



Federal Financial Analytics, Inc.

## **PETROU TESTIFIES BEFORE CONGRESS ON KEY POWERS FOR NEW GSE REGULATOR**

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CONTACT: Arezou Rafikian (202) 296-5240

WASHINGTON, D. C. – Today, Karen Shaw Petrou, managing partner of Federal Financial Analytics, testified before the House Financial Services' Subcommittee on Capital Markets on the new GSE-reform legislation. Petrou's testimony focused on the safety-and-soundness provisions in the new legislation, detailing how the capital, product-review, portfolio and other sections of the bill meet the goal of establishing a "bank-like" and "world-class" GSE regulator.

Petrou told Congress that, "Sometimes, long-accepted provisions in a bill surprisingly end up on the cutting-room floor in the middle of the night." "Too much hard work and too disturbing a history at the GSEs have occurred to allow this to happen now," she continued.

Major points in Petrou's testimony include:

- The reform bill should, as provided in the pending compromise, give the new regulator discretion over the amount and components of GSE minimum and risk-based capital. To make the measure more "bank-like," the bill could also dictate standards for well-capitalized GSEs, not stipulate only that they be "adequately" capitalized as is now the case. Some have suggested the new regulator be allowed only to raise capital under defined, limited conditions, but this would be a sharp departure from banking-agency practice and prove particularly risky for the GSEs.
- The proposed compromise rightly provides for appropriate advance regulatory and public scrutiny of new GSE ventures. When Congress last reviewed this issue for banks (in Gramm-Leach-Bliley), it required such a process. This is why Congress learned in advance of the proposal to expand real-estate agency powers. Early warning of controversial GSE ventures is at least as vital. Unlike banks, GSEs are not subject to competition or market discipline that would otherwise provide early warning of new products and ensure appropriate risk mitigation.

- Different proposals are under consideration regarding GSE portfolios. It should be noted that banks are in fact subject to express portfolio limits. For example, these bar commercial investments.
- H.R. 1461 as passed included specific direction to the new regulator to issue rules or guidance on topics such as asset quality, credit and counterparty risk, operational risk and liquidity. These are now major gaps in the GSE rulebook and this language should be maintained to ensure a specific mandate for the standards on a short turn-around.
- H.R. 1461 as passed also included important corporate-governance standards not in last year's Senate bill. These would strengthen the new regulator's hand in an area in which the GSEs have shown significant problems.

Petrou's testimony is attached.

*Federal Financial Analytics, Inc. has for the past twenty years counseled large financial institutions and even their regulators on major legislative, regulatory and policy issues that pose strategic risk. It does not lobby on behalf of clients, but advises them on appropriate responses in light of identified challenges, working on an array of GSE, Basel II, and acquisition-value issues. The firm publishes numerous information and analytical services, including Financial Services Management and GSE Activity Report.*

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