both competitive inequality among lenders and the shifting of credit availability in response to regulatory capital rather than market forces.

MBNA, like many other large credit card issuers, actively manages all credit line exposures, especially for lines associated with higher risk accounts. At MBNA, we employ a variety of risk mitigation techniques and strategies that prevent additional drawdowns for accounts that are at risk. We are able to minimize the increase in outstanding balance of higher risk borrowers through:

- Risk detection strategies that use predictive management technology to monitor account behavior and to identify borrowers with an increased risk profile and prepare these accounts for exposure mitigation action, including the reduction and closure of credit lines.

    - For example, high-risk segments are identified by comparing current account activity with the accounts' historic behavioral norms. We look to see if there is unusual activity regarding credit line utilization, loan balances, the number of transactions and the types of transaction of the individual customer. By using this technology to monitor account behavior, we can identify customers early in the process who may be having financial problems. This enables us to react quickly in order to mitigate any risk to the portfolio.

    - In 2002, for MBNA's U.S. credit card portfolio, we reduced $3.9 billion in high-risk exposures, through the use of these risk detection strategies, resulting in an average credit line reduction of $5,400. We anticipate that for 2003, more than 20% of the accounts that charge–off will have reduced exposure.

- Authorization strategies that prevent borrowers that are more than 49 days delinquent from accessing the unutilized lines. In addition, each time a customer

makes a purchase on the credit card, we evaluate the purchase from a credit perspective – prior to it being authorized. Using a proprietary internal behavior risk score, transaction level data combined with FICO score and other data and transaction type, we are able to evaluate risk to either authorize or decline the transaction as circumstances warrant.

- Automated-reduction programs which target: (a) current accounts with a projected two-year loss rate in excess of a threshold level; (b) 5 to 35 day accounts with a projected one-year loss rate in excess of a threshold level; and (c) shut down inactive accounts with a high probability of charge-off.

Because of the conditional nature of undrawn guidance lines and because of the way in which those lines are managed, we believe that it is inappropriate and unnecessary to hold capital against the undrawn portion of credit lines. Excessive capital requirements for undrawn guidance lines will change bank behavior, resulting in reduced credit availability to creditworthy consumers.

2. Qualifying Revolving and Other Retail Exposures

The capital requirements for the qualifying revolving and other retail exposures are too high, particularly for lower risk exposures. See Appendix 1. The asset value correlation ("AVC") and Expected Losses ("EL") credit assumptions used in the model are also not reflective of actual market experience. Moreover, the risk weights generated by these curves are not consistent with the standardized approach, which proposes that retail loans carry a more favorable 75% Risk Weight. This, in effect, creates a disincentive to move towards the IRB approach – contrary to the stated intention of Basel II as well as creating a serious competitive inequality for those institutions. CP 3's prescribed AVC factors have no demonstrated validity. Appropriate AVC factors should be based on each bank's internal experience, not prescribed by the New Accord.

a. AVC Assumption

The Committee provides a model that assumes an inverse relationship between AVC and probability of default ("PD") – AVC falls as PD rises and vice versa. This inverse AVC-PD relationship implies that low-PD obligors would have greater stocks of wealth (e.g., liquid assets, stocks, and home equity) that provide a buffer against idiosyncratic shocks (job loss, divorce and health issues) relative to high-PD obligors. It also assumes, however, that low-PD obligors would be more sensitive to systemic events (macroeconomic shocks).

MBNA does not conduct business in a way where this direct inverse relationship would consistently hold true. In fact, our loss experience is more representative of a flatter AVC-PD relationship. Customers are not extended credit solely on income, home value, job classification or some other proxy for wealth. While these concepts are instrumental in establishing credit lines, MBNA customers are granted credit based on solid, judgmental credit evaluation based not just on the customer's ability to pay (wealth proxy), but also

the customer's stability and willingness to repay. MBNA's credit analysts, in making lending decisions consider, among other things, the applicant's length of employment, homeownership, length of time at residence, debt-to-income, as well as performance on existing loans with other creditors. Each customer falls within established risk characteristics such as a booked FICO and internal risk scores that are within range of the portfolio averages. Customers with similar risk profiles are grouped in the same PD segment, regardless of wealth. Based on this, we do not believe that wealth proxies, solely, can clearly delineate future default and would raise concern about an inverse relationship between AVC and PD.

Moreover, using credit lines as a proxy for wealth, based on our average charge-off balance, the average defaulted customer is considered a low wealth individual, in that most high-wealth individuals generally have credit lines that are well in excess of $15,000 and well in excess of the average charge off balance. In the most recent recession, MBNA did not see a dramatic increase in its average charge-off balance, suggesting that MBNA's high wealth (or low-PD) customers were not as sensitive to systemic risk as the Basel AVC-PD relationship implies.

We know that, as idiosyncratic and systemic shocks occur over customers' credit life cycles, both low- and high-wealth customers adjust their respective asset, consumption and debt levels to avoid default. Therefore, the presumption of low-PD customers having greater sensitivity to systemic risks is overstated in the CP 3 model. MBNA believes that the periodic smoothing of assets, consumption, and debt among low- and high-wealth borrowers in combination with solid, judgmental credit underwriting would result to a flatter AVC curve relative to PD.

We note also that paragraph 299 (*Risk-weighted assets for qualifying revolving retail exposures*) and paragraph 300 (*Risk-weighted assets for other retail exposures*) provide the AVC assumptions embedded in the Basel model: 2% - 11% for QREs and 2% - 17% for the other retail exposures. Although the AVC assumptions for QREs in the CP 3 model is an improvement from the 2% - 15% in QIS 3, the upper end of this range, which will apply to the low PD accounts, remains excessive. If left unchanged, this will essentially penalize banks that have a higher concentration of lower risk customers and will create a disincentive for lower risk lending.

The Risk Management Association ("RMA") raised this concern about the QIS 3 curve in its February 2003 paper, "Retail Credit Economic Capital Estimation – Best Practices." The RMA paper notes "that the steeply declining Basel AVCs (as PD rises) for revolving credits and other credits result in very great differences between internally estimated AVCs and Basel AVCs in the low PD ranges." The RMA paper also notes that the implied AVCs of the banks surveyed ranged from 1.98% - 3.20% for credit cards and 3.93% - 6.06% for Other Unsecured Retail Loans, which are far below the ranges established in the QIS 3, and in the CP 3 model.

MBNA believes this assumed inverse linear AVC and PD relationship needs to be adjusted downward or subjected to more research and validation on actual portfolio data prior to implementation of the retail IRB framework. MBNA also believes that more guidance from the Committee on a suitable methodology to directly estimate AVCs is necessary to insure consistency among the industry and across various product lines. It would be very helpful for the Committee to share how it derived AVC calibration for CP 3.

b. Credit for Expected Losses

Paragraphs 299-301 provide the formulas for the QREs and the other retail exposures. We believe that the credit for expected losses is unreasonably low and should be increased to 100% for both the QREs and for the other retail exposures.

i. Increase the Expected Loss Credit for Qualifying Revolving Retail Exposures Curve from 75% to 100%

MBNA's U.S. securitization trust data over the past 60 months demonstrates that the average future margin income ("FMI") (in this case defined as net interest income less servicing fee) is almost two times the mean gross charge-offs (excluding recoveries). This does not include other non-interest related fees such as interchange income and fees, nor does it include recoveries from charged off loans. Moreover, the predictability of future credit card losses is strong, with the standard deviation at a low 16% of the mean charge-off.

The credit for the EL in QIS 3 was 90%, CP 3 proposes to reduce the credit to 75%, but without providing any empirical data to support this change. We strongly recommend that the credit be increased to 100%, while providing the supervisory process with the authority to disallow any portion of the FMI that the institution's primary regulator believes necessary. This is consistent with the approach outlined in paragraph 202.

ii. Provide the Expected Loss Credit for the Other Retail Exposures Curve

For the other retail exposures curve, in CP 3 Banks are required to hold capital for both expected and unexpected losses. Because retail lenders price their product with the expectation of future losses, the future margin income associated with that pricing is more than sufficient to cover expected losses. This conclusion is not limited to credit card portfolios, but applied equally to other unsecured forms of retail lending.

We believe that for loans that fall in the other retail exposures curve, recognition of EL, particularly for non-revolving unsecured loans where the pricing is generally higher to cover EL, must be permitted. By not allowing this recognition, CP 3 effectively penalizes non-revolving unsecured lending (e.g., installment loans) even where these loans have a much higher FMI.

This suggested approach is consistent with the recommendations of the RMA, "EL should be subtracted from loss at all the confidence interval with regard to all retail credit products, not just cards."

Although we recognize the desire of the Committee to create a distinction between the two retail exposures, recognition of the higher FMI for the non-revolving unsecured lending is appropriate so long as it meets the FMI test in paragraph 202.

B. CP 3 Creates No Incentive to Apply the Internal Ratings Based Approach

Ironically, CP 3 requires a substantially higher capital requirement for QREs under the IRB approach than under either the standardized approach or the Current 1988 Capital Accord (the "Current Accord"). The risk weights generated by CP 3 revolving and other retail curves are not consistent with the standardized approach, which proposes that retail loans carry a 75% risk weight.

The table below compares the total capital requirement per $100 of QRE exposures under the Current Accord, the CP 3 standardized and the IRB approaches. For this example, the alternative standardized approach was used for operational risk. Additionally, the IRB Credit Risk capital requirement assumes a PD of 5% and a loss given default ("LGD") of 108%. The LGD percentage reflects the risk of additional balance growth prior to default.

Capital Requirements Per $100 of Exposures	**Current Accord**	**Standardized Approach**	**IRB Approach**
Credit Risk	$8.00	$6.00	$9.47
Operational Risk	N/A	$0.42	$0.42
Total Capital	$8.00	$6.42	$9.89

The results demonstrate a capital requirement under the IRB approach that is 24% and 54% greater than the Current Accord and the standardized approach, respectively. The stated intent of the IRB approach is to create incentives for banks to invest the resources and adopt more sophisticated risk management techniques. CP 3 certainly fails to meet that objective with respect to credit card exposures, indeed, it creates a major disincentive for a credit card bank to take action that could result in the application of the IRB approach.

This disparity will also have the effect of making credit card banks less willing to expand into other countries, where they would become subject to the IRB approach, effectively depriving these banks with the benefit or opportunity of achieving greater geographic diversification.

The difference in capital requirements is the result of:

- The use of correlation factors in the current retail curve that are not supported by any empirical data.

- An approach to calibrating FMI and EL that does not make appropriate allowance for the structure of a card issuer's profit and loss account, or for widespread industry account management practices such as risk-based repricing.

- The requirement to hold capital against the exposure to additional draws on uncommitted credit lines.

Although this may not be an issue in the U.S. (U.S. regulators have indicated the standardized approach will not be implemented), it would put U.S. banks with foreign subsidiaries that opt for the IRB approach at a disadvantage against their host country competitors.

C. Asset Securitization

Since 1986, MBNA has securitized over $130 billion of credit card and other consumer loans through more than 210 separate transactions. These transactions have been structured with loans originated in the United States, United Kingdom and Canada. We have also played an integral role in the development of innovative securitization structures and have provided guidance to the Financial Accounting Standards Board and regulatory agencies on securitization matters. We believe the depth of our securitization experience uniquely positions us to recommend needed changes to the Committee's securitization proposal.

MBNA respectfully acknowledges the Committee's efforts to develop a risk sensitive treatment for securitizations (the "Securitization Proposal"). MBNA has been an active participant throughout the Basel II development process. We have actively participated in meetings with the Committee's Securitization Working Group and have provided specific recommended changes. We are disappointed that, to this date, few, if any of our recommendations have been adopted. We note further that the comments by the securitization industry have also been ignored in large part. [6] Additionally, it is our understanding, based on discussions with industry participants, that the securitization results for QIS 3 did not achieve a desired level of accuracy. Because of these issues, we would like to reiterate the concerns we have expressed on many occasions and implore the Committee to consider fully our recommendations. Our comments are primarily directed to the IRB approach to securitizations.

MBNA has four principal concerns with the Securitization Proposal:

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6 The American Securitization Forum, Australian Securitisation Forum, European Securitisation Forum, Bond Market Association, International Association of Credit Portfolio Managers, International Swaps and Derivatives Association and Japanese Banking Association have participated either jointly or separately in the commenting process. MBNA participated in the drafting of and endorses the recommendations included in the securitization industry comment letter.

1. Undrawn, Uncommitted Credit Lines on Accounts Included in Securitization Structures

CP 3 requires banks to hold regulatory capital for: (1) the "owned" (on balance sheet) retail loan exposures (both drawn balances and exposure to undrawn, uncommitted credit lines), and (2) retained securitization exposures, including a new early amortization capital requirement for loans securitized. CP 3 also requires banks to hold capital for available, uncommitted credit lines for accounts whose balances have been securitized. Specifically, paragraph 308 states: "When only the drawn balances of retail facilities have been securitised, banks must ensure that they continue to hold required capital against the portions of the credit lines that are undrawn." Paragraph 571 (*IRB approach for securitization exposures*) further provides: "The potential losses associated with the portion of the credit lines that are undrawn are to be reflected in the originating banks' IRB capital requirement as discussed in paragraph 308 regardless of the fraction of drawn balances securitised. The originating bank must reflect the likelihood of additional draws in its EAD estimate."

The requirement to hold capital against uncommitted credit lines for accounts whose balances have been securitized should be eliminated. As we have stated previously, credit lines on credit card accounts are uncommitted guidance lines. Credit card lenders can terminate any remaining "open to buy" (difference between credit line and balance) on customer accounts at will. Unlike committed corporate facilities that provide an unconditional grant of credit, lines for revolving accounts can be revoked at anytime. As an example, please refer to Section II. A. 1, above, for a more detailed explanation of MBNA's line management strategies.

Moreover, in typical revolving securitization structures, both current drawn balances and future customer draws, are securitized. Pursuant to the operational documents for revolving securitizations, third-party investors are obligated to purchase newly originated receivables (at par) in order to maintain their investor interest during the securitizations revolving period (generally 24 – 72 months). The investors do not have the ability to choose whether or not to purchase newly originated loans, nor do they have the ability to purchase only low risk receivables. The investors are required to purchase receivables, on a pro rata basis, from all accounts in the securitization vehicle, including those in high risk/high EL segments. The example below describes the monthly mechanics of a typical credit card securitization structure during the revolving period. This simple example only addresses the collection of principal receivables and new purchase/cash advance activity.[7]

	Beginning Balance (a.)	Customer Payments (b.)	Customer Activity (c.)	Ending Balance
Investor Interest	$900	($135)	$135	$900
Seller Interest	$100	($15)	$15	$100
Total Trust	$1,000	($150)	$150	$1,000

7 Collection and billing of interest and fees are excluded from this example because the collection of interest and fees is used to meet other monthly obligations of the securitization (coupon, servicing fees and credit losses) and is not relevant to the discussion.

a. The seller transferred $1,000 of principal loans to the securitization vehicle (the "Trust"). Investors purchased an interest in the Trust by paying the seller par ($900) for an undivided interest in the Trust.

b. The seller retains the $100 remaining undivided interest in the Trust. During the period, credit card customers repaid $150 of the $1,000 in loans originally transferred to the trust. The payments are allocated between the investor and seller based on their "ownership" interest in the Trust at the beginning of the period. In this case, the investor is allocated 90% of the principal payments of $150 (900/1,000), or $135. The seller is allocated 10% (100/1,000) or $15.

c. Under the governing securitization documents, during the revolving period, the investor is required to purchase (at par) newly originated receivables from the seller, in order to maintain the investor interest at $900. The investor uses the allocated principal collections to purchase the new loan activity. In this example, new loan activity equaled customer payments; therefore, the beginning and ending balances were also equal. To clarify, if there were new loan activity of $150, 90% of that activity would be allocated to the investor in order to maintain the investor's $900 interest – even if the $150 was related to high-risk accounts. There is no reason to require that the seller to hold capital for the 90% of the new loan activity, which would be allocated to the investor.

d. If the new loan activity were less than customer payments, the investor still purchases enough newly created receivables to maintain the investor interest of $900 and the seller interest would shrink. In the example below, if new loan activity was $140 (instead of $150), the balance in the total loan pool would shrink to $990. The investor would nevertheless purchase $135 of new loans to maintain an investor interest of $900. The seller interest, however, would shrink to $90.

	Beginning Balance	**Customer Payments**	**Customer Activity (d.)**	**Ending Balance**
Investor Interest	$900	($135)	$135	$900
Seller Interest	$100	($15)	$5	$90
Total Trust	$1,000	($150)	$140	$990

Once again, there is no reason to require that the seller hold capital for 96.4% of the new loan activity allocated to the investor.

This type of structure, which sells not only currently drawn balances, but also newly originated customer receivables, should not be subject to the requirements of holding capital against undrawn credit lines contained in paragraph 308. Given that revolving

securitization structures, by definition sell new loan originations, both 308 and 571 should be eliminated (or at the very least limited to any securitization structures that do not sell new loan orginations).

It is worth noting that, MBNA's actual experience with its credit card master trusts is consistent with this example demonstrating a reduction to the seller's interest. During the 3-year period ending December 31, 2002, MBNA added new accounts to its U.S. MBNA Master Credit Card Trust II (the "Master Trust") with aggregate loan balances of $29.5 billion, measured at the date of each account addition. During the same period, aggregate loan balances in the Master Trust increased by $21.7 billion. Without the addition of new accounts, both the aggregate loan balances in the Master Trust and the seller's interest would have shrunk. A shrinking seller's interest would reduce MBNA's exposure to retail credit risk, not increase it as implied by paragraphs 308 and 571.

Finally, if the requirement to hold capital against uncommitted credit lines from securitized loans arises from early amortization, that risk is already captured in the new early amortization capital requirements, contained in paragraph 510 (*Early Amortisation*). Any additional requirements, such as indicated in paragraphs 308 and 571, would be duplicative and unnecessary.

To summarize, each of the several different factors of– line management strategies, structure of revolving securitizations, and documented behavior of securitized loan pools, when combined with CP 3's additional early amortization capital requirements – demonstrates the "risk" for uncommitted lines relating to securitizations is non-existent and already captured. Accordingly, the requirements of paragraphs 308 and 571 should be withdrawn.

2. Early Amortization Capital Requirements

We support the Committee's proposal that recognizes early amortization risks and their associated capital requirements will vary based on both the asset type and the nature of the early amortization provisions. Nevertheless, changes to the qualification conditions for "controlled" early amortization treatment are needed to clarify the scope of the requirement.

Paragraph 510 *(Early amortisation)* should clearly provide that the "controlled" amortization requirements apply only to economic pay-out events and *not* normal amortization or accumulation periods. The early amortization capital charge represents a new capital requirement, specifically targeting the credit and liquidity risks associated with early amortization events – that is, when things go "bad" in the trust. As a result, the controlled amortization requirements should cover only that specific economic early amortization risk. During normal amortization periods, the loans, by definition, are performing well and liquidity requirements are incorporated into the bank's liquidity planning process.

Paragraph 510(b) also requires revision. The clause is redundant and too restrictive by requiring that there be "a pro rata sharing of interest, principal, expenses, losses and recoveries based on the balances of receivables outstanding at the beginning of the month." Clauses (c) and (d) go on to better establish the necessary conditions for "controlled amortization." Specifically: (1) the period for amortization must be sufficient for 90% of the total debt outstanding at the beginning of the amortization period or recognized as in default and (2) the amortization occurs at a pace no more rapid than straight-line amortization. We believe that Basel II must articulate only guiding principles and not establish prescriptive rules for early amortization. Accordingly, paragraph 510(b) is unnecessary and should be withdrawn.

3. Originators of Revolving ABS Transactions are Subjected to Disproportionate Capital Charges

Pursuant to paragraph 575 (*Hierarchy of approaches*), under the IRB approach, originators are required to deduct from capital *all* retained positions between zero and K_{IRB}, even if the retained position is rated by a debt rating agency. This requirement is also inconsistent with the requirements under the standardized approach contained in paragraph 530 (*Originators to deduct below-investment or unrated securitisation exposures*) that requires originating banks to deduct only those retained securitization exposures that are rated below investment grade.

The use of independent credit ratings is a fundamental component of Basel II. The requirement to deduct exposures below K_{IRB} ignores the rating, if any, and applies a capital charge that is not consistent with the risk. We strongly recommend amending paragraphs 530 and 575 to state that retained, rated securitization exposures will be subject to risk weights based on the rating of the exposure. With this change, unrated retained exposures, not qualifying for an inferred rating would continue to be deducted, up to predetermined limits (i.e., K_{IRB} under the IRB approach). This would ensure greater consistency in risk assessment and not unfairly penalize originators. It should also be noted that Basel II already builds additional degrees of conservatism into its securitization capital requirements. For example, lower rated securitization exposures require more capital than like rated corporate exposures, therefore no additional capital should be required for retained, rated securitization exposures.

We recommend that paragraph 580 be amended to read as follows: "A bank using the IRB approach to securitisation may apply the IRB capital requirement for the underlying exposures, if its capital requirement using the SF and/or RBA (*including any early amortization capital charge*) is greater than it would have been had the underlying exposures not been securitised. In addition, banks must deduct any capitalised assets as indicated in paragraph 523." The italicized parenthetical will help to clarify the maximum capital requirement.

4. Dollar for Dollar Reductions to Tier 1 Capital

CP 3 requires banks to deduct certain securitization exposures from Tier 1 capital. Specifically, paragraph 523 *(Implicit support)* requires that banks deduct from its Tier 1 capital any capitalized future margin income. Paragraph 522 *(Deduction)* requires that all other capital deductions be taken at 50% from Tier 1 and 50% from Tier 2. MBNA believes that the more appropriate method is to deduct the amount from a bank's total capital. This position is consistent with current FFIEC guidelines and more indicative of the risk of the asset. Additionally, we would recommend paragraph 523 be amended to require only amounts of capitalized future margin income greater than 25% of Tier 1 capital be deducted from Tier 1 capital. This approach would also be consistent with current FFIEC guidelines.

Regulatory capital deductions related to capitalized assets should be on a net of taxes basis. A capitalized asset such as an interest only strip receivable flows through earnings and are tax-effected prior to increasing capital.

D. Operational Risk

MBNA appreciates the efforts of the Committee to refine the operational risk aspects of the New Accord to reflect industry comments. Specifically, we believe the following areas represent improvements from the Second Consultative Paper:

- Removal of the capital floor for the AMA provides improved incentive for more sophisticated risk management techniques.

- The definition of operational risk provides more clarity for scope of coverage, although we believe additional changes and definitions are necessary.

- Allowance for exclusion of expected losses, assuming they can be supported, provides a more appropriate measure of operational risk funding exposure.

- Development of the alternative standardized approach for retail and commercial exposures provides a more realistic measure of loss exposure than gross income.

Notwithstanding these improvements, we remain concerned that the New Accord's specific allocation of capital for operational risk has the potential to cause an unwarranted and significant increase in the net amount of regulatory capital imposed on a number of institutions. Although there have been significant operational risk events within the banking industry, the vast majority of these losses have involved trading and capital market activities, which have a far different operational risk profile than the retail lending focused institutions such as MBNA. We continue to believe that a strong control and compliance environment, appropriate insurance coverage, and effective bank supervision is the most valuable method for managing operational risk. By now assessing capital for operational risk, the Committee is, for all intents and purposes, creating a new type of capital requirement without a demonstrating that there exists a concomitant increase in

overall risk. In general the complexity of the proposal for operational risk does not correspond to the general manner in which banking risk is managed today. Listed below are MBNA's specific concerns regarding the operational risk aspects of the New Accord:

1. A Statistical-Based Capital Charge for Operational Risk Fails to Capture True Risk

In the final analysis, the effective mitigant to operational risk is not capital, but strong risk management, careful contingency planning and a robust response capability. Even a sharp increase in capital may not be a realistic mitigant for certain events such as the loss of a data center. The events of September 11, and the banking industry's response to it, brought into clear focus the value of sound business recovery planning and the consequence of inadequate planning. In the end, it was not the allocation of operational risk capital that ensured a quick and effective response to the tragedy, but qualitative factors. Ironically the New Accord could discourage investment in risk mitigation and contingency planning because the capital charges for operational risk would ignore those investments.

At a minimum, the New Accord must provide more explicit weight and give clear incentive to qualitative efforts and preventative controls. Qualitative efforts that emphasize the importance of preventative controls should have equal footing with quantitative data analysis. Otherwise, this effort evolves into a purely statistical effort with the unintended consequence of degrading judgmental risk management skills and control techniques.

2. Lack of Clear Definition Makes Operational Risk Unworkable

We remain concerned that the quantification of operational risk is still in its infancy. It remains speculative and untested, not subject to precise measurement and may cause significantly different capital requirements, depending upon the underlying assumptions and the data capture methods used in measuring the risk. At a minimum, the following areas require further development:

- A more precise definition is needed regarding the correlation between the qualitative and quantitative requirements.
- The reliability of internal and external data needs to improve to support the recommended confidence level of 99.9%. Most banks data collection systems relating to operational risk are new and untested. Neither banks nor their regulators have had adequate time to determine whether the current loss data is predictive in nature or accurately reflects the institution's operational risk profile. In reviewing the 2002 Loss Data Collection Exercise ("LDCE"), only 5 of the 89 banks that participated in the LDCE provided more than 2,000 loss events and only two provided what was considered comprehensive data. This lack of comprehensive data from banks that have been collecting operational loss information for a relatively short period of time makes the use of this data to

determine capital adequacy for operational risk suspect and of questionable validity. Given these limitations of operational loss data, it is doubtful whether loss curves with a 99.9% confidence level could produce credible loss estimates and accurate estimates for operational risk capital. We would suggest a confidence level of 95% as being more realistic for the foreseeable future, unless or until the quantity and quality of loss data vastly improves.

3. Operational Risk Should be Included as Part of the Supervisory Process of Pillar 2

We continue to believe that operational risk more correctly belongs in the supervisory process of Pillar 2 and not as an explicit and formulaic capital charge under Pillar 1. As noted by Comptroller Hawke in his Congressional testimony, "[u]nlike credit risk and market risk, which a bank consciously assumes in the expectation for financial return, operational risk is an unwanted byproduct of day-to-day business activities." [8] The choice for banks in effectively managing operational risk is not risk vs. reward, but rather risk vs. the cost of reducing the risk. Risk mitigation and effective control are the most meaningful response to operational risk. The supervisory process is the best place where operational risk should be assessed and not through the formulaic approach in Pillar 1

4. At a Minimum, More Development is Needed Before Final Implementation

If, despite these concerns, if the Committee remains intent upon assessing a capital charge for operational risk in Pillar 1, we recommend that its final implementation be delayed for at least two years after the effective date of the New Accord and be subject to Pillar 2 during this transitional period. By doing this:

Industry data collection methodologies need to be enhanced and made consistent and results could be vetted to ensure consistent application across the industry.

Regulators would have a reasonable amount of time to become technically conversant in operational risk requirements and the emerging standards and provide necessary feedback to banks as they build their operational risk infrastructures.

These requirements could be rationalized and coordinated with other emerging and existing regulatory requirements (e.g., Sarbanes-Oxley and FIDICIA) to ensure banks as well as supervisors are not overburdened with conflicting and duplicate requirements.

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8 Hawke Testimony.

III. PILLAR 2 – SUPERVISORY REVIEW

We have a number of general concerns with Pillar 2, which should be addressed in the formal rulemaking:

- We remain concerned over the regulator's ability to develop clear benchmarks and sufficiently educate its staff in a timely basis on the intricacies and technical requirements of the entire proposal. Many of the requirements are highly quantitative in nature and require substantial statistical and econometric skills to assess and evaluate. Of specific concern is whether local supervisors will develop the resources and expertise to adequately assess and validate a bank's internal capital models

- The overall proposal remains unnecessarily burdensome and complex. We also believe that the inclusion of *twenty* previously issued guidance on page 153 of the proposal, make it virtually impossible to cogently assess and comment on this substantial volume of supplementary material within the New Accord. We question whether any one individual within the banking regulatory community has read all of the consultative papers and can speak to them with any degree of expertise and authority.

- We recommend that Pillar 2 be a top-down, whole firm self-assessment process based upon the identification of instances where a firm materially diverges from the assumptions underpinning the Pillar 1 regulatory capital model. Additional capital may be an appropriate response to such an assessment, but should not be the only or the automatic response, as this will encourage an unduly mechanistic approach, which will fail to focus in an appropriate manner on the risk profile of the firm. At a practical level, few banks will look to capital as its sole risk mitigant. Should a material risk be identified, the bank will (1) ensure there are proper controls in place to mitigate the risk to the extent possible, and (2) ensure that the referenced activity will earn a sufficient rate of return to justify the risk being taken. On the latter point, Pillar 2 should place significantly more emphasis on the risk/return ratio of a given banking activity. We submit that banks that price their products commensurate with the risk being taken and experience a positive accretion to capital as a result should be favorably viewed under Pillar 2. Overall, the New Accord does not give sufficient weight or emphasis to earnings capacity as a capital adequacy factor.

- We recommend that the number of areas of national discretion (currently 40) be significantly reduced. Otherwise there will simply not be uniform implementation of the New Accord across jurisdictions.

- Home-host supervisory issues should be clearly addressed to minimize the maintenance of multiple systems and procedures to comply with varying supervisory requirements.

- We are concerned the proposal will only seem to result in additional capital requirements being applied (for example - interest rate risk); it is not evident that a positive assessment under Pillar 2 could result in a finding by the regulators of lower capital requirements.

- Pillar 2 places undue emphasis on the board and management applying quantitative risk limits and controls to ensure bank operations remain within acceptable risk tolerances. We suggest that equal emphasis be placed on management judgment and decision-making.

- Further, Pillar 1 will, by design, deliver a sufficient capital charge based on the requirement that firms meet very robust and demanding qualitative and quantitative capital assessment standards; therefore, should the New Accord function as intended, additional capital requirements under Pillar 2 should be the exception not the rule and should be contemplated only in unusual circumstances as described above.

- As mentioned in our comments to operational risk above, we are concerned that Pillar 2 will force banks to implement an unprecedented number of new programs and systems to address the various legislative initiatives impending in the banking and overall business community. Specifically, International Financial Reporting Standards come into force in 2005 and the relevant implementation plans have been running concurrently with Basel. A further example is the Sarbanes-Oxley Act, which comes into effect by 2005 for U.S. institutions. An integrated approach to Basel and SEC requirements must be adopted where relevant.

IV. PILLAR 3 – MARKET DISCIPLINE

We support in general the concept of greater transparency, while balancing the concerns of regulatory burden, complexity of disclosures and the need to protect proprietary and competitive information. We believe that the requirements of Pillar 3 should be limited to information that is truly material to market assessment of risk while meeting these concerns.

Although significantly improved from earlier proposals, Pillar 3 continues to reach far beyond what is currently mandated by debt rating agencies, private creditors, or accounting and securities authorities. As such, under Pillar 3 regulated banking institutions will be required to disclose information that non-regulated competitors, that incur similar risks, would not be required to disclose.

Recognizing the Committee's commitment to greater transparency, but wishing to avoid competitive harm that additional disclosure may bring to financial institutions, we suggest that the Committee work with the accounting and securities regulators to develop a global disclosure requirement that would apply to all companies that incur similar risks.

We believe that there is an important distinction between encouraging greater transparency and requiring simply greater volumes of disclosure. Indeed, unnecessary disclosures actually create opaqueness rather than transparency. Burden, cost, competitive impacts must be measured against their actual benefit, if any, that additional disclosure would provide.

A. Interaction with Accounting Disclosures

We agree with the Committee's stated goal of working closely with accounting authorities and of promoting consistency between disclosure frameworks. In light the rapidly changing accounting disclosure requirements, however, we urge that both the content and the effective date of implementation for disclosures be coordinated with FASB or IASB to minimize confusion and ensure accuracy and consistency.

B. No Greater Transparency

Although some specific disclosures may be useful, we do not believe that the numerous and broad requirements in CP 3 are in fact necessary. Moreover, we are not convinced that, as a concept, the requirement of disclosing additional information will in fact lead to greater transparency. Market participants currently have access to substantial information. In achieving the Committee's goal that market participants have a greater understanding of the risks facing an institution, we must balance the requirement of providing relevant and probative information against the simplistic notion that greater volumes of information will always result in greater transparency. By requiring prescriptive and unreasonably large quantities of information, we may be overwhelming market participants with data that in the end may prove of little value and may not be useful to the reader of the financial statements.

Despite the prescriptive nature of Pillar 3 and the scope of detailed information that would be revealed through disclosures, we are uncertain whether this information would be comparable across institutions to be of any material value to market participants. Institutions by their very nature are unique. How risk exposures are defined and quantified will necessarily vary depending upon the size of the institution, the products and services that it offers and the way it controls and manages its exposures. No matter how prescriptive the disclosure requirements become, there can never be a true apples-to-apples comparison.

We remain unconvinced that the additional burden is worth the disclosure benefits envisioned by the Committee. Disclosure for disclosure's sake, without increasing actual transparency or the market participant's understanding of the institution creates an unnecessary regulatory burden. Although the CP 3 has reduced the level of disclosure, the

proposed disclosures continue to be far greater than what is reasonable under the circumstances. We continue to question whether market participants would in fact use the information provided as envisioned by the Committee.

C. Sensitive Competitive Information

Although CP 3 has incorporated many of the changes suggested by financial institutions, we remain concerned that some of the required disclosures will reveal sensitive, competitive information, which will be of little value to market participants, but will reveal to competitors the marketing strategies, pockets of opportunity and other sensitive information of an institution. For example, if an organization identifies certain factors or methodologies that are much more predictive of risk than current scoring models, it should not be required to disclose the nature of those factors/methodologies in a manner that would provide this critical information.

In paragraph 774 (*Credit Risk*), banks are required to disclose a substantial amount of quantitative data regarding credit risk exposures, broken down by major types of credit exposure. As part of this requirement, banks must provide a geographic distribution, industry or counterparty type distribution, and residual contractual maturity breakdown of the whole portfolio, broken down by major types of credit exposure. Banks must also disclose the amount of impaired loans and past due loans broken down by geographic areas including the amounts of specific and general allowances.

This highly detailed quantitative disclosure regarding the geographic and customer-type components of credit risk will reveal proprietary market strategies to competitors and may compromise a bank's competitive advantage over other institutions that could use this information strategically. We believe that this type of information is of limited value to the average market participant, particularly when compared against the potential competitive injury that such disclosures may cause. Accordingly, we recommend that the quantitative requirements in paragraph 774 be removed from Pillar 3.

The general, qualitative disclosures of credit risk concepts such as definitions of past due and impaired accounts, ALLL, statistical methods surrounding calculations of reserves, and overall credit risk management policy is more germane to understanding the quality of credit risk management and is where disclosure is appropriate and helpful. The focus of the disclosure should be on the techniques management uses to effectively manage credit risk and how these techniques affect the institution's risk profile.

In paragraph 775 (*Credit Risk: Disclosures for Portfolios Subject to IRB Approaches*), the level of detailed disclosure required also can cause competitive harm. Paragraph 775's requirement asks for a description for each portfolio of "[t]he definitions, methods and data for estimation and validation of PD, . . . LGD and/or EAD, including assumptions employed in the derivation of these variables" may require extensive and complicated disclosures, which are not easily explained to market participants, will be of little value to them, and may compromise a bank's competitive position. We believe that the only real

value these disclosures would provide would be to competitors – those who seek a competitive advantage by gaining insight into a rival's success in managing and growing its business. Moreover, we do not believe that providing IRB approach validation data is necessary to serve the interests of market participants, when that information is generally available to bank regulators and debt rating agencies. From the market participant's perspective, the key information is whether the rating agencies and the institution's primary regulator are satisfied with the approaches used.

We note that the CP 3 disclosure regime envisioned in Pillar 3 would disproportionately harm smaller institutions or those institutions with a limited range of products or businesses. Information provided by these institutions will reveal far more competitive information about the product, marketing investments and exposures than what would be disclosed by the larger institutions that have many businesses spanning multiple product offerings and business lines. We remain concerned that Basel II strike the appropriate balance between the need for meaningful disclosure and the protection of competitive proprietary information.

D. Frequency

Pillar 3 disclosures should occur on an annual basis, not the semi-annual basis proposed in paragraph 767 (*Frequency*). We agree that material changes to risk processes or significant shifts in risk exposures should be disclosed in a more timely fashion and as soon as practicable. The more comprehensive disclosures should be limited to an annual reporting regime.

E. Market Reaction

We remain concerned that additional disclosures may result in an unexpected and undesired market reaction. Given the increased scope of the disclosures envisioned in Pillar 3, we believe that it is important for market participants to be fully educated about the changes in required regulatory disclosures for financial institutions and that these changes are driven not by an actual change in risk exposure, but by a desire of the Committee to achieve greater transparency. Failure to adequately prepare the community for these regulatory changes may cause market participants to draw inappropriate conclusions about the risk profiles of individual institutions or of the industry as a whole.

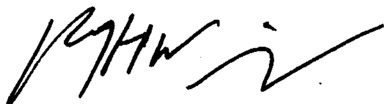
In conclusion, we remain concerned that proposed level of disclosure required under Pillar 3 continues to demand highly prescriptive and excessive levels of detailed and complex information – information that, in the end, will be of limited value to a market participant and will cause unnecessary burden and potential harm to the institutions that make these disclosures.

V. CONCLUSION

We would like to again emphasize our strong opposition to the allocation of capital for undrawn lines for retail credit, the allocation of capital for operational risk, and the broad additional disclosure requirements found in Pillar 3. If, despite our opposition, the Committee proceeds with the Proposal, it is critical for the Committee to invest the time necessary to develop a workable solution to the issues raised herein. Many items in CP 3 are new or are modifications of prior items. Additional testing and verification is needed and a new QIS study should be conducted before the final approval of the New Accord. Basel II will have a significant impact on the banking system and therefore additional time should be taken to refine this new regulatory framework.

We appreciate the opportunity to provide these comments to the Committee. If you have any questions regarding this submission or if we can provide further information, please contact me directly by telephone at 302-453-2074 or by e-mail at vernon.wright@mbna.com.

Yours truly,



Vernon H.C. Wright
Executive Vice Chairman
MBNA America Bank, N.A.

Chief Financial Officer
MBNA Corporation

Appendix 1 – Qualifying Revolving Exposure Curve

C:
Office of the Comptroller of the Currency
Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation
Financial Services Authority (United Kingdom)
Office of the Superintendent of Financial Institutions (Canada)
Office of Thrift Supervision
Irish Financial Services Regulatory Authority
Banco de España

Appendix 1
Qualifying Revolving Exposures Curve

Capital requirements for Qualifying Revolving Exposures ("QRE") increase steeply for relatively low probability of default ("PD") rates and level off over a wide range of PDs. In order to demonstrate our concern, we plotted the risk weights ("RW") derived from the Consultative Paper 3 ("CP 3") QRE formula across a wide range of PDs. The standardized capital requirement is also included in the graph to reinforce the inconsistency in CP 3. For simplicity, the CP 3 QRE data points are based on a LGD of 100%. The 100% LGD is reasonably close to actual experience for credit card portfolios. More importantly, the shape of the risk weight curve is similar across a wide range of LGDs. Therefore, the conclusions drawn from the results of the 100% LGD scenario would be valid for other LGDs as well. Also, if the LGD is held constant at 100%, then PD and EL are equal (PD=EL/LGD), which makes it easier to interpret the graphs.

Graph A below, demonstrates that the QRE RWs increase steeply from 16% at a PD of 0.10% to 86% at a PD of 2.0%. Additionally, a PD of only 1.30% produces a risk weight of 75% under the IRB approach, equal to the prescribed risk weight under the Standardized approach.