BANKTHINK
INFORMED OPINION

Raise Capital Levels, But Ditch Basel III

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There is a solid case that the banking system and the stability of the economy would benefit from more capital. How we get there is an open question.

The industry stated loudly and clearly what they thought of the proposed solution under Basel III. The fact is that U.S. banking regulators have the authority to increase the capital requirements regardless of Basel III. Keeping in mind we are only talking about "minimum" capital, the agencies should increase the levels. The current levels are well below where most banks would be comfortable operating. No buffers, no unrealized gains and losses, just tell the industry what the minimum capital should be. For most of the industry, they should have little trouble meeting a reasonable requirement.

The risk-based capital measurements are a different story. Federal Deposit Insurance Corp. Vice Chairman Thomas Hoenig has characterized risk-based capital as "an experiment that has lasted too long." FDIC Director Jeremiah Norton recently stated the risk weights were "not reliable predictors of future default." Many in the industry will tell you risk-based capital measurements are a regulatory exercise. This tells me we need a greater understanding of the value and role of risk-based capital.

If we believe that risk-based capital has supervisory utility, we would be far better off if the regime also enhanced the bank's risk management. We also need to determine the appropriate method to determine risk weights. We run the real chance of setting risk weights to be intentionally punitive and discourage certain types of lending. The foundation of capital adequacy is to support the risk within the institution. Capital policy should not be used to allocate credit.

Finally, we should assess the appropriateness of risk-based capital for all institutions. We should be open to the fact that perhaps even for supervision, risk-based capital may have limited value for smaller banks that have a much deeper understanding of their risk exposures.

There are fundamental truths about capital. Even banks with "a lot" of capital may not have enough on hand when it begins to experience losses. When a bank is in real need, capital is hard to come by. The federal agencies have the authority and ability to raise minimum capital in a direct and meaningful way. For the bulk of our industry, this can be done outside of the Basel III process.

The agencies can use Basel III parameters and the heightened prudential standards under Dodd-Frank to address the significant risks posed by the "Too Big to Fail" institutions. Quick, clear, and straightforward action for the rest of the industry will go a long way toward reducing uncertainty about capital requirements, achieving regulators' goal of improving the quantity and quality of capital, and fueling additional economic growth.

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