April 16, 2010

Basel Committee on Banking Supervision
Secretariat
Bank for International Settlements
CH-4002 Basel
Switzerland
baselcommittee@bis.org

Re: Consultation Package of Proposals to Strengthen Global Capital and Liquidity Regulations

Ladies and Gentlemen:

The Institute of International Bankers (the “Institute”) is an association that represents the interests of financial institutions headquartered outside the United States that conduct banking, securities and/or insurance activities in the United States. Its membership is comprised of internationally headquartered banking/financial institutions from 39 countries around the world. Collectively, the U.S. branches, agencies, banking subsidiaries, securities affiliates and other operations of the Institute’s member banks have approximately $4.58 trillion in assets, of which approximately $2.35 trillion are banking assets, representing approximately 21% of the U.S. banking market. The Institute is pleased to submit these comments to the Basel Committee on Banking Supervision (the “Committee”) regarding the December 2009 consultative proposals to strengthen global capital and liquidity regulations in order to promote a more resilient banking sector (“the Proposals”).

The Institute strongly supports the Committee’s commitment to enhancing the Basel Capital Accord and developing robust liquidity risk management regulatory standards and its striving to develop a more harmonized set of internationally applicable requirements regarding these matters that are of such fundamental importance to the soundness of the banking sector. The Proposals are broad in scope and far-reaching in their implications, and it remains to be seen what the practical consequences of the Proposals might be, especially in light of their complexity. It therefore is essential that a comprehensive perspective be taken in assessing their impact. This assessment should take into account both the inter-relationships among the various measures and their

The Institute’s mission is to help resolve the many special legislative, regulatory and tax issues confronting internationally headquartered financial institutions that engage in banking, securities and/or insurance activities in the United States.
potential macro-economic impact, including in particular with respect to the availability of credit.

The changes contemplated by the Proposals will have a significant impact on banks’ capital and dramatically reshape their asset-liability management practices. The funding requirements underlying the proposed liquidity standards place a substantially greater emphasis on high quality liquid assets than historically has characterized banks’ portfolios and likely will have a profound impact on the key role banks play as financial intermediaries. In addition, there is a very real prospect that compliance with the Proposals’ mandates, absent their modification, would constrain the availability of credit and impede economic recovery.

Given the magnitude of the changes portended by the Proposals and the potential severity of their consequences, it is essential to take a deliberate approach to their adoption and subject the proposed new measures to the most rigorous review before recognizing them as internationally applicable standards.

These considerations call for further refinements to the Proposals and additional quantitative assessment of their impact. It would be prudent to delay adoption of the capital and liquidity standards beyond 2010 pending their further study and, upon their adoption, to phase-in their implementation with appropriate grandfathering provisions and transitional arrangements. Moreover, a coordinated effort must be undertaken to ensure that these measures are implemented symmetrically in order to avoid cross-border competitive distortions.

Our specific comments on the Proposals are focused on the following three aspects: (i) with respect to capital adequacy, the proposal to incorporate a leverage ratio into the Capital Accord; (ii) with respect to liquidity, giving due account to intragroup funding arrangements and avoiding a fragmented approach that would mandate the maintenance of dedicated (or “ring-fenced”) amounts of liquidity in certain entities or jurisdictions; and (iii) the critical significance of ensuring that, in implementing whatever revised or new capital and liquidity requirements ultimately might be agreed, appropriate deference is accorded to home country supervisory authorities vis-à-vis their host country counterparts, taking into account whether an internationally active bank’s operates in a host country through branches and/or through locally incorporated subsidiaries.

**Incorporating a Leverage Ratio into the Capital Accord**

Recent experience has demonstrated the perils that can result from the build-up of inordinate amounts of leverage in the banking sector. In considering whether to apply a leverage ratio as a means to constrain the adverse consequences of excessive leverage care must be taken that this approach does not itself result in unintended consequences
by, for example, unduly constraining the availability of credit and/or creating perverse incentives disfavoring high quality/low risk-weighted assets. No less critical, and key to the maintenance of a level playing field among internationally active banks, any leverage ratio must be based on consistent accounting rules, especially with regard to the differences in treatment of netting of derivatives and repos under IFRS and GAAP.

Moreover, it is essential that any leverage ratio be properly structured and consistently applied internationally and that it be calibrated so that it does not in effect supplant the Capital Accord’s risk-based measures as the fundamental determinant of an institution’s capital adequacy. We believe there is a very real risk that the leverage ratio as proposed by the Committee would, as a practical matter, supersede risk-based measures of capital and thereby increase the cost of credit and unnecessarily restrict banks’ ability to support and sustain economic recovery and growth.

To address these concerns, we recommend that the leverage ratio be based on Tier 1 capital and not simply the predominant form of Tier 1 capital. In addition, the Committee should consider excluding high quality liquid assets from the calculation of the ratio, or at least reducing the weight given such assets in the calculation. We note in this regard that the emphasis placed on such assets under the Liquidity Coverage Ratio has the effect of increasing the amount of low-risk assets covered by the leverage ratio – compliance with the liquidity requirements thus would tend to inflate the leverage ratio in a manner that may unnecessarily restrict economically beneficial banking operations.

We also recommend that the Committee adopt a more discriminating approach in measuring the exposures on which the leverage ratio is based – for example, by basing derivatives exposures on the current exposure approach taken under Basel II, permitting netting and giving due recognition to credit risk mitigation measures. The inclusion of off-balance sheet exposures in the leverage ratio in particular would significantly depart from how leverage traditionally has been measured and should be carefully reviewed to ensure it does not result in a counterproductive and unwarranted inflation of the ratio.

A leverage ratio may provide a useful means to facilitate assessment of a bank’s capital under Pillar 2, but we urge the Committee to give further consideration to the prospect of eventually migrating a leverage ratio requirement into Pillar 1. In our view, the more prudent approach would be to limit use of a leverage ratio to Pillar 2 assessments and exclude it from Pillar 1 outright. In any event, we believe a cautious approach is warranted, one based on careful analysis of the anticipated impact imposition of a leverage ratio may have.
Avoiding Fragmented Liquidity Arrangements

We recommend that the Committee reassess the impact the proposed liquidity standards likely would have on intragroup funding arrangements and recalibrate the proposal accordingly. For purposes of the Net Stable Funding Ratio, the liquidity proposal contemplates that intragroup funding would be assigned an available stable funding factor ("ASF") of zero. We believe this approach is unjustifiably punitive, needlessly detrimental to the ability of a parent, global bank to support its subsidiary operations and an unwarranted deterrent to salutary cross-border relationships. We recommend that a more granular approach be taken to the determination of ASF values with regard to intragroup funding arrangements.

We also recommend that the Committee clarify how the standards are intended to apply to separately regulated entities that operate as part of a larger, global group. The proposal states that the standards “should be applied to all internationally active banks on a consolidated basis” (quoting paragraph 86), a principle with which we agree. The proposal further provides for situations where the standards also can be applied on a legal entity basis, but it does not explain how that approach relates to their application to the consolidated entity (the proposal states only that in this situation “affiliated entities should be treated no differently than unrelated third party financial institutions”). As discussed below, we believe it is essential that the application of the proposed liquidity standards to a separately regulated entity maintained by a global banking institution be undertaken with due regard to, and in consultation and coordination with the institution’s home country authority.

Our concern in this regard is that the proposal might be read as requiring the maintenance of ring-fenced (or “trapped”) amounts of liquidity in certain entities or jurisdictions, a result that would unduly restrict global banking institutions’ implementation of their overall risk management strategies. We recommend instead a balanced approach which enables institutions that operate in multiple jurisdictions the flexibility to deploy liquidity throughout their global network, while recognizing the importance of maintaining sufficient liquidity within their local operations. As a corollary to this approach, internationally active institutions should have the freedom to choose whether to conduct their wholesale banking operations outside their home country through branches and/or through separately incorporated local subsidiaries.

Further clarification by the Committee of its expectations regarding this aspect of the proposal would be very helpful, including especially with respect to the treatment of local branches, which in our view should not be viewed as stand alone entities for these purposes.
Achieving the Appropriate Balance Between Home and Host Country Oversight of Capital and Liquidity Requirements

The determination of the adequacy of a global bank’s consolidated capital, including with respect to its leverage ratio, is fundamentally the responsibility of the home country supervisory authority. The same principle applies to the regulation and oversight of a global bank’s overall liquidity. Concentrating these supervisory responsibilities in the hands of home country authorities ensures that oversight of capital and liquidity matters rests with the supervisory agency that is in the best position to comprehend and assess a global banking institution’s condition. Equally important, it provides an institution’s management the necessary assurance that it will not be subject to duplicative or potentially conflicting requirements on matters that are of such critical importance to the institution’s safety and soundness.

Under this approach, an internationally active banking institution’s home country supervisor should exercise principal responsibility for the following determinations regarding the parent bank’s global operations:

- The adequacy of the parent bank’s overall capital (including the extent of leverage with which the institution operates) and liquidity in relation to its risk profile.
- Whether to require the parent bank to hold regulatory capital or maintain liquidity in excess of the minimum amounts called for under the Proposals and, if so, what the appropriate level of regulatory capital (whether risk-based or a leverage ratio) or liquidity should be.
- The establishment of any minimum “trigger” ratios for supervisory action against the parent bank, which may be greater than the minimum called for by the Proposals, and the determination of any “target” ratios that would be used to provide a warning that the parent bank is operating too close to its trigger ratio.
- Whether, and if so how, to intervene to prevent the parent bank’s capital or liquidity from falling below required levels.
- Action that must be taken by the parent bank to restore its capital or liquidity in the event it falls below the minimum requirement.

In emphasizing the primary role of home country supervisors with respect to the parent’s bank condition, we do not mean to suggest that host country supervisors should have no role in these matters. An institution’s capital adequacy and liquidity is fundamental to its financial strength and as such is a relevant consideration to a host country supervisor in connection with its oversight of the institution’s operations in the
host country. In addition, the host country supervisor’s greater familiarity with conditions in its markets makes it a source of information and insight that can be valuable to a home country supervisor in its efforts to understand and assess the risks undertaken by institutions headquartered in the home country and the adequacy of such institutions’ capital and liquidity in the face of such risks.

In the event a host country supervisor develops serious concerns regarding the fundamental safety and soundness of a non-domestic banking institution, it should work with the home country supervisor to resolve the situation. The formation of supervisory colleges over the last few years has been a welcome development in this regard and provides a useful forum facilitating communications and coordination between home and host country authorities, as well as a means to help resolve disagreements among supervisors. The need for consultation and coordination between home and host country authorities is especially important in crisis situations.

The structure of an internationally active bank’s operations in a host country has an important influence on how the home-host balance should be drawn. For example, in the proper exercise of its supervisory and examination powers over a local branch of a non-domestic/global banking institution a host country supervisor will strive to understand and evaluate the institution’s risk management processes and systems as they relate to the operations of the branch. However, assessing the capital adequacy and liquidity of the parent bank as a global institution are matters uniquely within the supervisory oversight of the home country authority.

Additional considerations arise where a parent bank, whether or not it also chooses to operate in a host country through one or more branches, controls a locally-chartered depository institution subsidiary and/or other types of locally-chartered subsidiaries that themselves may be subject to separate capital and liquidity requirements prescribed under host country law. These local operations are, of course, subject to applicable host country requirements, but in determining whether a locally-chartered subsidiary meets these requirements (a matter that is of proper concern to the host country supervisor), a host country supervisor should adopt a flexible approach that takes into account the interrelationships between the subsidiary and the parent banking institution of which it is a part.

Consistent with the foregoing, it is appropriate to prescribe capital standards – whether risk-based or a leverage ratio – at the global/parent bank level on the basis of home country requirements (and not at the level of any intermediate holding company that might be operated in a host country). This approach is similar to that taken under the European Commission’s Financial Conglomerates Directive and avoids situations where, for example, a host country seeks to impose on a parent bank’s local operations capital requirements based solely on host country implementation of Basel standards (such as a...
requirement to apply its advanced IRB approach) without regard to the inclusion of those operations in the determination of the parent bank’s overall capital adequacy in accordance with home country requirements.

*    *    *

Please contact the undersigned or the Institute’s General Counsel Richard Coffman (rcoffman@iib.org) if we can provide any further assistance.

Very truly yours,

Lawrence R. Uhlick
Chief Executive Officer