MARKET-RISK RULES HAVE REAL MARKET IMPACT, FEDFIN STUDY FINDS

"The capital costs of an array of instruments now widely used by the market – credit-default swaps and collateralized debt obligations, for example – could rise, perhaps increasing user cost and/or leading to a new set of innovative financial structures. Big banks will lose their edge over investment banks in these arenas. The proposal would also impose significant new disclosure requirements on trading banks, with chief financial officers required to certify these disclosures."

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WASHINGTON, D.C. – Federal Financial Analytics (FedFin) today issued an in-depth assessment of an overlooked proposal to rewrite bank capital requirements. Although global attention has focused on the Basel II credit risk-based capital rules, the new market-risk proposal could, the report finds, have far-reaching impact. Importantly, this impact will hit the U.S. far more quickly than that of the Basel II rules because regulators want the market risk-based capital rules in effect on January 1, 2008.

"To the degree the proposal rights wrongs related to how out-dated current rules are, so far so good," said FedFin managing partner Karen Shaw Petrou. "However, the new rules will hit

U.S. banks without any offsetting benefits from the rest of the Basel II update," she continued. "As a result, U.S. banks are poised to get only the downside of regulatory-capital reform."

As with the rest of the international capital rules, the market-risk ones are final everywhere but the United States, the FedFin analysis notes. As a result, non-U.S. banks active in sophisticated financial instruments will be subject to more stringent rules that better capture real risk. Similarly, big U.S. investment banks are already under a capital regime (dictated by the Securities and Exchange Commission) that reflects much in the new banking-agency proposal. However, all of these entities are covered by the rest of the new capital standards, with big drops ahead that won't apply fully to U.S. banks until 2012, at the earliest.

The FedFin analysis is available on request.

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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