ING DIRECT

January 18, 2006

Regulation Comments
Attention: No. 2005-40
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington, DC 20552

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

Re: Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance: Domestic Capital Modifications

Dear Ladies and Gentlemen:

ING Bank, fsb (ING DIRECT) appreciates the opportunity to provide comment on the advance notice of proposed rule making entitled "Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance: Domestic Capital Modifications" (referred to as the Basel IA). ING DIRECT, a subsidiary of ING Group, with $54 billion in assets, provides retail banking services and financial products to individuals and businesses across the United States of America.

Because its parent, ING Group, is subject to Basel II standards in the European Union, ING DIRECT is in an almost unique situation to submit a comment on Basel IA. ING DIRECT is required to undertake many of the analyses required by Basel II in order to enable its parent to comply with the standards made applicable in the EU. As a domestic federal savings bank, though, ING DIRECT also must comply with the capital standards applicable in the U.S. ING DIRECT also may choose to be covered by Basel II standards in the U.S. ING DIRECT respectfully submits these comments informed by its exposure to these differing standards.

In our view, the Agencies are missing a crucial opportunity to put the US banking system on par with its international counterparts. Rather than adopting the faint-hearted proposal that has been proposed in Basel IA, ING DIRECT urges the Agencies to take this opportunity to implement the full Basel II agenda for all U.S. financial institutions. The world is moving forward. The proposed Basel IA reflects a retreat from the sound principles and procedures that have been developed in long and difficult consultations among the international banking community. Rather than leading the process, the Agencies are pulling back from the consensus reached worldwide. ING DIRECT urges the Agencies to reconsider and make all of the Basel II approaches available to all U.S.

banks. To the extent that some small banks cannot absorb the cost of developing and implementing appropriate internal risk systems expected under Basel II, the OTS should develop credit risk alternatives similar to the guidance the OTS developed earlier for interest rate risk.

Otherwise, however, ING DIRECT generally supports the Agencies' efforts to revise the current risk-based capital guidelines in order to enhance the risk sensitivity of the regulatory capital framework, to encourage the development of sound risk measurement and management practices, and to address competitive equity questions that may be raised by U.S. implementation of the Basel II framework.

ING DIRECT supports the approaches outlined in the Basel IA proposal such as increasing the number of risk-weight categories and using updated loan-to-value ratios for assigning risk weights to residential mortgages. ING DIRECT believes these changes will enable banks to better align regulatory capital requirements to underlying economic risks, to encourage better risk measurement processes, and to discourage excessive risk taking activities.

Nevertheless, as we discuss in more detail below, ING DIRECT perceives that the proposed Basel IA

- does not adequately recognize lower risk sensitivities of certain bank assets,
- does not align risk-based capital with levels suggested by U.S. Basel II,
- does not sufficiently allow use of internal credit risk ratings, and
- does not adequately address international competitive equality issues.

One stated objective of Basel IA is to help resolve potential competitive inequalities that implementation of Basel II may produce for banks remaining on the Basel I standard. The proposal does not go far enough in addressing such differences for banks in the U.S.

In addition, the Agencies have determined in connection with Basel II to permit U.S. financial institutions to use only the Advanced IRB approach. ING DIRECT suggests that the Agencies should consider enabling more U.S. banks to adopt the other two approaches that are permitted in the international Basel II Accord (Standardized approach and Foundation IRB[1] approach). By allowing three alternative approaches to the implementation of Basel II, U.S. banks would be put on the same level playing field with banks in other countries, while the risk sensitivity of credit risk could be improved.

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[1] The proposed Basel IA resembles the Basel II Foundation IRB approach in the context of external credit ratings based approach.

ING DIRECT also suggests that the Agencies take a flexible approach and allow banks to adopt portions of the new standards. The proposed capital rules draw sharp distinctions between methodologies to be used for separate kinds of assets. To the extent that a bank is active with respect to one type of asset, the regulatory burden of complying with the new rules is warranted. That bank should be allowed to adopt the new rules with respect to that class of assets, though, while adhering to simpler, less burdensome, standards for classes of assets that are less material to the bank.

Despite generally supporting the proposal, ING DIRECT remains concerned about the retention of the leverage capital requirement. The leverage capital requirement results in an excess capital charge against low risk assets such as mortgages and investment securities. As OTS Director John Reich noted in his recent testimony before the Committee on Banking, Housing and Urban Affairs, a risk-insensitive leverage ratio works against a financial institution's investment in low-risk assets and such a system may perversely motivate low credit risk lenders to pursue riskier lending. The retention of a leverage capital ratio that is not adjusted for credit risks, interest rate risks, liquidity risks or operational risks works directly contrary to the goal of the Basel process, which is to enhance the risk sensitivity of the regulatory capital framework. We strongly encourage the Agencies to consider removing the risk-insensitive Well-Capitalized Leverage Ratio for financial institutions, make it risk-sensitive, or at least significantly lower the ratio for savings organizations with significant residential mortgage exposures.

In assessing a bank's overall risk, we also suggest that the Agencies review each bank's risk level and risk management through a supervisory review process similar to the Basel II Pillar II standard.

Below we provide more specific comments and questions based on our understanding of the Basel IA proposal.

Specific Basel IA Proposals

1. *Increase Number of Risk-Weight Categories*

ING DIRECT believes that increasing the number of risk-weight categories would allow supervisors to more closely align capital requirements with risk and additional risk-weight categories would improve the risk sensitivity of the existing capital standards. The revised risk weight categories may also lead to improved returns, as pricing may be better aligned with risk as a result. Lowering the risk-weight requirement for investment grade assets is prudent.

The Agencies should consider a framework, however, that requires less capital for securitizations based on credit rating alone. The formulation of the Ratings-Based Approach under Basel II and the accompanying research that led to its formation is evidence that the credit risk in corporate bonds and securitizations are significantly different. Any interim Basel framework that does not partially reflect this difference will likely make the ultimate transition more disruptive to thrifts and the financial markets than should be necessary.

ING DIRECT proposes that lower than 20% risk-weight categories, such as 10%, should be warranted for the highest quality securities with very low probability of default (i.e. A+ rated and above exposures). For example, under the current Basel II framework, a less than 10% risk-weight is applied to some highest rated senior securities backed by the granular pools even if adding possible operational risk capital requirement (i.e. AAA rated receives 7% risk-weight and AA rated receives 8% risk-weight). In the Basel IA proposal, similar securities will receive a 20% risk-weight, which results in a much higher capital requirement than would occur under Basel II. As Basel IA intends to create appropriate incentives for banking organizations and resolve the potential competitive inequalities Basel II may produce for banks remaining on the Basel I standard, the distortion between Basel IA and Basel II capital requirement should be mitigated. We would highly encourage the introduction of additional lower risk-weight categories commensurate with Basel II. In addition, the granularity criteria should be extended to Basel IA as it is not overly burdensome to report.

The proposed risk weights for non-investment grade exposures are acceptable. Non-investment grade exposures should require additional capital charge given historical default rates for these classes. Financial institutions seeking higher returns at the expense of credit quality should be required to hold additional risk capital.

ING DIRECT does not believe that an increased number of risk-weight categories would place unnecessary burdens on banking organizations. An increased number of risk-weight categories would help enhance the risk sensitivities of the capital framework and align the risk more closely with the underlying credit exposures.

Those that invest in higher quality/lower risk rated assets will benefit financially in that these institutions can lower risk weighted capital levels to support those asset classes. Conversely, those that seek the highest possible returns and are willing to accept (knowingly or otherwise) the risk associated with that business approach, will need to demonstrate adequate capital levels to ensure solvency in the event of adverse credit events