



Speeches & Testimony

Opening Statement of FDIC Director Jeremiah O. Norton: Basel III and Enhanced Supplementary Leverage Ratio Final Rules and Notice of Proposed Rulemaking to Implement Basel Committee Revisions to the Denominator Measure for the Supplementary Leverage Ratio

April 8, 2014

Mr. Chairman, I would like to begin by thanking today's presenters and their staff, who have played an important role in working to modernize the capital framework for banking organizations in the U.S. for many years.

I support each of the capital initiatives before the Board today: (1) the Final Rule comprising the implementation of the Basel III accords in the U.S., (2) the Final Rule setting forth an enhanced supplementary leverage ratio requirement for the largest bank holding companies and their depository institution subsidiaries, and (3) a Notice of Proposed Rulemaking to Implement Basel Committee Revisions to the Denominator Measure for the Supplementary Leverage Ratio.

Today's measures represent an important step toward a more resilient U.S. banking system. In particular, I will focus on the final rule setting forth an enhanced supplementary leverage ratio requirement for the largest banking organizations in the U.S.

Banking organizations in the U.S. have long been subject to a leverage ratio requirement as part of the capital framework in the Federal Deposit Insurance Act.¹ This leverage ratio requirement is calculated using only assets required to be reported under U.S. Generally Accepted Accounting Principles (GAAP), which does not provide a complete representation of an entity's financial position, particularly for larger banking organizations engaged in extensive derivatives and securities financing activities. The Agencies' July 2013 Basel III final and interim final rules place a 3 percent supplementary leverage ratio requirement on advanced approaches banking organizations. This new requirement relies on both GAAP-reportable assets as well as certain categories of exposures and commitments that are not reportable under GAAP and therefore provides a better measure of total leverage exposure.

Recent experience and data, however, support moving forward with a stronger requirement than the 3 percent supplementary leverage ratio as a means to reduce the likelihood of distress at the largest banking organizations and to lessen the effects of such distress on the U.S. economy.

- First, as the Agencies noted last July, "[a]n estimated half of the covered BHCs that were BHCs in 2006 would have met or exceeded a 3 percent minimum supplementary leverage ratio at the end of 2006, and the other half were quite close to the minimum. This suggests that the minimum requirement would not have placed a significant constraint on the pre-crisis buildup of leverage at the largest institutions."² These data suggest that a more robust leverage ratio requirement for the very largest banking organizations is warranted.
- Second, there is recent economic research to support the conclusion that the leverage ratio is a statistically significant predictor of bank default while the Basel Tier 1 risk-based capital ratio is

not.³ Research from the Bank of England on a sample of 45 global banks shows that the leverage ratio is a statistically significant predictor of bank failure, while Tier 1 risk-based capital ratios are not. Likewise OECD economists, studying 94 banks between 2004 and 2011, have shown that the Basel Tier 1 risk-based capital ratio is not a statistically significant indicator of bank default; however, the leverage ratio is very statistically significant.⁴

- Third, research by the staff of the International Monetary Fund shows that a leverage ratio anchored in tangible common equity had a statistically significant impact on the degree to which banks reduced lending during the crisis, while regulatory capital ratios did not.⁵ In other words, banks with higher leverage ratios maintained the supply of credit more than their peers.

Finalizing a strengthened leverage ratio rule for the very largest banking organizations at 5 percent for bank holding companies and 6 percent for depository institution subsidiaries is an important step towards improving the resiliency of the banking system. As I have noted in prior remarks, however, the risk-based capital framework negotiated by the Basel Committee leaves unchanged measures that were proven deficient during the financial crisis, such as the risk-weights on mortgages and government-sponsored enterprises, and also fails to address appropriately foreign sovereign debt risk-weights.⁶ These and other deficiencies underscore the need for the U.S. banking system to have a meaningful leverage ratio requirement and for policymakers to continue to improve the capital framework going forward.

I look forward to receiving comments on the Supplementary Leverage Ratio Denominator NPR. Thank you.

¹ See, e.g., 12 U.S.C. § 1831o(c); 12 C.F.R. § 325.3.

² Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, *Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and Their Subsidiary Insured Depository Institutions* (Notice of Proposed Rulemaking) 78 FR 51101, 51105 (August 20, 2013).

³ Andrew Haldane, Economist and Executive Director of Financial Stability The Dog and the Frisbee, Speech Given at the Federal Reserve Bank of Kansas City's 36th Economic Policy Symposium, Jackson Hole Wyoming (2012) at Table 4 available at <http://www.bankofengland.co.uk/publications/Documents/speeches/2012/speech596.pdf>.

⁴ See Adrian Blundell-Wignall and Caroline Roulet, *Business Models of Banks, Leverage, and the Distance-to-Default*, OECD (2012) available at <http://www.oecd.org/finance/BanksBusinessModels.pdf>. (The relationship between leverage ratio and bank likelihood of default is statistically significant at the 1% level of significance).

⁵ Tumer Kapan and Camelia Miniou, *Balance Sheet Strength and Bank Lending During the Global Financial Crisis*, International Monetary Fund (May 2013) at 12 available at <http://www.imf.org/external/pubs/ft/wp/2013/wp13102.pdf>

⁶ See, e.g., Jeremiah O. Norton, *Opening Statement: Basel III Interim Final Rule and Enhanced Supplementary Leverage Ratio Notice of Proposed Rulemaking* (July 9, 2013) available at <http://www.fdic.gov/about/learn/board/norton/statement7-9-2013.html>; 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>.