Financial Guardian Group

900 Seventeenth Street, N.W., Suite 506
Washington, D.C. 20006
Phone: (202) 296-5240
Fax: (202) 452-6816

BASEL II OPERATIONAL RISK BASED CAPITAL RULE: A CHARGE FOR THE WORSE

> "U.S. banks have been global leaders in their business lines, but the new operational risk-based capital charge puts them at a major disadvantage because of the way Basel II will be implemented…"

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CONTACT: Christopher Young (202) 296-5240

WASHINGTON, DC – Answering suggestions that a capital charge for operational risk will have no competitive impact, the Financial Guardian Group (FGG) today released an in-depth study of the rule's serious, adverse implications. The Basel II Accord includes a new regulatory capital charge for operational risk – systems mistakes, fraud or disasters—and U.S. regulators have proposed including this in their own version of the sweeping rewrite of bank capital standards. The FGG study finds that the requirement will cost U.S. banks as much as $67 billion – or even more depending on how the total Basel II rules take effect here. As a result, they will have a major impact on the ability of banks – especially specialized ones – to compete against non-banks which will not come under the Basel II rules**.**

Lines of business affected by the operational risk charge – asset management, for example – are also businesses in which U.S. banks lead the world. Thus, the capital charge could, the FGG study finds, negatively affect U.S. global competitiveness. The proposal will undermine efforts to make the financial system safer from infrastructure shocks like 9/11 because the regulatory capital charge creates a perverse incentive against effective – and costly – risk management

“One can debate this complex rule all day long,” said FGG Executive Director Karen Shaw Petrou. “However, once in place, its effect cannot be quickly reversed. Banks that go out of business lines or disappear altogether cannot be quickly resurrected,” she continued. The FGG study thus recommends far more research before a regulatory capital charge is mandated for operational risk. It also details the FGG’s suggestions for effective operational risk management (Pillar 2 in Basel) and enhanced disclosures (Pillar 3).

The study also examines a variety of related competitiveness issues that have been of particular concern to the U.S. Congress and bank regulators. For instance, it notes that the disparate application of the Accord is likely to have a significant adverse impact on the ability of small and regional banks to compete against large, diversified ones that will benefit from large regulatory capital drops in key lines of business like mortgages. Similarly, the study comments on the potential adverse effects of U.S. banks having to compete with non-banks that will not be subject to the Basel II requirements.

A copy of the full study is available upon request. To receive one, call Chris Young or e-mail INFO@FEDFIN.COM

The Financial Guardian Group study was prepared by Federal Financial Analytics, Inc.

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