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Opening Statement

Chairman Michael G. Oxley

House Committee on Financial Services

Subcommittees on Financial Institutions and Consumer Credit
"Private Sector Priorities for Basel Reform"
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I want to thank Chairman Bachus for calling today's hearing on the proposed changes to the Basel Accord. Chairman Bachus has been a real leader on the issue of Basel II reform. Significant changes to the proposal have been made in response to his concerns. Additionally, by bringing attention to this process, this Committee has seen increased cooperation among U.S. regulators who are developing Basel II. It is important that these entities work together because the entire U.S. banking system will be affected by Basel II.

I don't think you will find much argument that the Basel Accord is outdated and needs revision. It was developed in the late 1980s, before liquid markets for credit had been developed and before the derivatives and securitization markets had taken off. These developments have made the Basel Accord obsolete and prone to abuse. I believe that U.S. regulators should continue working to update the Basel Accord so that all banks can benefit from changes in the obsolete framework.

In May, we heard from the U.S. regulators who will be in Switzerland next week to discuss Basel II. We saw at that hearing that considerable differences of opinion continue to exist within the U.S. regulatory community about the Basel II framework and its implications for U.S. banking and regulation. In addition, we learned that:

- Q-I-S 4 showed major swings in how much regulatory capital banks might need to hold using the new framework. Specifically, the Q-I-S 4 results showed estimated decreases of regulatory capital by as much as 40 to 60 percent as compared with the existing framework. In addition, the regulators were unable to tell us why these results came out the way that they did.

- The regulators were unable to tell us how the new framework might affect retail credit markets in the United States.

- The regulators were unable to tell us whether these results will create pressure to eliminate or change the leverage ratio in this country.

- The regulators were unable to tell us how regulators from different countries will work together to implement the framework for large banks in light of the large number of key areas where national discretion will continue to exist.

This is unacceptable.

In addition, very few European, Japanese, and Canadian banks participated in Q-I-S 4. Past Q-I-S exercises have shown widely disparate outcomes outside the United States as well, so there is reason to believe that the Q-I-S in Europe could generate results not to different from the American ones. Nonetheless, this morning, the European Parliament finalized the framework and timetable without knowing exactly what the impact will be. In fact, European banks will not even start working on a Q-I-S 5 until later this fall, after the legislative process in Europe is nearly completed.

I know concern exists in Europe that the United States will not implement Basel II or may not implement at the same time as Europe. I realize this might cause some regulatory burden and uncertainty among banks that operate on both sides of the Atlantic. And so I draw the conclusion that regulators on both sides of the Atlantic must be certain that they understand the likely impact of the new framework before they start asking banks to hold capital using it. Perhaps the European implementation should slow down to reflect these significant uncertainties regarding potential market impact rather than create pressure for the United States to rush through its process.

I believe that until better understanding exists regarding how Basel II will impact the markets, it would be irresponsible to finalize the framework globally or domestically. In addition, I think the U.S. regulators were wise to pause before finalizing Basel II. Significant changes to Basel II may be needed here and abroad before a final proposal is ready.

We have an additional issue in the United States regarding what kinds of improvements may be needed for banks that would use Basel II. I think it is imperative that the regulators share with banking community their thoughts on what a Basel I(a) approach may look like and how it relates to Basel II. It seems that this would be the most equitable way to make improvements to the capital standards. I am interested in hearing what the witnesses think about this idea and whether they have any insight into what Basel I(a) might contain.

Thank you and I look forward to hearing from the witnesses.