



Highlights of [GAO-08-953](#), a report to the Subcommittee on Financial Institutions and Consumer Credit, Committee on Financial Services, House of Representatives

Why GAO Did This Study

Basel II, the new risk-based capital framework based on an international accord, is being adopted by individual countries. It includes standardized and advanced approaches to estimating capital requirements. In the United States, bank regulators have finalized an advanced approaches rule that will be required for some of the largest, most internationally active banks (core banks) and proposed an optional standardized approach rule for non-core banks that will also have the option to remain on existing capital rules. In light of possible competitive effects of the capital rules, GAO was asked to examine (1) the markets in which banks compete, (2) how new capital rules address U.S. banks' competitive concerns, and (3) actions regulators are taking to address competitive and other potential negative effects during implementation. Among other things, GAO analyzed data on bank products and services and the final and proposed capital rules; interviewed U.S. and foreign bank regulators, officials from U.S. and foreign banks; and computed capital requirements under varying capital rules.

What GAO Recommends

GAO recommends that the U.S. bank regulators (1) clarify how they will use regulatory flexibility built into the rules and (2) fully develop plans, on a joint basis, for the required study of the impacts of Basel II. The bank regulators generally agreed with our recommendations in a joint response to this report.

To view the full product, including the scope and methodology, click on [GAO-08-953](#). For more information, contact Orice M. Williams at (202) 512-8678 or williams@ga.gov.

RISK-BASED CAPITAL

New Basel II Rules Reduced Certain Competitive Concerns, but Bank Regulators Should Address Remaining Uncertainties

What GAO Found

Large and internationally active U.S.-based banks (core banks) that will adopt the Basel II advanced approaches compete among themselves and in some markets with U.S.-based non-core banks, investment firms, and foreign-based banks. Non-core banks compete with core banks in retail markets, but in wholesale markets core banks often compete with investment firms and foreign-based banks. Because holding capital is costly for banks, differences in regulatory capital requirements could influence costs, prices, and profitability for banks competing under different capital requirements.

The new U.S. capital rules addressed some earlier competitive concerns of banks; however, other concerns remain. By better aligning the advanced approaches rule with the international accord and proposing an optional standardized approach rule, U.S. regulators reduced some competitive concerns for both core and non-core banks. For example, the U.S. wholesale definition of default for the advanced approaches is now similar to the accord's. Core banks continue to be concerned about the leverage requirement (a simple capital to assets calculation), which they believe places them at a competitive disadvantage relative to firms not subject to a similar requirement. Foreign regulators have been working with U.S. regulators to coordinate Basel II implementation for U.S. banks with foreign operations. The proposed standardized approach addresses some concerns non-core banks raised by providing a more risk sensitive approach to calculating regulatory requirements. But other factors likely will reduce differences in capital for banks competing in the United States; for example, the leverage requirement establishes a floor that may exceed the capital required under the advanced and standardized approaches.

Many factors have affected the pace of Basel II implementation in the United States and, while the gradual implementation is allowing regulators to consider changes in the rules and reassess banks' risk-management systems, regulators have not yet taken action to address areas of uncertainty that could have competitive implications. For example, the final rule provides regulators with considerable flexibility and leaves open questions such as which banks may be exempted from the advanced approaches. Although the rule provides that core banks can apply for exemptions and regulators should consider these in light of some broad categories, such as asset size or portfolio mix, the rule does not further define the criteria for exemptions. Some industry participants we spoke with said that uncertainties about the implementation of the advanced approaches have been a problem for them. Moreover, regulators have not fully developed plans for a required study of the impacts of Basel II before full implementation. Lack of specificity in criteria, scope, methodology, and timing will affect the quality and extent of information that regulators will have to help assess competitive and other impacts, determine whether there are any material deficiencies requiring future changes in the rules, and determine whether to permit core banks to fully implement Basel II.