

are not proposing to introduce specific requirements or guidelines to implement Pillar 2. Instead, existing guidance, rules, and regulations would continue to be enforced and supplemented as necessary as part of this proposed new regulatory capital framework. However, all institutions operating under the advanced approaches would be expected by supervisors to address specific assumptions embedded in the advanced approaches (such as diversification in credit portfolios), and would be evaluated for their ability to account for deviations from the underlying assumptions in their own portfolios.

#### Disclosure

An integral part of the advanced approaches is enhanced public disclosure practices and improved transparency. Under the Agencies' proposal, specific disclosure requirements would be applicable to all institutions using the advanced approaches. These disclosure requirements would encompass capital, credit risk, equities, credit risk mitigation, securitization, market risk, operational risk, and interest rate risk in the banking book.

#### D. Competitive Considerations

It is essential that the Agencies gain a full appreciation of the possible competitive equity concerns that may be presented by the establishment of a new capital framework. The creation of a bifurcated capital framework in the United States—one set of capital standards applicable to large, internationally active banking organizations (and those that choose to apply the advanced approaches), and another set of standards applicable to all other institutions—has created concerns among some parties about the potential impact on competitive equity between the two sets of banking organizations. Similarly, differences in supervisory application of the advanced approaches (both within the United States and abroad) among large, internationally active institutions may pose competitive equity issues among such institutions.

The New Accord relies upon compliance with certain minimum operational and supervisory requirements to promote consistent interpretation and uniformity in application of the advanced approaches. Nevertheless, independent supervisory judgment will be applied on a case-by-case basis. These processes, albeit subject to detailed and explicit supervisory guidance, contain an inherent amount of subjectivity and must be assessed by supervisors on an

ongoing basis. This supervisory assessment of the internal processes and controls leading to an institution's internal ratings and other estimates must maintain the high level of internal risk measurement and management processes contemplated in this ANPR.

The BSC's Accord Implementation Group (AIG), in which the Agencies play an active role, will seek to ensure that all jurisdictions uniformly apply the same high qualitative and quantitative standards to internationally active banking institutions. However, to the extent that different supervisory regimes implement these standards differently, there may be competitive dislocations. One concern is that the U.S. supervisory regime will impose greater scrutiny in its implementation standards, particularly given the extensive on-site presence of bank examiners in the United States.

Quite distinct from the need for a level playing field among internationally active institutions are the competitive concerns of those institutions that do not elect to adopt or may not qualify for the advanced approaches. Some banking organizations have expressed concerns that small or regional banks would become more likely to be acquired by larger organizations seeking to lever capital efficiencies. There also is a qualitative concern about the impact of being considered a "second tier" institution (one that does not implement the advanced approaches) by the market, rating agencies, or sophisticated customers such as government or municipal depositors and borrowers. Finally, there is the question of what, if any, competitive distortions might be introduced by differences in regulatory capital minimums between the advanced approaches and the general risk-based capital rules for loans or securities with otherwise similar risk characteristics, and the extent to which such distortions may be mitigated in an environment in which well-managed banking organizations continue to hold excess capital.<sup>8</sup>

Because the advanced framework described in this ANPR is more risk-sensitive than the 1988 Accord and the general risk-based capital rules, banking organizations under the advanced approaches would face increases in

<sup>8</sup> The Agencies note that under the general risk-based capital rules some institutions currently are able to hold less capital than others on some types of assets (for example, through innovative financing structures or use of credit risk mitigation techniques). In addition, some institutions may hold lower amounts of capital because the market perceives them as highly diversified, while others hold higher amounts of capital because of concentrations of credit risk or other factors.

their minimum risk-based capital charges on some assets and decreases on others. The results of a Quantitative Impact Study (QIS3) the BSC conducted in late 2002 indicated the potential for the advanced approaches described in this document to produce significant changes in risk-based capital requirements for specific activities; the results also varied on an institution-by-institution basis. The results of QIS3 can be found at <http://www.bis.org> and various results of QIS3 are noted at pertinent places in this ANPR.

The Agencies do not believe the results of QIS3 are sufficiently reliable to form the basis of a competitive impact analysis, both because the inputs to the study were provided on a best-efforts basis and because the proposals in this ANPR are in some cases different than those that formed the basis of QIS3. The Agencies are nevertheless interested in views on how changes in regulatory capital (for the total of credit and operational risk) of the magnitude described in QIS3, if such changes were in fact realized, would affect the competitive landscape for domestic banking organizations.

The Agencies plan to conduct at least one more QIS, and potentially other economic impact analyses, to better understand the potential impact of the proposed framework on the capital requirements for individual U.S. banking organizations and U.S. banking organizations as a whole. This may affect the Agencies' further proposals through recalibrating the A-IRB risk weight formulas and making other modifications to the proposed approaches if the capital requirements do not seem consistent with the overall risk profiles of banking organizations or safe and sound banking practices.

If competitive effects of the New Accord are determined to be significant, the Agencies would need to consider potential ways to address those effects while continuing to seek to achieve the objectives of the current proposal. Alternatives could potentially include modifications to the proposed approaches, as well as fundamentally different approaches. The Agencies recognize that an optimal capital system must strike a balance between the objectives of simplicity and regulatory consistency across banking organizations on the one hand, and the degree of risk sensitivity of the regulation on the other. There are many criteria that must be evaluated in achieving this balance, including the resulting incentives for improving risk measurement and management practices, the ease of supervisory and regulatory enforcement, the degree to