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Proposal and Comment Information

Title: Regulatory Capital Rule: Category I and II Banking Organizations, Banking Organizations with Significant Trading Activity, and Optional Adoption for Other Banking Organizations, R-1887

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Submitter Information

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Please see attached.

Benjamin W. McDonough, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
Docket Nos. 1887, 1888, 1889
RIN 7100-AH20, 7100-AH21, 7100-AH22

Jennifer M. Jones, Deputy Executive Secretary
Attention: Comments/Legal OES
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429
RIN 3064-AF29, 3064-AG23

Adam Cohen, Chief Counsel
Attention: Comment Processing
Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E-218
Washington, DC 20219
Docket Nos. OCC-2026-0265, OCC-2026-0034

Re: Regulatory Capital Rules: Category I and II Banking Organizations, Banking Organizations with Significant Trading Activity, and Optional Adoption for Other Banking Organizations; Regulatory Capital and Standardized Approach for Risk-Weighted Assets; Risk-Based Surcharges for Global Systemically Important Bank Holding Companies

My name is Hilary Allen, and I am a law professor at the American University Washington College of Law. I am an internationally recognized expert on financial stability regulation and new technologies, and am writing in response to proposed notices of rulemakings that, collectively, would serve to further reduce the amount of capital with which banks are required to fund their investments.

Several of my academic colleagues have submitted a letter that lays out empirical evidence demonstrating that financial stability would improve from implementing higher capital requirements, and that lowering capital requirements is not necessary for banks to satisfy the credit needs of the broader economy.¹ I will not restate the content of their letter here, but I note that that content is foundational to the comments I will make here. I offer this letter as further support for my colleagues' recommendations to: "Withdraw the arbitrary recalibration of the GSIB surcharge Method 2 coefficients ...Eliminate the material downward deviations from the Basel III standards...Reject the nonbank migration rationale as a basis for weakening bank capital standards...Retain the dual-stack calculation requirement for the largest banking organizations [and]...Evaluate these proposals holistically" in light of other steps being taken to reduce capital requirements and banking supervision and enforcement more generally.

¹ See comment letter submitted by Stephen Cecchetti, Jeremy Kress, Kermit Schoenholtz, *et al.*

In this letter, I will provide context for our current moment, a moment in which it is not just foolhardy but frankly immoral to reduce the capital requirements that help insulate society from financial crises. Since memories are often short, I will reiterate here some of the costs of the 2008 financial crisis. In the United States, 3.6 million jobs were lost in 2008 alone, according to the Financial Crisis Inquiry Commission. Unemployment peaked at around 10% in October of 2010, and didn't return to pre-crisis levels until 2017. Even a decade after the crisis, measures of broader economic growth like GDP remained persistently lower than their pre-crisis trend suggested they should be, with one study estimating the impact of the crisis as a "lifetime present-value income loss of about \$70,000 for every American."² The GAO has estimated the total cost of the crisis to the American people to be in the trillions of dollars.³

As former Treasury Secretary Yellen has observed, "[t]hese are not just statistics. . . . The toll is simply terrible on the mental and physical health of workers, on their marriages, on their children."⁴ For example, medical studies conducted following the 2008 financial crisis demonstrated increased rates in heart attacks⁵ and suicides,⁶ and people were less likely to seek preventative medical care in general because of concerns associated with the costs.⁷ Even among people who were able to keep their jobs and some sense of financial security during the recession, many experienced a pervading sense of uncertainty and precariousness that may have caused them to delay life events like marriage, home purchases and retirement. It is also important to note that the impacts of the crisis of 2008 were not distributed uniformly. Unemployment and wealth destruction resulting from the crisis hit Black and Latinx Americans harder than White Americans,⁸ and overall, the crisis has contributed to growing economic inequality and increasing political polarization.⁹

The costs of the 2008 crisis should not be reflexively dismissed, as a never-to-be-repeated aberration. There are many reasons to be concerned about the fragility of our financial system in 2026. Perhaps most prominently, there are rumblings that the private credit bubble could ignite a financial crisis in ways that are reminiscent of the mortgage-backed securities bubble,¹⁰ and threaten the stability of the banking system as a result. As Moody's has noted, "Banks are increasingly involved in private credit and other non-bank financial institutions through partnerships, fund financing and structured risk transfers that allow them to maintain economic exposure to credit markets while shifting assets off balance sheet."¹¹ It is conceivable that "a few loan defaults in private credit funds might raise concerns about fund valuations given their illiquidity, prompting investor redemption requests in semi-liquid credit funds. Funds then draw on bank credit lines to meet liquidity or sell any liquid holdings."¹²

² <https://www.frbsf.org/research-and-insights/publications/economic-letter/2018/08/financial-crisis-at-10-years-will-we-ever-recover/>

³ <https://www.gao.gov/assets/files.gao.gov/assets/gao-13-180.pdf>

⁴ <https://www.federalreserve.gov/newsevents/speech/yellen20130211a.htm>

⁵ [https://www.ajconline.org/article/S0002-9149\(10\)01497-9/abstract](https://www.ajconline.org/article/S0002-9149(10)01497-9/abstract)

⁶ [https://www.thelancet.com/journals/lancet/article/PIIS0140-6736\(12\)61910-2/fulltext](https://www.thelancet.com/journals/lancet/article/PIIS0140-6736(12)61910-2/fulltext)

⁷ https://www.nber.org/system/files/working_papers/w15843/w15843.pdf

⁸ <https://ourfinancialsecurity.org/wp-content/uploads/2020/09/AFREF-Cost-of-2008-Financial-Crisis.pdf>

⁹ <https://www.sciencedirect.com/science/article/abs/pii/S0014292116300587>

¹⁰ [https://www.reuters.com/markets/private-credit-alarm-bells-echo-2007-subprime-warnings-2026-03-10/;](https://www.reuters.com/markets/private-credit-alarm-bells-echo-2007-subprime-warnings-2026-03-10/)

<https://www.npr.org/2026/03/19/nx-s1-5747128/private-credit-equity-jamie-dimon-wall-street>

¹¹ <https://www.ft.com/content/b943a9b4-0ef3-441a-91b6-6a83e7b54d48?syn-25a6b1a6=1>

¹² <https://www.economy.com/getfile?q=2107637A-C535-4AFF-83BC-6CBA1AD1FAB9&app=download>

Even if the private credit market isn't large enough to cause a financial crisis on its own, there are many other intersecting fragilities in the financial system. Banks are lending to private credit funds that in turn are lending money to fund the data-center construction for an anticipated AI boom.¹³ If the AI bubble bursts, defaults on those construction loans will cause losses for private credit funds, which could cause problems for the banks that ultimately extended that credit. But private credit is not the only leverage associated with the AI bubble. While the conventional wisdom seems to be that any recession caused by the AI bubble will resemble the one that followed the dot-com bubble, equity-price bubbles can precipitate financial crises if they are fueled by enough borrowed money.¹⁴ After all, the Great Depression was preceded by a debt-fueled "roaring 20s" equity bubble.

Hedge fund concentration in the "Magnificent Seven" tech stocks (companies like Amazon, Microsoft, and Nvidia) was at near-historic highs in 2025,¹⁵ and while it has been reported that hedge funds sought to reduce their exposure in early 2026, there has also been reporting that hedge funds have returned to buying the largest tech stocks while increasing their leverage.¹⁶ In September 2025, analyst Adam Josephson noted that "hedge fund borrowing/leverage [is] at a record high of \$6.2 trillion, up more than 25% vs. a year ago at the end of March."¹⁷ In its 2026 Financial Stability Report, the Federal Reserve reported that hedge-fund leverage "remained near all-time highs."¹⁸ Outstanding margin loans from broker-dealers and repurchase agreements from primary dealers are also at historically high levels, and bank lending to non-bank financial institutions – including broker-dealers, primary dealers, and the hedge funds themselves – is also significantly elevated (bank loans to NBFIs accounting for \$1.3 trillion in bank loans, or 10% of total loans outstanding in Q3 2025; these loans are highly concentrated in the largest banks, with ten institutions holding 71% of these loans).¹⁹

The prices of the Magnificent Seven tech stocks are highly dependent on the companies' AI ambitions. If they fall short of their goals, and prices come crashing down, highly leveraged hedge funds may be forced into fire sales, unloading stocks to meet margin calls or repay bank loans. And if those fire sales don't fetch enough cash, the funds will default on their repayment obligations, potentially undermining the financial condition of the broker-dealers, primary dealers, and banks that extended them credit. Fire sales of tech stocks will also drive down the prices of tech stocks further, potentially forcing other leveraged financial institutions to sell off their portfolios, and so on. And we shouldn't assume that financial institutions desperate for cash will restrict themselves to selling off tech stocks. On the contrary, they may need – or prefer – to dump other types of assets, transmitting problems to other asset markets.

¹³ <https://www.noahpinion.blog/p/will-data-centers-crash-the-economy>

¹⁴ <https://www.nber.org/papers/w21486>

¹⁵ <https://www.reuters.com/sustainability/boards-policy-regulation/how-hedge-funds-performed-september-2025-10-03/>

¹⁶ <https://www.reuters.com/sustainability/boards-policy-regulation/hedge-funds-creep-back-into-tech-stocks-after-weeks-selling-2026-02-24/>

¹⁷ <https://adamjosephson.substack.com/p/financial-system-leverage-at-record>

¹⁸ <https://www.federalreserve.gov/publications/files/financial-stability-report-20260508.pdf>

¹⁹ <https://www.fdic.gov/analysis/bank-lending-nondepository-financial-institutions.pdf>;

<https://adamjosephson.substack.com/p/big-banks-highlighting-their-sizable>

In particular, we should expect to see crypto prices fall when the AI bubble bursts, and not just because of fire-sale dynamics. Both crypto and the AI bubble have been inflated by the same kinds of narratives about new technologies shattering old paradigms. As evidence of AI's limitations and public rejection of AI business models start to permeate public consciousness, this pessimistic sentiment on tech assets could well undermine crypto hype as well. Despite narratives about Bitcoin and other crypto assets serving as a hedge against risks in other markets, their price movements tend to be correlated with equities.²⁰ Crypto markets are also rife with leverage,²¹ and policymakers have increasingly pushed for their integration with banks.²² Banks could therefore be impacted by a crash in Ponzi-like crypto assets such as Bitcoin, as well as by runs on asset-backed stablecoins. If stablecoin issuers are forced to withdraw their cash reserves from banks, they could trigger a run on those banks; and if they are forced to dump Treasuries from their reserves, another critically important financial market could be sucked into the maelstrom, with likely spillovers for many other financial asset markets that banks are exposed to.²³

None of these outcomes are guaranteed, of course, but our financial system is vulnerable to many uncertainties. As I have previously explored in my academic work, capital serves as a cushion to absorb the impact of uncertain events on banks.²⁴ With leverage built up in so many parts of the system and asset-price movements so correlated, our financial system currently looks like a tinder box primed to explode when the first spark hits. That spark may come from private credit, the AI bubble, or the crypto markets, or it may come from a natural disaster, a war, a pandemic, or something else entirely unexpected. But with so many warning signs flashing red, it is obviously not the time to reduce bank capital requirements or otherwise permit the expansion of leverage. Indeed, reducing bank capital at this moment is antithetical to Congress' direction in Section 616(a)(2) of Dodd-Frank to make capital requirements "countercyclical, so that the amount of capital required to be maintained by a company increases in times of economic expansion and decreases in times of economic contraction, consistent with the safety and soundness of the company."²⁵

For all of these reasons, I urge you not to adopt the proposed notices of rulemakings in their current form. The capital that banks are required to fund their investments with should not be reduced in any way – instead, capital requirements should be strengthened.

Sincerely,

Hilary J. Allen
Professor of Law
American University
Washington College of Law

²⁰ <https://www.cmegroup.com/openmarkets/economics/2025/Why-Bitcoins-Relationship-with-Equities-Has-Changed.html>

²¹ <https://www.citationneeded.news/issue-94/>

²² <https://www.govinfo.gov/content/pkg/DCPD-202500169/pdf/DCPD-202500169.pdf>;

<https://www.federalreserve.gov/newsevents/pressreleases/bcreg20250424a.htm>

²³ <https://www.bis.org/publ/work1270.pdf>

²⁴ <https://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=5110&context=lcp> at 89-90.

²⁵ Dodd-Frank Wall Street Reform and Consumer Protection (Dodd-Frank) Act, Pub. L. No. 111-203, § 616(a)(2), 124 Stat. 1376, 1615 (2010) (codified as amended at 12 U.S.C. § 1844(b)).