3

Securities Industry Association
1401 Eye Street, NW • Washington, DC 20005-2225 • (202) 296-9410, Fax (202) 296-9775
www.sia.com, info@sia.com

January 29, 2001

By Hand and Via Electronic Mail

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

Docket No. 00-27
Communications Division
Office of the Comptroller of the Currency
250 E. Street, SW
Washington, DC 20219

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

Manager, Dissemination Branch
Records Management and Information Policy
Office of Thrift Supervision
1700 G Street, N.W.
Washington, D.C. 20552
Attention Docket No. 2000-96

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

Ladies and Gentlemen:

The Capital Committee and the Bank Holding Company Committee ("Committees") of the Securities Industry Association ("SIA")[1] welcome the opportunity to comment on the proposed amendments to the risk-based capital standards of the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of Thrift Supervision (collectively "the Agencies"). As outlined in the proposing release, the amendments would reduce the risk weight applied to claims on, and claims guaranteed by, certain "qualifying securities firms" from 100 per cent to 20 per cent under the Agencies' risk-based capital rules.

[1] The Securities Industry Association brings together the shared interests of more than 740 securities firms throughout North America to accomplish common goals. SIA member firms (including investment banks, broker-dealers, and mutual fund companies) are active in U.S. and foreign markets and in all phases of corporate and public finance. The U.S. securities industry manages the accounts of more than 50-million investors directly and tens of millions of investors indirectly through corporate, thrift and pension plans. The industry generates more than $300 billion of revenues yearly in the U.S. economy and employs more than 600,000 individuals. (More information about SIA is available at our Internet web site, http://www.sia.com.)

The Committees applaud the proposed reduction of the risk weight ascribed to "qualified securities firms." Due to the difference in risk weightings for banks and broker-dealers currently prescribed by the rules, securities firms have been at a disadvantage to banks, even though broker-dealers are subject to a stringent capital adequacy standard and comprehensive examinations by the Securities and Exchange Commission ("SEC"), and the two major self-regulatory organizations, the New York Stock Exchange ("NYSE") and National Association of Securities Dealers ("NASD").

While we support the overall proposal, we do disagree in some respects with the analysis contained in the proposing release, and we believe that the proposal should go further in some respects. In particular, we respectfully disagree with the statement in the proposing release that "[t]he agencies are of the view that supervision and regulation alone are not necessarily sufficient indicators of creditworthiness to warrant a 20 per cent risk weight" and therefore some form of credit rating should be an absolute precondition for a reduction from a 100 per cent risk weighting. As discussed in greater detail below, in our view broker-dealers are subject to rigorous examination and review by the SEC and the self-regulatory organizations that is comparable with regulation by the Agencies, and risk weighting for broker-dealers should therefore be reduced regardless of whether the broker-dealer or its parent has a credit rating. We also believe that Over-the-Counter derivatives dealers ("OTC derivatives dealers") regulated by the SEC should be treated like traditional broker-dealers for risk weighting purposes. Finally, we believe that entities subject to regulatory reporting as Material Associated Persons ("MAPs") under the SEC's risk assessment rules (Exchange Act Rules 17h-1T and 17h-2T) should receive a reduction in risk weighting significantly below the 100 per cent level in recognition of the increased information available to regulators. If a MAP also voluntarily reports information under the guidelines of the Derivatives Policy Group ("DPG"), a further reduction in risk weighting should be appropriate.

Responses to Questions Posed in the Release.

(1) Does the rating of a broker-dealer's parent consolidated organization serve as a reliable indicator of the credit quality of claims on, or guaranteed by, the broker-dealer.

Answer: Yes.

(2) Is there a rating or other indicator of a broker-dealer's credit quality that is more reliable and more consistent with market practices than the proposed standard?

Answer: Yes. The nature of regulatory supervision that broker-dealers receive provides an indicator of credit quality that deserves to be recognized in the proposed standard. The Committees believe that the quality of regulatory oversight and supervision provided by the SEC and self-regulatory organizations under the Securities Exchange Act of 1934 is of the same high quality as the oversight and supervision over banks provided by the Agencies. Regulation of a U.S.broker-dealer by a designated self-regulatory authority in the U.S. should serve as an adequate requirement to receive a 20 per cent risk weighting.

In this regard, it should be noted that broker-dealers are subject to stringent oversight and capital adequacy standards by the SEC, NASD and NYSE, yet there is currently a large disparity between the capital weighting applied to claims against banks and to broker-dealers. The Committees believe that, like banks, broker-dealers should receive a 20 per cent risk weighting without regard to whether they have debt issued in the marketplace and therefore require a credit rating.[2]

(3) Should claims on, and claims guaranteed by, certain subsidiaries of qualifying securities firms be accorded a 20 percent risk weight? If so, what should be the qualifying criteria be for such subsidiaries?

Answer: Yes. For example, OTC derivative dealers are subject to special requirements and regulatory treatment under the rules of the SEC. OTC derivative dealers are subject to many heightened regulatory requirements. They are subject to special limitations on the scope of their activities (Exchange Act Rule 15a-1), specified internal risk management control systems (Rule 15c3-3), recordkeeping obligations (Rule 17a-3(a)(10)), reporting responsibilities (Rule 17a-12) and net capital treatment (Rule 15c3-1(a)(5)). Notably, an OTC derivatives dealer is permitted to compute its market risk by using a value-at-risk methodology. That methodology is closer to the approach for computing capital requirements used by the Agencies and by regulators in many other OECD countries than is the approach applied to traditional broker-dealers under the SEC's Net Capital Rule. In light of these enhanced regulatory requirements, the Committees believe that claims on or guaranteed by an OTC derivatives dealer subsidiary and/or affiliate of a securities firm should receive a 20 per cent risk weight.[3]

In addition, the Committees believe that other subsidiaries and/or affiliates of broker-dealers should receive a reduction from a 100 per cent risk weighting if they are MAPs under the SEC's risk assessment rules. The purpose of the risk assessment rules is to provide the SEC with sufficient information about broker-dealer affiliates to permit it to respond to problems that may be posed for the broker-dealer as a result of difficulties encountered by the affiliate. MAPs are subject to special record-keeping and reporting obligations with the SEC. Voluntary reporting by MAPs under the DPG guidelines

[2] It should be noted that under the Amendment to the Basel Accord made in 1998, credit rating was not part of the conditions for securities firms to qualify for a 20 per cent risk weighting. Moreover, neither the European Union Capital Adequacy Directive nor the rules of the Financial Services Authority in the United Kingdom impose a credit rating requirement in order to receive a 20 per cent risk weighting. By diverging from these multinational standards, the credit rating requirement could put many U.S. broker-dealers at a competitive disadvantage.

[3] Footnote 4 of the Agencies' proposing release notes that it excludes OTC derivatives dealers from the proposal because they "are subject to a less rigorous net capital rule" and are exempt from broker-dealer margin requirements. As noted above, OTC derivatives dealers are subject to a net capital requirement that is more consistent with the Agencies' own net capital requirements than is the SEC's net capital requirements for broker-dealers. Moreover, OTC derivatives dealers are subject to margin requirements under Regulation U – the same margin requirements imposed on banks that receive a 20 per cent risk weighting.

provides further assurance that regulators have ample information about the financial condition of the entity. The Committees believe that some substantial reduction in risk weighting for MAPs below 100 per cent is appropriate. A further reduction in risk weighting should be applied if the MAP also voluntarily provides regulatory information under DPG guidelines.

Thank you for providing the Committees with the opportunity to comment on the proposed amendments to the Agencies' risk-based capital standards. If we can be of further assistance, please do not hesitate to contact the undersigned, or George R. Kramer or Alan Sorcher of the SIA staff at 202/296-9410.

Sincerely,

Cheryl M. Kallem /s/ GRKramer

Cheryl M. Kallem, Chair
Capital Committee

Richard T. Chase /s/ GRKramer

Richard T. Chase, Chair
Bank Holding Company Committee

Cc: Annette L. Nazareth, Director, Division of Market Regulation, Securities Exchange Commission

Michael A. Macchiaroli, Associate Director, Division of Market Regulation, Securities and Exchange Commission