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Docket No. 00-27,
Office of the Comptroller of the Currency
Public Information Room
250 E Street, S.W.,
Mail Stop 1-5
Washington, DC 20219

Robert E. Feldman,
Executive Secretary,
Attention: Comments/OES
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, DC 20429

January 24, 2001

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the
Federal Reserve System,
20th Street and Constitution
Avenue, N.W.
Washington, DC 20551
Re: Docket No. R-1085

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INFORMATION SERVICES DIVISION

Manager, Dissemination Branch,
Information Management and
Services Division
Office of Thrift Supervision
1700 G Street, N.W.,
Washington, DC 20552
Attention: Docket No. 2000-70

**Re: Risk-Based Capital Standards:
Claims on Securities Firms**

Dear Ladies and Gentlemen:

J.P. Morgan Chase & Co. ("JPM") appreciates the opportunity to comment on the proposal by the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation and the Office of Thrift Supervision (the "Agencies") to amend their risk-based capital guidelines (collectively, the "Guidelines") with regard to the risk weight applicable to claims on securities firms (the "Proposal"). 65 Fed. Reg. 76180 (December 6, 2000).

Summary of the Proposal:

The Proposal would reduce the risk weight applied to claims on, and claims guaranteed by, *qualifying securities firms* from 100 percent to 20 percent. In this regard, the Joint Proposal would define *qualifying securities firms* as those that met the following three criteria:

1. The *qualifying securities firm* would have to be incorporated in an "OECD country";[1]

2. The *qualifying securities firm* would have be subject to supervisory and regulatory arrangements that are comparable to those imposed on banks incorporated in OECD countries; and

3. The *qualifying securities firm* or its parent would have a credit rating that is in one of the three highest investment grade rating categories used by a *nationally recognized statistical rating organization* ("rating agency").

JPM's Position:

JPM supports the reduction from 100 percent to 20 percent of the risk weight ascribed to *qualifying securities firms.* As noted in the Proposal, this action would partially implement the amendment to the Basel Accord adopted by the Basel Committee on Banking Supervision in April 1998 (the "1998 Amendment").

Although a substantial portion of JPM's credit exposure to securities firms is to firms which have (or whose respective parent company's have) long-term credit ratings in one of the three highest investment grades, JPM strongly opposes the imposition of the requirement that a securities firm maintain a specific credit rating in order to qualify for a reduction in risk weight. By imposing such a requirement, the Proposal would leave U.S. banking organizations at a competitive disadvantage to their foreign counterparts by failing to implement fully the 1998 Amendment which does not contain such a requirement. The Proposal would, therefore, only mitigate rather than eliminate the competitive inequity that presently exits between U.S. banking organizations and their principal foreign competitors.

The requirement that a securities firm maintain a specific credit rating is unnecessary. There are already sufficient safeguards in the case of securities companies that are subject to minimum capital requirements and supervisory review.

In the United States, a significant number of broker-dealers do not issue debt in the marketplace, and therefore, have no reason to obtain an external credit rating. Their lack of such a credit rating is not indicative of weaker credit. Ascribing a twenty-percent risk weight to only those securities firms with external ratings would engender distortive effects. Some firms would incur the expense of obtaining external ratings solely to facilitate their access to credit from depository institutions. Other firms would forgo obtaining such otherwise unnecessary ratings and be disadvantaged when seeking such credit. The imposition of a requirement for external

[1] In general, for the purposes of the Risk-Based Capital Guidelines, the term "OECD countries" includes those countries that are full members of the Organization for Economic Cooperation and Development ("OECD") or that have concluded special lending arrangements associated with the International Monetary Fund 's General Arrangements to Borrow.

credit rating would tend to concentrate the credit from depository institutions among a limited number of securities firms.

On a number of occasions, JPM, its predecessors and subsidiaries[2] have pointed out the disadvantages of incorporating external credit ratings into the Guidelines. For example, in its comments on last year's joint proposal of the Agencies on Recourse and Direct Credit Substitutes, JPM (then known as The Chase Manhattan Corporation) pointed out that such use of credit ratings would place inordinate reliance on a small number of rating agencies. JPM noted, *inter alia,* that banking organizations have a responsibility to evaluate their credit risk; that banking supervisors have a responsibility to review that evaluation process, and that the incorporation of credit ratings in the Guidelines would, to some extent, delegate these responsibilities to private entities not supervised by banking regulators.[3]

The leading banking organizations that extend credit to the securities industry have developed their own internal ratings systems and analytical models. These tools allocate each banking organization's economic capital to reflect the relative risk associated with its assets and off-balance sheet positions. Such sophisticated systems and models would provide a more comprehensive evaluation of the banking organization's credit exposure because many securities firms lack external credit ratings. Moreover, requiring a specific external rating would run counter to the principal thrust of the New Basel Capital Accord ("New Capital Accord") that was issued for comment last week by the Basel Committee on Banking Supervision. In this regard, the New Capital Accord would encourage banking organizations to develop their own internal ratings systems and rely on such systems to allocate capital.

The application of the Proposal to U.S. registered broker-dealers should be clarified. The Proposal would require that:

> "Qualifying U.S. securities firms also must be subject to and *comply* with the SEC's *net capital rule, and margin and other regulatory requirements* applicable to registered broker-dealers." [*Emphasis added.*][4]

First, this provision is overly broad because the phrase "other regulatory requirements" would include a panoply of "regulatory requirements" not relevant to the financial strength of the broker-dealer. The Proposal should only be concerned with violations of regulations that would substantially affect the financial ability of the broker-dealer.

Second, it is unclear when a banking organization would have to increase the risk-weight assigned to a specific broker-dealer because of a regulatory violation. In the absence of the banking organization's actual knowledge to the contrary, the banking organization should be able to rely on the representations of the broker-dealer that it meets the relevant regulatory requirements.

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[2] JPM was formed by the recent merger of J.P. Morgan & Co. Incorporated into The Chase Manhattan Corporation. JPM's principal depository institution subsidiaries are Morgan Guaranty Trust Company of New York and The Chase Manhattan Bank.

[3] *Nationally recognized statistical rating organizations* must meet certain criteria to be designated as such by the Securities and Exchange Commission ("SEC") under the Securities Exchange Act of 1934 (the "Exchange Act").

[4] 65 Fed. Reg. 76181.

Comments by the Securities Industry Association:

JPM has actively participated in the preparation of the comments that are being submitted on the Proposal by Securities Industry Association (the "Association"). JPM concurs with the recommendations made by the Association and strongly endorses its comments.

In conclusion, JPM appreciates this opportunity to express views on the Proposal as well as its support for the comments made by the Association. If there are any questions on the above comments, please contact the undersigned by telephone at 212-270-7559 or by E-mail at Joseph.Sclafani@Chase.com.

Very truly yours,

Joseph L. Sclafani

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