

June 22, 2004

Opening Statement by Congressman Paul E. Gillmor
House Financial Services Committee
Subcommittee on Financial Institutions and Consumer Credit Hearing entitled, "The New Basel Accord: Private Sector Perspectives"

Thank you, Mr. Chairman, for holding this important hearing. I appreciate this opportunity to be updated on negotiations regarding the new Basel Capital Accord (Basel II) to regulate international banking risk.

Currently, over 100 nations utilize the original Basel Accord (Basel I) model for capital standards. However, I understand many financial institutions concerns that this general approach failed to take into consideration the specific characteristics of larger entities, frequently changing market conditions, and risk reduction strategies implemented by individual financial institutions.

I was happy to support this committee's action in passing HR 2043, the United States Financial Policy Committee for Fair Capital Standards Act, to require the development of a unified position for U.S. banking regulators before negotiating in the Basel Committee on Basel II and have been pleased to see our regulators come together on this issue. I was also happy to see federal regulators decide to delay U.S. implementation of the Accord until the end of 2007 to allow banks and regulators to better assess the potential impact of this new framework on our American banking market.

However, I do not feel that our federal regulators have adequately addressed the concerns regarding Pillar I treatment of operational risk expressed in a November 3, 2003 letter to Federal Reserve Chairman Alan Greenspan, Federal Deposit Insurance Corporation Chairman Donald Powell, Comptroller of the Currency John D. Hawke, Jr. and Office of Thrift Supervision Director James E. Gilleran signed by our House Financial Services Committee Full Committee Chairman and Ranking Member and all our Subcommittee Chairmen and Ranking Members.

In the US, the Basel II Accord and its operational risk-based capital requirements will cover only banks and not their non-bank competitors. This disparity will place banks at a substantial competitive disadvantage, particularly banks that specialize in the asset management, custody, and payments processing lines of business. These new competitive pressures could force some US banks to move these businesses out of the bank, sell them, or to de-bank completely. Such a development could increase systemic risk because major institutions would operate outside bank supervision.

It is also the case that the banking industry and federal regulators have yet to agree on a definition of operational risk. Many in the United States feel that the Basel Committee's proposal on operational risk gives only limited recognition to proven forms of operational risk mitigation and creates a perverse incentive to downplay insurance, contingency planning and similar activities that have proven effective.

I would like to see these industry concerns discussed this morning and look forward to hearing from our federal regulators on the possibility of Pillar II treatment of operational risk.

Thank you again, Mr. Chairman, for bringing these important negotiations to this subcommittee's attention. I look forward to a very informative session.