Federal Financial Analytics, Inc.

U.S. BASEL RULES POSE PROFIT PROBLEM

> "Although the Basel II rules fix a lot of the problems caused by Basel I – a long over-due fix – implementation in the U.S. will come at precisely the time of broader market problems. Thus, significant amounts of risk-based capital will need to be raised in a hurry, driving a new wave of industry mergers and acquisitions."

FOR IMMEDIATE RELEASE – December 6, 2007
CONTACT: Arezou Rafikian (202) 589-0880

WASHINGTON, D. C. – Federal Financial Analytics, Inc. (FedFin) today released an in-depth analysis of the new U.S. Basel II rules. "The rules will significantly improve U.S. bank risk-based capital," said FedFin managing partner Karen Shaw Petrou. "However, long-delayed implementation means the new rules kick in at a time of major credit-market problems, which will mean a sharp spike in U.S. bank regulatory capital," she continued. This could exacerbate liquidity problems at higher-risk market segments, increasing the flight to quality already a driving market factor.

The FedFin analysis notes that the U.S. rules, like the international Accord, are hundreds of pages long and will have significantly different impact depending on a bank's business mix.

1121 Fourteenth Street, N.W.
Washington, DC 20005
www.fedfin.com

PHONE 202.589.0880
FAX 202.589.0423
E-Mail: info@fedfin.com

Although the final rules bend a bit to demands from the biggest banks to bring the U.S. standards into closer alignment with international ones, many critical differences remain. For example, the rules will only govern the biggest banks, with non-bank parent companies of large insured depositories and other financial-services firms wholly outside the new rules. Smaller banks are awaiting a revised version of new capital rules to replace the twenty-year-old Basel I framework.

The U.S. rules will also phase in more slowly than the international rules and could be pulled back in whole or part between years two and three of the transition period. This responds to FDIC fears that U.S. risk-based capital could drop precipitously under Basel II despite retention of the unique U.S. leverage capital requirement and other safeguards. However, as the FedFin analysis notes, risk-based capital could actually rise sharply in the next three years, creating a significant drain on large-bank profitability and leading to more mergers among the biggest banks and between them and major non-bank financial institutions.

A copy of the analysis 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.

########