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# **Operations Report**

March 2007

### **Basel II Basics**

#### **Related Practices:**

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The federal bank regulators published their joint proposal on supervisory guidance related to Basel II implementation. (72 Fed. Reg. 9084 (Feb. 28, 2007).) The proposed guidance describes agency expectations for banking organizations that would adopt the advanced internal ratings-based approach for credit risk, and the advanced measurement approaches for operational risk. The proposal also includes guidance on the Basel II supervisory review process for assessing capital adequacy. The comment deadline is May 29.

This follows on the heels of a recent GAO study reporting that the Basel II Standardized Approach should be given "serious consideration" as an option for all U.S. banks. The Basel II envisions a three-pronged approach to enhancing the safety and soundness of financial institutions: (i) new capital standards; (ii) enhanced supervision; and (iii) increased market discipline through additional public disclosures. The GAO, among other things, also recommended that the banking regulators "improve transparency by publicly reporting more frequently on the progress and results of [Basel II] implementation efforts and any resulting regulatory adjustments."

### **Swiss Fondue**

In December, the FDIC and the FRB issued for comment a draft interagency notice of proposed rulemaking that would allow the majority of financial institutions not adopting the Basel II capital accord to choose between the current Basel II system and a more risk-sensitive Basel IA capital regime. This "menu approach" will allow banks to step up the risk sensitivity of their capital rules to fit the risk in their balance sheets. The Basel 1A proposal would, among other things: (1) expand the use of external credit ratings for certain exposures; (2) expand the range of eligible collateral and guarantors used to mitigate credit risk; (3) use loan-to-value ratios to determine risk weights for most residential mortgages; and (4) add three new risk weights to the existing framework, 35 percent, 75 percent, and 150 percent.

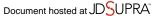
## Joining the Conga Line

As you may know by following these pages, figuring out which agency's telemarketing rules apply to financial institutions is a little bit like competitive double-Dutch rope skipping. The FCC, which exercises jurisdiction over banks and other financial institutions' telemarketing activities, permits prerecorded calls to customers where there is an established business relationship ("EBR"). The FTC doesn't have an EBR exception. The Consumer Bankers Association has urged the FTC to approve the use of such prerecorded calls, or, in the alternative, to rule that the FCC has jurisdiction over the firms making such calls on behalf of national banks.

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### **Prepayment Penalty Preempted**

A California appellate court found that HOLA and OTS regulations preempted claims challenging



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prepayment penalties brought under California's Unfair Competition Law and common law. In *Weiss*v. Washington Mutual Bank, 147 Cal. App. 4th 72 (2007), the court refused to consider plaintiff's argument that his challenge fell within the exception for claims that only incidentally affect the bank's lending operations. Rather, the court found that it could consider the exception only if the challenged practice was not expressly listed in the regulation's illustrations of preempted areas.

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