



Federal Financial Analytics, Inc.

## Congress to Take Active Basel Role, Petrou Predicts

April 8, 2003

FOR IMMEDIATE RELEASE – CONTACT AREZOU RAFIKIAN (202) 296-5240

In remarks today before the Federal Bar Association, Karen Shaw Petrou, Managing Partner of Federal Financial Analytics, described the role Congress has begun to play in the Basel negotiations and outlined likely next steps. The Basel Committee is currently working on the final version of the rules that govern risk-based capital for the world's largest banks, and these rules will, Petrou said, dictate "who gets what loans at what price starting now." Although some think the rules aren't important because they won't be effective until 2007, Petrou noted that funds are already being redistributed in the global financial system based on guesses about what Basel will look like. "Banks can't change their portfolios overnight," she said. "Capital requirements drive profitability models, so they are having a major impact even in draft form."

Congress began its review of the Basel rules at a Financial Services Subcommittee hearing on February 27 at which Petrou testified. In the wake of that hearing, some in the international community harshly criticized Congress for weighing in on these complex rules. Petrou said that, "While some have said Congress should let the regulators work their will, the Basel rules are so important that the ongoing inquiry is not only appropriate, but also necessary."

Petrou indicated that Congress plans to continue its look into Basel, with more hearings set not only for the House Financial Services Committee, but also for Senate Banking. At these hearings, the toughest questions facing Basel – whether a capital charge should be imposed on operational risk, for example – will get a thorough going over. Also, questions have arisen over how the rules will be implemented in the U.S. Here, the biggest question now is which banks will fall under Basel. The EU wants all banks in, but smaller ones fear the competitive impact of coverage. Petrou said, "The best course here is for Basel and the U.S. to adopt quickly the changes that virtually everyone agree will end regulatory arbitrage, holding over those issues that could have unintended and even dangerous consequences."

Federal Financial Analytics, Inc. advises global financial services firms on U.S. legislation, regulation, and policy affecting their strategic plans. Clients include the largest banks in the U.S., as well as major non-bank financial services firms and domestic and international government agencies.

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