COMMENT DOCUMENT
July 29, 2003

Synovus Financial Corp.

Comments on the Third Consultative Proposal of the New Basel Capital Accord (Basel II)

The following are the most significant issues and concerns of Synovus Financial Corp. regarding the Third Consultative Proposal of Basel II ("CP3").

OVERALL COMMENTS

1. **BANK RATINGS.** There is some concern that even if the methodology allows banks to reduce their levels of capital, ratings agencies will look unfavorably on this benefit of Basel II compliance. For those not complying with Basel II, there is concern that a Basel I bank will be viewed as a separate (and lower) class of financial institution.

2. **CHANGE IN REGULATORY STATUS.** There is concern that a bank's regulatory status will change because of Basel II rather than because of a change in the bank's risk profile.

3. **COMPETITIVE EQUALITY.** The assets of U.S. banks that will be required to adhere to Basel II's most advanced approaches constitute two-thirds of the total domestic assets. The risk measurement practices and consequent capital allocation adjustments will have a significant impact on the competitive environment and on Basel I banks' abilities to compete fairly with Basel II banks.

4. **CONSISTENT IMPLEMENTATION.** . Regulators may have difficulty with the intricacies and complexity of Basel II, particularly in their ability to ensure consistent implementation of Basel requirements across states, districts, and countries.

5. **Costs.** The costs of developing and implementing Basel II approved risk assessment and data collection systems may outstrip banks' abilities to comply.

6. **Stress Tests.** There is concern that stress tests may be applied inappropriately as an independent reason for imposing additional capital requirements. A range of bank-defined general stress tests should be considered, and capital requirements should not be linked directly or automatically to any particular stress test.

7. **Third Party Understanding.** We are concerned that third parties (e.g., investors) will not be able to understand the disclosures outlined in Basel II. We agree that regulators need full disclosure, but we request a limited universe of disclosures given to the public.

8. **Timeframe.** It is believed that the current timetable—particularly the December 2003 release date of the final Accord and the full implementation of Basel II in 2006—is too aggressive. Banks will not have enough lead time to implement any December 2003 changes in data collection effective January 1, 2004 resulting in an inability to gather appropriate data for the three years leading to the final implementation date.

9. **Transition Periods.** We request a flexible transition period reflective of the scope of mergers and acquisitions between Basel I and Basel II banks.

Pillar 1: Minimum Capital Requirements

Credit Risk Management: Identification, Assessment, Monitoring, and Mitigation/Control

1. **Commercial Real Estate (CRE) Lending Markets.** CRE lending constitutes an important component of our loan portfolio and those of other regional banks in the U.S. If economic capital is based on special criteria rather than actual loan loss experience, Basel II may have a significant impact on regional banks' competitive position compared to other banks and non-bank lenders. This impact has the potential to disrupt CRE lending markets.

2. **Concentration Limits in Ratings Grades.** Concentration limits are not realistic for some (particularly high quality) portfolios. Though understanding the reasoning behind concentration limits, the more objective criteria is used for determining ratings, the less need for limits.

3. **Credit Risk Charges for Commercial Real Estate Lending.** Credit risk charges are still too high in view of loan loss experience, even after taking into consideration CP3's Advanced IRB formula for High-Volatility Commercial Real Estate (HVCRE). All CRE loans should be treated comparably like other corporate exposures.

4. **Definition of Classified Assets.** There is concern that shifting focus primarily to borrower credit rating could increase the level of classified assets for businesses with high PDs/low LGDs.

5. **Definition of Default.** The definition of default in CP3 ¶414 (the 90 days past due standard) is not necessarily appropriate for all types of exposures and business lines and conflicts with historical loss data. We suggest replacing the default definition with more flexible guidelines to truly reflect internal ratings-based methodology.

6. **Definition of Loss Given Default (LGD).** Basel II's shift from a cycle-neutral LGD to a recession-based LGD may result in overly conservative capital calculations for all types of assets. We suggest a cycle-adjusted definition instead.

7. **Expected Losses (EL)**. Since expected losses are covered by loan loss reserves and are factored by banks into pricing transactions, there is concern that economic capital requirements will count expected loss twice.

8. **Leasing.** The fixed 100% risk weight for residual value of financing leases is not risk-sensitive. The result overstates capital requirements and fails to take into account differences in valuation standards and processes used by different banks. A value-at-risk (VaR) approach to evaluating the true risk of residuals should be permitted as an optional, advanced alternative to the blanket 100% risk weight.

9. **Other Retail Exposures.** A preferable approach to determining credit risk capital charges for retail lending would be a framework based on expected loss. Banks should be able to rely on the volatility of expected loss that they experience in their own portfolios to determine capital requirements.

10. **Prescriptive Nature of Credit Risk Management.** We are concerned that Basel II's credit risk methodology, has become too prescriptive. We request assurance that there will be enough flexibility in the Basel methodology to allow for advances in risk management as they occur.

11. **Qualifying Revolving Retail Exposures (Credit Cards).** The credit risk capital charges for credit cards are too high under the IRB approaches (especially for high-quality cards) and may negatively affect the competitive equality of U.S. banks' abilities to compete in other countries whose banks will be allowed to use standardized approaches.

12. **RESIDENTIAL MORTGAGE LENDING – LGD FLOOR.** The 10% floor on LGD for residential mortgages should be eliminated, given that historical data is below 10% for many mortgage portfolios.

Operational Risk Management: Identification, Assessment, Monitoring, and Mitigation/Control

1. **EXPECTED LOSSES.** We are concerned that expected loss is accounted for in operational costs before they can be excluded from the operational risk capital charge. It would be better to require banks to recognize expected loss as an operating cost wherever accounting rules permit.

2. **EXTERNAL DATA.** The availability and quality of external data on operational risk is a source of concern. The requirement that institutions must use "relevant external data" under the AMA approach should be clarified. Guidance would be appreciated on issues relating to the availability and scaling of external data.

3. **LITIGATION RISK.** Litigation risk presents a significant concern in the development and improvement of operational risk databases. Banks must be permitted flexibility to develop sound methodologies for measuring operational risks that retain protections of any self-assessment, attorney work product or other privileges from disclosure to the full extent available by law. Statements or actions by authorities to protect the confidentiality of this data would be appropriate.

4. **OPERATIONAL RISK LOSS DATA.** Loss data that is considered in credit risk and market risk capital charges should not also be required to be captured in operational risk calculations.

5. **PILLAR 1 TREATMENT.** Despite the discussions that have been on-going, we believe that Operational Risk methodology should remain in Pillar 1 of Basel II.

6. **RISK MITIGATION/INSURANCE.** Any offset for insurance should be related to a reasoned assessment of its quality. CP3's standards (the 20% ceiling and the standards that banks and insurance companies have to meet for the banks to qualify for this offset) will inhibit the development of this important risk mitigation tool. We suggest modifying the criteria so as to address the issues of the extent of coverage, the certainty of coverage, and insurer solvency.

PILLAR 2: SUPERVISORY REVIEW PROCESS

1. **MINIMUM CAPITAL REQUIREMENTS.** Pillar 2 reviews should not become a vehicle for imposing *de facto* higher across-the-board minimum capital requirements. Only in cases of identified significant risk management deficiencies should Pillar 2 require capital increases above institutions' own economic capital assessments.

2. **CONSISTENT APPLICATION.** More guidance is needed on Pillar 2 review standards to reduce the risk of inconsistent application, domestically as well as internationally. Examiners should be provided guidance, direction and training to ensure that assessments are objective and consistent. Parameters for determining when additional capital is to be required should be formalized by supervisors internationally.

3. **RISK MANAGEMENT CULTURE.** A bank's earnings volatility or stability should be given greater weight when supervisors evaluate the strengths of the institution's risk management practices, rather than mandating changes to existing risk management processes as part of eligibility standards under Pillar 1 advanced approaches. Care should be taken not to disrupt successful risk management cultures that have been developed through years of training and experience.

PILLAR 3: MARKET DISCIPLINE

A distinction should be made between the information needs of supervisors and those disclosures that are meaningful for the markets and the general public.

Please direct any questions/comments to:

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