



WACHOVIA

November 3, 2003

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the
Federal Reserve System
20th Street and Constitution Avenue, NW.
Washington, DC 20551
Attention: Docket No. R-1154
Via EMail: regs.comments@federalreserve.gov

Office of the Comptroller of the Currency
250 E Street, SW.,
Public Information Room, Mailstop 1-5,
Washington, DC 20219
Attention: Docket No. 03-14
Via EMail: regs.comments@occ.treas.gov

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

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW.
Washington, DC 20552
Attention: No. 2003-27
Via EMail: regs.comments@ots.treas.gov

Re: Advance Notice of Proposed Rulemaking – Internal Ratings-Based Systems for Corporate Credit and Operational Risk Advanced Measurement Approaches for Regulatory Capital (68 FR 45900)

Dear Sirs and Madams:

Wachovia appreciates the opportunity to comment on the Advance Notice of Proposed Rulemaking (ANPR) regarding the implementation of the new Basel Capital Accord. We likewise appreciate the consultative process that has characterized the development of the new Accord. U.S. and international banking regulators have clearly worked hard to understand the concerns expressed by the banking industry and to improve the Accord in response. The Basel Committee's October 2003 announcement of additional revisions in response to comments on the third consultative paper illustrates the point perfectly. We commend the U.S. regulatory agencies for their diligence and look forward to continuing a constructive dialogue as we work toward implementing the new Accord.

Although several key areas within the new Accord require further revision, the proposed rules significantly improve the regulatory capital framework by aligning capital requirements with risk. Most notably, the proposed rules incorporate advances in risk measurement and management practices that have been developed in the years since the adoption of the 1988 Accord. ***We firmly believe that the key to success is the continued convergence of regulatory capital standards and continually improving sound risk management practices.***

We note our strong agreement with the ANPR's proposed use of internal models to compute capital for market risk, operational risk, and equity investments. This approach builds on the work banks are doing – and must do – to better understand the risks they are taking. It recognizes that banks

have considerable incentives to develop analyses tailored to their risks and their approach to managing those risks, and that no single set of formulas can capture the range of practices in this ever more complex industry.

We believe that the Agencies should take the additional step of permitting full use of internal models to determine minimum capital levels for credit risk. Internal models can produce a more careful consideration of diversification effects than can be achieved with a single factor model. Using internal models for credit risk would be consistent with the handling of market and operational risk.

A similar approach is needed for implementation. Even carefully crafted capital rules will fall short of success if not implemented and executed properly. We believe that much more flexible implementation interpretations are needed, or the new framework will impose substantial new costs and regulatory burdens on banks that will obstruct improved risk management.

Implementation must be built on top of continually improving risk management processes and systems. Minimum standards should be expressed in terms of principles and results, not in terms of methodologies and narrow definitions. Banks would then be encouraged to find the best techniques to explain how their loans and other risks behave given their approach to risk management and the latest best practices. ***The value of empirical evidence is paramount when developing internal practices,*** and should take precedence over preconceived ideas of what “ought to be.” Mandating how banks structure their analyses will stifle innovation and slow the development of better risk management practices.

Further, imposing definitions or methodologies instead of building on banks’ well-founded decisions will trigger enormous, unnecessary costs. For example, nearly all U.S. banks use non-accrual as their definition of default. The supervisory regime currently addresses which loans should be placed on non-accrual; banks take appropriate steps to identify these loans. If regulators impose a separate default definition, banks will have to modify all their loan accounting systems to accommodate another default definition, modify data feeds and warehouses to gather this information, train operations personnel throughout their organizations to understand the difference between non-accrual and default, track both results, develop audit procedures to ensure the accuracy of both measures, and convert their historical default data measured in terms of non-accrual to estimates of what their rates would be with the new definition. If not consistent with banks’ risk management practices, these expensive actions will have few, if any benefits beyond regulatory compliance. If such decisions are common, Basel will be a huge drain on the banking system.

Choices like this will be repeated hundreds of times for both credit and operational risk as we move toward implementation. In these situations, supervisors should allow – and encourage – banks to develop and employ ever more effective risk management and modeling approaches. True soundness is understanding the risks we are taking and having controls in place to ensure that those risks are considered appropriately, not just having capital to cover losses. A superior regulatory framework will build on today’s best practices and accelerate the development of better risk management.

Where necessary, the ANPR should acknowledge that risk quantification is in the early stages of development. Operational risk is a prime example. Standards, including validation requirements, need to recognize this. We believe that a practical implementation of Pillar I that includes operational risk will serve as a catalyst for the development of management and measurement practices in this area. Over time, this will lead to more consistency, greater transparency, better comparability, and more effective industry practices. The state of the art in credit risk will advance, too, if the regulatory climate supports it.

The adoption of these rules may lead to lower levels of minimum required capital, especially as banks respond to the opportunity to improve their capital ratios by holding lower risk assets on their balance sheets. This will not necessarily lead banks to reduce their actual capital levels. ***The Agencies should state that lower Pillar I minimums are acceptable if sophisticated risk assessments and risk sensitive capital formulas produce that result. The new framework will not achieve its goals if lower risk is offset by recalibration simply to maintain current minimum capital levels.***

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The enclosed document includes Wachovia's comments on many aspects of the ANPR. Men and women throughout our firm collectively have spent hundreds of hours analyzing the proposals and recommending useful comments. We hope that their work will lead to further improvements to the Accord and contribute to a successful regulatory capital regime for the United States.

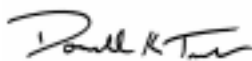
Our comments include many recommendations for improving the proposed rules. In our view, significant changes are necessary in several areas. We are pleased to note that the Basel Committee has announced its intention to revise many of the rules we believe are most problematic. These include the rules for securitized assets, the substitution approach for credit derivatives, and the rules requiring that credit capital be held for both expected loss (EL) and unexpected loss (UL). We believe that the latter concept should be extended to operational risk, so that capital would cover only unexpected losses. Additional comments concern the relative capital rates among retail products; the excessive conservatism required for some input estimates; and the voluminous, prescriptive disclosure rules that we believe would create uncertainty and misinformation among analysts and investors; among other issues. Without revisions to the proposal, these areas are likely to create significant distortions and inhibit sound risk management practices.

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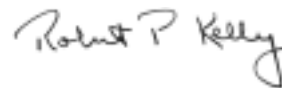
Wachovia is absolutely dedicated to understanding and managing risk in order to create value for our shareholders. We look forward to a regulatory capital regime that complements our efforts. We would oppose, however, implementation mandates that divert tens of millions of dollars from productive uses to regulatory compliance activities that produce no marginal benefits for our owners or other stakeholders.

Wachovia is committed to this process and to an improved regulatory capital framework. We have committed countless hours to this task over several years, and we are willing to invest additional resources to further improve these proposals. The efforts of U.S. regulators in this process provide clear evidence of their intent to produce rules that will improve the U.S. banking system, as well. We look forward to working with you toward this result.

Sincerely,



Donald K. Truslow
Chief Risk Officer



Robert P. Kelly
Chief Financial Officer

cc (by electronic mail):

Mark C. Treanor, Senior Executive Vice President and General Counsel
Michael A. Watkins, Senior Vice President and Deputy General Counsel

