Capital One Financial Corporation
1680 Capital One Drive
McLean, Virginia 22102

March 22, 2016

Via Electronic Delivery

Legislative and Regulatory Activities Division
Office of the Comptroller of the Currency
400 7th E Street, SW, Suite 3E-218
Mail Stop 9W-11
Washington, DC 20219
Docket ID FFIEC-2014-0001

Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street & Constitution Ave., NW
Washington, DC 20551
Docket No. R-1510

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

Re: Regulatory Publication and Review under the Economic Growth and Regulatory Paperwork Reduction Act of 1996

Capital One Financial Corporation ("Capital One")[1] appreciates the opportunity to provide comments to the Board of Governors of the Federal Reserve System (the "Federal Reserve"), the Federal Deposit Insurance Corporation (the "FDIC"), and the Office of the Comptroller of the Currency (collectively, the "Agencies") in response to their review of regulations under the Economic Growth and Regulatory Paperwork Reduction Act of 1996 ("EGRPRA").[2] The

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[1] Capital One Financial Corporation (www.capitalone.com) is a financial holding company whose subsidiaries, which include Capital One, N.A., and Capital One Bank (USA), N.A., had $217.7 billion in deposits and $334.0 billion in total assets as of December 31, 2015. Headquartered in McLean, Virginia, Capital One offers a broad spectrum of financial products and services to consumers, small businesses and commercial clients through a variety of channels. Capital One, N.A. has branches located primarily in New York, New Jersey, Texas, Louisiana, Maryland, Virginia and the District of Columbia. A Fortune 500 company, Capital One trades on the New York Stock Exchange under the symbol "COF" and is included in the S&P 100 index.

[2] *Regulatory Publication and Review Under the Economic Growth and Regulatory Paperwork Reduction Act of 1996*, 80 Fed. Reg. 79,724 (Dec. 23, 2015).

Agencies have requested that the public identify "outdated, unduly burdensome, or otherwise unnecessary regulatory requirements," and EGRPRA mandates that the Agencies act to "eliminate unnecessary regulations to the extent that such action is appropriate."[3] We respectfully submit that the Advanced Approaches Risk-Based Capital Rule ("Advanced Approaches")[4] is a clear example of a regulatory requirement that is outdated, unduly burdensome, and unnecessary and urge the Agencies to eliminate the Advanced Approaches capital rules from the U.S. bank regulatory capital framework.

The Advanced Approaches framework is an outdated and unnecessary component of the current regulatory capital framework in the United States.

The U.S. regulatory capital framework has been significantly strengthened since the financial crisis, leaving the Advanced Approaches framework with little role in ensuring that U.S. banking organizations have sufficient capital. Capital planning and supervisory and company-run stress tests are possibly the most important innovations in regulatory capital coming out of the recent financial crisis. Capital planning and stress testing processes have strengthened balance sheets by increasing capital levels and helped restore the public's confidence in the U.S. financial system. The inherent weaknesses of the Advanced Approaches framework stand in stark contrast to the strengths of capital planning and stress testing processes. The Advanced Approaches framework leverages a banking organization's historical data to estimate losses, without regard to the potential future state of the economy, while today's capital planning and stress testing requirements, including the Federal Reserve's comprehensive capital analysis and review exercise, introduce more dynamic measures of capital that capture the relationship between losses and a variety of supervisory and company-developed macroeconomic scenarios. As a result, capital planning and stress testing have become key supervisory tools for determining the capital adequacy of large U.S. banking organizations.[5] Capital planning and stress testing are complemented by stronger leverage ratio requirements implemented in the United States, which act as a simple backstop to risk-based capital requirements.

The Advanced Approaches framework represents an unduly burdensome regulatory requirement.

Advanced Approaches, both at banking organizations and at the Agencies, represents a poor return on a considerable investment. The costs to institutions of using Advanced Approaches to calculate risk-weighted assets are extraordinarily high, and the benefits difficult to identify or quantify. As Andrew Haldane, the Executive Director of the Bank of England, stated in 2011, speaking of the extraordinary complexity of Advanced Approaches:

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[3] *Id.* at 79,726-27.

[4] 12 CFR Part 3, Subpart E; 12 CFR Part 217, Subpart E; 12 CFR Part 324, Subpart E.

[5] Banks certainly can and do derive value from evaluating and reviewing their risk exposures through use of internal models. Such models are leveraged to provide insights, along with management judgment, to help bank boards and management identify, manage, and govern risks, including in the stress testing and capital planning processes. Use of models, supported by robust model governance, will continue to be an important risk management tool even with elimination of Advanced Approaches from the risk-based capital framework.

> [C]onsider the position of a large, representative bank using an advanced internal set of models to calibrate capital. Its number of risk buckets has increased from around seven under Basel I to, on a conservative estimate, over 200,000 under Basel II. To determine the regulatory capital ratio of this bank, the number of calculations has risen from single figures to over 200 million. The quant and the computer have displaced the clerk and the envelope.
>
> At one level, this is technical progress; it is the appliance of science to risk management. But there are costs. Given such complexity, it has become increasingly difficult for regulators and market participants to vouch for the accuracy of reported capital ratios. They are no longer easily verifiable or transparent. They are as much an article of faith as fact, as much art as science. This weakens both Pillars II and III. For what the market cannot observe, it is unlikely to be able to exercise discipline over. And what the regulator cannot verify, it is unlikely to be able to exercise supervision over. Banks themselves have recently begun to voice just such concerns.[6]

Mr. Haldane's estimates of the complexity of Advanced Approaches demonstrate that it requires significant investment of time, resources, and management and board attention, against which its limited benefit must be weighed. The continued existence of this regulatory requirement is value-reducing. Moreover, Advanced Approaches diverts important financial and technical resources from other priorities at both banks and the Agencies, not to mention that it commands critical time and attention of bank board and senior management and Agency principals and staff. With the increasing tide against Advanced Approaches in the risk-weighted capital framework, and the significant enhancements to capital regulation and supervision, discussed herein, it would seem incongruous to allow Advanced Approaches to continue as part of the U.S. capital framework.

Not only does the inherent complexity of the Advanced Approaches create undue burden, but the Dodd-Frank Act established a capital floor that requires Advanced Approaches banking organizations to calculate their required minimum risk-based capital ratios using both the Advanced Approaches and the generally applicable risk-based capital rules (i.e., the Standardized Approach under the Agencies' Basel III capital rules). As a result, the process for determining risk-weighted assets and calculating risk-based capital ratios of Advanced Approaches banking organizations has become more complex for banking organizations to implement, more challenging for supervisors to monitor, and more difficult for the markets to understand.

The Advanced Approaches capital framework should be eliminated.

Although the future of Advanced Approaches has been the subject of some debate since the financial crisis, key policymakers have questioned whether banks, regulators, or markets derive any value from the Advanced Approaches capital framework and have suggested that it be abandoned. A summary of policymaker statements in this regard is included in *Appendix A* to this letter.

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[6] Andrew G. Haldane, *Capital Discipline*, Jan. 9, 2011, at 2-3, *available at* http://www.bis.org/review/r110325a.pdf.

In apparent recognition of the weaknesses of Advanced Approaches, the Agencies have taken steps to limit its impact and incorporation into other aspects of the regulatory framework:

- The Federal Reserve indefinitely delayed the use of Advanced Approaches in its capital planning and stress testing exercises on the basis of concerns that "use of advanced approaches in the capital plan and stress test rules would require significant resources and would introduce complexity and opacity without a clear prudential benefit."[7]

- The FDIC eliminated banks' ability to use Advanced Approaches internal models in measuring counterparty exposure because use of such models resulted in significant reductions in *measured* counterparty exposure, not driven by actual reductions in risk exposure.[8]

Steps to limit the Advanced Approaches capital framework have not been limited to the United States. The Basel Committee recently proposed to rescind the Advanced Measurement Approach ("AMA") for operational risk capital requirements from the Basel framework, stating that

> [t]he inherent complexity of the AMA and the lack of comparability arising from a wide range of internal modelling practices have exacerbated variability in risk-weighted asset calculations, and have eroded confidence in risk-weighted capital ratios. The Committee has therefore determined that the withdrawal of internal modelling approaches for operational risk regulatory capital from the Basel Framework is warranted.[9]

As the supervisory tools for measuring capital adequacy and the corresponding risk identification and measurement processes of banking organizations have evolved since the Advanced Approaches were first introduced, there are few remaining benefits of retaining them as part of the U.S. regulatory capital framework. There is no statutory directive requiring application of the Advanced Approaches risk-based capital rules to U.S. banking organizations. Accordingly, we urge the Agencies to eliminate the Advanced Approaches risk-based capital rules in the United States.

* * *

[7] 80 Fed. Reg. 75,419 (Dec. 2, 2015).

[8] *See* 79 Fed. Reg. 70,427, 70,432-33 (Nov. 26, 2014) ("Based on assessments data, the adoption of the IMM by itself has caused a significant reduction in measured counterparty exposure amounts and changed the scorecard results in a way that significantly reduces deposit insurance assessments for the banks using the IMM. This significant reduction in assessments does not appear to be driven primarily by a change in risk exposure, but rather by a change in measurement methodology.").

[9] *See Consultative Document: Standardised Measurement Approach for operational risk* (March 2016) at 1, *available at* http://www.bis.org/bcbs/publ/d355.pdf.

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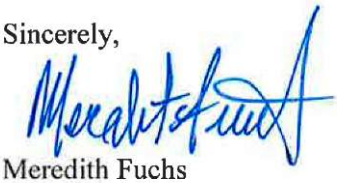
We appreciate the opportunity to highlight the topics raised in this letter and would be happy to meet with the Agencies to discuss further these comments.

Sincerely,



Meredith Fuchs
Senior Vice President,
Chief Counsel – Regulatory Advisory

Appendix A

Recent Policymaker Statements on Advanced Approaches

Governor Daniel K. Tarullo, *Rethinking the Aims of Prudential Regulation*, May 8, 2014

> The combined complexity and opacity of risk weights generated by each banking organization for purposes of its regulatory capital requirement create manifold risks of gaming, mistake, and monitoring difficulty. The IRB approach contributes little to market understanding of large banks' balance sheets, and thus fails to strengthen market discipline. And the relatively short, backward-looking basis for generating risk weights makes the resulting capital standards likely to be excessively pro-cyclical and insufficiently sensitive to tail risk. That is, the IRB approach—for all its complexity and expense—does not do a very good job of advancing the financial stability and macroprudential aims of prudential regulation. . . . For all these reasons, I believe we should consider discarding the IRB approach to risk-weighted capital requirements. . . . [I]n light of all that has happened in the last decade, I see little reason to maintain the requirements of the IRB approach for our largest banks.

Vice Chairman Stanley Fischer, *Financial Sector Reform: How Far Are We?*, July 10, 2014

> Following the global crisis, the BCBS moved to the Basel III agreement, which strengthens capital requirements, as opposed to Basel II, which tried to build primarily on measures of risk capital set by internal models developed by each individual bank. This approach did not work, partly because the agreed regulatory minimum capital ratios were too low, but also because any set of risk weights involves judgments, and human nature would rarely result in choices that made for higher risk weights.

Vice Chairman Thomas M. Hoenig, *Remarks at FDIC Open Meeting*, July 16, 2014

> I particularly think that we should turn very carefully away from the internal models since they are being shown on a global basis to vary dramatically among institutions, not based on the assets held but on the weightings sometimes assigned.

Director Jeremiah O. Norton, *A More Prominent Role for the Leverage Ratio in the Capital Framework*, February 6, 2013

> Despite their sophistication, the models used to measure RWAs may not produce sufficiently accurate measures of capital adequacy. . . . The notion that investors do not understand risk weightings is supported by market research. A recent survey of 130 bank investors at more than 100 institutions suggested that they do not trust RWAs and the Internal Ratings Based model adopted as part of the Basel agreement for the largest banks to do their own modeling of RWAs. Research also indicates that it is more difficult for investors to make comparisons of the riskiness of a bank's assets, even within specific asset classes. This lack of transparency could reduce the efficiency of banking markets and lead investors to become overly reliant on regulatory exercises and judgment. . . .

> Further, there is the persistent danger that the complexity of Basel capital models will prevent regulatory authorities, who have an even a greater level of access to company information, from using Basel capital measurements to arrive at an accurate assessment of a bank's capital adequacy.

Andrew Bailey, Bank of England 2012 Financial Stability Report, Testimony before the Treasury Select Committee – U.K. House of Commons, January 15, 2013

> Investors "do not understand" risk-weighted assets and "have lost confidence in it."