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Re: Comment on Basel II Joint Notice of Proposed Rulemaking – Board  
Docket No. R-1261; OCC Docket No. 06-09; FDIC RIN 3064-AC73;  
OTS No. 2006-33

Comments on Basel I-A Joint Notice of Proposed Rulemaking – Board  
Docket No. R-1238; OCC Docket No. 06-15; FDIC RIN 3064-AC96;  
OTS No. 2006-49

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Ladies and Gentlemen:

The Institute of International Bankers appreciates this opportunity to comment on the Joint Notice of Proposed Rulemaking to implement the Basel II Capital Accord (“Basel II NPR”)<sup>1</sup> and on the Basel I-A Joint Notice of Proposed Rulemaking (“Basel I-A NPR”)<sup>2</sup>, both of which are addressed herein. The Institute and its member organizations are committed to supporting international efforts to achieve consistent implementation globally of Basel II, and we welcome the opportunity to submit comments on the Basel II NPR, as well as on the Basel I-A companion rulemaking.

The Institute commends the process followed from the beginning stages of the rulemaking process by the U.S. banking agencies to solicit formal and informal

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<sup>1</sup> 71 Fed. Reg. 55830 (Sept. 25, 2006). See also 71 Fed. Reg. 77518 (Dec. 26, 2006) (extending the comment period for the Basel II NPR until March 26, 2007).

<sup>2</sup> 71 Fed. Reg. 77446 (Dec. 26, 2006).



comments and input from domestic and international banking institutions. We are appreciative of the transparency that has characterized the agencies' implementation efforts and the ongoing dialogue between the industry and bank supervisory authorities regarding Basel II. One of the core principles underlying Basel I and Basel II is the importance of having harmonized capital standards for internationally active banking institutions.

The Institute has long been active in addressing the impact of the United States' implementation of Basel II on internationally headquartered institutions with U.S. banking operations and in supporting the achievement of a closer conformity of the U.S. Basel II approach to the provisions of the Capital Accord as agreed upon by the Basel Committee. These efforts have included participating in meetings and calls with U.S. regulators and the Basel Committee's Accord Implementation Group to discuss home-host implementation issues, and in particular the difficulties presented by the inconsistencies in the definition of "default" between the U.S. approach to Basel II and Basel II as implemented in the European Union and elsewhere, which are being further addressed in comments of certain of our member institutions.

The Institute is very appreciative of the spirit of cooperation displayed in these discussions by all concerned and believes that considerable progress has resulted. We applaud the efforts underway among banking regulators and through the Accord Implementation Group globally to improve cross-border coordination. Only through coordination and harmonization can the heavy burden and expense of duplicative systems be avoided. At the same time, we believe that some aspects of the Basel II implementation still deserve attention to achieve better harmonization and avoidance of unnecessary burdens for international banks.

1. Application of Basel I-A to International Banks with U.S. Bank Subsidiaries

The Basel I-A NPR recognizes that some banking organizations may prefer to remain under the existing risk-based capital framework without revision and, moreover, indicates that the agencies intend to permit banks in the United States not applying U.S. Basel II to elect at their option to continue to use the existing Basel I system rather than Basel I-A.

The Institute strongly supports this optionality for U.S. banks, including U.S. bank subsidiaries of international banks, that are not core banks<sup>3</sup> required to apply U.S. Basel II or that do not opt-in to use U.S. Basel II. The Institute is gratified that the Basel I-A NPR recognizes the need for and desirability of expanding this optionality to cover all U.S. banks (including subsidiaries of international banks) that do not apply Basel II in the United States, consistent with the January 18, 2006 comments that the Institute submitted on the Basel I-A ANPR. We believe it is particularly important, as recognized

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<sup>3</sup> We address our concerns regarding the inclusion of intermediate U.S. holding companies in the proposed definition in the Basel II NPR of core banks as regards international banks in Section 2 below.



by this proposal, for international banks that are subject to home country Basel II on a consolidated basis but that do not intend to apply Basel II in the United States to have the flexibility to elect to continue to apply Basel I or Basel I-A to their U.S. subsidiary banks. Consistent with its support for such flexibility, the Institute would similarly support permitting U.S. subsidiary banks of international banks to be able to elect any standardized or foundation IRB Basel II methodologies that may be adopted in conjunction with these rulemakings.

International banks are undertaking very substantial system modifications globally in preparation for the full implementation of Basel II by the end of 2007. This is, of course, a massive undertaking requiring an enormous commitment of economic resources and personnel over a sustained period continuing beyond initial implementation in order to convert their existing databases, models, and other operational and capital compliance systems to conform to their home country implementation of the requirements of Basel II. These conversions must be implemented on a consolidated global basis by international banks and therefore directly affect the operations and systems of their U.S. subsidiary banks. Under these circumstances, we believe the Basel I-A NPR correctly recognizes that international banks with U.S. bank subsidiaries should not be obligated to make new and different modifications to their existing systems for compliance with new Basel I-A guidelines in the United States.

Many international banks are concerned that if the proposed modifications to the existing Basel I framework were not made optional, they could result in additional and duplicative burdens on their U.S. bank subsidiaries that would be excessive and counter-productive, particularly during this period of extensive conversion of operations. For example, many U.S. subsidiaries of international banks do not collect data in the categories that would be necessary for application of Basel I-A as proposed and any such system modifications would be extremely difficult given the different and extensive data modifications that they are already required to undertake as part of their global Basel II compliance.

While certain U.S. bank subsidiaries of international banks may be able to integrate a second contemporaneous system conversion into their global implementation of Basel II, and may prefer to do so to better reflect risk factors applicable to their business, for others the added burden of developing a second set of different data criteria to address Basel I-A would be extremely onerous. Indeed, for many institutions the same personnel would be necessary to undertake any Basel I-A modifications as are already necessary and committed to the implementation of Basel II in compliance with the home country requirements of their consolidated global supervisor.

For these reasons we have urged, and continue to strongly support, the proposal that any implementation of Basel I-A be elective as regards U.S. banks, including U.S. bank subsidiaries of international banks. Making Basel I-A permissive rather than obligatory will help assure that it does not result in any unreasonable burdens for such subsidiaries. This will permit international banks to take into account the benefits of



enhanced risk-factor elements that would result from the proposed modifications in the context of their existing burden of developing systems to comply with home country Basel II in determining whether to undertake the additional burden of developing the different data definitions and systems that would be necessary to implement Basel I-A in their U.S. bank subsidiaries.

2. Mandatory Application of U.S. Advanced Method Basel II to Intermediate U.S. BHCs of International Banks and their U.S. Subsidiary Banks

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For many years the Federal Reserve has recognized that intermediate U.S. bank holding companies of international banks that are themselves well capitalized and well managed on a comprehensive consolidated basis should be exempted from U.S. capital requirements.<sup>4</sup> We strongly believe that this longstanding exemptive policy is correct and that the proposed trigger requiring intermediate U.S. bank holding companies of international banks and their U.S. subsidiary banks to calculate their capital using the U.S. Basel II advanced method based upon the size of that intermediate U.S. bank holding company<sup>5</sup> would be inconsistent with this policy and also with the principle of optionality reflected in the Basel I-A NPR.

Under the Basel II NPR an intermediate U.S. bank holding company with substantial U.S. securities activities but relatively small U.S. banking activities could be required to apply the U.S. advanced approach to both its bank and nonbank activities. Indeed, several international banks now face the prospect of having to comply with the U.S. advanced approach principally because of the size of their nonbank securities operations in the United States. Moreover, the prospect exists that future acquisitions in the United States, as well as organic growth of existing U.S. activities, could mandate the U.S. advanced approach for the U.S. operations of additional international banks even if their banking “footprint” remained a small fraction of the \$250 billion threshold.

In implementing the Financial Conglomerates Directive<sup>6</sup>, the EU has accommodated U.S. bank holding companies, U.S. securities firms and other U.S. financial institutions operating in the EU by deferring to U.S. home country global capital supervision over the parent consolidated institution and not requiring intermediate EU holding companies to meet EU host country Basel II capital standards. While this was controversial, the EU accepted U.S. arguments that U.S. capital supervision is equivalent. The same supervisory considerations are present here and strongly support the elimination of any requirement that intermediate U.S. bank holding companies of a certain size be required to apply the U.S. advanced methodology to their consolidated operations. We strongly believe that evaluation of consolidated capital similarly should

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<sup>4</sup> Federal Reserve Board SR Letter 01-01 (January 5, 2001).

<sup>5</sup> \$250B assets/\$10B foreign exposure test.

<sup>6</sup> 2002/87/EC, Official Journal (February 11, 2003).



be on a global basis based on the parent consolidated institution and its applicable home country Basel II implementation.<sup>7</sup>

Application of Basel II advanced methodology is unquestionably burdensome and expensive for any banking institution. However, it would be doubly burdensome and unreasonable to mandate its imposition on the intermediate U.S. bank holding company and subsidiary banks of an international bank that is already subject to its home country Basel II methodology on a consolidated basis based on the size of that intermediate bank holding company when the subsidiary banks themselves are not of a size that would make such a requirement apply.

Similarly, we believe that there would be no countervailing justification for mandatory application of the U.S. Basel II advanced method by intermediate U.S. bank holding companies of international banks that are themselves applying home country advanced methodologies to implement Basel II on a global consolidated basis. In our view, no overriding risk management or other supervisory benefits would be served by any such burdensome capital calculation requirement at the U.S. intermediate holding company level. The capital calculation based on the U.S. advanced method proposed to be required at an intermediate bank holding company level would add no meaningful value to (and be duplicative of) the existing U.S. host country review of the parent consolidated capital based upon home country Basel II standards under the existing bank holding company standard. This is particularly the case for an international bank that is recognized as well capitalized on a consolidated basis for financial holding company purposes, consistent with the longstanding interpretation of the Federal Reserve reflected in SR 01-01.

The related aspect of this proposal that would mandate use of the advanced method for U.S. subsidiary banks with an intermediate U.S. bank holding company based on the consolidated size of that intermediate U.S. bank holding company rather than on the size of the U.S. subsidiary banks themselves also raises major concerns. For the reasons explained in our comment in Section 1 above (and not repeated again here) in support of the optionality proposed under Basel I-A, international banks face special challenges and potential burdens in implementing their home country Basel II while at the same time also implementing host country standards for their U.S. subsidiary banks in the absence of having the option of the simple standardized or the foundation IRB method of Basel II. Indeed, the burden of collecting two sets of differently defined data, which could be quite burdensome for U.S. subsidiary banks in the context of Basel I-A, would be greatly exacerbated by any mandatory requirement on intermediate U.S. bank holding companies (and their U.S. bank subsidiaries) of international banks to apply the highly complex data requirements of the U.S. Basel II advanced methodology. As a result, we strongly urge that the application of U.S. Basel II advanced methodology be

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<sup>7</sup> We understand that home country capital standards under Basel II without any non-Basel host-country elements will continue to be applicable for purposes of the equivalency determination for an international bank under the financial holding company well-capitalized test.



optional and not mandatory for U.S. subsidiary banks of international banks that are not themselves core banks. We would also support a decision to add an option to permit application of the Basel II standardized and foundation IRB methodologies.

Apart from the United States, implementation of Basel II around the world has generally permitted host country subsidiary banks to choose to apply the standardized method for credit risk and either the basic indicator or standardized approaches for operational risk, and in any event has not based any requirement of a particular methodology upon the characteristics of any host-country intermediate holding company. In particular, it is our understanding that a U.S. banking organization subject to U.S. Basel II implementation that has bank subsidiaries in the EU may either apply the Basel II standardized method or else, if it is a core bank, may apply its U.S. Basel II advanced methodology in such subsidiary banks with host country regulatory concurrence. There is no requirement on the U.S. banking institution to implement host country Basel II advanced methodology in its EU subsidiary banks.

In the application and implementation of the Financial Conglomerates Directive the EU has recognized the equivalency of consolidated capital standards applied by the SEC and the OTS to parent holding companies subject to their respective supervision. As a result, intermediate EU holding company subsidiaries of those U.S. institutions are not required to adopt different EU Basel II methodologies. We also draw to your attention that there is no U.S. proposal to require U.S. securities and thrift holding companies to apply the U.S. Basel II advanced methodology reflected in the Basel II NPR in their U.S. holding company operations. Thus, absent modification of the Basel II NPR, the only institutions among domestic and international global financial institution competitors that would be subject to a host country Basel II advanced method at their host country intermediate holding companies and subsidiary banks, as well as their home country Basel II advanced method on a global consolidated basis, would be international banks with U.S. bank subsidiaries. Any such requirement on the U.S. operations of international banks would place international banks at a significant competitive disadvantage and burden.

Moreover, the proposed imposition of a pillar 3 public disclosure requirement at the level of such an intermediate holding company would be both burdensome and misleading. Pillar 3 public disclosure requirements will apply to the parent international bank. Under SR 01-01 there is no obligation to maintain capital meeting Basel standards at an intermediate U.S. holding company when the international bank is well capitalized and well managed, and we strongly believe that this exemption should be maintained. Public disclosure of such non-meaningful intermediate level capital ratios would only create confusion in such circumstances. We also urge that any reporting obligation imposed on an intermediate U.S. bank holding company be based either on home country capital standards applicable to the global institution or on the option of Basel I or Basel II as elected by that institution.



The late notice in 2006 of the proposal to mandate use of the U.S. Basel II advanced method by intermediate U.S. bank holding companies and U.S. bank subsidiaries of international banks based on the size of that intermediate U.S. bank holding company as opposed to their U.S. subsidiary banks imposes an undue burden on international banks that have justifiably planned their capital compliance and data keeping based on the prior proposals. Imposing mandatory complex new and different host country data definitions based on the U.S. Basel II advanced methodology on U.S. intermediate bank holding companies and U.S. subsidiary banks of international banks would deviate from Basel II implementation in other countries around the world. The new U.S. requirements would not only be extremely burdensome, given continuing differences between such requirements as compared with EU and Basel II data requirements, but also would require years of data gathering to implement to reliable standards, thereby handicapping international banks in that situation in comparison to their domestic U.S. competitors.

The burden of this proposed new requirement would fall only on international banks and not on any domestic U.S. financial institutions (including banking, thrift and securities firms). Moreover, it would fall particularly on international banks with large U.S. securities subsidiaries despite the fact that their U.S. securities firm competitors are not subject to any such requirements. It has long been recognized that national treatment cannot be satisfied by facial neutrality and instead calls for equality of competitive opportunities and burdens – a standard that would not be satisfied if this requirement were imposed.

### **Conclusion**

The Institute welcomes the proposal in Basel I-A to accord optionality to U.S. banks that do not apply U.S. Basel II, including the U.S. subsidiary banks of international banks.

At the same time, we respectfully urge that the proposal to require certain intermediate U.S. bank holding companies of an international bank and their U.S. subsidiary banks to use U.S. Basel II advanced methodology and to comply with applicable Pillar 3 disclosure requirements based on the size of those intermediate U.S. bank holding companies either be withdrawn or be made optional, in view of the unique burden that such a rule would impose on international banks. This would be consistent with the longstanding capital exemption of such intermediate U.S. bank holding companies of international banks (and the equivalent treatment of intermediate EU holding companies of U.S. financial institutions in the EU).



## INSTITUTE OF INTERNATIONAL BANKERS

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The Institute appreciates the opportunity to comment on the Basel II NPR and the Basel I-A NPR. Please contact us if we can provide any additional information or assistance.

Very truly yours,

A handwritten signature in black ink that reads "Lawrence R. Uhlick". The signature is written in a cursive, flowing style.

Lawrence R. Uhlick  
Chief Executive Officer