

**Remarks by**  
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It is an honor and a pleasure to be here to speak with you this evening. Japan and the United States share many close linkages – notably in trade and finance, but more and more, I find, in sports and popular culture, marked by Japanese exports of animation, baseball players, and TV game shows to an American audience. Some of these areas are clearly more significant than others, and the focus of my remarks will be financial regulation – and, in particular, policies regarding banking. Japan is always an important partner in discussions of international policy on banking regulation and supervision, whether bilaterally or through multilateral groups such as the Basel Committee on Banking Supervision, the Financial Stability Board, or the G20. Of note was the recent ascension of the FSA’s Ryozi Himino to the chair of the Basel Committee’s Standards Implementation Group.

I head the Office of the Comptroller of the Currency or OCC, which is one of the three federal banking regulators in the United States, along with the Federal Reserve and Federal Deposit Insurance Corporation. The OCC regulates banks and thrift institutions chartered at the federal level in the U.S., a total of about 2,000 banks and thrifts. Most of them are small community or regional institutions. But this number also includes most of the largest banks in

the U.S., so the banks we regulate account for 70 percent of the \$13.6 trillion in total banking and thrift assets in the United States.

The last few years have been a tumultuous time for banks, and for bank regulators like me. Out of the financial crisis of 2007-2009 has emerged an extensive international regulatory reform agenda. This evening I will address the many changes proposed for the global financial system in the wake of the financial crisis, and how reform is being pursued at the national level. The disruption that had its origins in the U.S. subprime residential mortgage market exposed serious defects in other products and markets and spread to financial institutions and markets throughout the world. This systemic financial disruption resulted in reduced economic activity and slower growth, and the impact continues today. Against this background, political authorities and financial regulators reasonably turned to a reexamination of existing regulatory policies and institutions to determine what changes might be appropriate. The result has been a broad array of measures that is transforming the world's financial system.

### **Capital and Liquidity**

One area of particular international focus has been the adequacy of capital for banks and similar firms. Problems at a number of major financial institutions in the depths of the crisis revealed significant deficiencies of capital and liquidity. Prior to the financial crisis, the Basel Committee developed the framework for capital adequacy requirements known as Basel II. But as the financial turmoil began, the Basel framework had been implemented fairly recently in many countries, and was still in the process of being implemented in others and had not yet taken effect in the United States. So it is hard to argue it was the source of these problems, but given the depth of those problems, it was essential for the Basel Committee to undertake a fairly broad

reconsideration of the capital framework, and to try to identify aspects that might warrant improvement in view of the lessons learned during the financial crisis.

The results of that reconsideration are probably largely familiar to this audience. There were changes to the definition of what qualifies as capital – the “quality” of capital – to improve its ability to absorb loss when needed. This was accompanied by a general increase in the minimum capital requirements, and introduction of a capital conservation buffer that would trigger actions to preserve and build capital at banks when capital ratios fall to levels approaching the minimum. The Basel Committee has also put forward a variety of proposed enhancements for the capital treatment of risks that were particularly prominent during the financial crisis, such as counterparty credit risk. A leverage ratio was introduced to complement the risk-based capital framework, and the Basel Committee considered a number of steps that could help make capital less cyclical. Most recently, the Committee has been establishing methods to assess the systemic importance of banks, together with a system of capital requirements that would lead the most systemically important banks – the globally systemically important banks, or G-SIBs – to hold significantly more capital than other banks.

The companion body of work has been the development of global minimum liquidity standards. The Basel Committee has developed a new liquidity framework, including two specific metrics: a Liquidity Coverage Ratio reflecting shorter-term aspects of liquidity, and a Net Stable Funding ratio reflecting longer-term aspects. The draft framework has been found wanting, and efforts to refine it are continuing. But its importance is beyond question, and the Committee’s liquidity initiatives reflect broad agreement that liquidity is a first-order concern for financial firms, and that regulators and the industry were not doing enough prior to the crisis to ensure adequate liquidity under conditions of stress.

I believe there is broad agreement on the need to address capital and liquidity standards. And the process has been reasonably well coordinated through a shared G20 commitment to higher standards, a commitment put into practice through the Financial Stability Board, the Basel Committee, and similar groups.

But although much has been accomplished, much remains to be completed, including final work on the G-SIB framework and the liquidity standards. And perhaps even more crucially, much difficult work still lies ahead to actually implement the various policy agreements within the prevailing legal frameworks in various parts of the world. Details of implementation are likely to be crucial in determining the ultimate effect of the agreed upon standards, a point to which I will return in a few minutes.

In the United States, we are continuing to implement Basel II in our largest banks. We also are working on rules to address Basel III, as well as some of the earlier enhancements known as “Basel 2.5” that treat important aspects of trading activities and securitization. But in the U.S. we face an additional complication: the Dodd-Frank Act, the major package of financial reforms that became law in the U.S. last year. Dodd-Frank added additional capital and liquidity requirements that align reasonably, but not precisely, with the various Basel agreements. Among these are heightened prudential standards for all banks with more than \$50 billion in assets, floors under risk-based capital requirements, and elimination of the use of external credit ratings from financial regulations. Interweaving all these national and international requirements, and meeting our statutory mandates and our commitments in Basel, will be the challenge of the next 6-12 months.

#### **Other Aspects of Financial Reform**

But the scope of the Dodd-Frank Act extends beyond capital and liquidity to changes in the structure of financial services, in the nature of banks' permitted activities, and in the regulatory order more generally. U.S. financial regulation is broadly in flux as a result of the Dodd-Frank Act. We are now in the midst of trying to translate the requirements of the law into regulatory language, and that is by no means an easy process. In part, that's because there are so many mandates in the law. There is the so-called "Volcker Rule," which restricts proprietary trading and bank investments in hedge funds and private equity funds. There are new requirements governing margin for derivatives and non-cleared swaps, and for risk-retention in securitizations. There are new regulations on incentive compensation at banks, and a requirement that large institutions develop plans for orderly resolution. Not surprisingly, there are many changes in the regulations governing mortgage underwriting and securitization. And I can assure you, the list goes on.

Many of the Dodd-Frank provisions address aspects of financial reform that are also the subject of international discussion. For some of these, there is an element of shared commitment and general agreement on broad principles that offer hope of international policy coordination. A good example here is enhanced rules for derivatives clearing and related margin and settlement requirements. The Financial Stability Board has identified this as a matter of some urgency and importance for its members, providing impetus for consistency across major markets in North America, Europe, Asia, and the Pacific.

Other components of the Dodd-Frank Act – the Volcker rule, the possible push-out of derivative activities from banks – address the organizational structure of financial institutions and the types of activities in which they are permitted to engage. In these areas, the U.S. approach differs from policy actions contemplated or taken by other nations or authorities.

For example, in the UK, the report of the Independent Commission on Banking – the so-called Vickers Report – recommends a significant structural change that would require strict separation between retail banking and investment banking at the big British banks. The retail banking portion would face significantly higher capital requirements. This fundamental shift in the UK banking system reflects a view that the costs imposed by problems at large banks are very serious indeed – so serious that they warrant a dramatic change in the structure of the industry. Switzerland takes a decidedly different approach in its decision to impose capital requirements on Swiss banks that are considerably higher than the internationally agreed minimums, but without changing the structure or permissible activities of Swiss banks.

Not only are there large differences in the types of policies being implemented in different jurisdictions, but the impact of those policy changes depends upon the underlying regulatory and supervisory regimes. These also vary across countries, and the regulatory regimes are themselves in flux in the wake of the financial crisis. In the U.S., the Dodd-Frank Act brought some new players onto the regulatory stage, including a Consumer Financial Protection Bureau, an Office of Financial Research, a Federal Insurance Office within the Department of Treasury, and a new Financial Stability Oversight Council of all US regulators that aims to ensure financial stability at a systemic level. And, as discussed at this conference a year ago, the former regulator of U.S. thrift institutions, the Office of Thrift Supervision, was integrated into our agency, making the OCC the sole regulator of all federally chartered banks.

Regulatory frameworks continue to change outside the U.S. as well. In the European Union, the role of the European Banking Authority continues to evolve. In the UK, the banking regulation functions of the Financial Services Authority, moved out of the Bank of England just over a decade ago, are now largely moving back. Japan, of course, also followed the trend to

consolidate financial supervision in a single entity when it created the Financial Services Agency in 2000.

### **The Impact of Differences**

The financial reforms we are all undertaking are many, varied, and – without question – complex. No one can accurately foresee how they will all fit together. I use a “drug interaction” analogy: an individual medication taken alone to attack a single illness can be beneficial, but many medications taken together to address a variety of ailments may offer less benefit than the sum of the parts, and may cause dangerous interactions. Even for reforms to which we are all committed, there is the risk of inconsistent national implementation and weak international coordination, when so many features are changing so significantly all at roughly the same time.

What are we to make of this? Some aspects of financial reform – especially capital and liquidity standards for internationally active banks – are being addressed simultaneously in multiple settings around the world, under different environments and legal regimes, but reinforced by a shared commitment to consistent application. Other areas of financial regulatory reform are not subject to the same degree of coordination: in some areas, coordination is less; in others, it is essentially absent. Does this mark a failure of international coordination? Is it a source of systemic risk?

Not necessarily. Different countries and regions have different policy preferences and requirements. The Volcker rule can be thought of as a successor to Glass-Steagall, which uniquely defined the U.S. banking system for many decades. Yet such differences are likely to change the “playing conditions” of international financial activity, affecting the “financial geography” of the global system. By this I mean not only physical locations of financial firms, but also the locus of types of financial activity such as derivatives trading.

The results are hard to predict. Where will future financial activity take place? Where will the risk reside? Will this change the degree of control that national authorities are able to exercise over certain aspects of the financial system? Effects may well vary by product and activity. Such differences are not in themselves an argument against taking these policy actions, but we have to acknowledge the differences and consider the consequences.

Given the status of the Basel Committee and its commitment to consistent implementation of capital, liquidity rules, and other regulatory priorities, there is reasonable assurance that changes will not unduly “tilt” the playing field in one direction or another. However, coordinating mechanisms like the Basel Committee are either absent or relatively new in some of the other areas of regulation that I have discussed, making it more difficult to achieve congruence.

Financial policy makers should be giving serious thought to the consequences of significant differences in the direction taken in these less-coordinated elements of post-crisis financial reform. Our ultimate policy decisions might be the same, but only by considering the possibilities will we have a chance of being prepared for the responses to those policies in a dynamic global financial system.

Some suggest that uneven implementation of financial reform or more basic differences in regulatory policy might lead certain financial activity to migrate to new financial centers: from North America to Europe or on to Asia. That would be unfortunate indeed if it was a response not to market forces and opportunities but to perceived differences in the intensity of supervision and regulation. Frankly, I don’t expect this to happen. I have been struck by the commitment of authorities in European and Asian financial centers to implement internationally



agreed changes to the treatment of derivatives – such as centralized clearing, and improvements to trade reporting – as well as capital requirements and other aspects of financial regulation.

### **Closing Thoughts**

Regulation at its best can address the risks and issues we know about today. But the system we regulate will continue to change and evolve, as will the individual institutions and the financial markets in which they operate. This is a good thing – innovation can bring new and better financial products and financial services, delivered in new and better ways. But change and innovation require nimble financial authorities who understand the system, who make the effort to anticipate dynamic change, who can address unusual cases as they arise, and who maintain a certain degree of flexibility to modify regulations as the world changes. This will require ongoing coordination, cooperation, and communication among the world's regulators. We will only achieve that through relationships of trust and mutual respect, which in my experience are best built at the personal level. That is yet another reason I am pleased to be here with you this evening, and I look forward to continuing discussions with all of you.

Thank you.