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Deregulating in a Financial Boom: What Could Go Wrong?

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Thank you for the opportunity to speak to you.¹ The U.S. economy relies on a strong and stable banking system that extends credit to households and businesses. America's prosperity as well as the day-to-day needs of people and their efforts to plan for and build a better future depend on it. Today I want to share with you a few thoughts on the Federal Reserve's role in overseeing the banking system and supporting financial stability, and concerns that I have about how the Fed and other banking regulators are weakening regulation and supervision of banks. I've spoken before about the risk of deregulation, but now that it is coming to pass, I want to highlight the combined effects of these deregulatory steps on the safety and soundness of banks and risks to the stability of the financial system. Considerable, sometimes bitter, experience has shown that the safety and soundness of banks is crucial to the jobs, financial security, and hopes and dreams of everyone in America. Deregulation can provide a short-term sugar high in the economy, but it can also lead to long-term costs for society.

Achieving appropriate bank regulation and supervision is a balancing act. Banks need room to grow so that their lending can support innovation and aspiration throughout the economy. At the same time, long experience has shown that without proper safeguards, banks striving to innovate in pursuit of higher profits may take excessive risks. When banks get in trouble, their downfall threatens businesses and households, putting the viability of communities, and sometimes even the entire economy, at risk. That is the legacy of the Great Depression, the savings and loan crisis of the 1980s, and the Global Financial Crisis that occurred nearly 20 years ago. Though it can feel like these events are in the distant past, it is important to remember the damage they did to the

¹ The views expressed here are my own and are not necessarily those of my colleagues on the Federal Reserve Board or the Federal Open Market Committee.

economy and the pain that they caused, shattering the lives of millions of people. Research that attempts to quantify the costs of these episodes, and consider the causes, is a helpful place to turn to make sure we have learned from these experiences to avoid repeating mistakes and to promote a healthy economy.

For regulators, the challenge lies in striking the right balance—supporting growth and innovation while maintaining the safeguards that keep the banking system resilient. I am concerned that we’re losing that balance. I believe that recent steps by the Federal Reserve and other agencies will undermine the safety and soundness of banks and increase financial stability risks. Vulnerabilities that result from deregulation may not be apparent today, but they will result in problems that will build over the coming years and could threaten serious harm to the economy.²

The lesson from history and economic research is that reducing financial regulatory requirements can and often does produce financial stress and harms growth down the road. The academic literature is clear on the large and persistent economic costs of financial crises and the role of resilient banks in lowering the risk and severity of those crises. Reducing financial regulation is effectively reducing insurance against risk, and I fear that we are becoming underinsured.

The Current Trend of Deregulation of the Banking Sector

Over the past year, the Federal Reserve has issued a number of regulatory proposals and made other changes that together considerably weaken bank regulation and supervision. I will start by discussing decreases in capital requirements.

² See Michael S. Barr, “Booms and Busts and the Regulatory Cycle,” speech delivered at the Brookings Institution, Washington, D.C., July 16, 2025, <https://www.federalreserve.gov/newsevents/speech/barr20250716a.htm>.

Bank capital rules work to ensure that banks fund themselves with capital commensurate with the risks of their activities and the risks that they pose to the U.S. financial system. The erosion of these rules leaves both banks and the financial system more vulnerable.

Over the past year and a half, the Federal Reserve, along with the other federal banking regulatory agencies, lowered capital requirements through a series of regulatory proposals, and I have dissented from each of the decisions that apply to large banks. This began with reducing the stressfulness of bank stress tests, and making them less likely to be able to keep up with new risks.³ These changes also included eroding the leverage ratio applied to large banks and thus weakening its ability to serve as an effective capital backstop.⁴ The current proposal for the U.S. implementation of the international Basel III agreement falls short of the agreement's capital standards in a number of ways.⁵ And the Board reduced the GSIB surcharge, an important capital add-on for the largest and most systemically important banks designed to offset the potential harm they could cause to the economy at large. Other banks saw reductions in their capital requirements as well.

So far, in aggregate these deregulatory proposals reduce the amount of capital required for the largest banks by 6 percent. This matters because these eight GSIB firms play a dominant role in the banking system, holding around 60 percent of banking sector assets. A 6 percent reduction may not sound like a lot, but it is significant. It translates

³ See "Statement on Proposals to Enhance the Transparency and Public Accountability of the Board's Stress Testing Framework by Governor Michael S. Barr," press release, October 24, 2025, <https://www.federalreserve.gov/newsevents/pressreleases/barr-statement-20251024.htm>.

⁴ See "Statement on Enhanced Supplementary Leverage Ratio Final Rule by Governor Michael S. Barr," press release, November 25, 2025, <https://www.federalreserve.gov/newsevents/pressreleases/barr-statement-20251125b.htm>.

⁵ See "Statement on Bank Capital Proposals by Governor Michael S. Barr," press release, March 19, 2026, <https://www.federalreserve.gov/newsevents/pressreleases/barr-statement-20260319.htm>.

to \$60 billion less in capital to protect against bank failure and instability that could spread through the financial system. Our capital standards are already near the low end of the range of optimal levels estimated by academic research—that is, the levels that strike the best balance between growth and safeguards. It is also important to note that when we deviate from internationally agreed-upon accords, we set a bad example for other governments that I fear could lead to a “race to the bottom” for capital requirements across jurisdictions. The result of these reductions in capital standards is that the global financial system becomes more vulnerable. This is a channel of risk that can come back to threaten U.S. financial stability.

At the same time that capital requirements are being lowered, bank supervision is also becoming weaker. Lighter-touch supervision compounds financial stability risks from deregulation. The Board weakened the rating system we use for the 36 largest financial institutions. The changes are essentially “grade inflation” that would allow poorly managed banks to be judged as well managed, potentially ignoring weaknesses in risk management that may go unacknowledged and unaddressed.⁶ Regulators are proposing to put less weight on risk management, which is a key indicator of future risk, and to focus instead on backward-looking measures of financial conditions. Also, regulators are curtailing issuance of an important form of supervisory input, matters requiring attention, which means that banks’ risks may go unaddressed in time to make a difference for bank safety. In fact, the latest report on Supervision and Regulation shows that the level of these matters at the end of 2025 had already fallen to roughly half of

⁶ See “Statement on Large Financial Institution Rating Framework by Governor Michael S. Barr,” press release, November 5, 2025, <https://www.federalreserve.gov/newsevents/pressreleases/barr-statement-20251105.htm>.

what it was in 2024 for the largest banks. The report also shows that the share of large banks considered well managed under the new, weaker rules doubled from the end of 2024 to the most recent observation.⁷ On top of that, sharply lower staffing levels at the Board and curtailing horizontal reviews may leave us unable to uncover key issues. As a result, we may have less visibility into potential weaknesses building across firms, leaving the financial system more vulnerable.

I expect to see further weakening as well. A push to lower liquidity requirements appears likely. And I have spoken recently about my concerns with proposals that would degrade requirements that banks hold sufficient portfolios of high-quality liquid assets relative to their projected needs in stress.⁸ We know that liquidity is essential to reduce the risk and severity of bank runs, and I fear that such a reduction would make bank runs more likely or more severe, which could burden deposit insurance funds and potentially threaten financial stability.

Weaker capital rules, weaker liquidity requirements, and weaker supervision expose all of us to increased risks of bank stress, failures, or crises that can harm the economy.

Declines in Oversight of Consumer Protection Laws

On top of these reductions in capital rules, liquidity requirements, and supervisory practices, we also have seen declines in consumer protection. Financial consumer

⁷ See Randall Guynn and Julie Williams, “Updated Statement of Supervisory Operating Principles,” memorandum, April 21, 2026, <https://www.federalreserve.gov/supervisionreg/files/statement-of-supervisory-operating-principles-20260430.pdf>; and Board of Governors of the Federal Reserve System, *Supervision and Regulation Report* (Board of Governors, June 2026): 23, figures 17 and 18, <https://www.federalreserve.gov/publications/files/202606-supervision-and-regulation-report.pdf>.

⁸ See Michael S. Barr, “Efficient and Effective Central Banking: Beyond the Balance Sheet,” speech delivered at the Money Marketeers of New York University, New York, NY, May 14, 2026, <https://www.federalreserve.gov/newsevents/speech/barr20260514a.htm>.

protection regulations and supervision have been scaled back by the Consumer Financial Protection Bureau. Weakening protections against fraud, excessive fees, predatory lending, and unfair or discriminatory financial practices risks conditions that are harmful to consumers and sometimes can even destabilize the economy. It was exactly these conditions of lax consumer protections that were allowed to fester in the years before the Global Financial Crisis and then did devastating damage. We risk making that mistake again.

Taken together, the regulatory and supervisory changes recently enacted or proposed represent the most significant deregulation of the banking system since the Global Financial Crisis. They tip the imperative balance that must be maintained between openness to innovation, on the one hand, and safety and soundness, on the other, in a way that will increase the risks of financial instability. I have voted against these changes, and I feel it is also my duty to continue to speak about them and explain that the costs they impose, in the form of risk, greatly outweigh the promised benefits of a lighter regulatory burden.

The Costs of Underinsurance in Banking Regulation: Key Findings from Research

In accounting for the macroeconomic costs and benefits of financial deregulation, there is a tradeoff between short- and long-term effects. In the near term, deregulation can deliver something akin to a sugar high, in the form of more lending or market activities and higher profits.⁹ But this comes at the expense of greater vulnerability and

⁹ See Basel Committee on Banking Supervision, *An Assessment of the Long-Term Economic Impact of Stronger Capital and Liquidity Requirements* (BCBS, August 2010), <https://www.bis.org/publ/bcbs173.htm>; Jose M. Berrospide and Rochelle M. Edge, “Bank Capital Buffers and Lending, Firm Financing and Spending: What Can We Learn from Five Years of Stress Test Results?” *Journal of Financial Intermediation* 57 (2024), <https://www.sciencedirect.com/science/article/pii/S104295732300044X>; and Josh Lerner, Amit Seru, Nicholas Short, and Yuan Sun, “Financial Innovation in the Twenty-First Century: Evidence from US

risk for the financial system and the economy in the longer term. These risks have often led to devastating crises that have more than offset those benefits and severely harmed millions of households and businesses.

Regulation helps ensure strong bank balance sheets. With solid capital and stable funding sources, both individual banks and the banking system as a whole can absorb a wide range of shocks, such as unexpected losses, while still continuing to lend. If capital falls short, by contrast, and banks' solvency is questioned, it becomes hard to lend, and bad economic conditions become worse, potentially leading to a crisis.

While there may be benefits of deregulation in the short term, the long-term costs of a possible crisis would be much larger, and financial regulation exists in recognition of this tradeoff. In deciding on the appropriate extent of regulation, it is helpful to see this tradeoff as similar to the decision we face in buying less insurance. Anyone who has ever driven a car or owned a home or a business is familiar with this tradeoff. Deciding whether to reduce the amount of insurance one is carrying should involve a clear-eyed balance of the marginal gains of this reduction versus the probability and consequences of an uninsured loss. As I have discussed in an earlier speech, the short-term benefits of deregulation and the passage of time combine to lead many people to underestimate the probabilities of a financial crisis and forget the consequences.¹⁰ The series of banking crises in the Great Depression, the Savings and Loan crisis, and the Global Financial Crisis were all preceded by either a failure to adapt regulations to a shifting financial landscape or an identifiable weakening of existing regulations.

Patents," *Journal of Political Economy* 132, no. 5 (2024), https://www.journals.uchicago.edu/doi/10.1086/727712#_i34.

¹⁰ See Barr, "Booms and Busts."

The economic costs of the resulting crises were substantial: by some counts, one-third of U.S. banks failed in the 1930s, but the costs were much higher, helping drive a devastating economic depression. Unemployment reached 10 percent in the Global Financial Crisis and 8 percent in the early 1990s recession, a period of persistent low growth and high inflation that was partly related to the consequences of the savings and loan crisis.¹¹

Resolving these crises and restoring bank lending also imposed massive fiscal costs. It cost \$160 billion, or 5 percent of one year's U.S. gross domestic product (GDP) at the time, to resolve the savings and loan crisis, the equivalent of \$1.6 trillion in today's economy. The direct fiscal outlay of government interventions to stabilize the banking system during the Global Financial Crisis totaled 4.5 percent of yearly GDP, or approximately \$650 billion dollars at the time. The ultimate cost was much smaller, but that was only because of unprecedented and unpopular government intervention to support individual financial firms and the financial system as a whole.¹² The most recent brush with a severe financial crisis came with the onset of the COVID-19 pandemic. It was avoided in part because of massive government intervention and in part because of the robust levels of capital and liquidity among banks due to post-Global Financial Crisis reforms, the regulatory standards that are unfortunately now being weakened. And the bank stresses of 2023 revealed once again the importance of sound risk management and appropriate levels of capital in the banking system.

¹¹ See U.S. Bureau of the Census, *Historical Statistics of the United States, Colonial Times to 1970*, Bicentennial Edition (1975): 121–82, chapter D, https://www2.census.gov/library/publications/1975/compendia/hist_stats_colonial-1970/hist_stats_colonial-1970p1-chD.pdf.

¹² See Luc Laeven and Fabian Valencia, “Systemic Banking Crises Database II,” *IMF Economic Review* 68 (2020), <https://link.springer.com/article/10.1057/s41308-020-00107-3>.

Impaired Bank Balance Sheets Harm Growth

A long line of research, based on seminal findings related to the Great Depression authored by Ben Bernanke, shows how disruptions in financial intermediation generate severe and prolonged economic harm by restricting many borrowers' access to credit.¹³ Many studies have found that financial crises are followed by large and highly persistent declines in GDP. For example, Christina and David Romer sampled 24 advanced economies that experienced such crises and found that the GDP decline related to these events peaks at 6 percent after three and a half years, with larger declines following periods of extreme and persistently elevated financial distress.¹⁴ An official study supporting the design of Basel III found that persistent effects of a financial crisis resulted in cumulative output losses that were much higher, with estimates on the order of 20 to 60 percent of GDP.¹⁵ For the Global Financial Crisis, this would be between \$2.9 and \$8.7 trillion in pre-crisis dollars in terms of a hit to U.S. GDP. The lengthy periods when economic activity falls short of its potential occur because the balance sheets of banks, businesses, and households take a long time to repair. With impaired bank balance sheets, credit becomes harder to obtain for many creditworthy borrowers, leading to constrained investment and innovation.¹⁶

¹³ See Ben Bernanke, "Nonmonetary Effects of the Financial Crisis in the Propagation of the Great Depression," *American Economic Review* 73, no. 3 (1983), <https://www.jstor.org/stable/1808111?seq=1>.

¹⁴ See Christina Romer and David Romer, "New Evidence on the Aftermath of Financial Crises in Advanced Countries," *American Economic Review* 107, no. 10 (2017), <https://www.aeaweb.org/articles?id=10.1257/aer.20150320>.

¹⁵ See Basel Committee on Banking Supervision, *Long-Term Economic Impact*.

¹⁶ See Laurent Clerc, Alexis Derviz, Caterina Mendicino, Stephane Moyen, Kalin Nikolov, Livio Stracca, Javier Suarez, and Alexandros P. Vardoulakis, "Capital Regulation in a Macroeconomic Model with Three Layers of Default," *International Journal of Central Banking* 11, no. 3 (2015), <https://www.ijcb.org/journal/v11n3/capital-regulation-macroeconomic-model-three-layers-default>.

How These Ill Effects Can Be Prevented

The research literature also shows how these bad effects can be prevented: bank capital and liquidity requirements reduce the probability and severity of financial crises. Economies with higher pre-crisis bank capital ratios recover more quickly following financial crises due to stronger recovery in credit growth.¹⁷ Increases in bank capital ratios reduce the likelihood of the worst GDP outcomes.¹⁸ There is also evidence that U.S. states that deregulated less in the 1980s experienced smaller credit booms during the expansion but smaller declines in activity and employment in the subsequent recession.¹⁹ In other words, the short-term “sugar high” of a credit boom from deregulation is outweighed by longer-term loss of output, employment, and income.

Estimates of Optimal Capital Levels

Recognizing that there are benefits that must be weighed against costs, some research estimates what level of regulation would be needed to avert a crisis. Research by economists at the International Monetary Fund estimated that bank capital ratios between 15 and 23 percent of risk-weighted assets would have been enough to absorb the bank losses seen in most historical banking crises in advanced economies and thus likely

¹⁷ See Oscar Jorda, Bjorn Richter, Moritz Schularick, and Alan Taylor, “Bank Capital Redux: Solvency, Liquidity, and Crisis,” *Review of Economic Studies* 88, no. 1 (2021), <https://academic.oup.com/restud/article/88/1/260/5889963>.

¹⁸ Boyarchenko, Giannone, and Kovner (2024) find that a 100 basis point increase in capital among banks raises the left tail of one-year-ahead GDP growth around 1 percentage point, meaning there’s less risk of a bad recession; see Nina Boyarchenko, Domenico Giannone, and Anna Kovner, “Bank Capital and Real GDP Growth,” Federal Reserve Bank of Richmond Working Paper Series 24-08 (Richmond Fed, September 2024), https://www.richmondfed.org/publications/research/working_papers/2024/wp_24-08.

¹⁹ See Atif Mian, Amir Sufi, and Emil Verner, “How Does Credit Supply Expansion Affect the Real Economy? The Productive Capacity and Household Demand Channels,” *Journal of Finance* 75, no. 2 (2020), <https://onlinelibrary.wiley.com/doi/full/10.1111/jofi.12869>.

would have prevented these crises in the first place.²⁰ Taking into account these benefits as well as the costs, there is a range of optimal capital requirements in the research literature, depending on the data period and whether researchers draw conclusions from examples of real-world experience or economic models.²¹ According to this research, current regulatory requirements for U.S. banks are toward the low end of the optimal range, and the proposals would lower them further. Moreover, the costs of getting it “wrong” are asymmetric: in most studies, a capital requirement that is modestly “too high” has a small cost to growth, but a capital requirement that is even a little “too low” can result in sharply rising costs to financial stability, as the rate of bank failures or risk of a financial crisis shoots up quickly. Again, this is akin to buying less insurance: yes, you are locking in a lower premium, but you are also increasing the risk of a really bad outcome, and maybe one that is hard to afford.

²⁰ See Jihad Dagher, Giovanni Dell’Ariccia, Luc Laeven, Lev Ratnovski, and Hui Tong, “Benefits and Costs of Bank Capital,” IMF Staff Discussion Note 16/04 (International Monetary Fund, March 2016), <https://www.imf.org/external/pubs/ft/sdn/2016/sdn1604.pdf>.

²¹ Many papers examine the question of optimal capital requirements quantitatively, including Juliane Begenau, “Capital Requirements, Risk Choice, and Liquidity Provision in a Business-Cycle Model,” *Journal of Financial Economics* 136, no. 2 (2020), <https://www.sciencedirect.com/science/article/pii/S0304405X19302508?via%3Dihub>; Juliane Begenau and Tim Landvoigt, “Financial Regulation in a Quantitative Model of the Modern Banking System,” *Review of Economic Studies* 89, no. 4 (2022), <https://doi.org/10.1093/restud/rdab088>; Clerc et al., “Capital Regulation”; Vadim Elenev, Tim Landvoigt, and Stijn Van Nieuwerburgh, “A Macroeconomic Model with Financially Constrained Producers and Intermediaries,” *Econometrica* 89, no. 3 (2021), <https://onlinelibrary.wiley.com/doi/10.3982/ECTA16438>; Jorge Abad, David Martinez-Miera, and Javier Suarez, “A Macroeconomic Model of Banks’ Systemic Risk Taking,” working paper (September 2024), https://www.cemfi.es/~suarez/Abad_Martinez-Miera_Suarez_2024.pdf; Thien Nguyen, “Bank Capital Requirements: A Quantitative Analysis,” Charles A. Dice Center Working Paper No. 2015-14, Fisher College of Business Working Paper No. 2015-03-14 (October 2015), <https://ssrn.com/abstract=2356043>; Skander Van den Heuvel, “The Welfare Cost of Bank Capital Requirements,” *Journal of Monetary Economics* 55, no. 2 (2008), <https://www.sciencedirect.com/science/article/pii/S0304393207001572>; Simon Firestone, Amy Lorenc, and Ben Ranish, “An Empirical Economic Assessment of the Costs and Benefits of Bank Capital in the United States,” Federal Reserve Bank of St. Louis *Review* 101, no. 3 (2019), <https://www.stlouisfed.org/publications/review/2019/07/12/an-empirical-economic-assessment-of-the-costs-and-benefits-of-bank-capital-in-the-united-states>; and James R. Barth and Stephen Matteo Miller, “Benefits and Costs of a Higher Bank ‘Leverage Ratio,’” *Journal of Financial Stability* 38 (2018), <https://www.sciencedirect.com/science/article/pii/S1572308917306526?via%3Dihub>. See also Michael S. Barr, “Why Bank Capital Matters,” speech delivered at the American Enterprise Institute, Washington, D.C., December 1, 2022, <https://www.federalreserve.gov/newsevents/speech/barr20221201a.htm#fn16>.

Taking into account the lessons from history and research, it is clear that while deregulation may provide a short-run boost to growth, the benefit is outweighed by increased longer-term risks of devastating financial crises, lower growth, lost jobs and businesses, and disrupted lives. Unfortunately, bank regulators are moving in this direction. Given the tradeoffs involved, especially the large costs of crises, I view the cumulative relaxation of capital requirements, other regulations, and supervision as unwise. I am concerned that a relaxation of liquidity regulations is coming next. These changes will result in harm to the resilience of banks and the U.S. financial system.

The Need for a Strong Banking Sector Amid Growing Risks in the Nonbank Sector

While some have argued that we should deregulate the banking sector so that it can compete more effectively with private credit and other nonbanks, I would argue the opposite: we should maintain and improve bank regulation because forces outside of the banking sector can, and eventually will, threaten bank balance sheets. Banks are the bedrock of our financial system because they play a crucial role in lending to the real economy. Nonbanks have always been an important source of credit, often driving technological innovation, as we have seen with the rise of fintech.

Through credit lines, as well as in other ways, banks are exposed to nonbanks. Bank credit commitments to other financial entities are growing rapidly and reached over \$2.6 trillion in the second half of 2025. Banks and nonbanks are now closely entwined and interdependent, with banks acting as liquidity providers to nonbanks, which in turn take on credit risk.²² Banks also have asset-holding commonalities with many nonbanks.

²² See Viral V. Acharya, Nicola Cetorelli, and Bruce Tuckman, “Transformed Intermediation: Credit Risk to NBFIs, Liquidity Risk to Banks,” NBER Working Paper No. 34679 (National Bureau of Economic Research, January 2026), <https://www.nber.org/papers/w34679>.

If nonbanks come under stress and must fire sale their assets, this could harm bank portfolios as well. Second-round effects from bank and nonbank interconnectedness may also play a role if fire sales cause institutions that are highly connected with banks to come under pressure.²³

What all of this means is that we need strong banks at the core of the financial system to deal with shocks, including from nonbanks. Dealing with those shocks requires robust capital and liquidity, and loosening bank regulatory standards moves in the opposite direction. Bank deregulation can also lead to a race to the bottom. If the goal is greater overall safety, it is perverse to relax safeguards. Deregulating banks so that they can better compete with nonbanks may lead to even more risk-taking by nonbanks.²⁴ The answer is thus not to regulate banks less, but to regulate unsafe practices at nonbanks more.²⁵

Conclusion

So, to sum up, while I agree with the objective of ensuring the banking sector can support the economy, I don't agree with the remedy: reducing bank capital. We have seen again and again that capital is crucial to long-term financial stability and thus economic growth. We're now in a risk-on environment with a booming stock market, robust bank profits, and a deregulatory mindset. The bank deregulation undertaken so far, and the plans for more to come, is ultimately going to make our financial system less robust. And when the bill comes due, we will all pay the price.

²³ See Nicola Cetorelli, Mattia Landoni, and Lina Lu, "Non-Bank Financial Institutions and Banks' Fire-Sale Vulnerabilities," Federal Reserve Bank of New York Staff Reports No. 1057 (New York Fed, March 2023), https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr1057.pdf?sc_lang=en.

²⁴ See Begenau and Landvoigt, "Financial Regulation."

²⁵ See Andrew Metrick and Daniel Tarullo, "Congruent Financial Regulation," *Brookings Papers on Economic Activity* (Spring 2021), <https://www.jstor.org/stable/27093823?seq=1>.