Opening Statement: Basel III Interim Final Rule and Enhanced Supplementary Leverage Ratio Notice of Proposed Rulemaking

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Thank you, Mr. Chairman. I would like to begin by thanking today's presenters and their colleagues at this agency who have spent a number of years working to update and reform the framework for capital regulation for U.S. banking organizations.

I support moving forward with both capital initiatives before the Board today: (1) the interim final rule (IFR) comprising the implementation of the Basel III accords in the U.S., and (2) the Notice of Proposed Rulemaking setting forth an enhanced leverage ratio requirement for the largest bank holding companies and their depository institution subsidiaries. Taken together, these initiatives improve upon the capital regulatory regime that has been in place since before the financial crisis. However, in many respects, both the magnitude and the pace of capital regulation reform undertaken by the U.S. agencies are disappointing

Basel III Interim Final Rule

My support for the Basel III IFR is based on weighing a number of factors. From my perspective, too much effort has been placed on achieving a global agreement at a cost of a more suitable framework for the U.S. economy. As I stated when the Basel III agreement was proposed for comment in June 2012, I hold the view that we should implement a more streamlined capital standard that requires more and higher quality capital in the banking system.[1] Moreover, as I laid out in remarks earlier this year, there is a good deal of economic literature highlighting the shortcomings of risk-weighted capital as a predictor of bank distress, suggesting caution in becoming overly reliant on Basel risk-weights.[2]

Today's IFR contains a number of provisions that fail to address known and potential risks to the banking system. For example,

1. The U.S. housing market was at the center of the financial crisis – yet today we are not modernizing the risk-weights on banks' mortgage loans;
2. Government-sponsored enterprises (GSEs) such as Fannie Mae and Freddie Mac were placed into government-controlled conservatorships – yet the banking agencies continue to assign low risk-weights to GSE exposures;
3. Linkages between highly levered financial institutions are a significant risk to the financial system – yet, subject to deductions, exposures to supervised depository institutions carry a risk weight that is one-fifth of the risk weight of non-financial investment grade corporate exposures;
4. Since 2008 many sovereign nations have experienced severe stress in the sovereign debt markets – yet, the IFR assigns a risk weight of zero to sovereign OECD exposures that do not have a country risk classification rating; and
5. Notwithstanding the Federal Reserve's unconventional monetary policy

to hold long-term interest rates below market-based prices, for regulatory purposes we are not requiring some banks to recognize the effects that changes in interest rates would have on the value of their securities – even at a time when securities holdings as a percentage of assets are at relatively high levels.

Despite these shortcomings, I support the interim final rule implementing Basel III because it does increase both the quality and quantity of capital required of all U.S. banks. The definitional improvements are heavily based in the numerator as opposed to the denominator; nonetheless, they strengthen our current definition of regulatory capital.

Enhanced Supplementary Leverage Ratio Notice of Proposed Rulemaking

In my view, the serious shortcomings in the Basel III IFR make it all the more important that the U.S. implement a strong capital standard based on total leverage. I believe the debate has shifted and a great deal of progress has been made since Basel III was first proposed for comment in June 2012. At that time, there was no significant momentum to enhance capital regulation based on total non-risk weighted assets. It should not have been as difficult as it has been for the agencies to come together on today's leverage ratio proposal, which hardly seems like a seismic shift in capital requirements and represents an attempt to address one of the core causes of the financial crisis. Today's proposal to seek comment on a more stringent leverage restriction for a category of the largest globally active U.S. banks does mark a step in the right direction. I am hopeful that with the aid of the comment process, the agencies will strengthen this important component of the capital framework in 2013. A meaningful increase in the leverage ratio requirement as a complement to the Basel framework is critical to making considerable progress towards a better financial system.

I look forward to receiving comments on both initiatives before us today. Thank you.

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[1] Jeremiah O. Norton, *Opening Statement: Basel III and Improved Capital Measurement Standards*; Given at the Meeting of the Board of Directors of the Federal Deposit Insurance Corporation (June 12, 2012), *available at* http://www.fdic.gov/about/learn/board/norton/statement6-12-2012.html.

[2] Jeremiah O. Norton, *A More Prominent Role for the Leverage Ratio in the Capital Framework*, Speech Given to the Florida Bankers Association (February 6, 2013) *available at* http://www.fdic.gov/news/news/speeches/spfeb0613.html.

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