Statement of FDIC Vice Chairman Thomas M. Hoenig
to the Board of the FDIC
on the Notice of Proposed Rulemaking on simplifications to the capital rule
pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996

September 27, 2017

This NPR is intended to simplify capital requirements and reduce regulatory burden for banks following comments received during the EGRPRA process. Its preamble suggests it is designed to simplify the regulatory treatment for certain assets. However, in reviewing this NPR, I find that it is neither simpler nor less burdensome than the current rule. It is just different. Different, but it still remains overly complicated and burdensome offering mostly technical adjustments. It falls well short of achieving the kind of simplification that would provide truly meaningful benefit to the industry, investors, and the public. Unfortunately, the proposed changes will only perpetuate the disparate capital benefits across banks of different sizes and provide only minimal regulatory reporting relief.

Fortunately, we were able to include additional questions in the NPR so that the agencies can seek comment on meaningful alternative proposals. There is one question in particular that I support – Question 14. Because the NPR was expanded to include this question, I am voting in favor of releasing the NPR. I am particularly interested in receiving comments and encourage the nearly 6,000 banks of all sizes to address the question in the NPR**.** I think this is important enough that I would like to read Question 14 for the record:

> While the proposed rule addresses comments received during the EGRPRA review regarding the complexity of the risk-based capital standards, the agencies seek comment on additional alternatives to simplify and streamline the regulatory capital rules. The agencies recognize the difficulties in achieving simplification of the risk-based capital standards, particularly the burden related to their calculation and reporting, and the potential disparate impact to smaller and medium sized banks relative to their GSIB counterparts.
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> Therefore, the agencies seek comment on whether they should consider a fundamental change to the manner in which banking organizations calculate and comply with minimum capital standards such as through the use of a simple U.S. GAAP-based equity-to-assets ratio (leverage ratio) for non-GSIB banks. If so, what would be the appropriate definition and level for the ratio? Also, what relief should be realized upon implementation of this capital standard relative to changes in the call report and other reporting standards?

Critics opposing the use of a leverage ratio for judging the adequacy of bank capital argue that it would encourage banks to "risk up" their balance sheets since required capital is the same for different assets. However, this NPR shows that the risk-based capital framework explicitly incentivizes the same type of "risk up" to balance sheets. Nowhere are the perverse incentives of risk-based capital as clear as in the proposed change to the treatment of commercial real estate. The NPR effectively lowers the assigned weightings on riskier commercial real estate assets from 150 percent to 130 percent without any change to underwriting standards, thus encouraging banks to leverage these riskier assets even further. The NPR then increases the weightings on less risky commercial real estate loans, mostly held by community banks, thus penalizing their longstanding efforts to reduce exposure to higher risk and more volatile commercial real estate transactions.

Finally, I have long had concerns regarding the agencies' well-intentioned but repeated failure to forecast and assign common risk-weights across the balance sheets for thousands of banks. The imposition of these rules, and their enormous cost on the industry and the public when they achieve such poor outcomes, is wasteful. A leverage ratio assumes no special regulatory clairvoyance regarding a bank's shifting risk. It is simpler to calculate and more understandable to the public and investors. It is less burdensome to report and more useful in judging the overall solvency of a bank of any size. It also recognizes the ongoing role of the examination process in assessing a bank's risk profile. If the industry were to rely more explicitly on such a simplified measure, bankers could realize a significant reduction in reporting burden and better use those resources for lending and investing in their local economies while simultaneously promoting safety and soundness.