March 26, 2007

Bank of America

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Secretary, Board of Governors of the
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20th Street and Constitution Avenue, NW
Washington, DC 20551
Docket No. R-1261
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Robert E. Feldman
Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
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RIN No. 3064-AC73
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Office of the Comptroller of the Currency
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250 E Street, SW
Washington, DC 20219
Docket No. 06-09
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Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552
Attention: No. 2006-33
regs.comments@ots.treas.gov

Re: Risk-Based Capital Standards: Advanced Capital Adequacy Framework

Dear Ladies and Gentlemen:

Bank of America Corporation (Bank of America) appreciates the opportunity to comment on the Notice of Proposed Rulemaking entitled "Risk-Based Capital Standards: Advanced Capital Adequacy Framework" (the NPR). Bank of America, with $1,460 billion in total assets, is the sole shareholder of Bank of America, N.A., with full-service consumer and commercial operations in 30 states and the District of Columbia. Bank of America provides banking, investing, corporate and investment banking services and financial products to individuals and businesses across the United States of America and around the world.

Over the last decade, the banking industry has evolved and transactions have become increasingly complex. The limitations of the Basel I Capital Accord have become apparent and highlighted the need for regulatory capital requirements that more appropriately reflect the risk profiles of individual banks and the industry as a whole. The agencies published the US interpretation of the Basel II international framework in their Advanced Notice of Proposed Rulemaking (the ANPR) in August of 2003. We commented on the ANPR in a letter dated November 3, 2003. Shortly thereafter, in June 2004 the Basel Committee on Banking Supervision issued the final international rules, "International Convergence of Capital Measurement and Capital Standards: A Revised Framework" (the Basel II Accord).

We remain very supportive of efforts to modernize the risk based capital regime. We strongly support the three-pillar paradigm of minimum capital requirements, supervisory review and market discipline as part of a comprehensive risk-based capital approach. We support the efforts to better align regulatory capital requirements to underlying economic risks, encourage better risk measurement and management processes and promote international consistency in regulatory standards.

The agencies' proposals for the NPR deviate from the international Basel II Accord in several important respects and may have far-reaching consequences for the US banking industry. Collectively, we believe the changes place US banks at a competitive disadvantage relative to foreign banks and domestic investment banks, reduce the risk sensitivity of the capital framework, increase the costs of compliance and limit the comparability of capital ratios across jurisdictions. Our key elements of concern include the following:

- Risk Sensitivity and Competitive Impact of 10% Aggregate Floor
- Retention of the Leverage Ratio & Impact on Competitive Equity
- Limited Range of Options for US Implementation
- Extended Transition Period and Floors
- Wholesale Definition of Default
- Expected and Downturn LGD Estimation Requirements
- Equity Investment Exclusions and Treatment of Funds
- Elimination of Firm Size Adjustment for Small & Medium Sized Entities
- Securitization Treatment
- Conflicting and Excessive Disclosures

In this letter, we highlight those aspects of the NPR which are of particular concern to Bank of America. In the attached Appendix, we provide comments on the specific questions raised by the agencies throughout the text of the NPR. As a member of the Risk Management Association (RMA), the International Swaps and Derivatives Association (ISDA), the Institute of International Finance (IIF), the Clearinghouse Association and the American Securitization Forum (ASF), we have also participated in the preparation of their comment letters. With some minor differences, we endorse the comments of those organizations. Therefore, we have limited repetition of many of the more technical points common to Bank of America, RMA, ISDA, IIF, the Clearinghouse Association and ASF.

Risk Sensitivity and Competitive Impact of 10% Aggregate Floor

The agencies have included a statement in the NPR that a 10% aggregate decline in minimum required capital among banks using the advanced approaches for credit and operational risk would trigger modifications to the supervisory risk functions or other aspects of the framework. This litmus test is arbitrary and unique to the US implementation. While we understand the agencies' motivation for imposing this condition, we believe it is not necessary, it places US banks at a competitive disadvantage, and it inappropriately exposes banks to uncertainty in their capital management processes.

The Pillar 2 supervisory process is designed to provide safeguards to ensure that capital requirements satisfy Pillar 1 rules, the underlying models meet strict qualification standards, the models are properly validated and the capital results are consistent with the risk profile of the institution. In light of the stringent requirements, supervisory review process and reservation of authority, we do not believe a litmus test for further modification is necessary. First, each bank's calculations under the IRB framework will be subject to independent validation and ongoing backtesting requirements. Second, the bank's primary supervisor will review all components of the AIRB and AMA models for compliance and provide written approval. Finally, Pillar 2 requires banks to discuss their internal economic capital, regulatory capital and stress testing results with their primary supervisors in a comprehensive review of capital adequacy. If significant risks are not captured under Pillar 1, the primary supervisor has the authority to require capital to be held above the Pillar 1 requirements.

Tying further modifications to a numerical benchmark ignores the principle of risk sensitivity underlying Basel II. A 10% change in minimum required capital as conditions improve should not be viewed as a warning signal. In a risk sensitive regime, it is natural to expect the minimum required capital for a portfolio to change throughout the cycle.

Linking modification of the NPR to the minimum requirement fails to recognize that banks typically hold capital well in excess of the minimum requirement and allow the buffer to fluctuate through the cycle. Fluctuations in *minimum* Pillar 1 capital requirements will not necessarily result in similar fluctuations in *actual* capital held. A bank with a robust capital planning process will ensure it has adequate resources throughout the credit cycle. While regulatory ratios are an input to the capital management process, other elements of the process, such as capital market expectations, rating agency targets, business strategy, stress testing results and economic capital requirements, have equal, and in some cases, greater importance. Together, these elements limit fluctuations in capital and result in a buffer between the actual capital held and the minimum regulatory requirement that grows and contracts with the cycle.

In certain circumstances, declines in capital are appropriate reflections of risk management practices and therefore do not threaten the solvency of the system. By design, a risk sensitive regime provides banks with incentives to manage their credit risk through the use of credit hedging, collateral practices and other risk mitigation tools. Industry minimum capital requirements might decrease simply because several large banks pursue more active credit risk management to rebalance their portfolios in favor of lower-risk assets. A risk-based regime would appropriately reflect a corresponding decrease in capital. It is contrary to the objectives of the international accord to penalize such actions with modifications to the framework and reduce incentives through application of an arbitrary floor. The threat of significant modifications to Pillar 1 rules could stunt the development and innovation of new tools for risk management if banks are unsure whether the regulatory capital benefits of certain practices might be eliminated by future changes to the rules. Pillar 2 is therefore a more appropriate means for requiring additional capital.

Finally, as currently structured, the threshold would be triggered by the aggregated minimum required capital rather than capital held by the individual banks. The decisions of one or two banks to adopt conservative lending policies or restructure their balance sheets could trigger modifications of the Pillar 1 rules for the rest of the industry. Depending on their timing, nature and size, these modifications could interfere with capital planning of other banks and potentially disrupt execution of their strategic initiatives.

If the agencies modify the Pillar 1 capital requirements in response to a 10% difference, the US implementation of Basel II will further diverge from the international version. Depending on the specific nature of the modifications, the impact could have differential effects on US banks and upset competitive balances. Perhaps more importantly, US banks will have higher capital requirements than their international counterparts and domestic investment banks for the same assets and will be competitively disadvantaged. The costs of the additional capital could be borne by customers and shareholders in the form of higher pricing and lower shareholder returns. On a long term macroeconomic level, higher capital requirements in the US reduce the flow of credit to the economy from US banks.

We recommend the agencies remove the 10% aggregate threshold for modifications from the NPR. The supervisory approval process, parallel implementation, transitional floors and, ultimately, the authority under Pillar 2 to require additional capital provide supervisors with ample safeguards against inappropriate declines in capital for IRB banks. We recognize that capital regulation is an evolving process and that the rules must therefore also evolve to capture emerging risks or correct deficiencies in the measurement of risk for certain exposures. We believe regulatory attention should be directed at specific problem areas as they emerge. This is preferable to an industry-wide trigger that would result in wholesale recalibration of the US implementation.

Retention of the Leverage Ratio & Impact on Competitive Equity

The US agencies plan to permanently retain the leverage ratio. As their balance sheets have grown more complex, banks have made tremendous progress developing risk management techniques. Although it is simple and transparent, the leverage ratio provides little information value for the supervision of large, complex banking organizations; instead, it generates incentives that are counterproductive to capital management and creates a competitive disadvantage for US banks.

The leverage ratio is a blunt measure of capital in relation to total assets. It lacks risk sensitivity and makes no adjustment for the presence of low risk assets such as prime mortgages, reverse repurchase agreements and high grade investments. Furthermore, it ignores the techniques used by modern financial institutions to manage their risk, such as diversification, collateral management, and credit risk hedging.

In a risk-based capital regime the leverage ratio will become binding for many banks. Banks with low-risk assets will be penalized because the leverage ratio simply does not reflect the economics of their balance sheets. Once the constraint becomes binding, the leverage ratio creates a perverse incentive for banks to shift their mix to riskier assets or reduces their willingness to provide credit. As a result, the leverage ratio encourages banks to hold riskier assets and drives low-risk assets out of the banking system. We believe this unintended consequence is counterproductive and not consistent with prudential goals.

Like the 10% aggregate floor, the retention of the leverage ratio places US banks at a competitive disadvantage. The US banking system is virtually alone in requiring the leverage ratio. Foreign banks are not subject to a leverage requirement and therefore have an advantage in holding low risk assets. While it is certainly true that US subsidiaries of foreign banks are subject to the leverage ratio, their parent companies can use double leverage to mitigate its impact. This provides foreign banks with a distinct competitive advantage even for domestic business.

We believe the agencies should reevaluate the utility of the leverage ratio in a modern capital framework and consider phasing it out at the end of the transition period. We agree that it may be necessary as a safeguard as the industry transitions from Basel I to Basel II. However, we recommend the agencies consider modification of the ratio to better represent capital adequacy of banks with significant volumes of low-risk assets on their balance sheets. For example, investment grade securities, reverse repurchase agreements, and other low-risk assets could be deducted from the total asset denominator. A modified version of the leverage ratio, while still an imperfect measure of capital adequacy, would then cause less distortion and better represent the capital adequacy of firms with low-risk balance sheets.

Limited Range of Options for US Implementation

The US implementation of Basel II requires a defined group of banks to implement the Advanced Internal Ratings Based Approach (AIRB) for credit risk and Advanced Measurement Approach (AMA) for operational risk. Banks outside this defined group have the option to implement the advanced approaches, adopt Basel IA or remain on Basel I. In contrast, the international framework allows banks to choose between the Standardized, Foundation and AIRB approaches for credit risk and the Basic Indicator, Standardized and AMA approaches for operational risk. The range of options allows banks to transition to more advanced approaches as their risk management systems evolve. Although the choice is available in principle for all banks, the international Accord made it clear that larger banks were expected to implement approaches consistent with their complexity and risk management processes. Bank of America would fit into this category and is committed to implement the AIRB and AMA approaches for credit and operational risk as soon as practicable. We believe these approaches allow us to leverage our significant investment in risk management processes, reflect our conservatively managed risk profile and communicate our strong capital position relative to our risk exposures.

Nonetheless, we believe the full range of options should be available in the US. With these options, banks could select the alternatives that are most appropriate for their business processes. Providing the full range of options would also allow banks to make their own assessments of the balance between the costs and risk sensitivity of each approach. This would help level the playing field by giving US banks the same range of options available internationally and alleviate some competitive concerns. Additionally, it would help control compliance costs by allowing banks to transition to the advanced approaches over time and more efficiently allocate resources. We understand that such a change may result in a slight delay as the agencies draft and submit a revised NPR for comment by the industry, but believe its duration could be minimized by more fully leveraging the Basel II international framework.

Extended Transitional Period and Floors

The US agencies have departed from the international rules by extending the transition period between Basel I and Basel II and imposing more restrictive floors governing the reduction in risk-weighted assets. We do not believe that a more restrictive transition period is necessary. The floors established in the international framework provide sufficient safeguards during the transition period. The longer transition period and more restrictive floors create a competitive disadvantage through 2011 and possibly longer.

The international rules allow banks to transition to full implementation of the Accord after a parallel run and a two year transition period. Over the transition period, risk-weighted assets are allowed to fall relative to the Basel I rules by 10% per year for a total reduction in risk weighted assets of 20%. Not only have the US agencies delayed the implementation by at least 12 months, they have also extended the transition period to three years and limited the reduction in risk weighted assets to 5% per year (15% total reduction). These floors apply to individual banks and are in addition to the 10% constraint on the aggregate decline in capital requirements for the industry, which was discussed previously.

Unlike their international counterparts, US banks cannot move between floor levels without explicit approval by their primary supervisor. Because the standards have not been defined, we are concerned that the approval process for transitioning between floors could become arbitrary and inconsistent across banks. If supervisory approval to move between floors is withheld, a US bank could remain constrained by the transitional floors for an indefinite period.

The following table contrasts the maximum capital relief for US and International banks. It is evident from the table that US banks will be at a competitive disadvantage for several years as they transition from Basel I to Basel II. Given the final floor value of 15% and the aggregate industry floor of 10%, it is unclear whether the disadvantage will be eliminated after full transition. Even if the floors converge at the end of the transition period, the impact of competitive inequity on loss of market share or strategic opportunities during the transition period may not reverse for many years.

Comparison of Transitional Floor Requirements
Basel II Accord vs. US NPR

	2007	2008	2009	2010	2011
Basel II Accord	Parallel	90%	80%	80%+	80%+
US NPR	NA	Parallel	95%	90%	90% - 85%*

* Effective floor for individual banks depends on impact of 10% aggregate threshold

Furthermore, the US agencies have diverged in the mechanics of the floor calculation. The NPR calculation is based on current Basel I risk-weighted assets. The international rules contain an adjustment for the separation of expected and unexpected loss. This results in a higher transitional requirement for US banks, since the point of reference for US banks is a greater level of risk-weighted assets.

In summary, the additional requirements for capital floors further reduce the risk sensitivity of the framework proposed in the US, introduce a competitive disadvantage to US banks and reduce the comparability of capital ratios across jurisdictions. We believe the parallel calculation period and floors adopted in the international accord provide sufficient safeguards during the transition period. We strongly recommend aligning the transitional floors to the international framework, adopting mechanics of the international calculation and removing the requirement for a bank to seek permission from its primary supervisor for transition between floors.

Wholesale Definition of Default

The NPR and the international framework further diverge in their respective definition of default. The primary differences are that the NPR definition specifies 5% as a threshold for materiality of credit related loss on sale of an exposure, applies non-accrual status as the minimum criterion rather than 90 days past due and makes no exception for immaterial amounts. As a result, internationally active US banks will be faced with greater compliance costs and all US banks will face higher Pillar 1 capital requirements.

The differences between the domestic and international definitions have several consequences. First, the PD and LGD parameters would be inconsistent across jurisdictions and not comparable for validation purposes. Second, many US banks have already developed their quantitative models to support Basel II based on the international definitions due to the delay in publishing the NPR. A change in definition from the international standard at this late stage would require a great deal of re-work to implement. More significantly, banks with operations across multiple jurisdictions would have to maintain databases, develop estimation procedures, implement rating systems, and manage validation processes with multiple definitions of default. These dual systems would require significant additional compliance costs.

The definition of default captures loans sold at a material credit-related discount. The US definition is prescriptive, specifying a 5% threshold. The international rules allow some discretion for the bank to determine whether a discounted sale of an exposure should be classified as a default. We have three concerns regarding the use of an explicit threshold. First, there are many factors in addition to credit quality that determine the discount on sale of assets, including the level of interest rates, market risk premia, market liquidity, the size of the exposure and technical supply and demand factors. It would be quite difficult and ultimately arbitrary to disentangle these elements from the credit-related component. Second, banks sell assets for a variety of portfolio management reasons. Loan sales are motivated by concentration management, balance sheet usage, market liquidity and many other factors. Including sales of performing loans in the definition of default would clearly introduce comparability problems across institutions with different portfolio management strategies. Moreover, artificial thresholds could have the negative and perverse consequence of discouraging early action on deteriorating exposures or interfering with management's portfolio decisions. Third, even in cases where the credit-related component is dominant, a 5% discount is only an indication of a change in default probability rather than a reflection of borrower default. As an obligor approaches default status, the economic value of the exposure approaches the present value of the recovery stream. The discount on the sale of the exposure therefore approaches the LGD on the exposure. Typically, LGDs are much higher than the 5% threshold, in the range of 40%-50% for unsecured exposures. While we oppose a specific definition of materiality, we believe a suitable threshold would be much greater than the specified level of 5% and would depend on the LGD characteristics of the exposure.

The US agencies have also dropped the explicit 90 days past due criteria for material obligations. Although they have retained classification of non-accrual in the definition of default, sole reliance on non-accrual will miss a large number of silent defaults. Loans where the borrower is 90 days past due will typically be classified as non-accrual assets. However, there is an important exception to this process. When the exposure is well secured and in the process of collection, the asset remains on accrual accounting. Reliance on non-accrual status will miss these cases, which are true defaults but expected to be low LGD exposures. Based on this definition, US banks will estimate lower PDs and higher LGDs than their counterparts. In consequence, PD and LGD parameters will not be comparable across jurisdictions, benchmarking efforts to validate rating models will have limited scope and the effectiveness of market discipline under Pillar 3 will be undermined.

Of greater concern, the more narrow definition of default will introduce an upward bias in the capital requirements of US banks. For the calculation of expected loss, the effect on PD and LGD is largely offsetting. The calculation of risk weighted assets, however, is distorted by the more narrow definition of default. Due to the non-linear nature of the formula, the impact of the LGD increase will more than offset the PD decrease resulting from the narrower definition. As a result, US banks will have greater capital assignments than their international counterparts.

In summary, we strongly recommend harmonizing the definition of default with the international framework. This could be accomplished by a complete alignment of definitions or by allowing internationally active banks to choose between the international and domestic definitions in order to reduce compliance costs and apply consistent models across international jurisdictions. As an alternative but less preferable approach to full alignment, we recommend removing the reference to a numerical threshold for discounts on sale of assets in favor of the less prescriptive international language.

Expected and Downturn LGD Implementation Requirements

The US agencies have also deviated from the international framework in the use and calculation of downturn LGDs. Areas of divergence include the use of expected LGD in the adjustments of risk-weighted assets and loan loss reserves for expected loss, adoption of an all-or-nothing approach for internal downturn LGD estimates, and introduction of a supervisory mapping function for banks that cannot estimate internal downturn LGDs.

The US agencies require banks to subtract expected LGD rather than downturn LGD in the deduction of expected loss from risk-weighted assets and eligible reserves included in Total Capital. The international framework does not include the concept of expected LGD and instead deducts downturn LGD to remove expected loss. Since expected LGD is generally lower than downturn LGD, the approach proposed by the US agencies will increase risk-weighted assets for US banks. The offsetting deduction of expected loss from eligible reserves included in Tier 2 Capital also uses expected LGD. It is important to note that the impact of using expected LGD in risk-weighted assets is offset in the calculation of Total Capital rather than Tier 1 Capital. The resulting Tier 1 Capital requirements will be higher for US banks than for their international counterparts. Additionally, banks are only allowed to recognize loan loss reserves in excess of expected loss up to 0.6% of risk weighted assets. Banks with reserves beyond this threshold will not receive the offsetting impact to the increase in risk weighted assets. As a result, Tier 1 Capital requirements for all US banks and Total Capital requirements for well-reserved US banks will be higher than for their international counterparts. This compounds the competitive inequities discussed in previous sections.

The international framework requires banks to apply downturn LGDs to calculate risk-weighted assets. The underlying premise is that LGD is higher in periods of high defaults and economic stress that are relevant for determining minimum capital requirements. In the NPR, the US agencies introduced a supervisory mapping function to translate between estimates of expected LGD and corresponding downturn LGDs. The implementation of the supervisory mapping function raises a number of concerns. These include an all-or-nothing approach to implementation, an excessively conservative and unsupported calibration of the function and lack of clear standards for approval of internal estimates.

The US agencies have adopted an all-or-nothing approach for US bank implementation of downturn LGDs based on internal estimates. If a bank is not able to estimate reliable downturn LGDs for a subcategory of exposures, it would have to use the supervisory function for all portfolios. We understand the agencies' need to ensure the approach is not subject to cherry picking. However, we feel the requirement is unnecessarily restrictive. It is significantly more constraining than the international implementation, which would allow conservative adjustments to address the uncertainties in the LGD estimates for specific portfolios.

We also believe the calibration of the supervisory mapping function is overly conservative. The functional form of the supervisory function has a greater proportional impact on low-LGD exposures. Yet there is no conclusive evidence to support the presumption that LGD in downturn conditions is greater than expected LGD for highly secured loan exposures.

Finally, unless a bank has written approval to use its internal estimates, it is required to use the supervisory formula. There is no clear uniform standard on which these approvals are to be based. Consequently, there is a risk of making substantial investments in developing internal downturn LGD estimates that do not meet specific examiners' interpretation of the very general standards.

We strongly recommend aligning the approach for deduction of expected loss from risk-weighted assets and loan loss reserves with the international framework. While we understand the conceptual merits of the approach, we believe the costs of introducing inconsistencies in capital requirements across jurisdictions and for banks with different reserve levels far outweigh the benefits of the change. Further, we recommend the agencies eliminate the all-or-nothing requirement for internal downturn LGD estimates, provide clearer standards for their approval, and consider a less conservative mapping function as industry research develops.

Elimination of Firm Size Adjustment for Small & Medium Sized Entities

The US agencies have eliminated the firm size adjustment for small and medium-size entities (SMEs). The international framework permits a firm-size adjustment to the corporate risk weight function for companies with annual sales less than 50 million Euros. As a result, it recognizes, through lower correlations, the substantial benefits of diversification for middle market and small business lending portfolios. In the international framework, capital for a wholesale exposure can be reduced by as much as 20% for these exposures. It has been empirically shown that asset correlations increase with firm size. The risk of smaller firms is mostly idiosyncratic and is diversified in the context of the overall portfolio. The risks of larger firms, on the other hand, tend to be more systematic and therefore more highly correlated.

By eliminating the favorable treatment for smaller borrowers, the NPR places US banks at a competitive disadvantage relative to international banks and their domestic operations. We recommend the US agencies reconsider the treatment of SMEs in light of competitive equity and allow US banks the option of using the firm size adjustment as specified in the international framework.

Equity Investment Exclusions and Treatment of Funds

We generally support the broader definition of equity based on the economic substance of the instrument. The US implementation allows banks to select between the Simple Risk-Weighted Asset (SRWA) approach using standardized risk weights and the Internal Models Approach (IMA) based on a value at risk framework. Our primary concerns include the application of the materiality exclusion under the IMA framework, the availability of a look-through IMA for investment funds and the treatment of investment funds with material liabilities.

Under the SRWA, there is a materiality exclusion for non-significant equity investments up to 10% of Total Capital. Exposures below this threshold are risk weighted at 100% rather than the 300% and 400% risk weightings for public and private equity investments, respectively. The IMA, on the other hand, does not allow for a similar exclusion of exposures. As a result, the capital assignment for most institutions under the more sophisticated IMA is guaranteed to be higher than capital calculated under the SWRA. This creates a significant disincentive for banks to invest in improving risk management for equity instruments and is contrary to the Basel II philosophy of allowing greater capital relief as an institution develops more sophisticated risk measurement approaches.

The operational requirements for the IMA require daily market prices for all modeled equity exposures, either direct holdings or proxies. Proxies for private equity investments are available on a monthly basis. These proxies represent the unique risks of venture capital and other private investments. They are more relevant than public market proxies and are available for complete equity cycles. We believe these indices, even though they are monthly, should be eligible to be used in the IMA.

The treatment of investment funds specifies that institutions should look through the fund to the assets and assign capital as though the assets were on the balance sheet. Our understanding is that the agencies intended the calculation of capital for the fund to be based on the table of standard risk weights contained in the text. This table applies a risk weight of 1250% to an exposure class of an investment fund that would have a risk weight in excess of 400% if it were held directly on the balance sheet. We see no reason to include such extreme differences in risk weighting for assets that only differ in the form of ownership, whether they are direct or indirect investments.

Perhaps more importantly, we believe banks should have the option to choose either the SRWA or IMA based on their risk management practices and the availability of position data for the fund investments. The IMA, in concert with data that allows the bank to look through the fund and reflect its proportional ownership of individual positions, should satisfy the criteria of assigning capital as though the individual assets are held directly on balance sheet. This method would achieve the agencies' objective to prevent arbitrage and ensure that banks do not receive a punitive treatment for exposures to investment funds that hold low risk assets.

Unlike the international framework, investment funds with material liabilities are excluded from the treatment outlined in the US NPR. We understand the agencies' concerns related to the leverage of these funds and agree that an appropriate risk weight under the SRWA might exceed 400%. However, we are concerned that the exclusion may be interpreted as requiring the securitization approach. Investment funds are neither publicly rated nor able to be modeled under the Supervisory Formula Approach (SFA), which was originally designed for credit exposures. The hierarchy of approaches within the securitization treatment would therefore lead to capital deduction for these investments. We believe this approach would be punitive relative to the risks of these assets and overly conservative. We recommend the agencies consider an alternative treatment which extends the SRWA table of risk weights to include the impact of leverage.

Securitization Treatment

We remain supportive of the proposed securitization framework; however, we are concerned with both the broad range of financial products subject to the framework and the seemingly punitive capital treatment under the hierarchy of approaches documented in the NPR text.

The NPR emphasizes tranching of credit risk as a defining criterion when determining the applicability of the securitization framework to a given transaction. As a result, language in the NPR will result in application of the securitization framework to a very broad range of financial transactions, some not currently considered securitizations and not transacted with the intent of entering into a securitization. The result of applying the securitization framework hierarchy of approaches to this broad range of transactions is dollar-for-dollar capital treatment, which does not properly reflect a bank's risk in the transaction.

For example, suppose an unaffiliated third party creates a Special Purpose Entity (SPE) for the purpose of originating or purchasing mortgages or commercial loans. Bank of America provides a revolving loan facility to the SPE, and the SPE pledges the mortgage and/or commercial loan assets being financed to Bank of America as collateral to secure payment and performance of the revolving facility. In addition, the third party may provide recourse to Bank of America for a predefined percent of loan losses. The securitization framework would appear to view the third party's recourse to Bank of America and Bank of America's facility as a tranching of credit risk on the underlying pool of loans, and therefore requires us to follow the securitization framework, applying the hierarchy of approaches. Similarly, in a situation where Bank of America has recourse only to the underlying loans, the securitization framework would seem to view the SPE's equity interest and the more senior facility to Bank of America as a tranching of credit risk on the underlying loans.

Since the revolving loan facility to the SPE would not be externally rated and a rating cannot be inferred from a subordinate exposure, the Ratings-Based Approach cannot be utilized. The revolving loan is not supporting an ABCP program so the Internal Assessment Approach cannot be utilized. Bank of America does not have access to loan-level data and therefore is also not able to utilize the SFA. The result is that a punitive dollar-for-dollar capital charge would be assessed on the transaction. Clearly this does not reflect the level of risk Bank of America assumes in this transaction.

In another example, Bank of America purchases a pool of loans from a third party originator who retains servicing. The transaction is structured such that a portion of the purchase price is retained by the purchaser as an incentive for quality servicing. The servicer earns the holdback if actual credit loss performance is better than predefined expected credit loss performance. Under the NPR's broad definition of a securitization transaction, this arrangement could be viewed as a tranching of credit risk between Bank of America and the seller/servicer. Bank of America views the servicer incentive not as a sharing of credit risk, but as a contingent purchase price.

These examples illustrate that more precise language is needed to define the scope of transactions included in the securitization framework. Additionally, alternative approaches should be available for transactions in which application of the securitization framework results in a capital charge disproportionate with the bank's risk in the transaction. In the first example above, an alternative approach would be to evaluate the line of credit to the SPE as a secured loan under the wholesale framework. Thus, we recommend a revision of the NPR to narrow the scope of transactions included in the securitization framework and to enable banks to apply other parts of the Basel framework, with supervisory approval, when they more appropriately reflect the substance of the transaction.

The securitization framework does not specifically include put options structured to provide liquidity to an ABCP program. We request the addition of language specifically permitting the application of the Internal Assessment Approach to such puts. Addition of such language will ensure consistent capital treatment of financial products that provide liquidity to ABCP programs and prevent punitive capital treatment.

We generally support the NPR's objective to align capital requirements with additional risk a banking organization may bear from an early amortization event. However, we note that the early amortization provisions are punitive in transactions that are not designed to have excess spread, and instead rely on other structural features such as overcollateralization to provide structural support to investors. For example, assume a securitization of revolving assets will never have excess spread but has an early amortization trigger when senior tranche enhancement decreases to a specified level. We seek alternative early amortization provisions for transactions that, by design, do not have excess spread and have early amortization triggers based on other factors. We believe that the requirement to recognize additional capital should be based on the early amortization trigger unique to each transaction and request inclusion of language with some flexibility to address transactions with non-traditional performance measures.

The terms "originator" and "servicer", among others, are used somewhat interchangeably throughout the NPR in regards to both securitization exposures and related underlying assets. We request some clarification of these terms within the securitization framework to remove potential ambiguity, specifically in the Operational Requirements and in determining which party to a transaction is eligible to exercise a clean-up call. The NPR currently requires an eligible clean-up call to be "exercisable solely at the discretion of the servicer..." However, the use of the word "servicer" could be interpreted as referring to an entity merely servicing the underlying loans. The current regulatory framework permits clean-up calls in recognition of the real market need to call a transaction when the costs of keeping it outstanding are burdensome. Since many securitizations involve loans serviced by parties other than the bank sponsoring the securitization, the language in the NPR would potentially give the ability to call a transaction to an entity that would not necessarily be burdened by keeping a securitization outstanding.

Conflicting and Excessive Disclosures

We agree in principle with the intent of Pillar 3 to promote increased transparency, understanding and market discipline through enhanced disclosure. Unfortunately, we do not believe that the current draft accomplishes this objective. The current level of required reporting is excessive. Not only does it place a burden on the preparers, but we believe that the required level of disclosure will make it difficult for users to locate and evaluate the appropriate information.

These requirements also contain substantial qualitative requirements that in some cases duplicate information available in other public documents. We recommend streamlining the disclosure requirements to more directly address information that is specific to Basel II in an effort to simplify the disclosures across all publicly available documents.

The regulators also proposed new reporting templates in OMB Control No. 1557-NEW (the Proposed Templates). The Proposed Templates are separated into public and confidential templates and are viewed as separate and distinct from Pillar 3 reporting requirements, which are all public. However, some of the confidential information requested in the Proposed Templates is also contained in the Pillar 3 requirements and could lead to certain information being classified as confidential by the templates and public under Pillar 3. This appears to be contradictory. We request that the agencies clarify this in regards to the proposed public and confidential reporting environment.

We believe streamlining the disclosures and addressing the apparent contradiction will strike a more appropriate balance for disclosures.

Summary

While we strongly support the approaches in the Basel II Accord, we are concerned that changes made in the US interpretation of the international framework reduce risk sensitivity, place US banks at a competitive disadvantage relative to foreign competitors and US investment banks, limit the comparability of capital ratios across jurisdictions, and increase the costs of compliance.

We would be happy to discuss our views in greater detail, or to discuss any new ideas that the regulatory authorities wish to pursue. In that regard, please contact John S. Walter, our Senior Vice President for Risk & Capital Analysis at (415) 953-0243, or Randy Shearer, our Senior Vice President and Director of Accounting Policy at (980) 388-8433.

Sincerely,

JL Price

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Chief Financial Officer
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Appendix I
Bank of America Response to Specific Questions

I. Introduction

A. Background
B. Conceptual Overview

Question 1: The agencies seek comment on and empirical analysis of the appropriateness of the proposed rule's AVCs for wholesale exposures in general and for various types of wholesale exposures (for example, commercial real estate exposures). (pg 19)

- Generally, we believe the asset correlations for wholesale exposures are too high in both the NPR and the Accord. Several empirical studies have shown that commercial asset correlations are lower than the 8%-24% range currently assumed in the regulatory capital framework (See Hamerle et al, Benchmarking Asset Correlations, 2003 and Chernih, et al, Asset Correlations: A Literature Review and Analysis of the Impact of Dependent Loss Given Defaults, 2006).

- We understand that the correlations have been set conservatively to compensate for structural characteristics of the model, such as the assumption of an infinitely granular portfolio and non-stochastic loss given default. As a result, it is difficult to empirically validate the Basel II correlations since they represent the combination of empirical analysis and upward adjustments for model risk. Recognizing the importance of international consistency, we recommend the agencies continue their dialogue with the Basel II Committee and seek modifications to the international framework as industry research on the topic further matures.

- As noted in our response to Question 25, we believe the capital framework should recognize lower correlations for small and medium size entities. The US agencies have eliminated these adjustments, while the international framework permits a firm-size adjustment to the corporate risk weight function for companies with annual sales less than 50 million Euros. As a result, it recognizes, through lower correlations, the substantial benefits of diversification for middle market and small business lending portfolios.

  By eliminating the favorable treatment for smaller borrowers, the NPR places US banks at a competitive disadvantage relative to international banks and their domestic operations. We recommend the US agencies reconsider the treatment of SMEs in light of competitive equity and allow US banks the option of using the firm size adjustment as specified in the international framework.

- We maintain our view that the wholesale asset correlation estimates of the ASRF model are improperly specified. The wholesale asset correlation assumptions for both the Accord and NPR are inverse functions of default probability. Asset correlation is a function of company size rather than default probability per se. As a firm increases in size, internal diversification reduces its level of idiosyncratic risk, resulting predominantly in exposure to systematic risk. Smaller companies are exposed to significant idiosyncratic risk from a narrow product set and geographic scope in addition to exposure to the overall economy. The relationship between correlation and default probability is spurious and simply reflects the tendency for larger companies to be highly rated.

Question 2: The agencies seek comment on and empirical analysis of the appropriateness and risk sensitivity of the proposed rule's AVC for residential mortgage exposures – not only for long-term, fixed-rate mortgages, but also for adjustable-rate mortgages, home equity lines of credit, and other mortgage products – and for other retail portfolios. (pg 20)

- We suggest the correlation estimates for mortgages, credit card and other retail products be reviewed in the context of ongoing efforts by the Basel Committee to refine the capital framework as further research becomes available.

- We participated in an RMA study investigating the differences between capital assignments under the regulatory approach and the economic capital models of RMA members. The RMA study found that the levels of correlation set in the proposed Accord and ANPR are generally higher than industry estimates. For example, the correlation assumed for mortgages is approximately 150% of the median of values used by industry participants. Mortgage asset correlations of 10% or less were almost uniformly used in industry Economic Capital models.

- As noted in the NPR, the 15% flat asset correlation for mortgages was based on an analysis of traditional long term fixed rate products. We understand that the correlation estimate is partially a reflection of the longer tenor of the product in order to offset lack of a maturity adjustment in the retail capital formula. Since home equity products, which typically have shorter tenors than traditional mortgages, are included in the mortgage category, the current classification scheme will not be sufficiently risk sensitive and results in overly conservative correlations for these products. Home equity loans and lines of credit are typically originated with tenors of 10-15 years. Their shorter term is not reflected if they are aggregated with traditional mortgages.

  Our internal models assign the same asset correlation to all mortgage exposures. There may be some merit, however, to assigning lower asset correlation to home equity loans and lines of credit. The supervisory authorities should consider either a separate category for home equity loans and lines of credit, as well as reverse mortgages, as industry research develops. Home equity lines of credit usually substitute for credit card debt. It is logical to expect that the performance of the real estate market will be less influential in driving default behavior for this portfolio than for traditional mortgages.

- Our own research on credit card correlations using 20 years of bankruptcy data suggests that the 4% correlation assigned to qualifying revolving exposures is conservative. This study calculated the implied asset correlations based on the historical mean and volatility of bankruptcy rates using the maximum likelihood approach. Our findings indicated that credit card asset correlations are more appropriately in the range of 1% – 2%.

- We maintain that asset correlation is inappropriately linked to default probability for other retail portfolios. The risk-weighting function assumes that asset correlation and systematic risk levels decrease as default probability rises. The RMA study found that this inverse relationship is not supported. This link overstates the capital requirement for high-quality consumer assets. For example, the median correlation value used by the industry for high-quality secured consumer loans (i.e., PD of 1%) is approximately 4%. The correlation used in the risk-weighting function for these assets is 12.72%.

Question 3: The BCBS calibrated the proposed 0.6 percent limit on inclusion of excess reserves in tier 2 capital to be approximately as restrictive as the existing cap on the inclusion of ALLL under the general risk-based capital rules, based on data obtained in the BCBS's Third Quantitative Impact Study (QIS-3) The agencies seek comment and supporting data on the appropriateness of this limit. (pg 21)

- A capital adequacy framework should match the risk measured by the model to the financial resources available to cover that risk. The financial resources available to cover expected and unexpected loss include common equity, other Tier 1 Capital elements, loan loss reserves and future margin income. Failure to recognize the full benefit of loan loss reserves through 0.6% limitation and the deduction for expected loss are fundamental flaws in both the NPR and Basel II Accord.

- Banks should be allowed to recognize the full amount of loan loss reserves in excess of expected loss on defaulted assets. Importantly, there should be no artificial limit to the amount of reserves which qualify as capital. This will better accommodate the different international accounting treatments and remove the competitive disparity caused by more conservative reserving practices in the US. Nor should reserves be viewed as a form of secondary capital. After income generated for the period, reserves buffer losses before common equity can be impacted. Because they absorb losses before equity, reserves should be included with common equity and other Tier 1 components. We strongly suggest the US agencies address this issue in the course of future work on the definition of capital with the Basel Committee.

  The 0.6% limitation appears more restrictive than the 1.25% limit imposed under the Basel I rules. As stated earlier, we disagree with the principle of establishing a limit for reserves. That said, we believe that if not removed the limit should be modified to be no more restrictive than under current rules. The proposed approach is more restrictive because it is based on a lower numerical benchmark, applies the benchmark only to credit risk weighted assets and deducts expected loss from total reserves.

- As expressed in our previous comment letters, we strongly believe it is inappropriate to assign capital for expected loss. Likewise, we do not believe that expected loss for performing assets should be deducted from the reserve amount included as Tier 2 Capital. Banks consider expected loss to be a cost of doing business. Margins on loan products are set at a level sufficient not only to cover operating costs, but also to cover expected loss and provide a favorable return on capital. Deducting expected loss from reserves disregards the most fundamental pricing practices. It assumes that revenue is sufficient only to cover operating costs, but not to compensate for the average level of credit losses.

- To determine capital adequacy, the capital requirement for unexpected loss should be compared to common equity and the total amount of reserves in excess of expected loss on already defaulted assets. This approach recognizes the risk mitigating benefit of margin income for performing assets. It assumes only that margin income on performing loans is sufficient to cover their operating costs and expected loss. It does not include the profit margin embedded in loan pricing as a financial resource and is therefore conservative.

C. Overview of Proposed Rule

Question 4: The agencies seek comment on the use of a segment-based approach rather than an exposure-by-exposure approach for retail exposures. (pg 27)

- Below the initial level of segmentation of mortgage, QRE, and other retail, we believe the IRB model should be less prescriptive on the use of segmented portfolios. The requirement of lower-level segmentation schemes suggests a simplified approach to parameter modeling, whereby average parameters would be assigned to large groups of loans. Such an approach appears to preclude more sophisticated methods, such as using loan-level risk characteristics in a statistical regression equation. In principle, we have no objection to such an approach, but believe that banks should have the option of using more sophisticated exposure level approaches.

D. Quantitative Impact Study 4 and Overall Capital Objectives

Question 5: The agencies seek comment on this approach to ensuring that overall capital objectives are achieved. (pg 36)

- Please refer to the Risk Sensitivity and Competitive Impact of 10% Aggregate Floor section of the comment letter.

Question 6: The agencies seek comment on all potential competitive aspects of this proposal and on any specific aspects of the proposal that might raise competitive concerns for any bank or group of banks. (pg 41)

- Please refer to the Risk Sensitivity and Competitive Impact of 10% Aggregate Floor and the Retention of the Leverage Ratio & Impact on Competitive Equity sections of the comment letter.

II. Scope

Question 7: The agencies request comment on whether US banks subject to the advanced approaches in the proposed rule (that is, core banks and opt-in banks) should be permitted to use other credit and operational risk approaches similar to those provided under the New Accord. With respect to the credit risk capital requirement, the agencies request comment on whether *banks should be provided the option of using a US version of the so-called "standardized approach" of the New Accord and on the appropriate length of time for such an option. (pg 42)*

- Bank of America intends to implement the advanced approaches under the Basel II framework. Nonetheless, we believe US banks should be afforded a full range of approaches available in the Accord for both credit and operational risk. Large complex banks should be expected to transition quickly to the advanced approaches. Smaller banks should be permitted to implement the standardized approaches and encouraged to transition to more advanced approaches as their risk management practices become more sophisticated.

Question 8A: The Board seeks comment on the proposed BHC consolidated non insurance assets threshold relative to the consolidated DI assets threshold in the ANPR (pg 44)

- We maintain that US banks should be allowed the full range of implementation options specified in the Accord. However, if US banks are required to implement only the advanced approaches, we do not object to using consolidated bank holding company assets rather than consolidated depository institution assets as the threshold criteria.

Question 8B: The agencies seek comment on the proposed scope of application. In particular, the agencies seek comment on the regulatory burden of a framework that requires the advanced approaches to be implemented by each subsidiary DI of a BHC or bank that uses the advanced approaches. (pg 44)

- The full range of options should be available to US banks at both the holding company and subsidiary levels. However, if the US implementation is bifurcated, only those subsidiaries meeting the threshold criteria on a standalone basis should be required to implement the advanced approaches. At a minimum, only subsidiaries filing Y-9C or Call Reports should be required to separately report capital ratios.

- In some cases, such as for operational risk or credit risk for low default portfolios, it would be not be feasible nor would it be prudent to develop subsidiary-specific models due very sparse data at that level. We believe the agencies should allow banks to determine capital requirements for subsidiaries using centrally maintained models developed from enterprise level reference data. Implementation of advanced approaches for standalone subsidiaries would be excessively burdensome if the agencies require customized models for each subsidiary based on reference data specific to the legal entity, separate documentation and redundant model validation processes.

Question 9: The agencies seek comment on the application of the proposed rule to DI subsidiaries of a US BHC that meets the conditions in Federal Reserve SR letter 01-01 and on the principle of national treatment in this context. (pg 44)

- No specific comment

III. Qualification

A. Qualification Process

Question 10: The agencies seek comment on this approach, including the transitional floor thresholds and transition period, and on how and to what extent future modifications to the general risk-based capital rules should be incorporated into the transitional floor calculations for advanced approaches banks. (pg 53)

- We do not believe that a more restrictive transition period is necessary. The floors established in the international framework provide sufficient safeguards during the transition period.

- The international rules allow banks to transition to full implementation of the Accord after a parallel run and a two year transition period. Not only have the agencies delayed the implementation by at least 12 months, they have also extended the transition period to three years and limited the reduction in risk weighted assets to 5% per year (15% in the NPR vs. 20% in the Accord).

- Because the standards have not been defined, we are concerned that the approval process for transitioning between floors could become arbitrary and inconsistent across banks.

- The US agencies have diverged in the mechanics of the floor calculation. The NPR calculation is based on current Basel I risk-weighted assets. The international rules contain an adjustment for the separation of expected and unexpected loss. This results in a higher transitional requirement for US banks, since the point of reference for US banks is a greater level of risk-weighted assets.

- Banks should have the option to use either Basel I or Basel IA in the floor calculations in order to minimize operational burden. A core bank that implements the advanced approaches under Basel II before Basel IA is finalized should have the option of switching to Basel IA as the basis for the floor calculations if it determines that the tradeoff between risk sensitivity and implementation costs are acceptable.

Question 11: The agencies seek comment on what other information should be considered in deciding whether those overall capital goals have been achieved. (pg 53)

- We do not believe that comparison between capital requirements under the Basel I and Basel II rules is an effective measure of whether overall capital goals are met. Such a comparison implicitly assumes the Basel I capital requirements are correct and would be sensitive to economic conditions at the time of comparison. Given the lack of risk sensitivity and many other flaws of Basel I, it would be more appropriate to compare required capital under Basel II to the bank's economic capital assessment and the actual capital held by the institution.

Question 12: The agencies seek comment on this proposed timetable for implementing the advanced approaches in the United States. (pg 54)

- No Specific Comment

B. Qualification Requirements

1. ***Process and System Requirements***
2. ***Risk rating and segmentation systems for wholesale and retail exposures***

Question 13: The agencies seek comment on this aspect of the proposed rule and on any circumstances under which it would be appropriate to assign different obligor ratings to different exposures to the same obligor (for example, income-producing property lending or exposures involving transfer risk). (pg 59)

- In cases where obligors have exposures in several countries and those exposures are subject to transfer risk, a separate rating for those exposures should be allowed. Generally, transfer risk is incorporated through a substitution approach where the greater of either the obligor or the sovereign rating is assigned to the exposures. This implementation properly reflects the principle behind transfer risk where a loss could occur either through default of the obligor or through sovereign intervention.

- For income-producing real estate loans, the probability that the obligor will default on any one facility is related primarily to the cash flows from the individual property, not to the overall condition of the obligor. When either the cash flows cannot service debt or the collateral value falls below loan value, the obligor will likely be in default. As a result, the collateral value at the individual facility level is important in determining default probability.

Question 14: The agencies seek comment on this proposed definition of default and on how well it captures substantially all of the circumstances under which a bank could experience a material credit-related economic loss on a wholesale exposure. In particular, the agencies seek comment on the appropriateness of the 5 percent credit loss threshold for exposures sold or transferred between reporting categories. The agencies also seek commenters' views on specific issues raised by applying different definitions of default in multiple national jurisdictions and on ways to minimize potential regulatory burden, including use of the definition of default in the New Accord, keeping in mind that national bank supervisory authorities must adopt default definitions that are appropriate in light of national banking practices and conditions. (pg 63)

- The differences between the domestic and international definitions have several direct consequences. First, the PD and LGD parameters would be inconsistent across jurisdictions and not comparable for validation purposes. Second, many US banks have already developed their quantitative models based on the international definitions due to the delay in publishing the NPR and the need to progress forward in their implementations. A change in definition from the international standard at this late stage would require a great deal of re-work to implement. Once these changes are implemented banks with operations across multiple jurisdictions would have to maintain databases, develop estimation procedures, implement rating systems, and manage validation processes with multiple definitions of default. These dual systems would require significant additional compliance costs.

- The definition of default captures loans sold at a material credit-related discount. The US definition is prescriptive, specifying a 5% threshold. The international rules allow some discretion for the bank to determine whether a discounted sale of an exposure should be classified as a default. We have several concerns regarding the use of an explicit threshold. There are many factors in addition to credit quality that determine the discount on sale of assets, including the level of interest rates, market risk premia, market liquidity, the size of the exposure and technical supply and demand factors. It would be quite difficult and ultimately arbitrary to disentangle these elements from the credit-related component.

  Banks sell assets for a variety of portfolio management reasons. Loan sales are motivated by concentration management, balance sheet usage, market liquidity and many other factors. Including sales of performing loans in the definition of default would introduce comparability problems across institutions with different portfolio management strategies. Moreover, artificial thresholds could have the negative and perverse consequence of discouraging early action on deteriorating exposures or interfering with management's portfolio decisions.

  Even in cases where the credit-related component is dominant, a 5% discount is only an indication of a change in default probability rather than a reflection of borrower default. As an obligor approaches default status, the economic value of the exposure approaches the present value of the recovery stream. The discount on the sale of the exposure therefore approaches the LGD on the exposure. Typically, LGDs are much higher than the 5% threshold, in the range of 40%-50% for unsecured exposures. While we oppose a specific definition of materiality, we believe a suitable threshold would be much greater than the specified level of 5% and would depend on the LGD characteristics of the exposure.

- The US agencies have also dropped the explicit 90 days past due criteria for material obligations. The sole reliance on non-accrual will miss a large number of silent defaults expected to be low-LGD exposures. Based on this definition, US banks will estimate lower PDs and higher LGDs than their counterparts. In consequence, PD and LGD parameters will not be comparable across jurisdictions, benchmarking efforts to validate rating models will have limited scope, and the effectiveness of market discipline under Pillar 3 will be undermined.

  The more narrow definition of default will introduce an upward bias in the capital requirements of US banks. For the calculation of expected loss, the effect on PD and LGD is largely offsetting. The calculation of risk weighted assets, however, is distorted by the more narrow definition of default. Due to the non-linear nature of the formula, the impact of the LGD increase will more than offset the PD decrease resulting from the narrower definition. As a result, US banks will have greater capital assignments than their international counterparts.

- We strongly recommend harmonizing the definition of default with the international framework. This could be accomplished by a complete alignment of definitions or by allowing internationally active banks to choose between the international and domestic definitions in order to reduce compliance costs and apply consistent models across international jurisdictions. As an alternative but less preferable approach to full alignment, we recommend removing the reference to a numerical threshold for discounts on the sale of assets in favor of the less prescriptive international language.

Question 15: In light of the possibility of significantly increased loss rates at the subdivision level due to downturn conditions in the subdivision, the agencies seek comment on whether to require banks to determine economic downturn conditions at a more granular level than an entire wholesale or retail exposure subcategory in a national jurisdiction.

- We support the idea of downturn LGD, as it enables the capital model to more accurately estimate extreme losses, which would occur when portfolio default rates are high and recoveries are potentially low. However, we do not support the concept of requiring LGD to be estimated using downturn conditions below the portfolio level.
- From a safety and soundness perspective, a bank's risk is reduced through diversification across regions, industry and other portfolio attributes. Application of LGDs estimated using downturn conditions determined at more granular levels implicitly assumes that high defaults and low recoveries occur simultaneously in all portfolio segments. Capital calculated using more granular subdivision LGDs would be significantly overstated as it would fail to recognize diversification effects.

3. *Quantification of risk parameters for wholesale and retail exposures*

Question 16: The agencies seek comment on and supporting empirical analysis of (i) the proposed rule's definitions of LGD and ELGD; (ii) the proposed rule's overall approach to LGD estimation; (iii) the appropriateness of requiring a bank to produce credible and reliable internal estimates of LGD for all its wholesale and retail exposures as a precondition for using the advanced approaches; (iv) the appropriateness of requiring all banks to use a supervisory mapping function, rather than internal estimates, for estimating LGDs, due to limited data availability and lack of industry experience with incorporating economic downturn conditions in LGD estimates; (v) the appropriateness of the proposed supervisory mapping function for translating ELGD into LGD for all portfolios of exposures and possible alternative supervisory mapping functions; (vi) exposures for which no mapping function would be appropriate; and (vii) exposures for which a more lenient (that is, producing a lower LGD for a given ELGD) or more strict (that is, producing a higher LGD for a given ELGD) mapping function may be appropriate (for example, residential mortgage exposures and HVCRE exposures). (pg 74)

- As noted in our response to Question 15, we acknowledge the importance of considering downturn LGD in the capital framework. However, for competitive equity reasons, we do not believe the agencies should diverge from the international framework by requiring both LGD and ELGD in the RWA formula. The international framework does not include the concept of expected LGD and instead deducts downturn LGD to remove expected loss. Since expected LGD is generally lower than downturn LGD, the approach proposed by the US agencies will increase risk-weighted assets for US banks. The offsetting deduction of expected loss from eligible reserves included in Tier 2 Capital also uses expected LGD but applies the offset in the calculation of Total capital rather than Tier 1 Capital. Additionally, banks are only allowed to recognize loan loss reserves in excess of expected loss up to 0.6% of risk weighted assets. Banks with reserves beyond this threshold will not receive the offsetting impact. As a result, Tier 1 Capital requirements for all US banks and Total capital requirements for well-reserved US banks will be higher than for their international counterparts.

- The agencies have adopted an all-or-nothing approach for US bank implementation of downturn LGDs based on internal estimates. If a bank is not able to estimate reliable downturn LGDs for a subcategory of exposures, it would have to use the supervisory function for all portfolios. We understand the agencies' need to ensure the approach is not subject to selective implementation. However, we feel the requirement is unnecessarily restrictive. It is significantly more constraining than the international implementation, which would allow conservative adjustments to address the uncertainties in the LGD estimates for specific portfolios. Our major concern is that an entire category of exposures, such as high volatility commercial real estate or other wholesale credit, would be required to use the supervisory function if there were just a small segment within the broad category which did not meet the requirements for downturn LGD estimation.

- We strongly believe that banks meeting eligibility requirements should be allowed to use internal LGD estimates rather than the supervisory mapping function. Therefore, we object to the notion that all banks should be required to use the supervisory mapping function. Large banks have invested considerable resources in the data infrastructure, analysis and reporting of the economic consequences of default to support their internal capital, pricing and portfolio management processes. At Bank of America, our research database currently includes over 18,000 defaulted credits over the period 2000 - 2007. While research into estimation of downturn LGDs is a relatively nascent topic, we believe the industry is well positioned and will make significant progress over the next few years in the analysis of the linkage between economic stress and LGD.

- The supervisory mapping function provides a method for banks to estimate downturn LGD from their internally estimated ELGDs. We appreciate the agencies' motivation for the mapping function to provide a fallback alternative for situations where a bank does not have sufficient data to develop its own internal estimates. However, the design and calibration of the function results in an overly conservative increase to LGD and resulting capital requirements for highly secured exposures. For example, a loan secured by a cash deposit with an ELGD of 5% would result in a mapped LGD of 12.6%. Thus, this example suggests that LGDs would more than double during downturn conditions. We recommend recalibration of the function to be less punitive to the exposure subcategories with the lower ELGDs.

Question 17: The agencies seek comment on the extent to which ELGD or LGD estimates under the proposed rule would be pro-cyclical, particularly for longer-term secured exposures. The agencies also seek comment on alternative approaches to measuring ELGDs or LGDs that would address concerns regarding potential pro-cyclicality without imposing undue burden on banks. (pg 74)

- The underlying drivers of LGD, such as loan to value, may be cyclical in nature. As a result expected LGD estimates based on these drivers would vary through the cycle. We believe sensitivity to current credit conditions, rather than long run averages, is a desirable characteristic of the capital framework. While expected LGD changes through the cycle, we believe the estimates of downturn LGD should remain fairly constant as they reflect our estimates of economic loss in stressed conditions.

- Said differently, the gap between the downturn and expected LGDs should vary through the cycle. We are concerned that the supervisory function, which is a simple linear scaling of expected loss given default, does not share this characteristic. This gross up process would exacerbate the pro-cyclical nature of the capital assignments, resulting in overstatements of downturn LGDs in periods of stress and significant increases in capital assignments. This problem would be alleviated through acceptance by the agencies of internal estimates of downturn LGDs and a flexible, principles-based supervisory approval process.

Question 18: The agencies seek comment on the feasibility of recognizing such pre-default changes in exposure in a way that is consistent with the safety and soundness objectives of this proposed rule. The agencies also seek comment on appropriate restrictions to place on any such recognition to ensure that the results are not counter to the objectives of this proposal to ensure adequate capital within a more risk-sensitive capital framework. In addition, the agencies seek comment on whether, for wholesale exposures, allowing ELGD and LGD to reflect anticipated future contractual paydowns prior to default may be inconsistent with the proposed rule's imposition of a one-year floor on M (for certain types of exposures) or may lead to some double-counting of the risk-mitigating benefits of shorter maturities for exposures not subject to this floor. (pg 76)

- We agree that active monitoring and exposure management in Asset Based Lending can significantly reduce banks' exposure to deteriorating clients and mitigate losses. Our internal models would naturally reflect this phenomenon through assignment of EAD factors that are less than zero. We appreciate the agencies' intent to allow such adjustments, but would prefer them to be made in the EAD parameter rather than LGD. Adjustments to LGD to compensate for pre-default paydowns will unnecessarily complicate backtesting efforts as resulting estimates will commingle the effects of balance changes and recoveries.

- We are concerned that the ability to make LGD adjustments will be limited to specific categories of lending. We suggest that the agencies allow adjustments for all portfolios where pre-default paydowns can be reliably and accurately estimated in order to avoid competitive equity. We note that contractual amortization of principal leads to reductions in EAD for a broader set of exposures and encourage the agencies to continue dialogue with the Basel II committee in the context of further improvements to the framework.

- We strongly support the inclusion of a maturity adjustment in the risk-weighting formula to appropriately differentiate the risk of instruments with different tenors. With regard to the last question, we do not believe the one-year floor on M is justified and maintain that the floor on M causes the capital for short-term credits to be overstated. We believe these restrictions should be removed. For all assets with maturities less than one year, we believe the lower risk of these transactions should be reflected by assigning both lower PDs and M parameters. An additional adjustment to LGD for pre-default paydowns does not overlap with these effects. It simply reflects that exposure at default for the facility is likely to be lower than the current balance, in addition to the obligor having a lower probability of default.

4. ***Optional approaches that require supervisory approval***
5. ***Operational risk***

Question 19: The agencies solicit comment on all aspects of the proposed treatment of operational loss and, in particular, on (i) the appropriateness of the proposed definition of operational loss; (ii) whether the agencies should define operational loss in terms of the effect an operational loss event has on the bank's regulatory capital or should consider a broader definition based on economic capital concepts; and (iii) how the agencies should address the potential double-counting issue for premises and other fixed assets. (pg 85)

- The guidance covers the major elements of an operational risk framework, outlining principles that are well thought out and congruent with our risk management practices. The most critical objective of the operational risk capital framework is risk sensitivity, and the key elements for achieving this are effectively identified in the proposal. In general, we believe that the operational risk guidelines strike the correct balance between principle and prescriptiveness.

- We believe that a definition of operational loss broadly consistent with GAAP rules is appropriate for this stage of industry development. We agree that economic losses such as opportunity costs, reputation impact and control improvement costs can be significant, but the difficulty of defining and accurately measuring these and other indirect costs will inevitably lead to inconsistent application. Additionally, adoption of a broader definition of operational loss will further increase the divergence between US and international implementations.

6. ***Data Management and maintenance***
7. ***Control and Oversight Mechanisms***
8. ***Documentation***

C. Ongoing Qualification

Question 20: The agencies seek comment on the appropriateness of the 24-month and 30-day time frames for addressing the merger and acquisition transition situations advanced approaches banks may face. (pg 102)

- We agree with the idea of a transition period for exposures of institutions that are merged with or acquired. The 24-month timeframe, coupled with the ability to obtain a 12-month extension, appears sufficient and reasonable. The 30-day window for submission of an implementation plan, however, appears too short and places an undue timing burden on a bank's merger transition resources. We believe a 90- or 180-day submission window is more reasonable.

- Additionally, we recommend expanding the qualifications of the transition treatment to include material purchases of portfolios from an institution that is not to be merged or acquired. Examples would include purchasing a card portfolio from a non-IRB bank, or purchasing a loan portfolio from the consumer financing arm of a manufacturer.

IV. Calculation of Tier 1 Capital and Total Qualifying Capital

Question 21: Commenters are encouraged to provide views on the proposed adjustments to the components of the risk-based capital numerator as described below. Commenters also may provide views on numerator-related issues that they believe would be useful to the agencies' consideration of the proposed rule. (pg 103)

- We agree with the proposed adjustments to Tier 1 and Tier 2 Capital with a few exceptions. Minimum regulatory capital requirements for insurance subsidiaries are deducted from Tier 1 Capital rather than 50% from Tier 1 and 50% from Tier 2 Capital as implemented in the Accord. To maintain competitive equity, the agencies should follow the international guidelines for the treatment of insurance subsidiaries.

- As noted in Question 3, we do not believe recognition of the loan loss reserve as Tier 2 Capital should be limited by a numerical threshold. Additionally, we believe the full amount of loan loss reserves in excess of expected loss on defaulted assets should be recognized as Tier 2 Capital.

Question 22: The agencies seek comment on the proposed ECL approach for defaulted exposures as well as on an alternative treatment, under which ECL for a defaulted exposure would be calculated as the bank's current carrying value of the exposure multiplied by the bank's best estimate of the expected economic loss rate associated with the exposure (measured relative to the current carrying value), that would be more consistent with the proposed treatment of ECL for non-defaulted exposures. The agencies also seek comment on whether these two approaches would likely produce materially different ECL estimates for defaulted exposures. In addition, the agencies seek comment on the appropriate measure of ECL for assets held at fair value with gains and losses flowing through earnings. (pg 106)

- We agree with the proposed treatment of and rationale for linking defaulted exposure ECL to the impairment estimate for ALLL. No material differences are expected between the impairment estimates and the alternative treatment based on best estimates of economic losses.

Question 23: The Board seeks comment on this proposed treatment and in particular on how a minimum insurance regulatory capital proxy for tier 1 deduction purposes should be determined for insurance underwriting subsidiaries that are not subject to US functional regulation. (pg 110)

- We believe that deducting the capital required by the insurance subsidiary's functional regulator while simultaneously consolidating and computing RWA for the subsidiary double counts the capital requirements for insurance activities.

- A more appropriate approach would exclude the insurance company assets from risk weighted assets and deduct the capital requirement under insurance regulation from the bank's capital. To preserve competitive equity, the approach should follow the Basel II framework which divides the deduction evenly between Tier 1 and Tier 2 Capital.

V. Calculation of risk Weighted Assets

A. Categorization of Exposures

Question 24: The agencies seek comment on how to strike the appropriate balance between the enhanced risk sensitivity and marginally higher risk-based capital requirements obtained by separating HVCRE exposures from other wholesale exposures and the additional complexity the separation entails. (pg 113)

- In order for an acquisition, development or construction loan to be excluded from the high volatility commercial real estate category it must satisfy certain exception criteria. While the exception for 1-4 family residential properties can be implemented without a significant burden, the data requirements for the remaining criteria may not be cost effective to source and maintain. The burden of the exception-identification may be too large and will force banks to classify all non-residential real estate acquisition, development or construction loans as HVCRE.

- This compliance burden could be greatly reduced if all multifamily residential real estate construction loans were also excluded from HVCRE. As noted earlier, multifamily residential real estate loans have properties similar to retail mortgages in that their defaults are less tied to systemic conditions than ordinary commercial real estate loans.

Question 25: The agencies request comment and supporting evidence on the consistency of the proposed treatment with the underlying riskiness of SME portfolios. Further, the agencies request comment on any competitive issues that this aspect of the proposed rule may cause for US banks. (pg 114)

- The US agencies have eliminated the firm size adjustment for small and medium-size entities (SMEs). The international framework permits a firm-size adjustment to the corporate risk weight function for companies with annual sales less than 50 million Euros. As a result, it recognizes, through lower correlations, the substantial benefits of diversification for middle market and small business lending portfolios. In the international framework, capital for a wholesale exposure can be reduced by as much as 20% for these exposures.

- It has been empirically shown that asset correlations increase with firm size. The risk of smaller firms is mostly idiosyncratic and is diversified in the context of the overall portfolio. The risks of larger firms, on the other hand, tend to be more systematic and therefore more highly correlated.

- The NPR notes that the agencies are not aware of compelling evidence that smaller firms with the same PD and LGD are subject to less systematic risk. A table from the Federal Reserve Research Staff paper referenced in the ANPR is reproduced below. It clearly shows that, when both size and default probabilities are included, size is the main driver of correlation. Holding EDF constant, there is a very clear increase in asset correlation for larger firms. When asset size is held constant, the table shows very little impact of credit quality except for within the largest open-ended bucket. Because the largest size category is not bounded from above, the average size of firms in each of the credit quality buckets could differ and drive the few differences that are shown in the table.

Table 5B2. Calibrated Average Asset Correlations at the 99.9% Percentile for the US Portfolios based on EDF and Asset Size Categories

	EDF Categories (%)		
Asset Size Categories	0.00% to 0.52 %	0.52% to 6.94%	6.94% to 20.00%
$0 mm to $100 mm	0.1375	0.1250	0.1250
$100 mm to $1,000 mm	0.1875	0.1875	0.1750
> $1,000 mm	0.3250	0.2750	0.2250

Source: Jose A. Lopez, "The Empirical Relationship between Average Asset Correlation, Firm Probability of Default and Asset Size", June 17, 2002

- Our own research included in the ANPR comment letter indicated that correlation has a much stronger relationship to the size of the company than to credit quality. The underlying data used in the analysis are the asset correlations measured by the Moody's KMV Global Correlation Factor Model for all U.S companies. It is clear from visual inspection that a size-based specification is more coherent and has more explanatory power. The R-squared of alternative asset correlation regression models were 27% for a credit quality-based specification and 44% for a size-based specification. This corresponds to almost a 60% improvement in explanatory power. We have confirmed using our own research that, after controlling for size of the company, the EDF relationship is not statistically significant.

- By eliminating the favorable treatment for smaller borrowers, the NPR places US banks at a competitive disadvantage relative to international banks and their domestic operations. We recommend the US agencies reconsider the treatment of SMEs in light of competitive equity and allow US banks the option of using the firm size adjustment as specified in the international framework. An optional approach will allow US banks to make their own assessment of the implementation costs versus improved risk sensitivity of the treatment.

Question 26: The agencies request comment on the appropriate treatment of tranched exposures to a mixed pool of financial and non-financial underlying exposures. The agencies specifically are interested in the views of commenters as to whether the requirement that all or substantially all of the underlying exposures of a securitization be financial exposures should be softened to require only that some lesser portion of the underlying exposures be financial exposures. (pg 119)

- We suggest a broader mix of underlying financial and non-financial exposures be permitted within a Basel II securitization transaction. The securitization industry is constantly evolving and we request regulatory language with some flexibility to address new structures. The framework should accommodate new asset classes for securitizations such as intellectual property rights, project finance revenues, lease securitizations or entertainment royalties.

- Expanding the available asset classes may require modification of the securitization hierarchy of approaches or alternative exclusion criteria for certain exposures. The agencies should carefully evaluate the options to avoid classifying existing transactions, such as individual project finance or commercial real estate loans, within the securitization framework. This would result in capital deductions when public ratings or underlying asset data are not available for the approaches currently specified in the securitization hierarchy.

Question 27: The agencies seek commenters' perspectives on other loss types for which the boundary between credit and operational risk should be evaluated further (for example, with respect to losses on HELOCs). (pg 122)

- The primary risk of boundary issues stems from under-counting or double-counting the loss impacts. Although operational loss data collection practices can be developed to collect boundary events, such events may not easily be identified within credit-related databases. An example provided in the NPR described a loan loss that was exacerbated due to the bank's improper securing of the collateral (operational risk). Exclusion of the impact of such a loss from historical credit-related databases would be impractical, and thus any operational risk treatment would result in a double-count of the risk. We support the proposed treatments, which generally follow both industry practice and the existing segregation of operational loss and credit data capture.

Question 28: The agencies generally seek comment on the proposed treatment of the boundaries between credit, operational, and market risk. (pg 122)

- Please refer to our comment letter on the Market Risk NPR and its discussion of bifurcation of the trading book.

B. Risk Weighted Assets for General Credit Risk

Question 29: The agencies seek comment on this approach to tranched guarantees on retail exposures and on alternative approaches that could more appropriately reflect the risk mitigating effect of such guarantees while addressing the agencies' concerns about counterparty credit risk and correlation between the credit quality of an obligor and a guarantor. (pg 127)

- We agree with the approach to treat tranched guarantees of individual retail exposures as an adjustment to ELGD/LGD rather than apply the exposure towards the securitization framework. Such guarantees, particularly private mortgage insurance and guarantees on student loans issued by highly rated private entities, state or federal governments, act as additional sources of repayment, thus reducing the LGD for those exposures.

Question 30: The agencies seek comment on wholesale and retail exposure types for which banks are not able to calculate PD, ELGD, and LGD and on what an appropriate risk-based capital treatment for such exposures might be. (pg 127)

- We support alternate approaches for ultra-low loss portfolios. Retail margin loans and similarly secured and managed banking book loans have exhibited such few historical losses that any empirical estimate of PD is not statistically significant. As a result, borrower-specific risk drivers, such as credit bureau score, cannot be adequately incorporated into the model.

- For these portfolios, where aggregate loss data is available banks should be allowed to use a top down approach to infer PD and LGD factors that replicate average historical loss experience. In cases where this is not feasible, we recommend a flat risk weight of 100% be applied to the excess of the exposure amount over the haircut adjusted collateral value.

Question 31: The agencies seek comment on the appropriateness of permitting a bank to consider prepayments when estimating M and on the feasibility and advisability of using discounted (rather than undiscounted) cash flows as the basis for estimating M. (pg 135)

- We support the proposal to allow banks to consider prepayments when estimating M. However, we believe incorporating prepayment should be an option rather than a requirement. Banks should be allowed to choose between using contractual term, weighted average contractual cashflow or weighted average expected cashflow based on their own assessment of the tradeoff between implementation cost and risk sensitivity. Prepayment parameters should be subject to comparable qualification requirements as PDs, LGDs and EADs and reviewed under the Pillar 2 supervisory process.

Question 32: The agencies seek comment on whether the agencies should impose the following underwriting criteria as additional requirements for a Basel II bank to qualify for the statutory 50 percent risk weight for a particular mortgage loan: (i) that the bank has an IRB risk measurement and management system in place that assesses the PD and LGD of prospective residential mortgage exposures; and (ii) that the bank's IRB system generates a 50 percent risk weight for the loan under the IRB risk-based capital formulas. (pg 143)

- See response to Question 33.

Question 33: The agencies seek comment on all aspects of the proposed treatment of one-to-four family residential pre-sold construction loans and multifamily residential loans. (pg 143)

- The RTCRRI Act of 1991 provides Basel I capital relief towards multi-family residential mortgages and residential 1-4 family construction loans that meet certain criteria. The capital relief is achieved by effectively treating them as residential mortgages rather than corporate loans, which reduces their risk weight from 100% to 50%.

- Basel II eliminates the simplified risk-bucketing scheme. The statutory rules required by the RTCRRI Act will therefore run counter to the intent of the Accord. As a result, the capital relief originally envisioned under the Act may change, and could turn into a capital penalty if the IRB formula would otherwise provide a risk weight less than 50%. We recommend that in light of the Basel II Accord, the agencies seek to amend or perhaps repeal the statutory capital requirements of the RTCRRI Act.

C. Credit Risk Mitigation Techniques

Question 34: For purposes of determining EAD for counterparty credit risk and recognizing collateral mitigating that risk, the proposed rule allows banks to take into account only financial collateral, which, by definition, does not include debt securities that have an external rating lower than one rating category below investment grade. The agencies invite comment on the extent to which lower-rated debt securities or other securities that do not meet the definition of financial collateral are used in these transactions and on the CRM value of such securities. (pg 147)

- Under standard market practice for securities financing transactions, Banks accept collateral of all types of credit quality but impose more conservative haircuts for lower-rated debt securities. To determine eligibility, it should be sufficient for the bank to demonstrate that it assigns haircuts appropriately reflecting the risks of the securities. The necessary regulatory oversight can be provided through the Pillar 2 supervisory process for review of internal haircuts.

Question 35: The agencies recognize that criterion (iii) above may pose challenges for certain transactions that would not be eligible for certain exemptions from bankruptcy or receivership laws because the counterparty—for example, a sovereign entity or a pension fund—is not subject to such laws. The agencies seek comment on ways this criterion could be crafted to accommodate such transactions when justified on prudential grounds, while ensuring that the requirements in criterion (iii) are met for transactions that are eligible for those exemptions. (pg 139)

- We agree that there may be certain counterparties, which are exempt from bankruptcy laws such as pension funds and sovereigns, where netting enforceability will be difficult to demonstrate. We recommend the criterion be modified to provide more flexibility in these situations. We note that the agencies have provided an exception to the no-stay rule in existing risk-based capital rules for securities borrowing transactions. We recommend the agencies adopt a similar exception in the Basel II implementation for all OTC derivatives and repo-style transactions.

Question 36: The agencies seek comment on the appropriateness of requiring that a bank have a perfected, first priority security interest, or the legal equivalent thereof, in the definition of financial collateral. (pg 151)

- In general, this requirement is stronger in its scope than that outlined in the Accord. The Accord applies this requirement in the context of physical collateral only as opposed to financial collateral. That said, such a requirement is consistent both with overall market and internal practice of seeking a perfected, first priority security interest or the legal equivalent thereof around collateral.

Question 37: The agencies recognize that this is a conservative approach and seek comment on other approaches to consider in determining a given security for purposes of the collateral haircut approach. (pg 152)

- Banks should have the ability to group like securities together when it can be demonstrated that they would almost always move in tandem or exhibit equivalent levels of risk sensitivity. For example, all Yen par-bonds with same or very similar maturities should be similarly sensitive to USD-Yen spot rates. Along the same lines, corporate debt from a single issuer with the same or similar maturity should exhibit almost identical price volatility, all other things equal. Separately calibrating haircuts for each of these risks adds little to no value but multiplies the amount of required effort several fold.

Question 38: The agencies seek comment on methods banks would use to ensure enforceability of single product OTC derivative netting agreements in the absence of an explicit written legal opinion requirement. (pg 159)

- The bank mitigates counterparty credit risk through almost entirely through the use of master netting agreements (ISDA, etc.) and relies on commissioned legal opinions as to the enforceability of the contract. These are used and are recognized in almost all jurisdictions where the bank has counterparty exposures. It should not be necessary for the firm to obtain its own legal opinion except in very few circumstances where the ISDA option does not cover the particular jurisdiction or counterparty type.

Question 39: The agencies request comment on all aspect of the effective EPE approach to counterparty credit risk, and in particular on the appropriateness of the monotonically increasing effective EE function, the alpha constant of 1.4, and the floor on internal estimates of alpha of 1.2. (pg 165)

- The effective EPE is more consistent with the bank's economic capital practice as opposed to the add-on approach of the current Basel regime. That said, EPE is a conservative metric, most especially for exposures less than 1-year in maturity that do not have a collateral agreement. In these cases, the maturity M is floored at the 1-year point. It is understood, however, that the proposed rules are intended to be conservative in their treatment.

- We also concur with ISDA's comments regarding the default alpha multiplier of 1.4 and multiplier floor of 1.2 as being conservative with respect to calculations on large dealer portfolios. To the extent that banks following the IMA have large, diverse, and granular portfolios, lower default and floor values for alpha are justified based on numerous simulation results.

- We do not believe there is a strong justification for specifying that effective EPE must be calculated at the netting set level. Effective EPE is generally reported at the counterparty level incorporating both transactions covered and not covered by netting agreements. These calculations fully reflect that only transactions covered by a single or cross-product netting agreement can be netted together. Requiring banks to calculate exposure profiles at the netting set level will materially increase computation and storage costs without adding value for internal risk management.

- We do not believe banks should be required to estimate gross and net EPE on a routine basis. This does not produce meaningful information for risk management purposes and represents a significant computational and storage burden. We urge the regulators to modify the operational requirements to require banks only to have the capability of modeling gross and net EPE and demonstrating the impact of collateral to their supervisors on request.

Question 40: The agencies request comment on the appropriateness of these criteria in determining whether the risk mitigation effects of a credit derivative should be recognized for risk-based capital purposes. (pg 174)

- We believe the criteria for determining eligibility for credit derivative risk mitigation effects are appropriate and consistent with industry standards.

Question 41: The agencies are interested in the views of commenters as to whether and how the agencies should address these and other similar situations in which multiple credit risk mitigants cover a single exposure. (pg 183)

- No specific comment

Question 42: The agencies seek comment on this alternative approach's definition of eligible retail guarantee and treatment for eligible retail guarantees, and on whether the agencies should provide similar treatment for any other forms of wholesale credit insurance or guarantees on retail exposures, such as student loans, if the agencies adopt this approach. (pg 189)

- For individually-guaranteed retail loans, we generally support the recognition of credit risk mitigation through an adjustment to ELGD/LGD. The proposed alternative accounts for counterparty credit risk by limiting such recognition to sovereign guarantors and high-quality PMI insurance companies. While the former is reasonable and defendable, we do not believe there is a need to limit the latter to one guarantee type (PMI) issued by specific guarantors (insurance companies and sovereigns). Counterparty credit risk arises from the possibility that the guarantor will not pay, and should be assessed relative to that guarantor and not the instrument that is being guaranteed.

- We recommend eliminating the requirement that the guarantee must be PMI provided by an insurance company or issued by a sovereign entity. More specifically, any guarantees from highly rated private entities, state or federal governments, or government agencies should be eligible.

Question 43: The agencies seek comment on the types of non-eligible retail guarantees banks obtain and the extent to which banks obtain credit risk mitigation in the form of non-eligible retail guarantees. (pg 190)

- We believe de-segmenting retail loans into covered and uncovered portions on a large scale is impractical and on a small scale would provide immaterial benefits. As noted in our response to Question 42, we believe that the definition of eligible retail guarantees should be expanded to cover all high-quality guarantors and guarantee types. This approach would provide credit risk mitigation benefits from such guarantors without resorting to additional burdensome requirements.

Question 44: The agencies seek comment on both of these alternative approaches to guarantees that cover retail exposures. The agencies also invite comment on other possible prudential treatments for such guarantees. (pg 190)

- While we support the idea of obtaining capital relief for the presence of ineligible guarantees, we generally are opposed to arbitrary floors. In certain circumstances, application of the recommended floors would result in a capital increase resulting from the presence of a guarantee. We believe this alternative undermines the risk-sensitive intent of the Accord by applying fixed capital rates towards certain asset classes.

D. Unsettled Securities, Foreign Exchange and Commodities
E. Securitization Exposures

Question 45: The agencies seek comment on this differential treatment of originating banks and investing banks and on alternative mechanisms that could be employed to ensure the reliability of external and inferred ratings of non-traded securitization exposures retained by originating banks. (pg 206)

- While we understand the framework's intent to build in more objectivity within the Ratings Based Approach, we do not believe requiring two ratings for originating banks' untraded positions is necessary to achieve that objectivity. The ongoing operation of the global securities market relies on the unbiased, independent ratings provided by the NRSRO's. The normal NRSRO processes provide sufficient safeguards to ensure the reliability of external ratings.

- We believe the requirement to obtain two ratings is an unnecessary burden on US banks that does not provide a prudential benefit to supervisors. We also note that the Accord does not impose this requirement; therefore we request that investors and originators are treated equally and only require one NRSRO rating for RBA eligibility.

Question 46: The agencies seek comment on whether they should consider other bases for inferring a rating for an unrated securitization position, such as using an applicable credit rating on outstanding long-term debt of the issuer or guarantor of the securitization exposure. (pg 206)

- We request the agencies consider allowing the IAA to be used for an unrated securitization exposure that is senior to a rated exposure in an ABCP conduit program. The IAA should be treated as a standalone IRB approach that is not trumped by an inferred rating under the RBA.

- The use of the credit rating for the long-term debt of the issuer or guarantor of the exposure may be an appropriate alternative depending on the substance of the securitization transaction. Generally, the rating of the issuer will be lower than the inferred rating of most unrated tranches, which are typically liquidity facilities in the most senior position of the structure. As a result, the long term debt rating of the issuer should be an option rather than a replacement of the inferred rating approach based on the subordinate tranche.

Question 47: The agencies seek comment on the appropriateness of basing the risk-based capital requirement for a securitization exposure under the RBA on the seniority level of the exposure. (pg 207)

- We agree conceptually with the approach of determining the capital requirement based on the seniority and granularity of a transaction, however, we request some additional provisions. First, we believe it would be costly and operationally burdensome to track the seniority of each outstanding tranche over time. Additionally, since multiple tranches within a class can be structured to have the same rating but have different maturities, it is not conceptually supportable that only the most senior of those tranches would qualify for a more favorable risk weighting. For example, if a structure has multiple AAA classes, it is not clear whether all of those tranches would qualify for the lower risk weights, or whether only the most senior tranche would qualify. Therefore, we request clarification that indicates that all tranches of the senior-most class would qualify.

- We are particularly concerned about liquidity facilities supporting ABCP programs. These facilities are obligations to step into funded positions. Both the senior tranche that the facility would fund and the liquidity facility itself should be treated as senior positions. We request allowance for multiple senior exposures, particularly in the case of facilities supporting the liquidity of an ABCP program.

- Additionally, we support permitting banks to use the risk-weights for non-senior exposures stated in Table G of the NPR ("Long-Term Credit Rating Risk Weights Under RBA and IAA") in lieu of tracking the seniority of each class over time.

- We agree with the concept of N under the securitization framework, however, believe there may be an operational burden or limited benefit associated with tracking the value of N for each pool of underlying exposures for the life of a securitization transaction. We suggest inclusion of provisions to allow a determination of N only at the outset of a securitization transaction.

Question 48: The agencies seek comment on how well this approach captures the most important risk factors for securitization exposures of varying degrees of seniority and granularity. (pg 208)

- See response to Question 47

Question 49: The agencies seek comment on suggested alternative approaches for determining the N of a re-securitization. (pg 224)

- We believe the determination of N for a re-securitization proposed under RBA should be based on the number of underlying exposures in the securitizations when the information is available and can be adjusted to avoid double counting of individual obligors. The method specified in the NPR is a reasonable alternative when the underlying exposure information is not available and specifies N as a count of securitization tranches in the underlying pool.

Question 50: The agencies have not included this concept in the proposed rule but seek comment on the prevalence of eligible disruption liquidity facilities and a bank's expected use of the SFA to calculate risk-based capital requirements for such facilities. (pg 226)

- Eligible liquidity facilities are currently used by some US banks and we believe capital requirements for those facilities would be calculated under IAA as opposed to SFA. Additionally, we believe these facilities would fall under the treatment for overlapping exposures since market disruption liquidity facilities are program-wide facilities and overlap with deal specific facilities.

Question 51: The agencies seek comment on the appropriateness of these additional exemptions in the US markets for revolving securitizations. (pg 241)

- We believe the exemptions related to the early amortization provisions are appropriate and necessary to ensure US regulations are competitive. Even if only a few securitization transactions with these features exist at the present time in the US markets, including the provisions will insure consistency with the international framework and accommodate changes in market practices.

Question 52: The agencies solicit comment on the distinction between controlled and non-controlled early amortization provisions and on the extent to which banks use controlled early amortization provisions. (pg 242)

- We believe that most US securitization transactions will fall into the "non-controlled" early amortization provisions, which has more punitive CCF versus the "controlled" provisions which are typically found in UK transactions. We request consideration of US deal structural differences as well as differences in underlying asset behavior (18 month versus 12 month straight line amortization period comparison) to ensure no competitive disadvantages are created with these provisions.

Question 53: The agencies seek comment on the appropriateness of the 4.5 percent excess spread trapping point and on other types and levels of early amortization triggers used in securitizations of revolving retail exposures that should be considered by the agencies. (pg 243)

- See response to question 54

Question 54: The agencies seek comment on and supporting empirical analysis of the appropriateness of a more simple alternative approach that would impose at all times a flat CF on the entire investors' interest of a revolving securitization with a controlled early amortization provision, and on what an appropriate level of such a CF would be (for example, 10 or 20 percent). (pg 244)

- While we generally support the NPR's objective to align capital requirements with additional risk a banking organization may bear from an early amortization event, the proposed rules should be modified to address two key issues.

- First, the current treatment – specifically the CCFs - are punitive during periods when excess spread is only slightly above a trapping point, during a period in which excess spread is trapped, and during an early amortization period. These high CCFs when combined with the capital deduction for a CEIO could cause a higher capital requirement for a bank than if the assets were not securitized. Clearly, this outcome is not commensurate with the risk assumed. Similarly, we do not support imposition of a flat CCF for the controlled early amortization provisions as this approach differs from the Basel II framework. Rather, we propose completion of additional analysis on the CCF tables for early amortization provisions to ensure capital requirements appropriately reflect transaction risk.

- Second, the early amortization provisions are punitive in transactions that are not designed to have excess spread, and instead rely on other structural features such as overcollateralization to provide structural support to investors. We seek alternative early amortization provisions for transactions that, by design, do not have excess spread and have early amortization triggers based on other factors. We believe that the requirement to recognize additional capital should be based on the early amortization trigger unique to each transaction and request inclusion of language with some flexibility to address transactions with non-traditional performance measures.

F. Equity Exposures

Question 55: The proposed rule defines a publicly traded equity exposure as an equity exposure traded on (i) any exchange registered with the SEC as a national securities exchange under section 6 of the Securities Exchange Act of 1934 (15 USC. 78f) or (ii) any non- US-based securities exchange that is registered with, or approved by, a national securities regulatory authority, provided that there is a liquid, two-way market for the exposure (that is, there are enough bona fide offers to buy and sell so that a sales price reasonably related to the last sales price or current bona fide competitive bid and offer quotations can be determined promptly and a trade can be settled at such a price within five business days). The agencies seek comment on this definition. (pg 247)

- The Accord defines a public equity exposure as any equity security traded on a recognized security exchange. We believe the additional criteria are overly restrictive and will be burdensome to document. As an alternative, we believe registration or approval by the national securities regulator should provide an ample safeguard to ensure there is a liquid, two way market for the exposure in non-US based securities exchanges.

- This definition would also appear to include directly-owned listed equity options since they are equity exposures and do trade on national security exchanges. In addition, it is possible for banks to own call options on publicly traded firms (sold to banks by the firm) where the call options do not trade publicly. For consistency, we believe the criteria above should be expanded to include these kinds of equity-like instruments.

Question 56: The agencies seek comment on the approach to adjusted carrying value for the off-balance sheet component of equity exposures and on alternative approaches that may better capture the market risk of such exposures. (pg 248)

- We support the agencies' proposal to adjust the carrying value of unrealized gains that are not included in capital. The adjustment prevents double counting of capital requirements since a portion of the gain is already deducted from regulatory capital.

Question 57: The agencies seek comment on the proposed rule's requirements for IMA qualification, including in particular the proposed rule's use of a 99.0 percent, quarterly returns standard. (pg 258)

- The operational requirements for the Internal Models Approach (IMA) require daily market prices for all modeled equity exposures, either direct holdings or proxies. Proxies for private equity investments are available on a monthly basis. These proxies represent the unique risks of venture capital and other private investments. They are more relevant than public market proxies and are available for complete equity cycles. We believe these indices, even though they are monthly, should be eligible to be used in the IMA.

Question 58: The risk-weighted asset amount for the nonexcluded publicly traded equity exposures would be subject to a floor of 200 percent multiplied by the aggregate adjusted carrying value or ineffective portion of hedge pairs, as appropriate, of the bank's non-excluded publicly traded equity exposures. The agencies seek comment on the operational aspects of these floor calculations. (pg 259)

- Under the Simple Risk Weighted Asset Approach (SRWA), there is a materiality exclusion for non-significant equity investments up to 10% of Total capital. Exposures below this threshold are risk weighted at 100% rather than the 300% and 400% risk weightings for public and private equity investments, respectively.

- The IMA, on the other hand, does not allow for a similar exclusion of exposures. As a result, the capital assignment for most institutions under the more sophisticated IMA is guaranteed to be higher than capital calculated under the SWRA. This creates a significant disincentive for banks to invest in improving risk management for equity instruments and is contrary to the Basel II philosophy of allowing greater capital relief as an institution develops more sophisticated risk measurement approaches.

Question 59: The agencies seek comment on the necessity and appropriateness of the separate treatment for equity exposures to investment funds and the three approaches in the proposed rule. The agencies also seek comment on the proposed definition of an investment fund. (pg 260)

- Providing a range of consistent risk-weighting approaches for funds is warranted when detailed information about fund holdings is unavailable. However, in cases where this information is available and is already used internally for risk management purposes, fund holdings should be treated the same way as direct holdings of equity.

- Our understanding is that the agencies intended the calculation of capital for the fund to be based on the table of standard risk weights contained in the text. This table applies a risk weight of 1250% to an exposure class of an investment fund that would have a risk weight in excess of 400% if it were held directly on the balance sheet. We see no reason to include such extreme differences in risk weighting for assets that only differ in the form of ownership; whether they are direct or indirect investments.

- We believe banks should be able to choose either the SRWA or IMA based on the availability of position data for the fund investments. We are concerned that standardized risk weights for assets of investment funds fail to appropriately capture portfolio concentrations across funds and exposure to specific risk. The IMA, in concert with data that allows the bank to look through the fund and reflect its proportional ownership of individual positions, should satisfy the criteria of assigning capital as though the individual assets are held directly on balance sheet. This method would achieve the agencies' objective to prevent arbitrage and ensure that banks do not receive a punitive treatment for exposures to investment funds that hold low risk assets.

- Unlike the international framework, investment funds with material liabilities are excluded from the treatment outlined in the US NPR. We understand the agencies' concerns related to the leverage of these funds and agree that an appropriate risk weight under the SRWA might exceed 400%. However, we are concerned that the exclusion may be interpreted as requiring the securitization approach. Investment funds are neither publicly rated nor able to be modeled under the SFA approach, which was originally designed for credit exposures. The hierarchy of approaches within the securitization treatment would therefore lead to capital deduction for these investments. We believe this approach would be punitive relative to the risks of these assets and overly conservative. We recommend the agencies consider an alternative treatment that extends the SRWA table of risk weights to include the impact of leverage.

VI. Operational Risk

Question 60: The agencies are interested in commenters' views on other business lines or event types in which highly predictable, routine losses have been observed. (pg 265)

- We strongly believe it is inappropriate to assign capital for expected loss. Banks consider expected loss to be a cost of doing business and including these in the regulatory capital requirement disregards the most fundamental pricing practices. To this end, the agencies have rightly identified losses relating to securities processing and credit card fraud as qualifying for expected operational loss (EOL) offsets.

- However, the language suggests that these are the only types of losses to be legitimately considered eligible for EOL offset. We believe the correct definition of EOL is much broader and should include other types of losses. Some examples include debit card fraud, ATM fraud, check fraud claims, robberies, teller balancing errors, employee defalcations and routine policy related losses below a specified dollar threshold which primarily impact banks through the liability side. The best approach for regulatory capital would eliminate the expected loss component of the capital charge altogether. As an alternative, we suggest the regulators consider a broader definition of loss to be eligible for the EOL offset.

VII. Disclosure

Question 61: The agencies seek commenters' views on all of the elements proposed to be captured through the public disclosure requirements. In particular, the agencies seek comment on the extent to which the proposed disclosures balance providing market participants with sufficient information to appropriately assess the capital strength of individual institutions, fostering comparability from bank to bank, and reducing burden on the banks that are reporting the information. (pg 273)

- Certain aspects of the disclosure requirements have the potential to impose undue burden not only on us, but also our investors and even the regulatory agencies themselves in navigating and comprehending the required information. In fact, the level of detail proposed by some of the requirements makes the information less transparent and more challenging to comprehend.

- We do appreciate the flexibility the agencies have provided within Pillar 3, by allowing us to utilize comparable SEC, GAAP and/or regulatory reporting requirements disclosed elsewhere to address the requirements. However, the requirements have the potential to blur the lines between Agency reporting, SEC requirements and GAAP accounting requirements, which could further lead to confusion and misunderstanding.

- It is not clear to which agency these disclosures should be reported, if any. There is significant overlap among SEC disclosure requirements and Agency call report requirements, both existing and proposed in OMB Control No. 1557-NEW. These disclosures far exceed any previously required by the agencies, and as such, clarity regarding delivery would assist in providing the best possible report.

- Certain requirements as detailed for US-based bank holding companies potentially lessen transparency or comparability relative to non-US requirements. This is true in regards to both general content and level of detail required. Specifically, there are requirements for more frequent reporting of quantitative measures in the US as well as different factors (namely ELGD and differing definitions of default) that further exacerbate the gap in cross-border comparability.

- The requirements state that we need to have Chief Financial Officer (CFO) certification of disclosures. We understand the need for appropriate certification, but we see two issues with this requirement. First, it specifies only the CFO, versus both the CFO and Chief Executive Officer, as is currently required under Sarbanes Oxley. We are concerned that this delineation has some significance to our Sarbanes Oxley certifications and related personal liability related to these disclosures. Second, the level of personal liability to be assumed by the certifier is not evident, but will further determine the appropriate party or parties within our organization that must be involved.

- We recommend that where requirements are met through previously certified documents, such as SEC Filings or Regulatory Call Reports, the existing certifications for the referenced documents are deemed sufficient. In the event of any separate disclosures that are not covered by previous certifications, we recommend that the above mentioned concerns are resolved. Separate non-covered disclosures could be subject to certification similar to call reports, on a limited scale.

- The first quantitative disclosure in table 11.4 labeled "(b)" requests gross credit risk exposure and average gross credit risk exposures but references "after accounting offsets in accordance with US GAAP (for example FASB interpretation 39 and 41)". These two FASB interpretations speak to netting, which would imply net credit risk exposures. We recommend that the agencies clarify specifically what level of credit risk exposure is required and the potential formats in which to report this information.

- Requirements labeled "(f)" in table 11.4 of the NPR ("Credit Risk: General Disclosures") request information to be allocated in a way that is not consistent with accounting practices. Allowance is calculated and managed on the aggregated exposure level as is consistent with accounting policy and requirements to maintain a general reserve available to absorb all credit losses. Allocating this information by counterparty type or by industry does not add value and in fact may imply that specific dollars are allocated to specific industries, counterparties or both.

- We believe it is best to continue to report allowance information as it is currently in SEC filings at an aggregate level to address losses that are probable and estimable. Alternatively it may be more appropriate to alter the disclosure requirement to request specific allowance by these categories, which typically is determined on a case by case basis due to concentration in one area and is consistent with broader accounting policies and requirements.

- Table 11.5 of the NPR ("Credit Risk: Disclosures for Portfolios Subject to IRB Risk-Based Capital Formulas") is one example of the general issue surrounding excessive information collection and preparation. This requirement has the potential to create an undue burden of data retention across all records for 10 years, and subsequent frequent manipulation on a quarterly basis.

- In the qualitative requirements labeled "(a)" in table 11.6 of the NPR ("General Disclosure for Counterparty Credit Risk-Related Exposures"), the last bullet specifies a "Discussion of the impact of the amount of collateral the bank would have to provide given a credit rating downgrade." It is not clear whether this refers to a credit downgrade of the bank or the counterparty or some other entity and why this might entail providing more collateral. We recommend that the agencies first clarify specifically to which entity this is referring in the counterparty transaction. Second, delineate the qualitative discussion into a discussion of the impact of the additional collateral required as well as a quantitative disclosure around the amount of collateral required.

- The requirements for table 11.7 of the NPR ("Credit Risk Mitigation") ask for information that is also requested in table 11.5, with regards to credit mitigation. These requirements seem to be redundant, especially where a bank holding company could address mitigation and report the effect on capital through the disclosures reported in table 11.5. We recommend that these requirements be simplified and consolidated with table 11.5, or incorporated into the general disclosure requirements, as discussed immediately before table 11.4 for ease and consistency in reporting and report generation.

Question 62: Comments on regulatory reporting issues may be submitted in response to this NPR as well as through the regulatory reporting request for comment noted above. (pg 277)

- In addition to the differences between the US requirements and those in the non-US markets, there is a significant disconnect between the Pillar 3 requirements in Table 11.8 of the NPR ("Securitization") and the proposed reporting schedules S and T for banks and bank holding companies. Pillar 3 has significantly more detailed requirements, while the level of detail in schedules S and T are very limited. While separate and distinct, the gap between Pillar 3 and these templates in this instance is significant.

- Additionally, there appears to be a contradiction in the reporting environment for the Pillar 3 requirements as compared to the proposed regulatory reporting templates, issued on September 25, 2006, in OMB Control No. 1557-NEW. As all Pillar 3 requirements are expected to be made public, we are concerned that much of this same information is also included in the templates which have been identified as being "private" or "confidential". Specifically, the schedules labeled C through and including U in FFIEC 101, part of schedule V, and all of FFIEC 102 have been identified by the regulators to be considered confidential or private after the parallel period. Specifically, OMB Control No. 1557-NEW states, "The confidential data submitted in these schedules by each bank would be shared among the four agencies but would not be released to the public. Data items that would not be publicly available comprise additional, but still aggregated, detail about the main data items and drivers of reporting banks' risk-based capital levels...The data items contained in Schedules C through V describe the main components of banks' risk-weighted assets and are essentially expanded detail of the more summary information contained in the public data items shown in Schedule B. The data submitted in these schedules would not be made available to the public."

- We think that these templates, considered in addition to the detailed public disclosures, create an overly burdensome reporting framework that provides limited benefit to the user, regulatory agencies and the reporting entity. The conflict between the public and private level of reporting, when compared to the public Pillar 3 disclosure requirements, further complicates this framework.