PRESS RELEASE

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FDIC Chairman Powell Discusses Minimum Capital Requirements for U.S. Banks

In remarks delivered April 8 at a derivatives conference co-sponsored by the Federal Deposit Insurance Corporation (FDIC), Cornell University and the University of Houston, Chairman Don Powell commented on the relationship between the new Basel capital framework and the leverage capital requirement mandated by the Federal Deposit Insurance Corporation Improvement Act (FDICIA).

"U.S. law and regulation require FDIC-insured banks to meet certain leverage ratio requirements. The leverage ratio is a simple, clear-cut minimum amount of capital banks need to hold as a percentage of their assets," said Chairman Powell. "Some observers are now suggesting that the arrival of Basel II will make this leverage requirement obsolete."

"We expect the process of implementing the Basel II framework to encourage, over time, a disciplined approach to risk management and measurement in banking, and to better align regulatory capital requirements with underlying risk profiles. Nevertheless, a leverage ratio is, and should remain, an integral part of our overall system of capital regulation. With regard to the relationship between the leverage ratio and the Basel II framework, a number of points need to be considered."

Chairman Powell went on to outline the following points:

- The Basel II framework does not purport to model all risks—interest rate risk, for example, is not modeled under Basel II.

- All models, but especially those that attempt to measure the extreme tails of a dynamically changing probability distribution are subject to error and uncertainty.

- The reliability of a model is limited not only by the statistical uncertainty of its outputs, but by the quality of its inputs—and the critical risk inputs of Basel II ultimately will be the product of human judgment.

- The systemic implications of a large bank failure give regulators good reason to require more capital than what a bank believes is optimal for its own purposes.

"In our view, phasing out the leverage ratio suggests we are willing to contemplate a significant expansion of the federal safety net. An important principle underlying the Prompt Corrective Action provisions of FDICIA was that there should be limits on regulators' discretion about the level of capital at which banks are permitted to operate. The FDIC continues to support that position. Any risk-based capital framework that addresses the risks and uncertainties of the real world must include a straightforward capital floor," Chairman Powell concluded.