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# New Bank Rules May Not Prevent More Meltdowns

## Financial watchdogs around the globe last week established new rules to prevent banks from creating another crisis. They may have failed.

by Joel Schectman

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The world's financial watchdogs hammered out new rules last week to stop banks from causing another financial catastrophe. But analysts, and even some bankers, are saying that the agreement known as Basel III, won't prevent more financial calamity.

Regulators from Europe and the U.S. came up with an agreement that would force banks to keep more capital on hand, as a cushion when loans go bad. In theory, this would make banks more conservative in lending out money, and allow them to cover their own losses when borrowers can't pay up. A buildup of rotten housing loans helped cause the financial crisis two years ago, and taxpayers were forced to cover the losses with billions in bailout

When Wall Street read the flaccid new rules, it liked what it saw. Shareholders had worried last week that stringent new requirements would dampen bank stocks, sending the financials down. But weak banks got a big lift in the market Monday, when investors saw that the new rules were candy-coated. "Basel could have been a lot tougher, but they backed off as a result of political pressure from lending institutions," **Bernard Baumohl**, chief global economist for the Economic Outlook Group, told NEWSWEEK.

Banks that were emasculated by the financial crisis, such as Zions Bancorp. and Marshall & Ilsley Corp.—both of which lost three quarters of their value since 2007—shined the brightest when the new rules were released. "There was a fear that they were going to come down very hard, especially on some of the weaker banks," Ryan Detrick, senior technical strategist at Schaeffer's Investment Research, told NEWSWEEK. "[But] it was very friendly to Wall Street."

One area where Basel regulators may have fallen short was fixing the way banks count what's in their coffers. The financial crisis was kick-started when investors realized that Lehman Bros. had massively overstated the value of its assets and was unable to handle an avalanche of losses from bad loans.

But the new agreement made in Basel, Switzerland, did little to block the questionable accounting practices that are still routine in the banking world, says Jack Ablin, chief investment officer of Harris Private Bank. And bad accounting means it doesn't matter how much capital is said to be in reserve, because those numbers may be phony. "They are sweeping a lot of issues under the rug and hoping that the economy can grow its way out of the problems," says Ablin.

Take, for example, the value of loans that a bank has on its books.

Banks often draw customers in with a low "teaser" rates, such as 4 percent, for example. Known as adjustable-rate mortgages, the loans have interest rates that can double after two years. Let's say the bank has calculated that this loan will net it $100,000 in profit. That's the value written in the books. But what if the homeowner starts to default, as millions have in the past few years? The bank may let the homeowner keep paying just the teaser rate. It's a nice for the homeowner and a good idea if the bank doesn't want to lose the whole value of the loan. But that means it may get only half of the profit that it has on the books.

And it's common practice for banks not to even revise their books to show that the asset is now worth far less. Banks call it "extend and pretend," says Ablin. The practice was left nearly untouched by the Basel III agreement. And with banks still able to toy with the value of their assets, they may not be able to cover the risk of loans, just as in 2007.

But even if Basel III had not been too little, it may have been too late. The rules won't go into effect until 2019, nine years from now. "We could very well have one or two more crises before these rules even come into play," says **Baumohl** of the Economic Outlook Group.