Paul Morales were all instrumental in reaching state champion status.

I commend the Sodus basketball team for their determination and exceptional season. Their outstanding achievements have set a standard that other teams should follow. Congratulations and good luck on future seasons.

HONORING THE RETURN OF SOLDIERS FROM IRAQ

HON. JEB HENSARLING

OF TEXAS

IN THE HOUSE OF REPRESENTATIVES

Tuesday, April 5, 2005

Mr. HENSARLING. Mr. Speaker, today I would like to honor several members of our Nation's military who have recently returned home after serving our country with distinction in Iraq.

Specialist Rocky Padgett, Specialist Chad Sumner, Specialist James Tyson Zigler, Specialist Bud Rath, Specialist Bradrick Graves, Specialist James Arnold, Specialist Jason Yanna, Specialist Michael Easdon, Corporal Jason W. Fitzgerald, Sergeant Christopher Callaway, and Sergeant John L. Tetty all deserve our deepest appreciation and respect. In the face of tremendous danger, these 11 men bravely answered the call of duty to fight our enemies abroad so that we would not have to fight them here at home. Because of their efforts, America is safer today than it was just 2 years ago.

On behalf of the grateful citizens of the Fifth District of Texas, it is my pleasure to welcome these heroes home. America owes these men, and all who serve beside them in the War on Terror, a tremendous debt, one that we will probably never be able to fully repay. Today, we thank them for their courage, their patriotism, their service, and their sacrifice.

As these men return to their families, friends, and the lives they left behind, I want to ensure that they do so secure in the knowledge that it is through their service that America will one day be free from the horrors of terrorism. It is because of their service, that future generations of Americans will be able to enjoy freedom, peace, prosperity, and the many other blessings that God has bestowed upon this great land, the United States of America.

Gentlemen, on behalf of a grateful Nation, welcome home.

JOHN LAFALCE'S VIEWS ON BASEL II

HON. BARNEY FRANK

OF MASSACHUSETTS

IN THE HOUSE OF REPRESENTATIVES

Tuesday, April 5, 2005

Mr. FRANK of Massachusetts. Mr. Speaker, my predecessor as the Ranking Minority Member of the Committee on Financial Services, John LaFalce, made enormous contributions during his tenure in Congress to our deliberations on financial services issues, and as a private citizen, he continues to do so. I have myself benefited in a number of conversations from his knowledge and wisdom about a range of issues. One of those about which he is most concerned is the current plan for a change in international financial regulations known as Basel II. On March 11, John LaFalce published a very thoughtful, well-informed article in the American Banker, outlining his concerns about the implications of Basel II. This is a subject currently before us in the Financial Services Committee, and while not widely known, is of great importance to our financial system. Because of that, I ask that the article by John LaFalce expressing his deep reservations about Basel II be printed here.

BASEL II PLAN IS A CRISIS IN THE MAKING

In the coming year Congress and U.S. bank regulators will decide whether to adopt new capital regulations that would impact the entire U.S. banking system.

Current discussions about Basel II are focusing on the minute details, rather than the more important question of whether the proposed accord makes any sense at all. In my view, Basel II is fundamentally flawed, and actually dangerous, for numerous reasons.

First, it is based on a fanciful premise that sophisticated risk-management models enable banks to allocate capital to each asset that is neither too low, nor too high, but just right. I hope my former colleagues and others do not gamble the stability of our domestic and global financial system on this theory.

Recent financial crises, such as at Long-Term Capital Management, should serve as stark reminders that all models, no matter how sophisticated, are subject to unpredictable market forces and, most important, human judgments, mistakes, and even manipulation.

With every large bank in the world lining up to play the Basel II capital game, and a financial system that is increasingly interdependent, the consequences of even an inadvertent mistake could be devastating. The odds are too high that Basel II, if adopted, could trigger a systemic financial crisis.

Second, Basel II's proponents have been too quiet about the most fundamental tenet of banking regulation—safety and soundness—and the critical role that an adequate capital cushion plays in the safe and sound operation of our banks and banking system. A Basel II regime would be reckless, unsafe, and unsound, inter alia, because:

It would allow banks to use complex risk-based models that few if any corporate executives or directors will ever comprehend adequately, if at all, and models that the regulators will lack the resources and technical skills to supervise adequately.

It is an ominous sign that the regulators recently published a formula that would have caused banks to underestimate their capital needs for retail credits by 60 to 70%.

Banks will implement Basel II only if they know their capital requirements will decline. That will also create powerful incentives, competitive pressures, and irresistible temptations for the nation's largest banks to revise their models over time to achieve the lowest amount of capital reserves possible.

Banks will be able to artificially improve their performance by manipulating capital levels, much as we have seen some companies manipulate earnings.

The new capital regime will seriously undermine the competitive viability of small to medium-size banks because of the dramatically lower capital levels that the largest banks will achieve. We now know that two former Federal Reserve economists came to that very conclusion in a paper that is being published independently.

Third, Basel II is overly optimistic about the ability and resources of regulators to supervise the new and complex capital rules. As Standard & Poor's has pointed out, ''National bank regulators could be overwhelmed by the implementation of Basel II, with its intensive need for verification of the internal systems and databases of individual banks.''

In addition, although the new accord allows regulators to make discretionary capital adjustments, banks will likely resist or seek to influence these adjustments, particularly after spending tens and even hundreds of millions of dollars developing their models.

As for market oversight, I discount that almost entirely. We are already seeing resistance by banks to making public disclosures about their models, ostensibly because of concern over the potential litigation exposure. Neither the markets nor the regulators nor most corporate officers or directors will be in any position to comprehend the underlying assumptions and idiosyncrasies built into the banks' models or to react quickly enough to emerging crises.

Fourth, some in the Federal Reserve would like us to believe that adoption of Basel II is necessary and inevitable. It is neither. Despite the perceived momentum behind Basel II, the accord seems to have little support beyond a few forceful players at the Federal Reserve and the handful of the largest banks that stand to gain the most because of reduced capital requirements.

I am convinced that the seasoned executives of some, if not most, of the nation's largest banks would themselves, in private conversation, acknowledge the folly of Basel II. Many former regulators have expressed serious reservations about, if not outright opposition to, Basel II, including Jerry Hawke, Bill Isaac, Bill Seidman, and others. Powell is apparently sufficiently concerned that he has reignited the debate over the FDIC's authority to examine banks already being examined by other federal regulators.

The fact that the chairmen and ranking members of both the House Financial Services Committee and its financial institutions subcommittee introduced legislation Thursday that could slow down or even prevent adoption of Basel II should also send a strong signal to the regulators.

Fifth, I am not even convinced that the Federal Reserve itself fully embraces Basel II, or even adequately understands many of its implications. Some prominent members of the Federal Reserve may still mistakenly believe that regulatory capital does not affect competition or the pricing and strategic decisions that banks make. This misconception could help explain their preference for theoretical models rather than practical realities.

Chairman Greenspan has been largely silent in the Basel II debate, although the irony is that he prudently questions the sufficiency of the capital levels at Fannie Mae and Freddie Mac. But Basel II would actually allow banks to hold less capital for the same mortgage assets than Fannie Mae and Freddie Mac are required to hold.

Current estimates of the capital that Basel II banks would have to hold for mortgage assets would also be at or below the capital level that led to the savings and loan crisis.

Some at the Federal Reserve appear to be more attuned to the importance of maintaining adequate regulatory capital reserves. Timothy Geithner, the president and CEO of the Federal Reserve Bank of New York, remarked recently that it was important for the nation's largest financial institutions to ''maintain an ample capital cushion over and above the high regulatory thresholds.''

He added that ''because of the broader implications of a failure for the financial system and for the economy as a whole, the supervisory framework for the largest systematically significant banking organizations