



Federal Financial Analytics, Inc.

BASEL CAN BE SAVED, PETROU TELLS SENATE

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“There is a “first things first” solution that fixes the Basel II’s complexity problem. Much in the proposal can be quickly implemented at reasonable cost for all banks and savings associations here and abroad. U.S. regulators should act now on those sections of Basel II on which they can agree unanimously, and defer other sections until they can do so.”

WASHINGTON, D.C. -- In testimony today before the Senate Banking Committee, Karen Shaw Petrou, managing partner of Federal Financial Analytics, argued that much in the pending Basel II standards can and should be saved. She urged regulators, however, to defer action on contentious and controversial aspects of the proposal – especially the operational risk capital charge – to avoid unintended safety-and-soundness problems. U.S. regulators also need to be keenly aware of the potential competitive impact of Basel II, she said.

Basel II is coming under increasing criticism as debate moves from technical review of its many models to the strategic consequences of the massive rewrite of international risk-based capital standards. Petrou’s testimony argues that much in the rule warrants immediate action to address problems in the crude capital standards now in place. However, the rules – after they are made less complex and the operational risk charge is dropped – should be applied to all banks in the U.S. to ensure that benefit and cost are spread across the board. Capital should then rise or fall with risk, and the U.S. should drop the out-dated leverage capital standard.

Petrou also pointed to problems bank supervisors will have implementing the current version of the capital standards. Basel II implementation at the biggest banks “will cost \$200 million per bank. One has to ask how it can cost so much for banks and not pose a comparable burden on supervisors who must assess these elaborate models.” Petrou said

the supervisory problems could lead to over-simplification of the rule in practice, defeating the whole purpose of the rewrite.

Federal Financial Analytics, Inc. is a financial consulting firm that advises on the strategic impact of U.S. legislative regulatory and policy issues. A list of clients can be found on the FedFin website. In addition to its advisory practice, the firm also offers a range of analytical information services, including one focused solely on the housing government-sponsored enterprises.

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