BRITISH BANKERS' ASSOCIATION

Pinners Hall
105-108 Old Broad Street
London EC2N 1EX

Tel: +44 (0) 20 7216 8800
Fax: +44 (0) 20 7216 8811

Office of the Comptroller of the Currency
Subject: Docket Number 06-09
regs.comments@occ.treas.gov

Federal Reserve System
Subject: Docket Number R-1261
regs.comments@federalreserve.gov

Federal Deposit Insurance Corporation
Subject: RIN 3064 – AC73
Comments@FDIC.gov

Office of Thrift Supervision
Subject: No. 2006-33/RIN 1550 – AB 56
regs.comments@ots.treas.gov

26th March 2007

British Bankers Association response to Basel II Joint Notice of Proposed Rule Making

The British Bankers' Association (BBA) is pleased to respond to the US agencies' joint Notice of Proposed Rule Making (NPR) on behalf of its members. The BBA represents 220 banks from 60 different countries, most of which are active in the financial markets in the City of London, trading foreign exchange, money market instruments and derivative products. The majority of our members do not have direct involvement with retail lending in the UK but are users of the securitisation and syndicated lending markets in London. So our response is based on our interactions with member banks, the majority of which are internationally active and thus keenly interested in the way in which Basel II is being implemented in the variety of jurisdictions in which they operate.

Overarching principles

We encourage the US regulators to base their US implementation of Basel II to two overarching principles - *timeliness* and *consistency*.

Timely implementation of Basel II in the US will:

- ensure that internationally active banks doing business in the US are able to minimise the extra costs incurred that will arise from the later implementation timetable in the US compared to many other developed economies;
- enable banks to plan their businesses in the US against a certain regulatory background;
- move the debate about the nature of the Basel II framework, which was the result of good interaction between regulators – including US ones – and the industry, from the more conceptual to the practical. Banks are keen to implement the more risk sensitive framework that Basel II delivers and want to do so speedily.

The new Basel II framework is a global framework which should be implemented in a broadly consistent manner, in order to:

- confirm the credibility of the standard setting process and affirm all regulators' commitment to the calculation of bank regulatory capital according to a global standard;
- enable banks to apply a common approach to the management of similar risks, regardless of the jurisdiction in which they are held. Requiring them to measure same risks in different ways will increase the implementation and validation effort and may render the use test impossible to meet;
- permit regulators in different countries involved in supervising the same banking group to have the confidence to rely on regulatory assessments of another part of the group made by another regulator;
- minimise the opportunity for country specific interpretation, which could distort the competitive environment or introduce arbitrage opportunities.

We believe that the most pragmatic approach to ensuring that US implementation of Basel II is both timely and consistent is for regulators to permit a degree of flexibility, enabling foreign banks operating in the US to employ the same Basel II techniques as are permitted by their home state regulator, based on the principles of mutual recognition and open dialogue.

Standardised Approach

The NPR asks for respondents' views on the introduction of the Standardised Approach. We fully support the availability of the Standardised Approach in the US.

In many countries Basel I will soon no longer exist as an option for the calculation of regulatory capital. Whilst many of the larger internationally active banks are moving to one of the IRB approaches to credit risk, they will be permitted by their home regulator to use the standardised approach for some of their portfolios. The availability of a truly Basel II congruent Standardised Approach in the US will facilitate this, hence our support.

Technical Issues

In addition we have a few concerns about the NPR's interpretation some technical issues. These are in the order of priority to us, *Definition of Default*, the approach to *Loss Given Default* and *Exposure at Default*.

Definition of Default

The Basel II framework establishes explicit tests as to whether a default has occurred - linked to the exposure category - of between 90 and 180 days past due. Contrastingly the NPR establishes retail default tests at 120 or 180 days and, for wholesale an exposure, being moved to non-accrual status or charged off, or incurring a credit-related loss of 5% or more – regardless of any collateral realisation. For wholesale exposures this is a markedly more prescriptive approach than that proposed in the Basel II framework, where banks can use their judgement about unlikeliness to pay based, on an array of different factors. Similar flexibility should be introduced into the US Definition of Default for wholesale exposures.

We do not believe that either the US or Basel definition is intrinsically wrong; what concerns us is the use of different definitions in the US compared to the rest of the world. These differences will require banks to run parallel systems for capital calculation purposes, resulting in extra expense, use test questions and with no real benefit in their approach to risk management.

It is likely that this impact will be greatest for wholesale portfolios but we urge the US agencies to adopt a definition of default that is identical to those included in the Basel II framework, a definition that was widely discussed in its creation and is now in wide use around the world. Failing this we would encourage US regulators to permit foreign banks operating in the US to use their home definition of default to minimise the need to re-engineer group-wide systems.

Loss Given Default

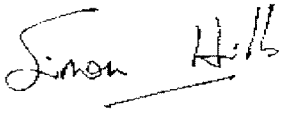
The need to estimate not only LGD – as required by the Basel II framework – but also ELGD for wholesale exposures at a sub-portfolio level adds further unnecessary detail. Furthermore, the requirement to employ a supervisory mapping function if a bank cannot use its own estimates, effectively imposing a floor, creates further divergence from the intentionally agreed framework. We are not convinced that there is actually a relationship between ELGD and LGD in a downturn, as implied by the mapping function. Both these requirements will again impose duplicative calculation burdens and may, where the supervisory mapping function is used, require additional amounts of capital to be held against the same exposures in the US compared to that required in the rest of the world. We urge the US agencies to remove the requirement to calculate ELGD, a new IRB parameter that is additional to the Basel framework

Exposure at Default

The NPR, which requires banks to estimate future net additions to exposures and to hold capital against them, contrasts to the Basel framework requirement just to project additional drawings. This will require banks to collect additional information in the US, again leading to the need to run two parallel systems, one for an internationally active bank's US activities and another for its businesses in the rest of the world. We do not believe such duplication is prudentially necessary.

To summarise the BBA encourages the US agencies to permit the use of the Standardised Approach in the US and to bring their implementation plans more closely into line with the Basel II framework, in order to avoid a duplication of systems which may not result in better risk management, but rather fragment an internationally active bank's risk systems.

Yours faithfully



Simon Hills
Director