

05.03.2007 D/000514

Ms Jennifer J. Johnson
Secretary
Board of Governors, Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551
USA

Subject: Joint notice of proposed rulemaking to revise existing risk-based capital framework for banks that do not use Basel II (Basel IA) Board Docket No. R-1238, OCC Docket No. 06-15, FDIC FIL-111-2006, OTS No. 2006-49.

Dear Ms. Johnson,

This letter constitutes the response of the European Commission to the call for comments made by the Office of the Comptroller of the Currency, Treasury; Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; and Office of Thrift Supervision, Treasury (hereinafter, the Agencies) in relation to the notice of proposed rulemaking (hereinafter NPR or Basel IA) issued December 26, 2006.

The European Commission welcomes the opportunity to comment on Basel IA, and the views put forward in this response are supported by the European Banking Committee, which represents the Finance Ministries of all 27 Member States of the European Union.

The European Commission supports the Agencies' goal to make risk-based capital rules more risk sensitive, and consequently we strongly encourage the Agencies to permit the full use of the Standardised approach to credit risk as set out in the Basel Committee's "International Convergence of Capital Measurement and Capital Standards: A Revised Framework" (the Revised Framework, June 2006). We believe that the Standardised approach offers a more risk-sensitive approach for banks than the existing rules, without creating competitive distortions or undue regulatory burden. As the Standardised approach has been developed within the Revised Framework, we consider that it represents the appropriate alternative to the more advanced approaches to credit risk. We also consider that to promote consistency, all banks should also be subject to the Revised Framework approaches to operational risk, and the requirements set out in Pillar II and Pillar III.

In supporting the option to allow banks to use the Standardised approaches, the European Commission acknowledges the challenge that this may give rise to in terms of allowing the Agencies to meet the agreed timetable for implementing the Revised Framework. We strongly encourage the Agencies to maintain the existing timetable for the advanced approaches, even if this means that the Standardised approaches become available later than the advanced approaches. If the Agencies consider the introduction of the Standardised approaches to be

appropriate, then we would encourage a pragmatic and practical approach to transitional arrangements to facilitate such changes. Allowing banks that may seek to use the Standardised approaches to remain on Basel I during a transitional period would allow for a seamless introduction of the Standardised approaches, whilst ensuring that the implementation of the advanced approaches under the Revised Framework are not subject to further delay.

In relation to the scope of Basel IA, we would also like to indicate that there may be scope to clarify whether, or to what extent, the application of Basel IA will be optional. Although the Agencies indicate that a non-mandatory bank¹ may, if it chooses, adopt the proposed Basel IA rules, there is also a stipulation that the Agencies would retain the authority to require a non-mandatory bank to use either the existing or the proposed risk-based capital rules if the banking organisation's primary Federal supervisor determines that a particular capital rule is more appropriate for the risk profile of the banking organisation. In our view, the extent to which the rules will be optional would benefit from further clarification.

Notwithstanding our support for the introduction of the Standardised Approach for banks operating within the United States, the European Commission would like to make a first general comment that Basel IA should be aligned as much as possible with the requirements of the Revised Framework's Standardised Approach. In this regard, whilst we do not consider that it would be appropriate to indicate all of the areas where Basel IA diverges from the Standardised Approach, we would like to highlight the following areas simply by way of example:

- a) In terms of the increase in the number of risk weights, in our view it is not just a question of whether the risk weights proposed in Basel IA should be used, but more importantly that they be used consistently in the same way as in the Standardised Approach. So, for example, we do not consider that a risk weight of 10% would be appropriate, and we do consider that it would be appropriate to introduce risk weights of 350% and 1250% for certain securitisation exposures as is the case under the Standardised Approach;
- b) In relation to the use of external ratings, the proposal under Basel IA "if an exposure has two or more external ratings, the banking organisation must use the lowest assigned external rating to risk weight the exposure"², is contrary to the Standardised approach which states "if there are two assessments by ECAs chosen by a bank which map into different risk weights, the higher risk weight will be applied and if there are three or more assessments with different risk weights, the assessments corresponding to the two lowest risk weights should be referred to and the higher of those two risk weights will be applied"³.
- c) In Basel IA, the Agencies indicate that they are proposing to assign a 10 percent CCF to short-term commitments, which would represent a further inconsistency with the Standardised approach.

The examples indicated above should not be considered to be exhaustive or to highlight the areas where divergent approaches may be the most material or important. However, the European Commission considers that these examples are indicative of some of the challenges

¹ A bank that is, under the relevant NPR, not required to adopt the advanced approaches set out in the Revised Framework.

² Fed. Reg 71 77451

³ BCBS: A Revised Framework, Comprehensive version, June 2006 §97, 98

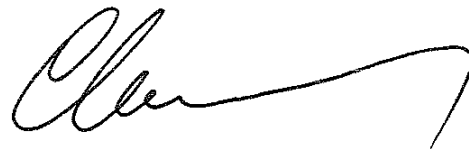
raised by the differences between Basel IA and the Standardised approach, and consequently we encourage the Agencies to align the Basel IA rules as much as possible with the Revised Framework's Standardised approach.

As a second general comment, we would encourage the Agencies to endeavour to ensure that there is as much consistency as possible when mapping exposures to risk weights. We consider that this consistency and transparency in the mapping process will be essential in order to maintain the integrity of the risk capital calculations. This consistency will be particularly important in the case of mortgages, should the proposal to use not only LTV but borrower creditworthiness in the determination of risk weights be introduced, as this treatment proposes up to fifteen different risk weight categories.

Beyond these general comments, it is not our intention at this stage to provide more detailed remarks on Basel IA. We hope that the comments that we have put forward will be of assistance to the Agencies in its further work on the development and finalisation of Basel IA. The European Commission is open to discuss or further explain the comments set out in this letter, and to work with the Agencies in a co-operative framework to facilitate the timely application of the Revised Framework and of Basel IA in the United States.

Please note that we have sent the same response to the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation and the Office of Thrift Supervision.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Charlie', followed by a long, sweeping horizontal line that ends in a small hook.

Charlie McCreevy