



Petrou Urges Go-Slow to Get Basel Capital Rules Going

“An effort to craft the best international bank capital rule is driving out a very good one on which rapid action is essential,” said Karen Shaw Petrou, managing partner of Federal Financial Analytics in testimony today before the International and Domestic Monetary Policy Subcommittee in the House.

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EMBARGOED UNTIL 10:00 am EST, 2/27: Contact Arezou Rafikian (202) 296-5240

Speaking today before the International and Domestic Monetary Policy, Trade and Technology Subcommittee of House Financial Services, Karen Shaw Petrou, managing partner of Federal Financial Analytics, outlined an incremental strategy that improves financial system’s safety and soundness quickly without the immediate and adverse impact of controversial aspects of the Basel rewrite of global bank capital rules. Speaking on behalf of her firm, Petrou argued that some sections of the Basel proposal should be delayed while regulators act quickly to eliminate flaws in the current rules that lead to undue bank risk-taking.

Of particular concern is the operational risk-based capital section of the Basel rules, which could lead banks to rely on an arbitrary regulatory capital requirement instead of proven forms of risk mitigation to address challenges like natural disasters or even terrorist attacks. Petrou also noted that U.S. regulators have yet to decide which banks here will be subject to the capital rules, and leaving smaller banks out could put them at a substantial disadvantage to big banks that expect large drops in capital for low-risk assets like mortgages and small-business loans.

“Some of the Basel proposal is so good and so important that I think it should be immediately implemented,” Petrou said. “I fear, however, that other aspects of the complex rule could have unintended consequences, and these should be approached cautiously after the keystones of the current proposal are put in place,” she continued.

In addition to operational risk and the question of which banks will be covered by Basel, Petrou noted problems in the proposed rules for asset securitization, commercial real estate and mid-sized businesses. She also raised questions about the readiness of regulators to deal with the complex rules, suggesting that this too argues for action now only on agreed-upon, non-complex sections of the proposed reforms. “Failures in the current system helped to create the Asian crisis in 1998 and the massive bubble in stocks like Enron and WorldCom still working their way through the U.S. markets,” Petrou said. “Fix these problems first, and then address other issues.”

Copies of Petrou’s testimony can be found at...