



Federal Financial Analytics, Inc.

PETROU POINTS TO PROBLEMS IN KEEPING U.S. BASEL RULES UNCHANGED FOR TOO LONG

“We can debate all day long if the housing “bubble” will burst or fizzle, but we know for sure that U.S. consumers are highly leveraged and are making use in unparalleled fashion of high-risk mortgage products. The current Basel I rules woefully under-capitalize high-risk assets, creating a regulatory incentive for banks to hold them. Getting the risk right in risk-based capital is not just an issue for model builders. It’s a critical challenge to protect the FDIC and the economy more generally.”

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WASHINGTON, D.C. – In her fourth Congressional testimony on the Basel rules, Federal Financial Analytics’ managing partner Karen Shaw Petrou today addressed growing fears that the U.S. will simply opt out of the Basel II standards or impose them in so limited a way as to, for all intents and purposes, have done so. Petrou argued not only that this could lead to a surge in foreign takeovers of U.S. banks, but also that banking-system risk will increase. Thus, she urged U.S. regulators to act as quickly as possible on as much of the Basel II standards as possible, putting a framework in place now that can be refined down the road.

Speaking on the new issue about whether U.S. banks should be allowed to use the Basel II “standardized” option, Petrou told the House Financial Institutions Subcommittee that this should be a decision made by banks, not their regulators. She argued that all Basel II options

-- modified as necessary for specific U.S. factors -- should be available to all U.S. banks, with regulators reviewing these decisions and, if desired, reversing them.

Petrou also disputed the value of the U.S. leverage ratio. She noted that this has a perverse impact on risk-taking – the reverse sought by those now pushing to retain the leverage standard when the U.S. Basel rules are implemented. She testified that, “This panel will well remember the thousands of banks and S&Ls that failed in the 1980s and early 1990s even as the leverage standard applied to each and every one of them.”

Finally, she continued to argue against the operational risk-based capital provisions in Basel II, noting they too will have a perverse impact as banks are distracted from urgent contingency planning to comply with a capricious capital charge.

Copies of the testimony are 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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