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Opening Statement on the Large Bank Capital Requirement Proposal
by Vice Chair for Supervision Michael S. Barr

I'd like to thank the staff—those around the table and countless others here at the Fed and at the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency—for all the work to get to this place today. In my opening remarks, I'll start by explaining the importance of this proposal, provide some more context for the proposal's requirements, and then end on the significance of the comment period, as well as the comments we receive, as we move toward the final rule.

First, a safe and sound banking system is critical to a healthy economy, and capital is foundational to that safety and soundness. Capital is the cushion that allows a bank to absorb losses—no matter their source—and ensures that banks can continue to play their critical role serving households and businesses. The goal of our actions today is simple: to increase the strength and resilience of the banking system by better aligning capital requirements with risk.

As we learned earlier this year, banks with inadequate levels of capital are vulnerable, and that vulnerability can cause contagion, which threatens the stability of the banking system and hurts families and businesses. A crisis was averted through invocation of the systemic risk exception that permitted the FDIC to support uninsured depositors and the establishment of an emergency lending program for the banking system. However, one clear message was that regulatory requirements, including capital requirements, must be aligned with actual risk so that banks bear the responsibility for their own risk-taking. The proposal takes an important step

toward better aligning capital requirements with risk, both for the specific risks in play this spring, and for a much broader set of risks that banks face.

As staff will explain in more detail, there are two proposals today. The first would update our capital standards to better reflect credit, trading, operational, and derivative risk for banks with $100 billion or more in total assets.

For a firm's lending activities, the proposed rules would end the practice of relying on a bank's own individual estimates of their own risk and instead use a standardized, but risk-based measure of credit risk. Standardized credit risk approaches do a reasonably good job of approximating risks, while internal models are prone to underestimate such risks.

Second, for a firm's trading activities, the proposed rules would adjust the way that the firm is required to measure market risk, which is the risk of loss from movements in market prices. These changes are intended to correct for gaps in the current rules.

For instance, the proposal would provide less credit for diversification across risk classes, since correlations across risks can change dramatically in times of stress. The proposal would require banks to use a standardized risk-based approach for hard-to-model risks. In addition, the proposal appropriately requires more capital for positions that are less liquid, in order to better capture the risks of illiquid trading positions.

Third, for operational losses—losses from inadequate or failed processes, such as from fraud or cyber attacks—the proposed rules would replace an internal modeled operational risk requirement with a standardized measure. The proposal would approximate a firm's operational risk charge based on the firm's activities, and increase the charge based on a firm's historical operational losses to add risk sensitivity and provide firms with an incentive to mitigate their operational risk.

Fourth, the proposal improves the capital treatment for derivatives activities by introducing a standardized but risk-sensitive measure of valuation risk due to changes in counterparty credit.

The second proposal would help to ensure that the surcharge applied to global systemically important banks (G-SIBs) better reflects the systemic risk of each G-SIB. In particular, it would make adjustments to limit so-called "window dressing," reduce "cliff effects," and improve how we measure some systemic indicators to better align them with risk.

These changes are designed to improve the risk sensitivity of the requirements. The changes are expected to increase capital requirements overall for banks with $100 billion or more in assets, but I want to emphasize that they would principally raise capital requirements for G-SIBs—the largest, most complex banks—better reflecting the risks their activities pose to financial stability. Increases would be small for large banks that are not G-SIBs. Banks under $100 billion in size without significant trading activities are not affected by these proposals. Community banks are not affected by the proposals.

To put these changes in context, recall that banks are, by nature, very leveraged and fund only a small portion of their assets with capital. The proposal would raise capital on average by 16 percent. One can think of the proposal's more accurate risk measures as equivalent to requiring the largest banks to hold about an additional 2 percentage points of capital, or an additional $2 of capital for every $100 of risk-weighted assets.

Staff has conducted extensive analysis on the economic impact of the proposal, which can be found in the preamble to the final rule. Specifically, this analysis suggests that the benefits of a robust financial system, as well as resilient financial institutions, outweigh the costs to economic activity that may result from additional capital. With respect to lending activities,

staff analysis suggests that the capital impact on these activities would be modest, and the greater resilience provided by the rule would contribute positively to economic growth by enabling firms to continue to serve as intermediaries and providers of credit through a range of economic and market conditions. We also intend to collect additional data to refine our estimates of the rule's effects.

These changes would be implemented with an appropriate phase-in, which will allow ample time for banks to adjust their balance sheets and activities, and to build capital over time. In fact, most banks already have enough capital today to meet the new requirements. For the banks that would need to build capital to meet new requirements—assuming that they continue to earn money at the same rate as in recent years—we estimate that banks would be able to build the requisite capital through retained earnings in less than two years, even while maintaining their current dividends.

Additionally, this proposal has already benefited from a robust development process, and I'd like to briefly outline some of that. Work on the market risk framework began shortly after the global financial crisis—more than a decade ago—and the international negotiations on the full set of reforms concluded in 2017. The agencies, including many of the people at the table today, began work on what would become the proposal shortly after that agreement. The pandemic delayed the proposal's launch, but work continued up to and after my arrival at the Fed. We held countless meetings with our sister agencies and briefed the Board's Committee on Supervision and Regulation; staff have met with individual members of the Board and provided many helpful analyses and supplemental information regarding the proposal; we heard from and engaged with banks, industry groups, public interest organizations, academics, and members of Congress; and all Fed governors have had the opportunity to review the substantive materials and

get detailed briefings from staff since early June. The proposal has benefited from this robust process and culminates with what is in front of us today. And now, we are finally at the stage where we can get more data and feedback and identify areas for refinement.

I want to emphasize that all comments will be carefully considered. We will be vigilant in working to avoid unintended consequences and I encourage commenters to provide us their analyses on all of the issues presented. The extended 120-day comment period is appropriate and will allow all parties adequate time to fully analyze the issues presented in the rule. We will be attentive to those comments and look forward, as always, to the public comment process.

We welcome comment on all aspects of the proposal, but I will mention a few areas in which I will be particularly interested in reviewing public feedback and analysis. For instance, we are aware of concerns that the overall increase in capital requirements would be significant, and I look forward to comments in that regard. There are of course both costs and benefits in this space and I believe we should be mindful of both and hear the views of a range of parties. We have heard concerns that the proposal—when combined with our stress test requirements—might overestimate market and operational risk. We want to ensure that the rule is supportive of resilient and liquid financial markets. I look forward to comments on how specific activities may or may not be affected by the proposed changes. In addition, we want to ensure that the capital rules support a vibrant, diverse banking system with banks of all sizes by applying capital requirements appropriate to the size and risks of institutions. The proposal does adjust the size thresholds for capital rules, and we will benefit from additional views on whether the benefits of that increased resiliency outweigh the costs. And finally, we want to ensure that the proposal does not unduly affect mortgage lending, including mortgages to under-served borrowers.

These are several areas that I will pay close attention to and encourage thoughtful comments. Any rule will only benefit from a diversity of well-reasoned and good faith arguments. I look forward to the comments we will receive.

I'd like to end with a reminder of why capital requirements are so crucial to our mission of safety and soundness and financial stability. Neither regulators nor bank managers can anticipate all risks, or how risks may be amplified and propagated. Events over the past few months have only reinforced the need for humility about our understanding of the causes and consequences of financial stress, and for an approach to capital regulation that makes banks resilient to both familiar and unanticipated risks.