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

March 26, 2007

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street & Constitution Ave., N.W.
Washington, DC 20551
Docket No. R-1238
Regs.comments@federalreserve.gov

Regulations Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, N.W.
Washington, DC 20552
Attn: No. 2006-49
Regs.comments@ots.treas.gov

Office of the Comptroller of the Currency
250 E Street, S.W.
Mail Stop 1-5
Washington, DC 20219
Docket No. 06-15
Regs.comments@occ.treas.gov

Mr. Robert E. Feldman
Executive Secretary
Atten: Comments
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429
RIN 3064-AC96
comments@FDIC.gov

Re: Risk-Based Capital Guidelines (Basel IA)

Dear Sirs and Madams:

Capital One Financial Corporation ("Capital One") is pleased to submit comments in support of the federal banking agencies' Joint Notice of Proposed Rulemaking on the subject of Risk-Based Capital Guidelines.[1]

Capital One Financial Corporation is a financial holding company whose principal subsidiaries, Capital One Bank, Capital One, F.S.B., Capital One Auto Finance, Inc., Capital One, N.A., and North Fork Bank, offer a broad spectrum of financial products and services to consumers, small businesses, and commercial clients. As of

[1] 71 Fed. Reg. 77446 (Dec. 26, 2006).

December 31, 2006, Capital One's subsidiaries collectively had $85.5 billion in deposits and $146.2 billion in managed loans outstanding, and operated more than 700 retail bank branches. Among its product lines, Capital One is one of the largest issuers of Visa and MasterCard credit cards in the world. Capital One is a Fortune 500 company and is included in the S&P 100 Index.

Capital One Supports the Basel IA Initiative as an Inexpensive, Risk-Sensitive Alternative to Basel I and Basel II.

The Basel II Advanced capital regime, the Basel II Standardized regime, and the current Basel I capital rules offer a wide spectrum reflecting radically different trade-offs between risk sensitivity, on the one hand, and cheapness and simplicity of implementation on the other. The Basel IA proposal is an important addition to that spectrum of alternatives. We support the Basel IA project, and specifically we support the Agencies' decision to make the Basel IA regime optional for banks currently subject to Basel I. As we explain in our comment letter filed today in the Basel II rulemaking, we believe that the Basel II capital regime likewise should be optional, for the banks for which it is currently proposed to be mandatory, and we believe that this proposed Basel IA regime should be an available option for those Basel II mandatory banks. We believe that the risk factors identified in the Agencies' Question 20 can be appropriately addressed, within the framework of proposed Basel IA, using existing capital guidance and supervisory processes, for example as described in the Board's Supervisory Letter SR 99-18 (July 1, 1999).

Because the proposed Basel IA regime would be optional – hence, banks feeling that its advantages are not worth its cost of implementation can remain under the existing Basel I regime – the Agencies can appropriately lean toward greater risk sensitivity in its design. A principal motivation of Basel IA is to allow non-Basel II banks competitive parity through the reduced capital levels that they perceive a more risk-sensitive regime as offering. To obtain that benefit, it is appropriate to require the implementation of some risk-assessment methodology, as long as that methodology does not entail the intense statistical infrastructure necessary to calculate the Basel II Advanced parameters. We approach the Basel IA proposal from that point of view.

A Much More Risk-Sensitive Capital Regime for Consumer Lending Is Achievable.

Basel IA presents a substantial opportunity to increase the risk sensitivity in capital requirements for unsecured consumer lending (as well as for unsecured loans to individuals for business purposes, which are underwritten using the same techniques)--an opportunity that the Agencies have declined to take.[2] Unsecured consumer lending is the largest part of Capital One's lending business, and hence we have great experience with it. On the basis of that experience, we do not share the Agencies' view that "any increase in risk sensitivity is outweighed by the additional burden that would result from the

[2] 71 Fed. Reg. at 77463.

suggested approaches."[3] The methodology that the Agencies are exploring for mortgage loans, in which the lender maps borrowers' credit scores to a credit bureau's validation chart, is equally applicable to unsecured consumer lending. In fact, it is *more* applicable to unsecured consumer lending because the risk of loss is more dependent on the consumer's creditworthiness. In our comments on the Agencies' Advance Notice of Proposed Rulemaking on Basel IA (our letter of January 18, 2006), we outlined a detailed methodology for calculating the capital charge for credit cards using this approach. Using FICO®[4] credit scores, we segregated card accounts into industry-recognized risk categories (superprime, prime, near prime, subprime, deeper subprime) and estimated PD values by mapping the credit scores to a bureau validation chart. We developed other key variables in the Basel II capital formula from publicly available data drawn from Quantitative Impact Study 4 (or in the case of AVC, our own portfolio data) in order to calculate the capital charge.

Based on our own extensive experience managing consumer loan portfolios, we are confident that the increase in risk sensitivity of this approach is *not* outweighed by additional burdens of implementing it. The methodology requires only the use of scoring data from credit bureaus that is inexpensively available and that consumer lenders in fact do obtain and use in order to manage credit risk in a safe and sound manner. Other necessary parameters can be supplied by the Agencies using the methodology we described. The key to the approach is that it does not require estimation of Basel II Advanced parameters using expensive Basel II Advanced statistical data-management infrastructure. It is that infrastructure that makes Basel II Advanced so problematic, and suitable only for the largest institutions.

Our proposed methodology does require a more complex capital calculation than simply assigning a 100% risk weight to all unsecured consumer loans, whatever their credit risk. But it builds on data that lenders already have, or have inexpensive access to: the credit scores and validation charts. The slight additional effort is fully justified by the enormously greater risk sensitivity of the capital charge. The Agencies should make this tradeoff, in light of the fact that Basel IA is being offered as an option and not a mandatory substitute for Basel I. If a bank prefers a truly cheap and primitive capital regime, it can remain under the current rules.

The Capital Charge for Securitization with Early Amortization Provisions Is Too High.

In our comment on the Advance Notice of Proposed Rulemaking, we argued that the presence of early amortization should not result in a capital charge on a securitization portfolio, because the risk presented by early amortization is a risk of liquidity, not credit, and should be addressed by the development of robust liquidity management tools. We still believe that that is true.

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[3] *Id.*

[4] FICO is a registered trademark of the Fair Isaac Corporation.

Even if one were to adopt the Agencies' position and treat early amortization as an instance of credit risk instead of liquidity risk, the credit conversion factors (CCFs) that the Agencies prescribe are too high. That result is cogently demonstrated by the Risk Management Association's responses to the Agencies' Questions 52-54 in the Basel II Notice of Proposed Rulemaking,[5] responses that Capital One endorses and joins. The RMA convincingly shows that, taking the various elements of the proposed capital treatment together, the capital requirement for a securitized portfolio that is approaching, or is actually in, early amortization would actually be higher than the capital requirement if the bank had retained those receivables on its books. That result makes no sense, because securitization, including with early-amortization provisions, in fact does shift significant credit risk in the portfolio to investors. Hence the proposed capital requirement is excessively high, and may discourage use of genuinely risk-shifting securitization vehicles.

Notwithstanding the artificially high CCFs that the Agencies propose, Capital One would prefer that approach, tied as it is to excess-spread levels and hence reflective of the state of credit risk in the portfolio, to a flat CCF for the entire investor's interest (Question 16).[6] That approach is not risk-sensitive and should be avoided.

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Capital One supports the Agencies' development of the Basel IA capital regime as a viable alternative to both Basel II and Basel I. We appreciate the opportunity to comment on the Advance Notice of Proposed Rulemaking. If you have any questions about this matter and our comments, please call me at (703) 720-2255 or Dr. Geoffrey Rubin at (703) 720-3102.

Sincerely,

/s/

Christopher T. Curtis
Associate General Counsel
Policy Affairs

[5] 71 Fed. Reg. at 55894.

[6] 71 Fed. Reg. at 77461-62.