

Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429
United States
www.fdic.gov

Chris Barnard

02 January 2012

- 12 CFR Part 325
- RIN: 3064-AD70
- **Risk-Based Capital Guidelines: Market Risks; Alternatives to Credit Ratings for Debt and Securitization Positions**

Dear Sir,

Thank you for giving us the opportunity to comment on your notice of proposed rulemaking (NPR); amendment to market risk NPR published on January 11, 2011: Risk-Based Capital Guidelines: Market Risks; Alternatives to Credit Ratings for Debt and Securitization Positions.

You are proposing to amend the notice of proposed rulemaking (NPR) to modify the agencies' market risk capital rules, published in the Federal Register on January 11, 2011 (January 2011 NPR). The January 2011 NPR did not include the methodologies adopted by the Basel Committee on Banking Supervision (BCBS) for calculating the standard specific risk capital requirements for certain debt and securitization positions, because the BCBS methodologies generally rely on credit ratings, and this is not allowed under section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). In this NPR, the agencies are proposing to incorporate into the proposed market risk capital rules certain alternative methodologies for calculating specific risk capital requirements for debt and securitization positions that do not rely on credit ratings.

The objectives of the proposed amendments are that any alternative creditworthiness standard should, to the extent possible:

- Appropriately distinguish the credit risk associated with a particular exposure within an asset class;
- Be sufficiently transparent, unbiased, replicable, and defined to allow banking organizations of varying size and complexity to arrive at the

same assessment of creditworthiness for similar exposures and to allow for appropriate supervisory review;

- Provide for the timely and accurate measurement of negative and positive changes in creditworthiness;
- Minimize opportunities for regulatory capital arbitrage;
- Be reasonably simple to implement and not add undue burden on banking organizations; and,
- Foster prudent risk management.

I believe that in practice it is impossible to reasonably reconcile these conflicting objectives, particularly between appropriately and accurately distinguishing credit risk and changes in creditworthiness, and being simple to implement and not unduly burdensome on banks. However, the proposals are a step-improvement over reliance on credit ratings, and are clear, uniform, mostly objective and mandatory, and should therefore help to promote confidence in banks' risk capital methodology and requirements.

Specific comments on the proposed amendments

Question 3 (76 FR 79386) and sovereign debt positions: I do not agree that sovereign bond spreads would be reliable in order to assign specific risk-weighting factors, even for bonds determined in US dollars and other major currencies as base currencies. Such bond spreads could be affected by technical factors other than credit risk; for example the existence of currency controls, tax and holding treatment and other inefficiencies, frictions and agency costs. It is difficult, and rather arbitrary, to attribute and allocate bond spreads to these factors and to therefore isolate the appropriate credit risk in the bond spreads. For this reason, this methodology is not objective, reliable or robust enough to assign specific risk-weighting factors to sovereign debt positions that are commensurate with the relative risk of such exposures.

Question 6 (76 FR 79390) and proposed definition of "predominantly engaged" in financial activities: I do not support the bright line of 85% that you have set on total consolidated annual gross revenues or consolidated total assets (the 85% test), which is far too high. I would have thought that a more common sense level of 60% would suffice to indicate that an entity was predominantly engaged in financial activities.¹

Question 11 (76 FR 79393) and the OCC's proposed revisions to 12 CFR part 1 offering investment grade / non-investment grade approach as an alternative for banks that do not want to apply the three-indicator approach: I am not totally convinced that the OCC's proposed revisions are sufficient and complete to meet the statutory intent under the Dodd-Frank Act. Section 939A(b) thereunder states that: "Each such agency shall modify any such regulations... to remove any reference to or requirement of reliance on credit ratings and to substitute in such regulations such standard of credit-worthiness as each respective agency shall determine as appropriate for such regulations".

¹ See also my comment letter on the Board's NPR on Definitions of "Predominantly Engaged in Financial Activities" and "Significant" Nonbank Financial Company and Bank Holding Company: 76 FR 7731 (February 11, 2011).

The OCC's proposed revisions under § 1.2 (d) state that: "An issuer has an adequate capacity to meet financial commitments if the risk of default by the obligor is low and the full and timely repayment of principal and interest is expected". I am not convinced that "low" and "expected" are specific enough in order to represent a "standard or creditworthiness", as such standard would be subjective, entity-specific and possibly arbitrary.

Therefore, in the absence of further quantitative thresholds or guidance, I am not convinced that the OCC's proposed revisions to 12 CFR part 1 meet the stated objective of applying a standard that allows different banks to arrive at the same assessment of creditworthiness for similar exposures.²

Yours faithfully

C.R.B.

Chris Barnard

² See also my comment letter on the OCC's NPR on Alternatives to the Use of External Credit ratings in the Regulations of the OCC: 76 FR 73526 (November 29, 2011).