Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and Their Subsidiary Insured Depository Institutions

I am a university student currently studying business and politics at a prestigious research institution. Having lived through one of the most tumultuous periods in recent financial history, my interest in this proposal is both a result of my studies and my experiences. I hope to convey my thoughts on this proposal in a way that will help the relevant authorities make the most informed decision.

As it stands, the current proposal seeks to strengthen leverage ratio standards for large, interconnected U.S. banking organizations – more specifically Bank Holding Companies "with at least $700 billion in total consolidated assets or at least $10 trillion in assets under custody and any Insured Depository Institution subsidiary of these BHCs." Establishing adequate reserve capital standards for financial institutions is a critical component of a sound financial system. As discussed in the proposal, regulators must not only set reasonable leverage ratios, but they must also be very careful in how they define the financial institutions, assets, and activities to which these standards can be applied.

The financial industry's increasing reliance on structured financial products and special purpose entities (SPEs) has made what should be a transparent operation unfathomably convoluted and opaque. It is in the best interest of these firms to use these strategies in order to evade oversight by regulators, avoid tax obligations, and to conceal any losses that could jeopardize investor confidence. These same practices have helped destabilize the global financial system,

plunge the U.S. into a severe recession, and put into question the security and reliability of U.S. government debt.

Increasing leverage ratio standards for large financial institutions will help mitigate the effects of some of their more questionable investment activities. In light of the recent financial crisis, there is little evidence to suggest that Washington will take the appropriate steps to hold Wall Street accountable to the extent that it is responsible for the calamity. While economists differ greatly in their approach to the situation – suggesting solutions anywhere from government bailouts to 'creative destruction' of the financial system – they are all attempting to address the problem of moral hazard. Beginning with the deregulation in the 1980s, the banking industry has since developed a culture that revolves around the unfettered and unequivocal pursuit of profits. While increasing leverage ratio standards and other forms of regulation will help reign in some of the dangerous investment strategies of financial institutions, it does not address the underlying problem: banks are incentivized to participate in exceedingly risky transactions because they are confident that the U.S. government will bail them out should they become insolvent. As such, even with higher leverage ratio standards, it will only be a matter of time before these financial firms find other investment avenues that expose them and the U.S. economy to great risk and potentially catastrophic losses. The political and socio-economic impacts could be immeasurable.

Increasing reserve requirements and broadening the range of institutions, assets, and activities that fall under this regulatory scope is certainly a positive step towards a more stable financial system. As it stands, the proposal seeks to increase requirements for those large institutions

with hundreds of billions of dollars-worth of assets. I think that the proposal should be modified to include many more financial institutions with smaller asset bases, possibly in the tens of billions of dollars range. By focusing only on the largest institutions, the proposal seeks only to establish a bare-minimum safety net to prevent future crises – it does not address the issue of moral hazard, nor does it attempt to alter the destructive behavior that many financial institutions partake in. Expanding the scope of the proposal to include most financial institutions in the country will send a clear message that discourages excessive risk taking, and will help restore confidence in the U.S. government and its ability to make good on its obligations.