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Office of the Comptroller of the Currency
Federal Reserve System
Federal Deposit Insurance Corporation
Washington DC 20551

RE: OCC-2010-0003 Regulations H and Y; Docket No. R-140
Risk-Based Capital Guidelines: Market Risk; Alternatives to Credit Ratings for Debt and Securitization Positions

Dear Members of the Review Committee:

Thank you for the opportunity to comment upon the proposed changes to the market risk rule for regulatory capital. Fitch is not a detached observer on this subject as Fitch's perspective is that of a rating agency. This letter is meant to address investor concerns from the potential consequences of the proposal. Fitch appreciates the challenges in creating a single measure of risk that is a strong indicator of default and transparent across all asset classes. We agree investors benefit from multiple methods of risk assessment. No single measure should be relied upon in markets with constant information flows. Fitch actively uses market-implied ratings from bond and CDS prices in its evaluations of issuers where available and publishes a market implied rating on its website.

Fitch believes the elimination of external credit ratings for risk assessment fails to recognize the stability of corporate credit ratings demonstrated by published transition and default studies. Fitch has undertaken a number of improvements to its processes since the 2008 financial crisis. These changes will strengthen transition and default rates of our structured ratings. We believe our credit ratings provide a forward looking view of credit defaults.

There are several concerns with the proposed alternatives. Intended consequences include higher capital requirements for all banks based on the treatment of securitizations. However, the higher level of capital for securitized assets using the simplified supervisory formula (SSFA) may prohibit US banks from originating and owning securitizations. The impact will be substantial for the securitization market as a whole and may also have wider implications for the market. This may well result in a decline of the securitization market and, in absence of alternative forms of wholesale funding, a significant reduction of system-wide credit risk transfer.Analysis indicates the conservative calibration of the SSFA results in materially higher capital charges which may place US banks at a significant disadvantage relative to global peers which use the risk based approach (RBA) or simplified formula (SFA) to determine capital charges.

A second concern is the potential for further division of the US banking system as the largest financial institutions benefit from lower capitals resulting from their approved internal ratings approach. The changes to the standardized approach result in materially higher capital charges for counterparty credit risks and trading portfolios. Fitch's comparative analysis indicates the proposals do not sufficiently distinguish credit risks and lack a forward looking view also potentially resulting in adverse risk selection.
The use of Country Risk Classifications (CRC) published by the Office of Economic Cooperation and Development (OECD) potentially increases systemic risk for the U.S. banking system from the combination of adverse selection and the use of a single measure of risk assessment for sovereigns, municipals and financial institutions. The OECD has raised its own objections to the use of CRCs as they are designed to indicate risks of currency convertibility, not credit risk. The use of CRC for sovereign credit assessment may understate the risk. Comparisons between the CRC tiers and Fitch's current sovereign ratings indicate that insufficient differentiation may result. Capital risk for sovereigns, municipals and in some cases financial institutions will be assessed based on the sovereign rating. This may increase systemic risks from the combination of adverse selection and tying many ratings to a single measure.

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We consider impact on capital measures to represent underestimation of risk to both the sovereign and banking exposures. The required capital for municipal issuers results in a high dependence on the OECD sovereign designation. This ignores the fundamental separation between the US federal government and States' rights to tax and spend. Further, some products within the municipal market such as the VRDO market are highly dependent upon letters of credit or explicit credit enhancement. The derivation of ratings for municipals and banks from the sovereign ignores any potential diversification, results in higher capital ratios and could reduce or eliminate liquidity in these products.

The proposed corporate bond approach does not appear to provide sufficient credit differentiation for the middle and lower tiers. There appears to be greater optimism for higher credit risk issuers compared to noninvestment grade ratings assigned by Fitch. Notching differences from Fitch's credit ratings in noninvestment grade categories are visibly higher using the proposed approach of corporate tiers. Fitch believes this may result from fewer numbers of tiers as the ratios proposed generally correlate well to credit risk. The use of stock volatility provides a forward looking view that complements the use of leverage ratios. However, credit to corporations lacking public equity may be constrained given materially higher capital charges. While the use of publicly available data is designed to prevent inconsistencies amongst bank calculations, there is no prescribed process for the valuation of assets. This introduces a potential for significant differences in the market value of assets and potential for the manipulation of capital requirements.

Fitch understands the proposal addresses changes to the existing market risk framework (Basel Risk Based Capital framework (RBC)). Additional analysis is provided in a special report published today "Fitch Comments on Proposed Alternatives to Credit Ratings for Risk-Based Capital".

Sincerely

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