September 14, 2006

Opening Remarks Representative Maxine Waters, D-35th CA

Subcommittee on Financial Institutions and Consumer Credit

Hearing on

"A Review of Regulatory Proposals on Basel Capital and Commercial Real Estate."

Good morning ladies and gentlemen. I would like to thank the Chairman of the Subcommittee Mr. Bachus and the Ranking Member Mr. Sanders for holding today's hearing, "A Review of Regulatory Proposals on Basel Capital and Commercial Real Estate."

The 1988 Basel Accord, or Basel I, is the basis for our banking system's current risk based capital standards. However, by the 90's the Basel I risk based capital standards were no longer applicable to the risks being taken by within the banking system, particularly by our large money center banks. In other words, these banks outgrew the Basel Accord. In response to these circumstances, the Basel Committee initiated efforts to move towards risk-sensitive capital practices by adopting the Basel II Framework. Our regulatory authorities support Basel II, which include the advanced internal ratings-based approach (IRB) for credit risk and the advanced measurements approaches (AMA) for operational risk. In fact, we are in the 120 day comment period for proposed rules related to Basel II, and 12 major U.S banks would be affected by the new risk based capital rules.

I agree with the concept of aligning our capital requirements to the actual risk being taken by our banks, particularly for the larger banks. On then other hand, I am concerned that the rules promulgated take into consideration the concept of flexibility. That is, the capital rules must be tailored to fit the complexity of the bank's risks. Other banks in the system should be able to rely on less advanced approached to risk than their larger counterparts. In any event, I believe that the proposed rules must ensure that we protect the safety and soundness of our banking system. I understand that the rest of the world has gravitated to risk based standards, but are we implementing a risk-based capital framework for the U. S. banking system that represents best practices? I hope that the testimony will shed light on this question.

The focus of today's hearing is also on the rapid growth in commercial real estate loans held by some banks. According to recent published reports, commercial loans increased by 16 percent in 2005 to $1.3 trillion. In response to the growth in commercial real estate lending, federal regulatory authorities, including the Federal Reserve issued draft guidance in January. In effect, the proposed guidance would have banks that exceed certain levels of lending in construction and commercial real estate to increase risk monitoring or add capital. Alternatively, banks could be required to increase their capital, as well as monitor risk.

What is at issue here is a possible repeat of the financial crisis of the 80s and 90s where commercial banks savings and loans with bad real estate loans suffered losses beyond the absorption capability of the system. The former Resolution Trust Corporation had to be created to deal with the liquidation of assets of 1100 banks and 1000 S&Ls from 1987 to 1994, costing the American taxpayer billions of dollars. No one wants to see a repeat of that crisis. And no one wants to overreact to these investments, lest we send signals to the financial markets leading to what some observers warn would be a “credit crunch.” However, if the regulators have identified a potential problem within the financial services industry related to bank investments in commercial real estate then we need to listen to what they have to say.

Are the small banks being to aggressive in their lending practices? If they are, will the end result be beneficial to the economy, or will these practices result in bank losses and closures. In the last several years, we witnessed the incredible run up in the price of residential real estate in many regions of the country. As the market settles we know that many homeowners have mortgages that are higher than the equity in their homes. If this phenomenon is duplicated in the commercial real estate market how will it affect the overall integrity of our financial system?

There are as many as 1/3 of our national banks with 300 percent or more of their bank capital concentrated in commercial real estate. One bank has commercial real estate loans that represent “750 percent of, or 7.5 times, its capital.” Is this prudent banking practice, or is it inherently risky? I welcome the witnesses and look forward to their testimony. Mr. Chairman. Thank you.