February 7, 2007

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Docket No. R-1261

Office of the Comptroller of the Currency
250 E Street, S.W.
Mail Stop 1-5
Washington, DC 20219

Re: Docket Number 06-09

Mr. Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429

Re: RIN 1550-AB56

Regulation Comments
Chief Supervision
Office of Thrift Supervision
1700 G Street, N.W.
Washington, DC 20552

Re: No. 2006-33

Dear Sir or Madam:

Citigroup, JPMorgan/Chase, Wachovia and Washington Mutual appreciate the opportunity to submit this joint comment letter on the Basel II notice of proposed rulemaking ("NPR"). We wish to reiterate our support for the implementation of the Advance framework of the Basel II Capital Accord (the "Accord") in the United States. We also each plan to submit individual comment letters that will address the NPR in greater detail. However, we thought it important to express our mutual concern over the impact of the NPR on the competitiveness of the U.S. banking industry. We remain committed to working with all of the federal banking agencies to ensure that the NPR combines the objectives of safety and soundness and competitive equity.

I. The Federal Banking Agencies Have Added Provisions To The NPR That Are Inconsistent With The Objectives Of The Basel II Capital Accord And Will Give Foreign Banks a Competitive Advantage Over All U.S. Banks.

One of the primary objectives of the Accord is to eliminate, to the extent possible, differences between capital requirements in different countries. Unfortunately, the federal banking agencies have added several provisions to the NPR that are inconsistent with this objective. These provisions mandate higher minimum regulatory capital requirements for U.S. banks than will apply to foreign banks holding similar risks. As a result, foreign banks will gain a competitive advantage over U.S. banks in lending and investment activities. This competitive advantage will apply not only on the international level, but also domestically. Thus, the competitive impact of implementing the Accord in the United States is not just an issue for large U.S. banking institutions; it is an issue for small U.S. banks as well.

The competitive impact of the NPR also has implications for the health of the U.S. banking industry. Today, U.S. banking institutions are among the world's largest and most

profitable. To help ensure U.S. banking institutions remain strong and competitive, the federal banking agencies should avoid imposing domestic capital regulation that provides an advantage to non-U.S. banks, which are active service providers in our markets.

Additionally, the differences between the Accord and the NPR have turned Basel II into a costly compliance exercise. Each of our institutions has a sophisticated system for measuring risk, and the NPR would require very costly additional systems that have little bearing on the manner in which we actually measure risk and operate on a day-to-day basis.

The federal banking agencies justify the differences between the NPR and the Accord by reference to the QIS-4 survey.[1] The QIS-4 survey is not a valid basis for the provisions added to the NPR. The QIS-4 survey examined only one aspect of the Accord (Pillar 1), it was based upon limited data, and it was conducted without regulatory oversight or approved models during a benign economic period. Moreover, the limitations of the QIS-4 survey have been acknowledged by the federal banking agencies.

We believe that the competitive advantage the NPR grants to foreign banks should be addressed by harmonizing the NPR with the Accord. All of the federal banking agencies agreed to the Accord in June 2004. It aligns minimum required regulatory capital to risk in a more meaningful manner than the existing Basel I requirements. It also seeks to foster consistency in international capital requirements, thereby preventing institutions from gaining a competitive advantage simply based on where they choose to locate their headquarters. We also believe that concerns over capital levels under the Accord, which have been expressed by the federal banking agencies and smaller U.S. banks, can be addressed in conjunction with the harmonization of the NPR with the Accord without jeopardizing the objectives of the Accord.

In the balance of this letter, we (i) expand on why the changes based on the QIS-4 survey are inappropriate and premature, (ii) explain the significant competitive consequences of such changes, and (iii) discuss our recommendations for harmonizing the NPR with the Accord while addressing concerns over capital levels.

II. The QIS-4 Survey Does Not Justify, And Should Not Be the Basis For, The Changes Made In The NPR.

For the reasons given below, we believe that the QIS-4 survey results do not justify, and should not be the basis for, the modifications to the Accord proposed by the federal banking agencies.

[1] That survey found an average reduction in minimum risk-based capital of 15.5 percent under Basel II for the 26 largest U.S. banking institutions. Thus, the additions to the NPR are intended to maintain capital levels at Basel II banks that are comparable to Basel I levels.

A. The Survey Examined The Impact Of Pillar 1 Only And Not The Entire Accord

The Accord is a three-part framework, and the QIS-4 survey examined the impact of only one part of that framework, Pillar 1. It is inappropriate for the federal banking agencies to base major changes to the Accord upon such a partial test. Pillar 2, in particular, is integral to the operation of the Accord. Pillar 2 provides regulatory input and oversight for each bank's implementation of Basel II and assures that the appropriate regulatory agency is comfortable with the results derived under the framework. The Pillar 2 supervisory process was not captured in the QIS-4 survey.

B. The QIS-4 Survey Was A "Best Efforts" Exercise Since Sufficient Guidance Was Not Available

When the QIS-4 survey was conducted, the federal banking agencies were unable to provide the participating institutions with adequate guidance given the state of Basel II development. The NPR acknowledges that, at the time of the QIS-4 data collection, neither an NPR with associated supervisory guidance nor final regulations implementing the Basel II framework had been issued in the United States. Instead, the institutions participating in the survey had to make submissions based solely upon survey instructions that did not fully address many interpretive issues. As a result, each participating institution submitted data based upon its own interpretation of the instructions. Additionally, as the NPR acknowledged when the survey was conducted, "The agencies had not qualified any of the participants to use the Basel II framework and had not conducted any formal supervisory review of their progress toward meeting the Basel II qualification requirements." [2]

C. The Federal Banking Agencies Did Not Attempt To Resolve Sizable Divergence In The Results

The QIS-4 survey found that different institutions reported significantly different risk parameters for similar types of loans. A certain degree of dispersion is to be expected under the Accord. Loans that may be considered similar in the abstract may still have different risk parameters for different institutions. Any extraordinary dispersion should be, and under the Accord is designed to be, addressed in Pillar 2. Attempting to address outlier situations using blunt tools and aggregate capital floors in Pillar 1 undermines the risk sensitivity of the Accord and addresses the issue of outliers at the expense of all other Basel II banks. Under Pillar 2, the federal banking agencies have the authority to assess an institution's risk methodologies and processes and require the institution to make capital adjustments as necessary. This process was not part of the QIS-4 survey

D. The Survey Was Conducted At A Benign Point In The Credit Cycle, And Our Data Indicates That If The Survey Had Been Conducted During An Economic Downturn, Minimum Capital Levels Would Have Increased Over The Basel I Minimum

The QIS-4 survey was conducted at a time when the economy was strong and credit problems minimal. Under the Accord, minimum capital levels can be expected to decline in

[2] 71 Federal Register 55839, Sept. 25, 2006.

good economic periods to reflect the decreased risk during such periods. In other words, when the economy is strong, a risk-based capital system should indicate that less regulatory minimum capital is necessary. On the other hand, when signs of economic weakness appear, a properly functioning, risk sensitive capital system should require banks to hold more capital.

Various academic studies, and the results of our own internal analysis, indicate that had the QIS-4 survey been conducted during a recessionary period, the Accord would have required Basel II banks to hold significantly more capital than Basel I. [3] Attachment A indicates that the average increase in minimum capital from a benign economic period to an economic downturn would be 23 percent under the Accord. This translates to an increase in minimum capital during a recession of 12.5 percent over Basel I minimums. Other studies have found the increase in minimum capital from a benign economic period to an economic downturn could be as much as 35 percent.

E. It Is Inappropriate To Use The Basel I Minimum As A Basis For Comparison

The Basel I levels were set in the late 1980's and were not based upon the calibration techniques in common use today. Both the federal banking agencies and the banking industry agree that Basel I is no longer appropriate for large, sophisticated banking institutions. Thus, there is no inherent safety and soundness basis for the federal banking agencies to assume that the Basel I capital levels are the "right levels," and that any decreases in capital from those levels are inappropriate. The goal of this exercise should be to determine the *correct* minimum capital requirement in light of the risks presented by each individual bank's assets, and not to artificially constrain that determination by a desire to maintain aggregate capital to a pre-determined non-risk based number.

F. The Federal Banking Agencies Have Recognized The Limitations Of The QIS-4 Survey

Several of these limitations listed above have been acknowledged by the federal banking agencies. For example, in September 2005, Federal Reserve Board Governor Susan Bies stated that "… [the] QIS-4 does not represent the final version of Basel II in the United States and we realize that bank data and risk-management systems required by Basel II are not yet fully developed and implemented as expected by the framework." [4] Similarly, in testimony before the Senate Banking Committee, November 2005, Comptroller Dugan noted that "We have concluded that some of the weaknesses identified in QIS-4 are attributable to the fact that no "live" Basel II systems have been built – in large part because we have not yet fully specified all the requirements for such a system."

[3] Pillar 1 only.

[4] Speech by Governor Susan Bies before Institute of International Bankers, September 26, 2005.

III. The Provisions in the NPR That Give Foreign Banks An Advantage Over U.S. Banking Institutions Include A 10 Percent Aggregate Floor, The Application Of The Unique U.S. Leverage Ratio, A Longer And More Restrictive Transition Period For U.S. Banks, And Different Measurements For Equities And Loans

The NPR grants foreign banks a competitive advantage over U.S. banks in both foreign markets and within the United States.[5] The provisions of the NPR that give foreign banks this advantage include: (i) a 10 percent aggregate floor, (ii) the application of the unique U.S. leverage ratio, (iii) a longer and more restrictive transition period for U.S. banks, and (iv) different measurements for equities and loans. These provisions are summarized in Attachment B, and discussed further below.

A. Foreign Competitors Are Not Subject To An Aggregate Floor

The NPR provides that a 10 percent decline in aggregate minimum required risk-based capital at Basel II banks would constitute a material reduction warranting modifications to the capital framework. This provision creates a significant measure of uncertainty for U.S. banks that foreign banks will not face. It subjects individual banks to potential changes in capital requirements as a result of actions of other banks. Some banks will choose to manage this problem by holding additional excess capital that could otherwise support loans and investments that would contribute to economic growth. It also creates uncertainty in the debt and equity markets that may impact valuations and funding costs for U.S. banks. In other words, it results in significant, detrimental unintended consequences. Foreign banks are not subject to any similar requirement.

B. Foreign Banks Are Not Subject To A Leverage Ratio

The U.S. is almost alone in imposing an additional minimum capital requirement known as the "leverage ratio." The leverage ratio mandates capital to be held as a simple percentage of book assets, regardless of risk. This requirement dates from a time when risk analysis and risk measurement techniques were much less developed. In contrast, the Accord recognizes and utilizes many of the modern risk measurement techniques that are used by the world's most sophisticated financial organizations. Under the Accord, minimum regulatory capital levels are aligned with economic risk. Aligning regulatory capital with economic risk ensures that adequate capital exists to cover risk, but does not result in excess capital, which is then unavailable to support lending and investment activities. The leverage ratio does not adjust for risk, and will become the binding requirement for many Basel II banks. This will cause the safest U.S. banks either to hold more capital than required under the Accord, and give their

[5] A foreign bank operating a branch or agency in the U.S. will be able to comply with the capital standards of its home country, not the higher U.S. standards. Thus, for example, a foreign bank that has a branch office in California will have a capital advantage over any U.S. bank in offering loans to U.S. companies and consumers. Even a foreign bank that owns a subsidiary bank in the U.S. will gain a competitive advantage over U.S. banks, notwithstanding the fact that the foreign bank's U.S. subsidiary will be subject to U.S. rules. When the subsidiary bank's capital and assets are consolidated at the foreign parent, the parent's capital ratio will increase, and it will be able to exploit that higher reported capital ratio through additional investments at the parent level. Further, the foreign parent can fund its "equity" investment in the U.S. subsidiary with debt and still comply with U.S. and home country capital requirements.

foreign counterparts a capital advantage, or will cause U.S. banks to increase the risk of their portfolios in order to earn a market return on the higher capital requirements.

C. Foreign Banks Have A Shorter And More Flexible Transition Period

Under the Accord, foreign banks are subject to a two-year transition period, during which capital may decline by 10 percent in the first year and by an additional 10 percent in the second year. The NPR proposes a three-year transition period for U.S banks, and only permits a 5 percent decline in capital in each of these years. Moreover, U.S. banks cannot move from one level to another without the prior approval of the federal banking agencies, and the standards for advancement are not defined in the NPR. This difference in transition rules will artificially provide a competitive benefit to foreign institutions for at least 3 years, and the ramifications of this advantage could be enjoyed by foreign banks for a considerably longer period.

D. Different Measurements of Equities and Loans

The NPR measures equity investments and loans differently than the Accord in several respects. These include (i) a definition of default that deviates from customary U.S. practices, (ii) a more conservative treatment of loans to small- and medium-sized businesses, (iii) different measures for LGDs, and (iv) a different treatment for equity investments. Each of these differences is described more fully in Attachment B.

IV. The Competitive Advantage the NPR Grants To Foreign Banks Should be Addressed By Harmonizing the NPR With The Accord And Concerns Over Capital Levels Can Be Addressed Without Jeopardizing the Objectives of the Accord.

The competitive advantage the NPR grants to foreign banks should be addressed by harmonizing the NPR with the Accord. In other words, the differences between the provisions in the NPR that are described above, and are summarized in Attachment B, should be revised to conform to the Accord. A recent report on the competitiveness of the U.S. financial services industry noted the negative consequences of not harmonizing the Basel II capital regime for U.S. markets and U.S. consumers.[6]

Concerns over capital levels under the Accord, which have been expressed by the federal banking agencies and smaller U.S. banks, can be addressed in conjunction with the harmonization of the NPR and the Accord as follows:

A. Review the Impact of the Accord Based Upon "Live" Systems, and Then Make Adjustments to Capital Levels, if Necessary.

In lieu of the 10 percent aggregate floor, the federal banking agencies should clarify that they will review the impact of the regulation on capital levels during the transition period. This would eliminate the uncertainty associated with the 10 percent aggregate floor; yet provide the federal banking agencies with a mechanism for assessing capital levels. Such a review should include an evaluation of all factors that influence capital levels, including credit cycles. The results of the review would permit the federal banking agencies to make adjustments, if any, to

[6] *Sustaining New York's and the U.S.' Global Financial Services Leadership*, page 112.

the rule based upon an assessment of "live" systems and procedures, and following consultations with the industry and the public. This approach is consistent with the position of the foreign banking authorities and of the federal banking agencies as of November 2005 when Comptroller Dugan told the Senate Banking Committee that "We believe that certain of the concerns identified in QIS-4 will only be fully understood and resolved as the Basel II framework is implemented through a final rule, final supervisory guidance, and rigorous examiner scrutiny." Similarly, FDIC Chairman Powell told the Committee "committing to specific changes to the framework at this time, without the benefit of further experience and industry systems development, would be premature."

B. Review the Relevance of the Leverage Ratio

For the reasons given above, we view the leverage ratio as fundamentally inconsistent with the Accord, and we urge the federal banking agencies to review its relevance within a given period of time during the Basel II transition (e.g., three years). The review should consider the ratio's level and composition.

C. Pillar 2 and Benchmarking

The Pillar 2 supervisory process, as described in the Accord, is an important tool to address capital levels at individual Basel II banks. We support using Pillar 2, as designed, to address issues of capital adequacy, thus ensuring the right amount of capital is in each institution and not just "in the system". To the extent that the agencies are concerned about consistency in the application of Pillar 2, the Accord suggests that a system of "benchmarks" related to risk exposures could be developed that could guide supervisory actions under Pillar 2. As long as such benchmarks are not used mechanically (as in Pillar 1), it would be possible for banks to segment their portfolios somewhat differently, with the benchmarks adjusted or interpolated appropriately. Aggregate benchmarks for typical portfolios could be compared to the general capital rules to provide the federal banking agencies and the banking industry with a fair comparison from bank to bank, regardless of approach. The benchmarks should not be hard and fast capital requirements.

D. Compliance Options

Finally, we strongly recommend that the federal banking agencies offer all U.S. banks the option to use any of the approaches authorized under the Accord, including the so-called "standardized" approach. The standardized approach is part of the Accord. Its terms and conditions are set forth in great detail in the Accord that the federal banking agencies approved in June 2004. Giving banks a choice of methodologies for risk-based capital compliance has several benefits. It allows banks to choose among methodologies that are simple and transparent, it assures a competitive marketplace both domestically and internationally, it ensures appropriate minimum regulatory capital requirements, and it allows banks of all sizes to make their own cost/benefit assessments of the risk sensitivity of each option. The International Standardized approach includes Pillar 2, which – as noted above -- will ensure that each institution has adequate capital to cover all its risks. Any concerns about the adequacy of the Standardized requirements for individual portfolios are properly handled through the Pillar 2 process, rather that through piecemeal adjustments to the Standardized Pillar 1 rules.

We also believe that the Basel IA rule should be aligned with the capital rules applicable to large banks, to the extent possible, in order to avoid a competitive imbalance between large and small U.S. banks. In other words, we urge the federal banking agencies to more closely align the Basel IA rule and the capital rules for large banks to rationalize any overall differences in capital when considering credit, market, and operational risks.

V. Conclusion

The NPR includes several provisions that give foreign banks a competitive advantage over U.S. banks. These provisions were included in response to a survey of the impact of the Accord on Basel II banks. That survey is not a valid basis for the proposed changes. The competitive inequity created by the NPR can be alleviated by harmonizing the NPR with the Accord that was agreed upon by all of the federal banking agencies in 2004. Concerns over capital levels under Basel II can be addressed by (i) reviewing the impact of Basel II during the transition period, and then making adjustments to the rule, if any; (ii) retaining the leverage ratio, but reviewing its continued need after a certain period of time; (iii) making appropriate use of Pillar 2; and (iv) aligning, to the extent possible, the capital rules applicable to smaller U.S. banks with the rules applicable to larger U.S. banks.

Sincerely,

Donald K. Truslow
Chief Risk Officer
Wachovia Corporation

Michael Cavanaugh
Chief Financial Officer
JPMorgan Chase & Co.

Dave Bushnell
Chief Risk Officer
Citigroup

Ronald J. Cathcart
Executive Vice President and Chief Enterprise Risk Officer
Washington Mutual

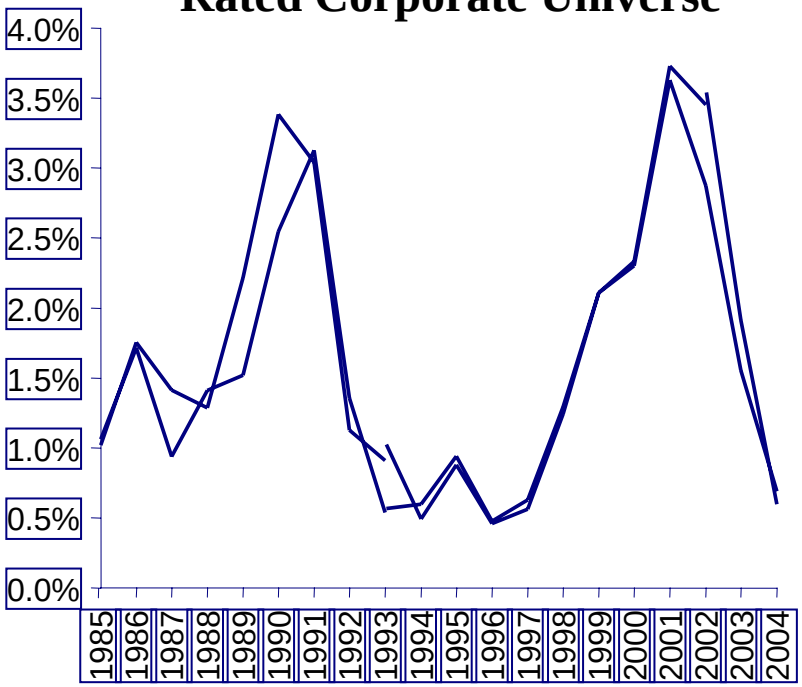
IMPACT OF CREDIT CYCLE ON U.S. BASEL II CAPITAL

- **There have been two recent credit cycles in the US with recessions in 1990/91 and 2001/02 (Slide 2).**
- **There have been about five independent studies on the impact of the credit cycle to minimum capital in the U.S. Additionally, five U.S. banks presented their own results on the impact of the credit cycle to the FDIC in January 2006 (Slide 3).**
- **The average change in minimum capital over these credit cycles from these studies was 23%.**
- **The results of QIS 4 for US banks was an aggregate fall in minimum capital of 15.5% from Basel I requirements for the 26 institutions that participated.**
- **The 2004 QIS study was conducted near the most benign part of the credit cycle.**
- **The average increase in capital from benign periods to recession is 23% and the reduction in minimum capital during a benign period – QIS4 – is 15.5% (versus Basel I). Therefore, if the QIS4 had been conducted during a recession, average Basel II minimum capital would be 7.5% and 12.5% higher than Basel I with and without the 1.06 scaling factor, respectively (Slide 4).**
- **Average Basel II minimum capital requirements will be higher than Basel I during the worst half of a credit cycle.**

Significant Credit Cycles

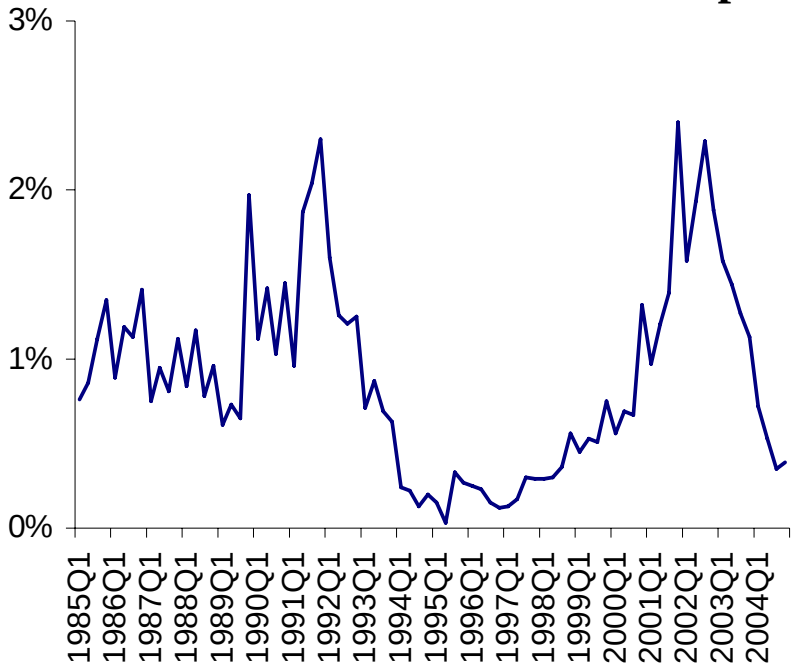
Moody's and S&P Default %ages

Rated Corporate Universe



Study by US banks for FDIC - Internal

Bank Credit Losses on Corporates

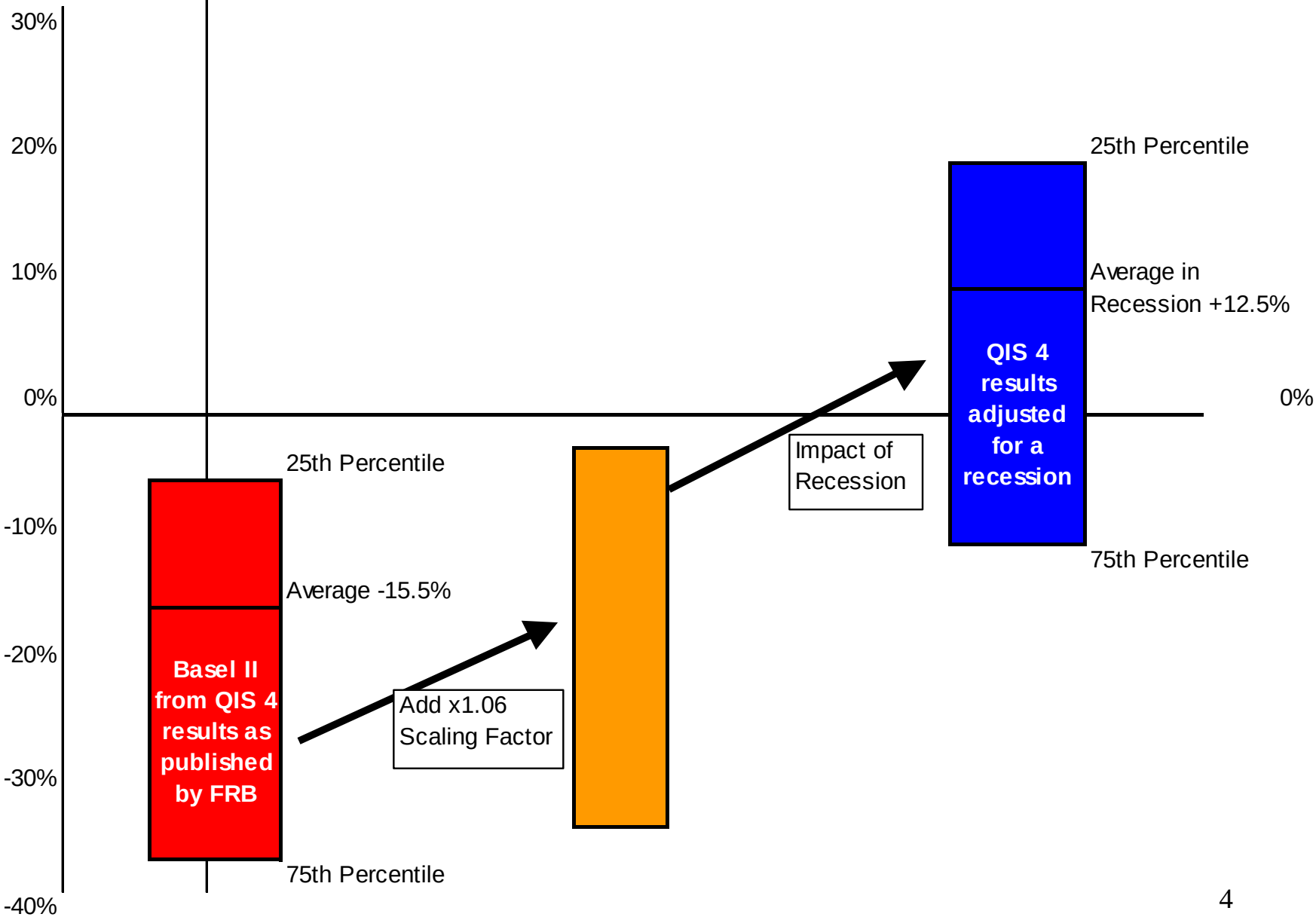


There have been two recent recessions – in 1990-91 and in 2001-02. An analysis of the cyclical nature of the Basel II capital requirements can be studied by including either or both of these periods.

ESTIMATES OF CHANGE IN MINIMUM CAPITAL OVER CREDIT CYCLE in USA

	DATES: Of Credit Cycle	MAXIMUM CHANGE IN CAPITAL OVER CYCLE: 0-5% 5-10% 10-15% 15-20% 20-25% 25-30% 30-35% 35-40%	
1	1990-92	Ervin & Wilde -'*RISK'* *October 2001*	20%
2	1990-92	Catarina-Rabell, Jackson & Tsomocos, Bank of England 2003	Average 16%
3	1996-2001	Jordan, Peek and Rosengren (FRB Boston 2003)	20% (based on S&P ratings migration)
4	1982-2000	Rosch (Univ of Regensburg 2002)	20%
5	1992-2002	Kashyap and Stein (FRB Chicago) 2004	35% based on S&P
6	2000-2004	Group of 5 US Banks - study for FDIC Jan 2006 - Bank A	35%
7	1998-2002	Group of 5 US Banks - study for FDIC Jan 2006 - Bank B	30%
8	2000-2004	Group of 5 US Banks re FDIC Jan 2006 - Bank C	18-22%
9	2001-2004	Group of 5 US Banks - study for FDIC Jan 2006 - Bank D	28%
10	2001-2004	5 US Banks - study for FDIC Jan 2006 - Bank E	10-11%

PERCENTAGE CHANGE IN MINIMUM CAPITAL REQUIREMENT



Attachment B

Major Differences Between the NPR and the Accord

The following is a description of the more significant differences between the NPR and the international Accord.

A. 10 Percent Aggregate Floor

The NPR provides that a 10 percent decline in aggregate industry wide minimum required risk-based capital would constitute a material reduction warranting modifications to the capital framework. This limit has no relationship to either U.S. or global economic conditions. In strong economic cycles a drop in minimum regulatory capital of 10 percent or more may well be expected, and would not pose any safety and soundness concerns.

B. More Restrictive Transitional Capital Floors

The NPR for limits on the amount by which a bank's risk-based capital requirements may decline over a period of at least three years. Other countries apply a shorter two-year transition period.

Under the NPR, U.S. banks will be required – for a minimum of 12 months – to maintain regulatory capital equal to at least 95 percent of their Basel I capital requirement whereas non-U.S. banks must maintain only 90 percent of their Basel I capital during the first year of the Accord. In the second year, a U.S. bank, if permitted by its regulator, is required to maintain at least 90 percent of their minimum Basel I capital requirement, whereas non-U.S. banks are subject to an 80 percent limitation, and non-U.S. banks do not have to seek the agreement of their regulator to move to this lower level. In the third year, if a U.S. bank is again been permitted to move to the next level by their U.S. regulator, they are still restricted to maintaining at least 85 percent of their Basel I capital, whereas non-U.S. banks are not subject to any restriction.

Thus, not only do U.S. banks have more restrictive transitional arrangements (longer and higher minimum requirements), but they also must seek the permission of their U.S. regulator to move to the next transitional floor. In addition, U.S. banks will have the cost of maintaining the calculation of an equivalent Basel I minimum capital requirement for at least 12 months longer.

C. Leverage Ratio Permanently Retained

The NPR provides that each bank using the advanced approach will continue to be subject to the Tier I leverage ratio requirement, which is a capital charge based on total on-balance sheet assets. Under Basel I, the leverage ratio and the minimum risk-based capital requirement were roughly equivalent. Under the NPR, however, the leverage ratio will become the controlling capital requirement for many banks. Thus, the continuation of the leverage requirement, which is a non-risk adjusted charge, is in direct conflict with the goal of establishing a risk-based capital system. Moreover, since it is not sensitive to risk, it either causes

conservatively managed banks to hold excess, non-productive capital, or it encourages banks to acquire riskier assets until their regulatory risk-based capital and leverage capital requirements are equalized.

D. Altered Definition of Default for Wholesale Exposures

The NPR deviates from both the international framework and customary U.S. practice by stating that a credit-related loss of 5 percent or more on the sale of an asset will be treated as a default, even if the loan is fully performing.

Implementation of this new definition of "default" will require higher levels of capital than justified by current risk models in use both in the U.S. and abroad. Further, existing models will have to be revamped at considerable additional costs. Equally important, an unintended consequence of this provision will be to discourage the use of asset sales as part of risk mitigation strategy.

E. Multiple Loss Given Defaults (LGD)

The NPR would require U.S. banks to compute both default-weighted average Expected Loss Given Default ("ELGD") and a downturn LGD. If a bank's use of its own estimates is not approved, the bank must use a supervisory formula whereby LGD increases at an increasing rate as default-weighted average ELGD decreases. Thus, for high quality assets with a low loss in the event of default, any U.S. bank that has not been able to prove to the satisfaction of its regulator that it has sufficient experience of losses for that type of asset in a recession would be required to increase the capital backing that asset. For example, if the bank which does not have enough recession-based data, or is not approved, calculates it's ELGD as 10 percent of the exposure, the NPR would require the loss to be increased by 72 percent, which in turn increases the capital required to support that exposure by about 72 percent. If the ELGD is 20 percent the increase is 32 percent. This increases the capital requirements for U.S. banks and potentially makes them uncompetitive for these good quality assets. Additionally, a U.S. bank must maintain multiple loss given default estimates, increasing their compliance burden.

F. NPR May Differ From SEC Rules for U.S. Investment Banks

U.S. investment banks electing to be regulated by the SEC as investment bank holding companies are subject to the international Basel II framework without the modifications proposed by the banking regulators. Unless the SEC adopts the modifications in the NPR, U.S. commercial banks will be at a competitive disadvantage not only with respect to foreign competitors, but also against U.S. investment banks, since only U.S. commercial banks will be required to comply with the increased regulatory burden and different rules of the U.S. NPR.

G. NPR Disadvantages Small and Medium Size Business Credit

The international framework recognizes the lower risk in small and medium size business (SME) lending and reflects this in a lower level of required capital than under Basel I. Under the NPR, however, the lower risk of loans to small- and medium-sized businesses is not recognized,

and, thus, the required capital is higher than the international version for these loans. This will place U.S. banks at a competitive disadvantage compared to foreign banks when lending to small- and medium-sized businesses. Moreover, to the extent small-and medium-sized businesses rely on domestic credit sources, the availability of such funding will decrease.

H. Conservative Equity Treatment

The NPR differs from the Accord in the capital treatment of equity investments in a financial company that has material liabilities, such as bank loans. This different treatment is not applied to non-U.S. banks, and puts U.S. banks at a competitive disadvantage when seeking to expand business opportunities through equity investments.