April 5, 2007

Thrift Institutions Advisory Council
Basel IA (Docket No. R-1238) and Basel II Capital Regulations (Docket No. R-1266)

At the meeting of the Thrift Institutions Advisory Council with the Board of Governors on March 16, 2007, David E. Poulsen, President and Chief Executive Officer, American Express Centurion Bank, Salt Lake City, Utah, presented the Council's views on the Basel IA capital proposal, and Kerry Killinger, Chairman and Chief Executive Officer, Washington Mutual, Inc., Seattle, Washington, presented the Council's views on the Basel II risk-based capital proposal.

Basel IA

The Council members support the Agencies' efforts to develop a more risk-sensitive capital framework for non-Basel II banking organizations that will keep non-Basel II banks from being at a competitive disadvantage when the Basel II framework is adopted in the United States. The proposed framework is a positive step towards addressing the lack of risk sensitivity within the existing risk-based capital framework.

Council members have several thoughts regarding the Basel 1A and Basel II risk-based capital proposals, particularly concerning flexibility and the need to mitigate disparate treatment. First, the Council supports granting non-Basel II banking organizations, especially the smaller institutions, the ability to remain under current capital requirements if they so choose. Second, the proposed Basel IA framework must be expanded to mitigate competitive inequities that will result when most banking organizations find themselves in direct competition with newly empowered Basel II banks. Third, the Council agrees that U.S. Basel II banking organizations should be granted the flexibility to choose among the various approaches available in the International Accord to their foreign competitors, including the Standardized Approach. Finally, the Council would support a provision allowing Basel 1A banking organizations the option to adopt the Basel IA proposal as proposed, should their business model require changes only to the residential mortgage capital requirements sufficient to alleviate competitive disadvantages.

The Council members agree that the proposed changes in the Basel IA NPR fall short of what many banking organizations will need to remain competitive. The Agencies need to extend the proposed changes to address more of the assets on a bank's balance sheet. The Council members disagree with the Agencies' conclusion that the benefits for any increase in risk sensitivity for multifamily residential mortgages, commercial real estate, or other retail exposures would be outweighed by the additional burden imposed by any potential approaches. For these exposures, stratification into risk buckets similar to the matrix for residential loans as proposed, using LTV and other drivers of credit risk, would provide the needed risk sensitivity without undue burden for banking organizations willing to adopt Basel IA.

Basel II

The Council members generally support the Agencies efforts to develop a capital framework that more accurately aligns capital of risk. However, the Basel II NPR does not recognize certain market practices or economic measures of bank risk. Council members felt that Basel II does not adequately address interest rate risk. In addition, certain provisions and definitions in the Basel II NPR differ from those in the International Accord the may lead to competitive disparities between U.S. Basel II banks and their foreign counterparts.

One of the most significant differences raised by Council members is that U.S. Basel II banks will be required by the Agencies to use the Advanced Approaches to determine credit risk and operating risk capital, and will not be able to use the less complex Standardized Approach of the International Accord. The Council members support adoption of an optional standardized approach substantially similar to that available in the International Accord, and that banks be allowed to select the capital framework that best suits their business and risk profile.

Council members also recognized that modeling error and data fallibility can result in catastrophic failure of risk-management systems. Some Council members also expressed concern that the world's global banking system is becoming more leveraged and exposed to risk. As a result, the Council supports the retention of a leverage ratio for Basel II, both for the Standardized Approach and the Advanced Approaches.

Separate from the Basel II NPR, Council members discussed the role of regulatory capital at the holding company level. Holding company capital should be viewed differently from the regulatory capital requirements of the bank affiliate. Counsel members suggested that as the regulator of bank holding companies, the Federal Reserve Board should reconsider bank holding company capital and permit holding companies to replace a percentage of common equity capital with non-common capital. In this way common equity capital requirements could be reduced at the holding company level and the efficiency of capital utilization could be increased. Counsel members recognized the important role that rating agencies could play for larger institutions if increased use of non-common equity is permitted.

After the Council's presentation, Board members inquired if an optional Standardized Approach would be adequate for complex, internationally active banks, and if delays in U.S. implementation of Basel II would leave U.S. banking organizations at a disadvantage relative to European institutions. They also urged the Council to be as specific as possible about risk sensitivity and how they wanted regulators to implement it.

Council members noted that a Standardized Approach, although more simplistic, also produced less volatility. They also expressed concern about implementing the Advanced Approaches too quickly, given the data produced by some of their models.