Statement of

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Chairman Bachus, Ranking Member Frank, and Members of the Committee, I appreciate this opportunity to discuss the work that the OCC and the other banking agencies have underway to revise bank capital and liquidity requirements consistent with the Dodd-Frank Act and Basel III. This is a complex undertaking, and we believe it is important to determine not only how individual requirements of Basel and Dodd-Frank will impact U.S. firms and their international competitiveness, but the cumulative impact of the provisions as well.

The invitation letter raised the issue of an international "race to the bottom" but this is not a serious concern when regulatory requirements are becoming more stringent around the world. The concern instead is that standards are being raised so significantly and comprehensively that we could unnecessarily restrict financial intermediation and economic performance. At the same time, it is certainly true that if the same high standards are not adopted by all countries and enforced with the same vigor, U.S. institutions could be left at a competitive disadvantage. Our goal must be to address the problems that led to the financial crisis without undermining the ability of banking institutions to support a strong national economy, or placing U.S. institutions at an unfair competitive disadvantage internationally.

Both the Dodd-Frank Act and Basel III aim to promote a more resilient banking sector by imposing stronger capital and liquidity standards. They raise the amount of regulatory capital and, just as important, the quality of that capital is improved significantly by placing much greater reliance on common equity and raising capital charges on risky asset classes. Banks will also be required to hold substantially more liquidity in the form of short-term, low-risk assets and to increase their reliance on more stable, long-term debt and core deposits.

The Basel III standards were designed around the crisis experience of the largest, internationally active U.S. banks. So while the OCC has also supported a capital surcharge of common equity for a small number of the very largest banks, that add-on should be modest given where capital requirements have already moved. This is not to argue that surcharges should not be higher in countries where large institutions represent a greater risk to the national economy, particularly where the assets of the largest banks exceed national GDP like Switzerland and the U.K. The U.S., on the other hand, has imposed statutory caps on the size of our largest firms, and even the largest firms are only a fraction of GDP.

While 27 countries reached general agreement on the policies and standards outlined in Basel III, the details of its implementation will likely vary from country to country. U.S. implementation is likely to be more complex and impose additional constraints on our domestic banks than in other countries owing to the interaction with Dodd-Frank.

For example, the Collins Amendment sets a floor on capital based upon current Basel I standards, a dual capital calculation that non-U.S. banks will not face. And with the simpler Basel I framework still used to determine capital, large U.S. banks will have far less incentive to rigorously pursue the complex and costly task of implementing the Basel II framework.

The Dodd-Frank Act’s prohibition against the use of credit ratings also will impede our efforts to achieve international consistency in the implementation of Basel III, since Basel III, the Basel II framework upon which it is built, and Basel I for that matter, make use of external ratings in several areas including securitizations, assessment of counterparty credit risk, and trading book positions.

Given capital already raised by large banks, a return to profitability, and the extended phase-in period for the higher capital standards of Basel III, U.S. banks should be able to transition to the 7 percent standard without causing undue stress on the economic recovery. However, I am concerned with how much further we can turn up the dial without negative effects on lending capacity. A very real risk is that lending will fall, will become more expensive, and will again move from the regulated banking sector into the less regulated “shadow” banking sector. Certainly a lesson of the financial crisis is that risk can migrate to, and accumulate in, the unregulated “shadow’ sector, with undesirable consequences.

The fact that so many Dodd-Frank and Basel III reforms are occurring at once, with combined effects we cannot measure, is cause for caution. Before contemplating substantial further increases to capital and finalizing liquidity requirements, we need to take account of all the reforms being introduced to increase the ability of the financial system to absorb losses and to reduce the probability and potential impact of the failure of large institutions. The goal of all these changes is to improve the system's resilience but, taken too far, we may limit the availability of credit that is needed to support economic growth.

Thank you. I look forward to your questions.