Statement by Thomas M. Hoenig, Vice Chairman, Board of Directors, Federal Deposit Insurance Corporation on the Adoption of the Supplementary Leverage Ratio

April 8, 2014

As we vote to adopt a supplementary leverage ratio and other capital standards, I want to recognize the FDIC staff for their exceptional work. Because of their efforts we are preparing to vote on much needed improvements in the standards for judging the adequacy of bank capital that, in total, will serve to enhance the financial stability of the largest banks in the United States and the broader financial industry.

I will vote for the Basel III final rule to serve as a complement to the supplementary leverage ratio in judging the largest banks' capital strength. I also support the notice for proposed rule making designed to further enhance the reliability of the Basel III leverage ratio as an international standard.

I will vote for and strongly support adoption of the supplementary leverage ratio to judge the adequacy of capital for the largest banks. I will focus the majority of my comments on this critical rule which measures the total capital available to absorb loss that may arise from sources of both on and off-balance sheet risks. The supplementary leverage ratio is a more reliable measure that is simpler to calculate, understand and enforce than the subjective risk-weighted measures, and it provides a highly useful initial assessment of a bank's balance sheet strength.

Previously, under Basel II, banks and regulators relied solely on risk-based capital measures that essentially were regulators' estimates of the riskiness of asset categories and then banks would allocate capital accordingly. Experience has shown that relying only on a risk-based capital measure serves the public poorly. Reliance on risk-based capital measures has coincided with the build up of unacceptable levels of leverage in the largest banks. As recently as year-end 2013, reported risk-based capital ratios for the largest global banks averaged 13 percent while the average leverage ratio was less than 5 percent, depending on how off-balance sheet risk is measured[1]. If regulators had used a leverage ratio in the supervision of the largest banks prior to 2008, we might have better understood the high debt burden these institutions carried and better anticipated the inevitable deleveraging process that has restrained economic growth since the crisis began.

Banks with stronger capital positions are in a better position to lend, to compete favorably in any market, and to achieve satisfactory results for investors. Without sufficient capital, the opposite is true. For example, in the period 2006-2008, there was no binding leverage ratio on the largest institutions. It is evident now that during that period banks increased their leverage and took on excessive risks to meet targeted returns. It was the reliance on and manipulation of a risk-based capital framework that allowed risk to build up to a point that nearly brought the global financial system to collapse. Furthermore, the preponderance of studies show that banks that entered the

[1] Global Capital Index: http://www.fdic.gov/about/learn/board/hoenig/capitalizationratios4q13.pdf

financial crisis with relatively higher levels of capital, as indicated by the leverage ratio, also maintained lending and credit levels far more consistently than those with less capital.

I realize that the financial stability of a firm or industry depends on a host of factors. Economic performance and the quality of management are at the top of the list of such factors. However, capital is also a key element in that it provides stable funding and an important margin for error that all firms require to manage through poor economic conditions and mistakes in judgment. After all, we should not ask banks to stop taking risks, but we absolutely should expect banks to assume responsibility for those risks by providing themselves an adequate capital cushion. I am confident that supervisors will rely increasingly on the leverage ratio, as the market already does, to judge a firm's capital levels, loss absorbing capacity, and balance sheet strength.