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White House to Propose Big Reserves at Banks

By ERIC DASH
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Many banks are finally back on their feet. The question now is how to keep them there for good.

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So after propping up lenders with billions of taxpayer dollars, the Obama administration is contemplating long-term measures aimed at preventing, or at least minimizing, any future financial crisis.

The thrust of the plan is to have banks, particularly those deemed too big to fail, maintain larger capital cushions — a move bankers have traditionally opposed because it eats into their profits. The Treasury secretary, Timothy F. Geithner, is expected to outline the administration's proposals Thursday in a letter to the finance ministers of the Group of 20 industrial and emerging nations, who are scheduled to meet in London this week.

The measures are still under discussion and, if adopted, probably would not take effect for years. But capital levels, once the domain of academics and policy specialists, have quickly become Topic A in banking circles and underpin the administration's proposals for overhauling financial regulation. Compelling banks to hold more capital could radically reshape the industry.

Administration officials hope to reach a broad, international consensus on the issue and lay the groundwork for the rapid introduction of new capital guidelines after the Group of 20 summit meeting in Pittsburgh late this month.

But agreeing on an outline is one thing. Getting down to the details is quite another. The last international capital standards were years in the making. Those guidelines rely on banks' ability to assess risks, something most failed to do adequately in recent years, with disastrous results for the global economy.

Yet few policy makers see an easy fix. While requirements for more capital generally make banks safer, albeit less profitable, they also impede banks' ability to make the loans that fuel the economy and create jobs. The challenge is to strike a balance.

At the center of the Obama administration effort are two of the biggest issues in banking. The first is how to deal with institutions that are so large and interconnected that their failure might threaten the entire financial industry and the broader economy. The second involves institutions that take outsize trading risks, potentially exposing them to

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devastating losses. Some banks, like Goldman Sachs, fall into both categories.

Mr. Geithner is expected to propose that all banks maintain higher capital levels, with a big part in common stock. But so-called systemically important institutions — perhaps two dozen, mostly big banks, plus a handful of other financial institutions — would be held to even tougher standards. He is also expected to propose that institutions that engage in risky activities, like derivatives and proprietary trading, hold a larger buffer to guard against an industrywide shock.

"This is a critical part of making the financial system safer in the future," Mr. Geithner said in Washington on Wednesday. "This is not something we can take a long time to do."

Administration officials hope to reach a global consensus and are wary about putting American banks at a competitive disadvantage by imposing tighter restrictions unilaterally. Mr. Geithner said his goal was to come out early with a proposal to shape the debate.

It is unclear how regulators overseas will respond. European and Asian banks, which have typically held less capital than their American counterparts, might have to raise billions of dollars to comply with tough new global standards.

The Obama administration will meet plenty of opposition at home. Businesses like trading, derivatives and private equity would become far less lucrative if capital levels were sharply raised. The industry is unlikely to accept new rules without a fight.

Still, the failure of existing international standards, known as the Basel II accord, may prompt quick action. The health of banks has become a political issue as well as an economic one.

Under the current international rules set by the Basel accord, a bank is "well capitalized" if it meets a so-called Tier 1 capital level of 4 percent and a total capital level of 10 percent of its risk weighted assets. Under American rules, banks must hold even larger cushions.

Although no specific amounts have been settled on, it appears regulators now want more. In an interview on Tuesday, Sheila C. Bair, the chairwoman of the Federal Deposit Insurance Corporation, said there was already a consensus for a tougher international leverage ratio that would set consistent minimum capital levels around the world. "It needs to be a hard and fast simple measure to ensure adequate capital in good times and bad," Ms. Bair said.

Mr. Geithner is also expected to propose further measures intended to make banks less reliant on raising additional capital when the markets are under stress. One idea is to require banks to cut their dividends and stop buying back their own stock if their share price declines precipitously. Another is to encourage banks to issue preferred stock that automatically converts into equity in a severe downturn.

Putting new measures into effect could take years. American and overseas regulators are reluctant to raise capital standards, curbing lending, during a global recession.

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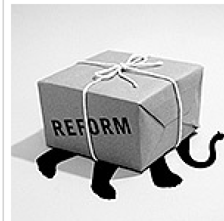

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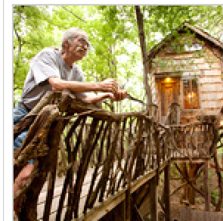

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