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October 22, 2012

Via Electronic Delivery

Department of the Treasury
Office of the Comptroller of the Currency
250 E Street, S.W.
Washington, DC 20219

Federal Deposit Insurance Corporation
550 17th Street, NW.
Washington, DC 20551

Board of Governors of the Federal Reserve System
20th Street & Constitution Ave., NW.
Washington, DC 20551

Re: *Basel III Capital Proposals, Advanced Approaches*
RIN Nos. 1557-AD46, 3064-AD97, and 7100AD-87

Ladies and Gentlemen:

American Express Company ("American Express") appreciates the opportunity to provide comments to the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Board of Governors of the Federal Reserve System (together, the "Agencies") in response to their three notices of proposed rulemaking that would substantially revise the regulatory capital framework for U.S. banking organizations.[1] In this letter, we offer our comments with respect to the treatment of charge and hybrid cards as qualifying revolving exposures ("QREs") under the Advanced Approaches NPR.

[1] Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action, 77 Fed. Reg. 52,792 (Aug. 30, 2012); Regulatory Capital Rules: Standardized Approaches for Risk-Weighted Assets; Market Discipline and Disclosure Requirements; 77 Fed. Reg. 52,888 (Aug. 30, 2012); Regulatory Capital Rules: Advanced Approaches Risk-Based Capital Rule; Market Risk Capital Rule; 77 Fed. Reg. 52,978 (Aug. 30, 2012) ("Advanced Approaches NPR").

I. Modification of the QRE Definition to Unambiguously Include Charge Cards

Under the current advanced approaches rules, credit card and other revolving credit exposures are classified as QREs, so long as the exposure is less than $100,000. American Express believes that charge card exposures present more benign risk characteristics than credit cards and, therefore, should be subject to a lower capital charge, given the same risk inputs (e.g. probability of default, exposure at default and loss given default). However, the current rules provide for only three retail exposure categories: residential mortgages, QREs and "other retail." Retail exposures that are not residential mortgages and ineligible for QRE treatment are generally classified as "other retail" exposures. This generally results in substantially higher capital requirements than QREs. Recognizing the more benign risk characteristics of charge cards as compared to credit cards, the Agencies have proposed to clarify the QRE definition to ensure that qualifying charge card exposures would clearly be classified as QRE.

In the absence of an additional retail asset category that would more appropriately align economic risk and regulatory capital requirements, American Express strongly supports modifying the definition of QRE to unambiguously include qualifying charge card exposures. As the Agencies state in the preamble to the Advanced Approaches NPR, "charge cards are more closely aligned from a risk perspective with credit cards than with any type of 'other retail' exposure."[2] American Express agrees, and notes that when compared to credit cards, charge cards exhibit:

- More favorable risk characteristics. Unlike credit cards, traditional charge card balances must be paid in full within one month of billing, which reduces the risk of credit deterioration. Although charge cards ordinarily do not have a pre-set spending limit, American Express uses "real time" exposure management practices, including risk-based underwriting, to continuously and rigorously manage customer risk.

- Lower loss rates. Net write-off rates for American Express consumer and small business charge cards have generally been lower than write-off rates for consumer and small business credit cards, including during the recent recession. Lower write-off rates result from charge cards' reduced risk of credit deterioration, as discussed above.

- Lower loss volatility. Charge cards exhibit a lower loss rate coefficient of variation ("CoV"), as well as a lower asset-value correlation of loss, than credit cards.[3]

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2 Advanced Approaches NPR, 77 Fed. Reg. 52,994.

3 CoV measures the volatility of losses in a specific class of exposures, normalized by the average level of losses. Asset correlation measures the extent to which losses in a specific class of exposures are correlated.

In sum, the proposed changes more accurately reflect the underlying risk characteristics of charge cards as compared to credit cards, and therefore represent an appropriate modification to the definition of QRE.

II. Technical Comments on the Definition of QRE

The Advanced Approaches NPR defines a QRE as an exposure (other than a securitization exposure or an equity exposure) to an individual that is managed as part of a segment of exposures with homogenous risk characteristics, not on an individual-exposure basis, and:

> (1) Is revolving (that is, the amount outstanding fluctuates, determined largely by a borrower's decision to borrow and repay, up to a pre-established maximum amount);
>
> (2) Is unsecured and unconditionally cancelable by the [BANK] to the fullest extent permitted by Federal law; and
>
> (3) Has a maximum contractual exposure amount (drawn plus undrawn) of up to $100,000, or the [BANK] consistently imposes in practice an upper limit of $100,000.[4]

American Express suggests the following modifications to this definition, in order to support the Agencies' efforts to expressly permit certain charge card products to qualify as QRE:

> (1) Is revolving (that is, the amount outstanding fluctuates, determined largely by a borrower's decision to borrow and, ***except for balances required to be paid in full every month, how much to*** repay***)*** up to a pre-established maximum amount~~)~~;
>
> (2) Is unsecured and unconditionally cancelable by the [BANK] to the fullest extent permitted by Federal law; and
>
> (3) ***To meet the pre-established maximum amount requirement in clause (1), (a)*** Has a maximum contractual exposure amount (drawn plus undrawn) of up to$100,000, or ***(b)*** ~~the [BANK] consistently imposes in practice an upper limit of $100,000~~ ***for products with a balance required to be paid in full every month, the total balance does not in practice exceed a maximum amount of $100,000.***

First, it should be made explicit that clause (3) modifies the clause (1) requirement for qualifying exposures to revolve "up to a pre-established maximum amount." Therefore, we propose that the phrase "To meet the pre-established maximum amount requirement in clause (1)" be inserted before the phrase "Has a maximum contractual exposure amount (drawn plus undrawn) of up to $100,000."

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[4] Advanced Approaches NPR § __.101, 77 Fed. Reg. 53,004-05 (emphasis added).

Second, the phrase "the [BANK] consistently imposes in practice an upper limit of $100,000" in clause (3) should be replaced with the phrase "for products with a balance required to be paid in full every month, the total balance does not in practice exceed a maximum amount of $100,000." Most charge cards do not have "bright line" upper limits on cardholders' ability to charge. Instead, charge card exposures are limited through risk-based underwriting of each transaction and continuous, real-time customer monitoring and risk management. For example, rather than impose a "front end" upper limit on a cardholder's ability to charge, American Express may define limited segments of charge card portfolios where the Cardmember's balance is highly unlikely to exceed $100,000 over the next 12 months. In the unlikely event that the balance on one of the charge cards in that segment does exceed $100,000 during that period, that exposure would be classified as an "other retail" exposure for the next 12 months, and then re-evaluated for QRE eligibility at the end of that period. Segments of the charge card portfolio with balances that are not assessed as highly unlikely to exceed $100,000, including of course balances that do exceed $100,000, will be classified as "other retail." In sum, our proposed modifications would more accurately capture the limits and controls used by American Express, which should be used to classify qualifying charge card customers as QREs.

Third, consumers may have limited discretion with regard to the amount repaid each cycle and the Agencies note that "[c]harge card exposures may be viewed as revolving in that there is an ability to borrow despite a requirement to pay in full."[5] Therefore, the definition should be revised to reflect that, for revolving products that require balances to be paid in full every month, outstanding amounts would not be determined by a borrower's decision how much to repay. American Express, therefore, proposes that clause (1) be modified to state that "…the amount outstanding fluctuates, determined largely by a borrower's decision to borrow and, ***except for balances required to be paid in full every month, how much to*** repay…"

III. Hybrid Cards as QREs

In the Advanced Approaches NPR, the Agencies request comment on whether "hybrid cards" exhibit similar risk characteristics to credit and charge cards, and whether the Agencies should permit them to qualify as QREs.[6]

As the Agencies note in the Advanced Approaches NPR, "hybrid" cards exhibit functional characteristics, such as payment features, of both credit and charge cards. While credit cards generally require that only a small portion of the outstanding balance be paid at the end of each billing cycle (typically 2 or 3 percent), many charge cards require that the entire balance be paid in full each cycle. Hybrid cards incorporate features of both credit and charge

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[5] Advanced Approaches NPR, 77 Fed. Reg. 52,994.

[6] Advanced Approaches NPR, 77 Fed. Reg. 52,994.

cards, and generally permit a cardholder to extend a portion of the card balance to revolve beyond one billing cycle.

American Express offers charge cards with a "Lending on Charge" feature that may be considered "hybrid" cards for purposes of the Advanced Approaches NPR ("Charge Cards with Lending On Charge"). American Express offers Charge Cards with Lending On Charge to consumers and small business customers with favorable risk characteristics. While typical charge cards require payment in full at the end of every month, Charge Cards with Lending On Charge permit a cardholder to extend payment on certain portions of the card balance.

American Express' experience indicates that its Charge Cards with Lending On Charge exhibit risk characteristics similar to traditional charge and credit cards. The average historical loss rates of Charge Cards with Lending On Charge, as well as the volatility of loss rates measured by coefficient of variation and implied asset-value correlation, are comparable to those of charge and credit cards.[7]

Because Charge Cards with Lending On Charge exhibit risk characteristics comparable to both credit cards and charge cards without the Lending On Charge feature, American Express believes they should qualify for QRE treatment. The Agencies have indicated their intent to unambiguously align traditional QRE exposures with exposures that have similar risk characteristics, and this objective would be advanced by including Charge Cards with Lending On Charge in the definition of QRE.

American Express believes that if a hybrid card meets the definition of QRE, it should not be excluded simply because it is a hybrid card. As discussed, Charge Cards with Lending On Charge demonstrate functional and risk characteristics of both traditional charge and credit cards; the Agencies' analysis of whether hybrid cards are QREs should therefore focus on whether the hybrid card meets the definition of QRE. Amending the definition of QRE in a manner consistent with our suggestions, will help to clarify that Charge Cards with Lending On Charge qualify as QREs.

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[7] The asset value correlation of losses for American Express consumer and small business credit and charge cards is lower than the 4 percent asset value correlation parameter applicable to QREs under the current advanced approaches rules.

Thank you for considering our comment letter. We appreciate the opportunity to share our views with the Agencies and would be happy to discuss any of them further at your convenience. If we may be of further assistance, please contact us at (212) 640-2000.

Sincerely Yours,

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