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Dear Officers,

On behalf of more than one million members and supporters of Public Citizen, we provide the following comment on a suite of three proposed rulemakings regarding bank safety standards. We oppose these rules because they ignore vital safety requirements for a stable financial sector, which, in turn, serves as the foundation of a healthy economy. These proposals in aggregate reduce solvency standards by 6 percent. Strong solvency standards ensure that banks, not taxpayers, American workers, and small businesses, shoulder the losses from reckless banker decisions. The financial crash of 2008 and the regional bank failures of 2023 stemmed from fraud and mismanagement. In both cases, taxpayers bailed out these banks. That experience must inform any rulemaking.

Three Proposed Rules

The Federal Reserve (Fed), Office of the Comptroller of the Currency (OCC), and Federal Deposit Insurance Corporation (FDIC) propose two related rules. The first implements the final elements of the so-called Basel III framework for the largest, most complex banks known as Global Systemically Important Banks (GSIBs). The major change involves the application of risk models. The second proposal reduces solvency requirements for a smaller tier of banks regarding certain lending activities. Separately, in a third proposal, the Fed proposes to reduce the additional solvency requirements for the largest banks, the so-called GSIB surcharge.

These proposals join other momentous moves by Trump's bank regulators to reduce financial safety standards. The three proposals would reduce solvency standards by roughly 6 percent. In all, these three proposals include more than 20 reductions in solvency levels. Regulators provide no empirical evidence to justify this reduction. Furthermore, when evaluated alongside recent regulatory amendments, the collective impact on major banks strips some $60 billion in capital.

These proposals also discriminate against community banks, which, in some scenarios, would face stricter rules than the largest banks.

Solvency Standards

Embedded in each of these proposals is a dangerously misleading concept of capital. The term "capital," when it applies to bank safety, is not identical to the common understanding of capital. Capital is not cash; it is not gold bars; it is not a reserve. It is not "held" at a bank. On the contrary, capital is loaned out to borrowers, along with the money that banks receive from depositors and other creditors. Capital is bank funding that is not borrowed. A dollar more in capital does not mean a dollar less in loan-making ability. On the contrary, a dollar more in capital means another dollar available for loan making. Capital, in banking, is simply the difference between what the bank owes and what the bank owns. It is a ratio. On the numerator is an arithmetic difference—the difference between assets and liabilities. On the denominator are the assets. Solvency better describes the difference between assets and liabilities. Insolvency means liabilities exceed assets. Greater solvency means healthier banks.

The American public is better served when banks operate with greater solvency, which means less risk of a bank bailout. The greater the solvency, the greater the assets must deteriorate in value before they become less valuable than a bank's liabilities. The 2023 failure of four regional banks, most notably Silicon Valley Bank, demonstrated that bailouts didn't end with the 2008 financial crisis. Just as solvency may be anathema to banks, it is the central safety mechanism for banking. Federal Reserve Gov. Michael Barr explained, "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."

Public Citizen believes bank capital should be 20 percent. This means that when a bank makes a loan, it should use 20 percent of its own capital (such as retained earnings) and only 80 percent borrowed funds, such as deposits or other debt.

On the surface, a bank may appear to be the epitome of safety. Many emphasize this in their names, using words such as "trust" or "security." Yet, as Americans have come to understand, banks are, in fact, highly speculative businesses that rely dangerously on debt. Moreover, much of that debt, namely, the debt that comes as deposits, is insured by the federal government. This introduces moral hazard. While the normal lender conducts due diligence on the borrower to ensure the money is not squandered, the depositor need not worry. If the bank fails, the insured depositor is repaid by the government. This invites a wayward banker to speculate unsafely.

There are three traditional means of controlling moral hazard: 1. examination and supervision; 2. uninsured depositor and creditor discipline; and 3. regulatory capital requirements.

Examiners and supervisors are important but fallible, as the reviews by the Federal Reserve and FDIC in the Silicon Valley episode acknowledged. Examiners alerted the bank to numerous "matters requiring attention," and the sterner "matters requiring immediate attention," but then failed to impose sanctions when the bank did not respond appropriately.

In the case of discipline exercised by uninsured depositors, a run caused the ultimate failure of Silicon Valley Bank. Before that, many uninsured depositors were prevented from removing their funds because of so-called tying arrangements. When some borrowers receive a sizeable loan, banks might require them to hold the unspent funds at the same bank. This frustrates their ability to exercise discipline.

Another important and perhaps overriding reason that bankers prefer to fund their operations with as much debt and as little equity capital as possible: executive compensation. Banker bonuses largely come in the form of stock grants. The higher the stock price, the richer the compensation. Less equity capital means the bank's profits are higher per share.

In short, bankers wish to operate with as little capital as permitted because it drives their leverage model and fattens their paychecks.

Stronger solvency standards were increased following the passage of the Wall Street Reform and Consumer Protection Act in 2010. This did not lead to fewer loans but to more. Nor did it weigh on bank profits, where sector net income increased by 225 percent during this period, according to industry consultant Mayra Rodriguez Vallardes.

Wall Street contends that higher bank solvency requirements in the United States will leave U.S. banks at a competitive disadvantage relative to their European counterparts. In fact, the point of the Basel accord is to unify bank capital requirements across developed countries. Further, European authorities are simultaneously requiring banks to increase capital.

Assessing the Three Proposals

1. **Standardized and Internal Models**

This proposal, officially known as "Regulatory Capital and Standardized Approach for Risk-Weighted Assets," alters how the largest banks calculate their Risk-Weighted Assets (RWAs)—the mathematical denominator that determines their mandatory solvency ratios.

Risk weighting, perversely, allows banks to reduce the value of a particular asset when calculating the ratio of bank assets to liabilities. A mortgage loan is treated differently from a small business loan. A Treasury bond also receives less weight. A Treasury might sound risk-free, but major changes in value due to shifting interest rates can significantly affect its value. Public Citizen opposes risk-weighting.

Crucially, the international Basel III framework mandates a strict floor. This floor dictates that, no matter how sophisticated a bank's internal mathematical risk models are, the capital requirement generated by those models cannot fall below a certain level of solvency requirement set by the standardized, regulator-set approach.

The proposal discards this international output floor, allowing the eight largest domestic G-SIBs to utilize a single, unconstrained internal model to calculate operational and credit risk weights. This allows institutions whose failure poses the greatest threat to global stability the absolute freedom to "model-game" their balance sheets, systematically compressing their calculated risk weights over time to artificially reduce solvency requirements.

Among the more significant reductions are those affecting trading and broker-dealer activities. These ill-advised proposals permit firms to reduce solvency standards for some of their riskiest activities. The framework this replaces helped capture the severe market risks incurred during the 2008 crash. This compounds incentives to trade and amplifies systemic risk. For example, the proposal allows firms to engage in "cross-product netting," which unwisely allows banks to offset exposures between unlike assets. Different commodities follow different volatility patterns and should be used to hedge risk.

These proposals undermine strong standards outside the United States. These reduced safety levels will only attract more trading and more risk within U.S.-domiciled institutions.

2. Trading and Size Regulations

This proposal, "Banking Organizations with Significant Trading Activity, and Optional Adoption for Other Banking Organizations," reviews the regulatory boundaries for mid-sized and regional banking institutions. This effort fails to address the gaps in solvency standards that led to the regional banking panic of 2023.

When Silicon Valley Bank (SVB) collapsed, it lost $42 billion in deposits in a single, hyper-digitized business day because it evaded federal liquidity coverage mandates. Despite this clear historical lesson, the proposal maintains a regime in which many regional banks are not required to meet any formalized daily liquidity standards. This leaves the mid-size banks vulnerable to the next wave of rapid, social-media-driven deposit flights.

3. G-SIB Surcharge Recalibration

This Fed proposal, known as "Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies," directly alters the solvency requirements for the largest banks. This lacks empirical foundations. If the Fed believes current models contain errors, these should be refined before relaxing safeguards.

For example, the proposal would change the framework so that the short-term wholesale funding component would account for a minimum percentage of the assessment score. Such funding refers to the high-volume, short-duration monies that banks and financial institutions borrow from institutional lenders—rather than from retail depositors—to meet their immediate liquidity needs. Banks' reliance on this form of borrowing exposes them to runs that undermine financial stability. When the Fed first addressed this issue, it assumed such funding would comprise about 20 percent. In reality, they are even more dependent, often using this source for 30 percent, even 40 percent. Rather than recognize this dependence, the board ignores it. There can be no basis for reducing solvency standards based on this reality.

Conclusion

Banks oppose strong solvency standards not because they restrict lending, but because they restrict stock values and associated executive compensation. The agencies must resist such fatuous arguments. We ask the agencies to withdraw these rules.

For questions, please contact Bartlett Naylor at bnaylor@citizen.org.

Sincerely,

Public Citizen