Federal Financial Analytics, Inc.

ANALYSIS SHOWS BASEL IA WINNERS, LOSERS

"Basel IA is a major contribution to a risk-sensitive regulatory regime for U.S. banks, addressing as it does the competitiveness problems smaller banks feared would result if the U.S. allowed only big banks to go under Basel II and everyone else kept regulatory capital as is. Big winners will be banks with large mortgage and small-business portfolios. Banks with big stakes in other retail lines – credit cards and auto loans, for example, may not get any capital help."

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WASHINGTON, D.C – Federal Financial Analytics, Inc. today released a detailed analysis of the Basel IA proposal approved earlier this month by U.S. regulators. The analysis goes through the overall framework of the new approach to risk-based capital, showing which banks and savings associations will win or lose if the new capital framework were to go final as is.

"Although the U.S. has put the whole Basel process on hold, this proposal is critical because the rest of the world is going live now with the new capital rules," said Federal Financial Analytics managing partner Karen Shaw Petrou. "Although seemingly technical, changes to bank risk-based capital have profound competitive impact," she continued. "Bank profitability is, at its core, based on return on equity (ROE). If regulatory capital is higher

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than what the market demands, banks are less profitable than non-banks or other competitors. If regulatory capital is lower, then unsafe activities are encouraged."

The Federal Financial Analytics analysis shows that:

- Basel IA would provide major capital incentives for prudent mortgage lending. This will encourage reliance on mortgage insurance and a turn away from the new mortgages Chairman Greenspan has dubbed "exotic."
- Small-business lenders will also get a big new capital advantage, helping small and mid-sized banks compete against big ones.
- Because the Basel IA proposal doesn't include a capital charge for operational risk, competitiveness problems under Basel II for specialized U.S. banks will not occur.
- The proposal to retain current leverage and "prompt corrective action" standards could offset the benefits of the proposed Basel IA at the smaller banks coming under the new rule.

Copies of the analysis are available on request via return e-mail or a call to Arezou Rafikian at (202) 296-5240.

Federal Financial Analytics, Inc. has for the past twenty years counseled large financial institutions and 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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