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Before the Subcommittee on Financial Institutions of the Financial Services Committee, United States House of Representatives. Hearing on "Right-Sizing the U.S. Bank Capital Framework: A Return to Tailoring, Economic Growth, and Competitiveness," Thursday, December 11, 2025, 10am.

1. The Vital Importance of Bank Capital

In its simplest terms, any corporate balance sheet comprises assets on the left and liabilities (various forms of debt) plus equity on the right. By definition, assets equal liabilities plus equity, with equity performing the balancing role. Banks issue liabilities such as deposits, commercial paper, and bonds, and use these funds to make loans and investments, typically with a degree of "maturity transformation" (i.e., many liabilities are potentially due before the bank's assets mature). When the value of assets grows relative to liabilities, so too does the value of shareholder equity - the owners of the bank participate in the upside. However, if asset values shrink relative to liabilities, so too does the value of shareholder equity. And if assets become sufficiently impaired, as happened for example for prominent financial firms during Fall 2008, the value of equity falls to zero and the ability of a firm to meet its liabilities (i.e., deposits and borrowings) is compromised and the bank is technically insolvent. Financial markets usually anticipate this development and troubled financial institutions find themselves cut off from private sources of funding. Illiquidity typically precedes (and anticipates) insolvency.

For this reason, a top priority for legislation and regulation is to ensure that banks have enough shareholder equity so that this equity can serve as fully "loss-absorbing" over the economic cycle (and in the face of even the largest plausible shocks). Ideally, any country wants to have a banking system that can absorb losses without resorting to cutting back on credit, because forced credit contractions have additional negative effects on the real (non-financial) economy. Credit contraction caused by distressed banks was a major cause of the deep recession that followed the Global Financial Crisis of 2008.

Banks have a privileged position in the credit system and credit plays an essential role in how the American economy functions. We need the private allocation of credit and we provide deposit insurance to reduce the risk of bank runs by retail depositors. The U.S. fiscal and monetary authorities have also provided extraordinary support to the financial system (banks and non-banks) during periods of extreme stress, such as 2008 and again in 2020 and 2023.

From the perspective of bank (and other financial sector) executives, there is an important asymmetry in their payoffs. This is due primarily to the fact that they are compensated on the basis of *return on equity unadjusted for risk*. When things go well, senior management and other key personnel receive large bonuses. But when things go badly and there is incipient or imminent bankruptcy, the authorities feel pressure to step in, effectively providing downside protection for executives. Small banks may be allowed to fail, if this failure does not have systemic implications. But medium and larger banks can create major externalities if they fail. For this

reason, it is important that *all banks with potential systemic implications* fund themselves with enough equity to keep the probability of failure as remote as possible.

It is important also to emphasize that while the authorities can save particular financial institutions, in the sense of fully protecting some liabilities under stress, experience in 2008 (and many other financial crises) is clear: such extraordinary measures do not necessarily prevent a deep recession, with many people losing their jobs. "Bailouts" of this kind protect relatively wealthy people; almost everyone else still suffers severe adverse consequences.

Low levels of bank equity capital create an important negative externality. Decision-makers within the financial system do not take into account the potentially catastrophic consequences of their actions (choosing low levels of bank equity capital) on regular Americans. This is not a question of morality but rather a simple statement about incentives - supported by repeated historical examples, including several times in the past two decades.

2. Some Misunderstandings About Bank Capital

It is common in the financial press and other circles to speak loosely about banks as "holding" capital. This terminology is problematic as it creates the impression that capital (loss-absorbing equity) is on the asset side of the balance sheet, whereas it is on the liability side (as money belonging to and therefore legally and practically owed to shareholders), as explained above. In fact, a much better gerund to use with regard to capital is "funding", for example as in a statement such as "banks are funding themselves with 95% debt and 5% equity".

It is also common for industry representatives to say or imply that "holding more capital" (i.e., higher capital requirements) somehow restricts credit for the economy as a whole. This is an incorrect statement. For the modern United States, the Federal Reserve System effectively controls the availability of credit. The sole exception to this statement is when the banking system is in danger of collapse due to too little capital (shareholder equity), as happened in 2008-09. In this case, banks become paralyzed by the fear of failure or, even worse, attempt to liquidate their assets in a fire sale and/or pull back on previously committed credit wherever possible. In 2009, the Troubled Asset Relief Program (TARP) provided capital on favorable terms to a wide range of banks, precisely to encourage them to lend again.

During the normal business cycle, such as in Fall 2025, if the Federal Reserve determines that credit is lacking in any aggregate sense, interest rates can be lowered and lending will expand. This is precisely why the Federal Open Market Committee (and many commentators) are debating whether and by how much to cut interest rates. Monetary policy works as long as banks are sufficiently well capitalized. If a large number of banks are under pressure because investors - either in equity or debt markets - regard their capital levels as deficient, then banks attempt to shed assets and monetary policy will struggle to stimulate the economy. This is what happened in 2008-09.

When the US economy is doing relatively well (with low unemployment, etc.), it is very common for bank representatives to argue that capital requirements should be lowered. Given that bank executives are compensated for return on equity unadjusted for risk, this will boost their bonuses. But allowing capital requirements to decline when times are good only increases the probability of serious problems when there is any kind of economic downturn. Looking at the American economy today (Fall 2025) and in the near future, it is vitally important not to allow

banks to deplete their equity capital. Anyone who is concerned about economic performance (including jobs and the rate of business startups) in 2026 should strongly resist the pressure to lower capital requirements.

The best way to ensure robust economic growth and shared prosperity in the United States is to require banks to fund themselves with more loss-absorbing equity (relative to debt and as a percentage of their assets). Capital requirements (i.e., the share of assets funded by shareholder equity) should be kept as high and as simple as possible.

For further reading on how to think about bank capital and avoid consequential misunderstandings, I strongly recommend *The Bankers' New Clothes* by Anat Admati and Martin Hellwig.

3. Serious Concerns Regarding Bank Capital Today

There are two main forms of bank capital requirements: the leverage ratio, and risk-based capital. The leverage ratio is stated as shareholder equity as a percentage of assets. This is a straightforward and transparent measure that is hard for banks to game. It is also robust against misjudgments of risk. This is important because most financial crises involve major misjudgments of risk by the private sector and by regulators. For example, U.S. mortgage backed securities pre-2008 were widely regarded as "low risk" until Lehman Brothers failed, and similarly European sovereign debt pre-2010 was considered "low risk" - until it wasn't.

Recently, the prudential regulators reduced the "enhanced Supplementary Leverage Ratio" ("SLR") from 5% for Global Systemically Important Banks ("GSIBs") and 6% for their subsidiary Insured Depository Institution ("IDIs") to on average around 3.8% for both.[1] The CFA Institute Systemic Risk Council ("SRC")[2], which I currently co-chair, has advocated for higher leverage ratios (i.e., more equity relative to assets) for over a decade.[3] Specifically the SRC has called for leverage ratios of at least 8%. The SRC strongly opposed the rule for a number of reasons that will be relevant to the broader conversation today. (As part of my testimony today, I am including a letter that I co-authored, from the SRC to the relevant regulators in August 2025, in which we confront all the technical dimensions of their flawed proposal.)

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[1] See Table 6 of the proposal showing an average 23% reduction from the current 5% SLR at the holding company level and an average 36% reduction from the current 6% SLR at the IDI level.

[2] CFA Institute Systemic Risk Council is a private sector, non-partisan body of former government officials and private sector experts committed to addressing regulatory and structural issues relating to global systemic risk, with a particular focus on the United States and Europe. It was formed to provide a strong, independent voice for reforms that are necessary to protect the public from financial instability. The SRC's mission is to help ensure a financial system in which we can all have confidence and that really works for Main Street. The SRC was founded by Sheila Bair, former chair of the FDIC, following the Global Financial Crisis.

[3] See, for example, the Systemic Risk Council letter to The Honorable Ben Bernanke, et. al., "Re: Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and Their Subsidiary Insured Depository Institutions" (October 15, 2013). Available at: https://systemicrisk.wpengine.com/wp-content/uploads/2013/10/Final-SRC-Comment-Letter-re-Leverage-Ratio-10-15-13.pdf

The systemic (and public policy) purpose of shareholder equity is to provide protection against losses in times of crisis. Reducing shareholder equity (for example through increased dividends) today means there will be less equity available to absorb losses in the future. Under the new rule, systemwide reduction in shareholder equity may be over $200 billion. This represents a significant increase in systemic risk. According to the best available data, leverage ratios are already moving towards 4% - i.e., the same levels that prevailed before the 2008 crisis (see this Better Markets fact sheet).

This is a very dangerous development, which can imperil both short- and medium-term economic performance, including job creation, in the United States.

4. The Problem With Risk-Based Capital

The leverage ratio compares "Tier 1 capital" - the truly loss-absorbing shareholder equity cushion - with a catchall measure of leverage, including some *off-balance* sheet exposures. This is a deliberately simple and transparent measure meant to take into account the unfortunate reality that in any modern economy, there are many "unknown unknowns". A higher leverage ratio means that a bank has less leverage (more equity relative to debt).

In contrast, "risk-based capital requirements" ("RBC") attempt to take into account the perceived riskiness of different types of assets. The notion of "risk-weighted assets" is appealing in principle but history demonstrates that the private sector (and officials) regularly get these risk assessments wrong. For example, the presence of zero risk-weighted assets in the Basel II framework encouraged financial institutions to have far greater effective leverage pre-2008 than was advisable. This was particularly a problem for big European banks, some of which approached 98 percent debt and just 2 percent equity; it does not take a big market disturbance to wipe out such a thin sliver of equity and create the prospect of bankruptcy. Fortunately, in the United States the FDIC resisted abandoning the leverage ratio and, in retrospect, this was wise - and prevented a lot more economic damage and taxpayer expense in the U.S.

The RBC rules embed other structural problems in the capital framework. They have become highly complex, at the same time as being static and generally backwards looking. They are driven by the risk perceptions of regulators or firm management, which may be affected by moral hazard. And they may create artificial incentives to hold lower-risk-weighted assets, which in turn may lead to "crowded trades" and correlated holdings among banks. The RBC rules offer their own logic but *need* the complementary leverage ratios to deal with some of these structural flaws and well-established problems.

5. At What Scale Do Banks Become Systemically Important?

In March 2015, I participated in a Senate Banking Committee hearing that dealt in part with the issue of thresholds, by asset size, for bank regulation.[4] The CEO of SVB Financial Group submitted a letter on behalf of Silicon Valley Bank (SVB) arguing that his bank was so small and so simple that it should be exempted from systemic considerations (e.g., "SVB, like our mid-sized bank peers, does not present systemic risks" (p.117 of the hearing record).

[4] https://www.govinfo.gov/content/pkg/CHRG-114shrg94375/pdf/CHRG-114shrg94375.pdf. Greg Becker's letter is on pp.115-121.

Following changes implemented by Congress and the financial regulators in 2019, banks in the $50-250bn asset range were no longer subject to the enhanced prudential standards.[5] SVB was not subject to the liquidity coverage ratios, underwent lighter stress tests, and perhaps most significantly in SVB's case, they were able to exclude Accumulated Other Comprehensive Income (AOCI) from their regulatory capital - meaning, in effect, they could ignore unrealized gains and losses for the purposes of measuring their capital requirements. Banks considered to be below certain risk thresholds can still impose significant costs and contagion risks on the financial system and on taxpayers.

6. Bank Capital in the Age of Unfettered Artificial Intelligence (AI)

We are now in a phase of intense development for a set of new technologies known loosely as AI. The precise impact on the banks, the broader financial sector, and the global economy remain unclear. However, three points relevant to this hearing are already quite evident.

First, the speed of decision-making by algorithms running on computers far exceeds the reaction time of humans. As the financial advantages from ultra-rapid trading increase, all attempts to keep a "human in the loop" will prove futile. The speed of the run on SVB was extraordinary, and that was powered only by well-established social media and digital banking. The speed and variety of bank runs, broadly defined, will only increase as AI becomes more widely adopted.

Second, on its best days, AI is very good at cutting through verbiage, to discover underlying realities. This creates an attractive tool for investors. It is not yet clear how many "foundational models" will survive today's intense market and technology development phase, but it would not be a surprise if the world ends up with between 2 and 5 truly powerful models. All informed investors will attempt to use one of these models, precisely because the capabilities of these models will be so impressive. This will have the effect of exacerbating asset price cycles – everyone will crowd into the same trades on the upswing and then rush for the doors when the news turns negative. Smaller pieces of news (e.g., about banks' holdings of crypto, or anything else) are likely to result in bigger market swings.

Third, AI can also be manipulated by bad actors in various ways. We have only just begun to understand the scope for misinformation and disinformation powered by AI. Most informed observers agree that the United States is now – and will likely always be – engaged in hybrid warfare (although there is disagreement about the identity of our most dangerous opponents). Cyber-attacks of all kinds will increasingly be powered by AI. Some of these attacks will be against specific firms. If an adversary wants to destabilize the US economy, our banking system presents an attractive attack surface. Without question, the US should and will develop its own countermeasures. But it would be unwise to assume that our defences can prevent wild asset price swings and the consequences for financial system stability.

In the new AI-driven world, which is forming around us, it is of vital importance that our core banking system remains well capitalized. This bank equity capital needs to be simple and transparent, further emphasizing the importance of maintaining a high leverage ratio (i.e., low leverage) for all banks whose failure can have potential systemic consequences.

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[5] See How US Bank Regulation Failed SVB and Its Supervisors, *Journal of Financial Crisis*, Volume 7, Issue 2, June 2025.

Legislators of all parties should be concerned about today's precipitate rush by regulators to allow more leverage in American banks. More leverage in this context will not speed growth or create more good jobs. This deregulation will help boost bonuses of financial sector executives who are already wealthy (aka "Wall Street"), it will not help most Americans ("Main Street") - in fact, this deregulation/increased leverage poses great dangers for jobs and for the financial security of most people. In the pre-AI world, excessive leverage in the financial system eventually led to trouble – as seen in the intense economic and human suffering that followed the 2008 financial crisis. But with AI, we should expect all effects to be brought forward in time, because the decisions of investors (big and small) will be made more quickly and with greater implicit coordination.

I strongly recommend that you speak with the full suite of U.S. bank regulators and ask them to examine carefully and report (to you and in public) the implications of AI-powered boom and bust asset price cycles for their quantitative models and for their qualitative thinking about bank capital. The regulators have not yet done this, and this lacuna represents a major and pressing risk to the financial system and to all Americans. Allowing core banking system leverage to increase in this situation – without proper evaluation of AI impact – creates significant commercial and national security risks. Pushing regulators to address (and mitigate) these risks should be a top priority for this Congress.

Appendix (attached below):

Letter from SRC to Bank Regulators, August 2025, regarding the Supplementary Leverage Ratio

CFA Institute®
Systemic Risk Council

Department of the Treasury
Office of the Comptroller of the Currency
Docket ID OCC—2025-0006
RIN 1557-AF31

Federal Reserve System
Docket No. R-1867
RIN 7100-AG96

Federal Deposit Insurance Corporation
RIN 3064-AG11

Submitted via publiccomments@frb.gov, comments@FDIC.gov, and https://regulations.gov

August 25, 2025

Regulatory Capital Rule: Modifications to the Enhanced Supplementary Leverage Ratio Standards for US Global Systemically Important Bank Holding Companies and Their Subsidiary Depository Institutions; Total Loss-Absorbing Capacity and Long-Term Debt Requirements for US Global Systemically Important Bank Holding Companies

Dear Vice Chair Bowman, Acting Comptroller Hood, and Acting Chairman Hill:

The Systemic Risk Council ("the Council")[1] appreciates the opportunity to respond to the recent rulemaking proposal to modify the enhanced Supplementary Leverage Ratio ("eSLR")[2], Total Loss-Absorbing Capacity ("TLAC"), and long-term debt-related capital requirements for US Global Systemically Important Banks ("GSIBs") and their Insured Depository Institution subsidiaries ("IDIs").[3]

[1] CFA Institute Systemic Risk Council (CFA Institute SRC) is a private sector, non-partisan body of former government officials and financial and legal experts committed to addressing regulatory and structural issues relating to global systemic risk, with a particular focus on the United States and Europe. It has been formed to provide a strong, independent voice for reforms that are necessary to protect the public from financial instability. Its goal is to help ensure a financial system in which we can all have confidence.

[2] Please note that we use "SLR" to refer to the enhanced supplementary leverage ratio as well as the supplementary leverage ratio throughout this letter.

[3] The full proposal is available here: https://www.federalreserve.gov/aboutthefed/boardmeetings/files/frn-leverage-ratio-20250625.pdf. Page number references throughout this letter refer to the Federal Reserve version of the release.

We are writing to strongly oppose the proposed changes, which we believe will add significant risk to the US banking system and deplete anti-crisis safeguards without any documented corresponding benefit to the real economy. Further, we seriously doubt that the stated rationales have a sound empirical basis. We also find it unconvincing to argue that the SLR functions as an improper constraint or a barrier to liquidity in the US Treasury ("UST") market.

I. Executive Summary

We urge the Agencies to withdraw this proposal for the reasons discussed here. Failing that, the Agencies must repropose the changes in the context of all contemplated changes to the capital rules in the US. Further, such reproposal must address the gaps in data and analysis highlighted in the letter below. Specifically, we would like to draw your attention to the following:

- The SLR was designed to address well-established shortcomings of the risk based capital regime, which played heavily into financial crises in 2008 and 2010.
- The Agencies' analysis lacks any credible estimate of how much capital could potentially leave the US banking system (through distribution to shareholders) or an analysis of the corresponding risks and costs from a decline in loss-absorbing capital.
- The Agencies fail to consider (or even mention) the broader deregulatory context in which they are making this proposal. They explicitly rely on other existing rules to rationalize this proposal while simultaneously contemplating weakening (or even abolishing) those same rules.
- Two important stated rationales are factually incorrect:
    - First, the SLR was intended as a backstop to complement the risk-based capital rules, and
    - Second, US capital regulations do not aim to reduce government interest costs. The Agencies have provided no credible evidence that the existing leverage ratio is interfering with the smooth functioning of the US Treasury market.
- Dramatic steps to reduce capital buffers should be reserved exclusively for macroeconomic emergencies and/or periods of extreme market stress.

The Agencies carefully calibrated current bank capital requirements, including the SLR, when they were originally imposed on the heels of the Great Financial Crisis.[4] Numerous studies conducted since then show that banks with relatively low leverage levels do a better job of lending through the cycle and that at current levels, capital requirements provide benefits to financial stability that outweigh any incremental impact on lending.[5]

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[4] See "Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and Their Subsidiary Insured Depository Institutions" Proposed by *the Comptroller of the Currency, the Federal Reserve System, and the Federal Deposit Insurance Corporation* (Aug 20, 2013). Available at: https://www.federalregister.gov/d/2013-20143/p-68

[5] See, for example, Barth and Miller, "Benefits and Costs of a Higher Bank Leverage Ratio" *Mercatus Center: George Mason University* (2017). Available at: https://www.mercatus.org/system/files/barth-leverage-ratio-mercatus-working-paper-v1.pdf

The Council feels strongly that weakening the SLR, TLAC, and long-term debt requirements is unwarranted and would undermine the safety and soundness of the US banking system.

II. Background

Prudential rules work to protect Americans and the economy from the worst outcomes in a financial crisis. Leverage limitations are a longstanding regulatory failsafe in the US dating back to the creation of the FDIC in 1933, when it required state-chartered banks to have loss-absorbing equity capital equal to at least 10% of deposits.[6] Leverage is critical to understanding and measuring risk in the financial system. Not only is it a key metric of firm-level risk (i.e., a highly levered firm will fail faster), it is also a primary conduit for the transmission of risk throughout the financial system (i.e., a higher levered firm with more counterparties will spread failure further and faster).

The current SLR was implemented in 2014 as part of the Basel III standards in the wake of the Great Financial Crisis, in which nearly 10 million US families lost their homes and over $10 trillion in household net worth was destroyed in a matter of months. It measures a bank's Tier 1 capital relative to its total leverage (i.e., the full extent of liabilities), including certain off-balance sheet transactions. At the holding company level, the eight US GSIBs are subject to the enhanced SLR, which is a 2% buffer on top of the 3% SLR that applies to all banks. Further, the insured depository institutions ("IDIs") that are subsidiaries of GSIBs are subject to a 6% enhanced SLR. [7] These work alongside the risk-based capital ("RBC") rules and other capital requirements to form a key pillar of prudential regulation in the US.

The Agencies' proposal would replace the 2% additional buffer for GSIB holding companies with one equal to 50% of the GSIB surcharge calculated under Method 1. This method scores a GSIB based on the weighted sum of five systemic indicators: size, interconnectedness, complexity, cross-jurisdictional activity, and substitutability. Based on the analysis put forward in the proposal, the average holding company SLR would fall from 5% to 3.85%. In other words, the 2% enhanced buffer would be reduced, on average, to approximately 0.85%.[8]

The proposal would also replace the 6% enhanced SLR for IDI subsidiaries with a 3% SLR and a buffer equal to that of the holding company, i.e., 50% of the GSIB surcharge calculated under Method 1. This would effectively align the SLR at the IDI level with that of the holding company; however, the impact would be far greater, reducing the requirement from 6% to 3.84%.

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[6] Scott and Labonte, "Bank Capital Requirements: A Primer and Policy Issues" *Congressional Research Service* (March 9, 2023). Available at: https://www.congress.gov/crs-product/R47447.

[7] Tapial, Leung and Hamandi, "Banks' Supplementary Leverage Ratio" *Office of Financial Research: The OFR Blog* (August 2, 2024). Available at: https://www.financialresearch.gov/the-ofr-blog/2024/08/02/banks-supplementary-leverage-ratio/

[8] See Table 6 of the proposal showing an average 23% reduction from the current 5% SLR at the holding company level and an average 36% reduction from the current 6% SLR at the IDI level.

The Agencies also propose to reduce the TLAC buffer to match the SLR buffer at the holding company and the IDI, again, 50% of the GSIB surcharge calculated under Method 1. The current TLAC requirement applies to GSIB holding companies and comprises a 7.5% requirement plus a 2% buffer. The proposal would change the 2% buffer to approximately 0.85% and estimates an average 5% reduction in TLAC requirements overall.

Finally, the Agencies propose to reduce the long-term debt requirement for GSIB holding companies from 4.5% to 2.5%. The 4.5% level was set with reference to the "capital refill framework" based on the 5% SLR and the amount of long-term debt required to recapitalize the GSIB.

III. Risk-Based Capital Rules are Not Enough.

The RBCRs suffer from several well-documented shortcomings:

(1) They are static and generally backward-looking assessments of risk.[9]
(2) They introduce misperceptions of risk from regulators or firm management, which may be affected by moral hazard.
(3) They create artificial incentives to hold lower-risk-weighted assets, which, in turn, may lead to "crowded trades" and correlated holdings among banks.

Specifically, the risk-based capital rules assign a 0% risk to UST holdings and repo transactions. While the relative risk of these products may be low, the scale of the transactions and of the market make the absolute risk highly significant at both the firm level and to the financial system as a whole. Furthermore, in times of stress both have shown volatility, indicating much greater risk.

The fact that the risk-based capital requirements exclude them entirely has two important consequences: (1) it obscures leverage that does, in fact, carry meaningful risk; and (2) it creates an incentive to direct capital to these transactions because they can generate returns without generating a capital charge.

The SLR mitigates these problems because it captures some off-balance sheet exposures and is agnostic to relative risk in a way that does not invite gaming or create "favored assets". As the Fed recognized in its 2020 release, the SLR "protects against an underestimation of risk both by banking organizations and by the risk-based capital requirements."[10]

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[9] See, the Systemic Risk Council letter to The Honorable Ben Bernanke, et. al., "Re: Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and Their Subsidiary Insured Depository Institutions" (October 15, 2013). Available at: https://systemicrisk.wpengine.com/wp-content/uploads/2013/10/Final-SRC-Comment-Letter-re-Leverage-Ratio-10-15-13.pdf.

[10] Board of Governors of the Federal Reserve System "Temporary Exclusion of U.S. Treasury Securities and Deposits at Federal Reserve Banks From the Supplementary Leverage Ratio" *Federal Register* Vol. 85, No. 72 (April 14, 2020). Available at: https://www.federalregister.gov/documents/2020/04/14/2020-07345/temporary-exclusion-of-us-treasury-securities-and-deposits-at-federal-reserve-banks-from-the

The Agencies' proposal undermines the SLR's risk-agnosticism by introducing the risk-sensitive GSIB surcharge into the calculation. Three of four proposed alternatives lean into the "favored assets" problem of the RBCR by excluding UST from the calculation of the SLR, either in part or entirely.

Past financial crises demonstrate that risk-based capital rules alone are insufficient.

Risk-based rules helped fuel the Great Financial Crisis of 2008 by incentivizing exposure to mortgaged-backed securities ("MBS") and derivatives. Before 2008, the risk-based rules assigned highly rated MBS a 20% risk weighting. Many institutions identified MBS as having greater returns than other assets with the 20% risk weighting, incentivizing them to build greater exposure to MBS than they otherwise would have. The result was both artificially inflated demand and correlated losses across the financial system when the MBS failed. The risk-based rules introduced static and incomplete perceptions of risk, generating significant systemic risk that metastasized into a crisis. The SLR is, by design, agnostic to risk in order to mitigate and counteract these weaknesses in the risk-based rules.

Risk-based rules exacerbated the Eurozone sovereign debt crisis of the 2010s by treating government debt as risk-free, thereby incentivizing some banks subject to the rules to build their exposure. Here again, the risk-based capital rules incentivized exposure to a specific type of asset above and beyond what a firm's internal risk models might have supported. In this case, it created a negative feedback loop of failure between European governments and the financial sector exposed to their debt, which some referred to as the "doom loop" or a "deadly embrace" between banks and governments. Again, the SLR alleviates some of these risks and shortcomings by providing an overarching limit on leverage regardless of the assessment or perception of risk.

Silicon Valley Bank demonstrates the significance of interest rate risk to UST holdings on bank balance sheets. Silicon Valley Bank ("SVB") had built up a large exposure to long-dated treasuries, designated as "held to maturity" (i.e., they did not have to mark to market). When the FOMC raised the federal funds target rate by more than 4% over a single year in response to spiking inflation, the value of SVB's treasury holdings fell precipitously. News of these unrealized losses spread quickly among SVB's clients, leading to rapid withdrawals, forcing the bank to lock in those losses, further fueling the run on the bank and its ultimate failure.[11] Among other things, the SVB example illustrates the risk embedded in UST holdings.

[11] Neely and Neely, "Interest Rate Risk, Bank Runs and Silicon Valley Bank" *Federal Reserve Bank of St. Louis* (May 11, 2023). Available at: https://www.stlouisfed.org/publications/regional-economist/2023/may/interest-rate-risk-bank-runs

IV. The Agencies failed to discuss a plausible range of scenarios and almost certainly underestimate potential capital distributions under the proposed changes.

The proposal estimates that the SLR reduction would reduce the tier 1 capital requirements of the GSIBs by only $13 billion and considers that amount potentially available for distribution. It expects that the $213 billion reduction in capital requirements at the IDI level would remain within the banking organization.[12] This fails to consider, however, that the holding companies are likely to re-optimize their asset mix to maximize potential payouts.

As the proposal points out, banking organizations have reduced their risk-weighted asset densities over the past decade. In other words, they've shifted their overall asset mix towards low- or no-risk weighted assets. To illustrate, "[f]rom 2015 to 2024, the aggregate total consolidated assets of GSIBs grew by almost 50 percent, from $10.5 trillion to $15.5 trillion, while their average risk-weighted asset density declined from 58 percent to about 45 percent."[13] That is to say, GSIBs substantially grew their total leverage while *at the same time* reducing the amount of capital they were required to maintain under the RBC rules.

Reducing the SLR would further incentivize this reduction in risk-weighted asset density because it would increase the ability to distribute capital. While the proposal recognizes that the GSIB could distribute equity capital and replace it with new debt while keeping their balance sheet size and tier 1 ratios the same,[14] just a page later,[15] the proposal fails to consider that the GSIBs could treat the capital released from the IDI in the same manner. Instead, it suggests that capital could be used for "financing activities at other subsidiaries [or] paying down external debt."[16] However, there is precedent for expecting the GSIBs to distribute money to shareholders: nearly all GSIBs increased payouts after the most recent stress tests yielded capital requirement reductions.[17]

Any reasonable attempt at a cost-benefit analysis must include an upper and lower bound of potential shareholder payouts – in other words, capital leaving the US banking system – along with the increased risk and potential costs of failure within the US banking system.

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[12] See the proposal at page 83. "[I]n the case that these depository institutions increase their leverage by distributing some of their equity capital and replacing it with new debt, most of this capital would be distributed to their parent companies and thus remain within GSIBs, which could not make large distributions to external shareholders because the proposal would reduce their tier 1 capital requirement only slightly."

[13] See the proposal at page 82, Footnote 97.

[14] See the proposal at page 82.

[15] See the proposal at page 83.

[16] See the proposal at page 83.

[17] Franklin and Quinio. "US Banks Announce Big Shareholder Payouts as Fed Eases Stress Tests." Financial Times, July 1, 2025. Available at: https://www.ft.com/content/081f8752-8022-4c02-9d85-cea6a133ac8f.

V. The Agencies explicitly rely on other capital rules to mitigate the costs of this proposal while planning to weaken those same rules.

The Agencies fail to address their own contemplated changes to the RBC rules and the rest of the capital framework for large banks. In fact, throughout the economic analysis, the Agencies explicitly rely on the current regulatory framework to mitigate the risks and costs generated by this proposal. For example,

> "All else equal, a reduction in required capital increases the size and likelihood of losses shifting from shareholders to creditors and the Deposit Insurance Fund in the event of failure. Such losses may lead to additional spillovers and costs. However, insured depository institution subsidiaries of GSIBs *would continue to be subject to heightened supervisory and regulatory standards, robust capital and leverage requirements, and resolution planning requirements*. The agencies believe that these requirements would appropriately mitigate such risks."[18]

However, the Agencies are also contemplating changes to *each part* of the bank capital framework, including the risk-based capital requirements, leverage requirements, the surcharge, and stress testing. As Chair Powell pointed out at a recent conference,

> it is of "great benefit … to consider all elements of the capital framework in concert, rather than look at each in isolation. We need to ensure that all the different pieces of the capital framework work together effectively. Doing so will help maintain a safe, sound, and efficient banking system, for the benefit of the people we serve."[19]

If the Agencies believe the US banking system is overcapitalized, that should be the explicit subject of the debate and analysis within the various proposals to change the capital framework. Further, those proposals should consider how such a reduction in capital might affect the likelihood of failure among US banks and bank holding companies, the magnitude of failure, the costs to the FDIC or other banks, the systemic impact given the interconnectedness of the GSIBs, and the impact on credit availability. A robust cost-benefit analysis must be conducted, considering all contemplated changes together, along with their likely impact on the safety and soundness of the US financial system. At a minimum, these changes should be proposed with a cost-benefit analysis that does not explicitly rely on rules and standards that are in the process of being changed.

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[18] See the proposal at page 84, emphasis added.

[19] Chairman of the Federal Reserve Jerome Powell, Opening Remarks at Integrated Review of the Capital Framework for Large Banks Conference, "A great benefit of this conference is the chance to consider all elements of the capital framework in concert, rather than look at each in isolation. We need to ensure that all the different pieces of the capital framework work together effectively. Doing so will help maintain a safe, sound, and efficient banking system, for the benefit of the people we serve." Available at: https://www.federalreserve.gov/newsevents/speech/files/powell20250722a.pdf

VI. The primary rationale that SLR should not be a binding constraint does not make sense.

The primary stated rationale for these proposed changes is that the SLR is calibrated "too high" and is too often a binding constraint when it was intended as only a backstop, and further, that when it is binding, it discourages low-risk activities. The problems with this rationale are numerous:

1) Recent reporting and market research suggest that the SLR is not, in fact, binding on GSIBs today.
2) The authors acknowledge that banks dramatically increased their UST exposure, which "increased [the] bindingness"[20] of the SLR. Yet, they fail to recognize how that pattern will likely repeat until the SLR is again binding … and we are presented with the exact same issues.
3) The SLR was *not* intended to be only a backstop; it was explicitly intended to complement the risk-based rules.
4) Even if the SLR was intended as a backstop, the notion that it should be moved because it functions as intended is inconsistent with sensible regulation.

First, there are several indicators that the RBC rules are more often the binding tier 1 capital requirement for GSIBs. The proposal states that, from Q2 2021 to Q4 2024, the SLR "was the binding tier 1 capital requirement 60% of the time, on average, for seven out of the eight GSIBs."[21] However, the results of the most recent stress tests led to a 1.8% decline in required CET1,[22] which drove a boost in dividend payouts and share buybacks.[23] This would suggest the SLR was not binding on those banks. Additionally, recent market research indicated that only one large-cap US bank in its universe was constrained by the SLR buffer and that banks were running 50-270 bps above their SLR minimums on average.[24] While not mutually exclusive, it is unclear how to reconcile these sources with the assertions in the proposal.

Second, the proposal acknowledges that the SLR is more frequently binding today in part because banks optimized their asset allocation under the rules and increased exposure to 0% risk-weight assets, i.e., UST. Yet, the proposal fails to take the next logical step and recognize that market actors will respond dynamically to these changes and will likely re-optimize their balance sheets, further increasing the allocation to 0% or low-risk-weighted assets until the SLR becomes binding

[20] See the proposal at page 57.

[21] See the proposal at page 46.

[22] Board of Governors of the Federal Reserve System. "Federal Reserve Board's Annual Bank Stress Test Showed That Large Banks Are Well Positioned to Weather a Severe Recession, While Staying above Minimum Capital Requirements and Continuing to Lend to Households and Businesses." Press release, June 27, 2025. Federal Reserve. Available at: .https://www.federalreserve.gov/newsevents/pressreleases/bcreg20250627b.htm

[23] Franklin and Quinio. "US Banks Announce Big Shareholder Payouts as Fed Eases Stress Tests." Financial Times, July 1, 2025. Available at: https://www.ft.com/content/081f8752-8022-4c02-9d85-cea6a133ac8f

[24] "US Banks: A New Era for Bank Regulation" *Morgan Stanley Research* (March 9, 2025).

again. Per the logic of this proposal, the answer in that future scenario would be to move the limit again. And again.

Third, despite repeated claims in the proposal that the SLR was only ever intended as a "backstop" to the RBC rules, the 2014 adopting release for the SLR revisions explicitly stated that the SLR and the RBC rules should be complementary.[25] The SLR was *not* intended solely as a backstop. The SLR must be allowed to function alongside the RBC rules because of the optimization described above. As discussed above, the SLR addresses critical weaknesses in the RBC rules, including their ability to get the risk-weights wrong (e.g., assigning a low-risk weight to mortgage-backed securities in 2007).

Finally, backstop or not, the notion that a regulatory limit must be moved because it is working (as a limit) renders the whole idea of regulatory limits meaningless.

The entire first rationale, then, rests on its assertion that the SLR is creating a negative bias against low-risk activities like US Treasury market intermediation. Yet this too fails. As the proposal points out, IDIs have more than doubled their exposure to UST relative to their total assets in the last decade – i.e., under the existing SLR.[26] Primary dealers also more than doubled their UST exposure in absolute terms (a 155% increase versus only a 29% increase in the total assets of the primary dealers).[27] Far from preventing low-risk activities like UST market intermediation, the SLR has accommodated significant growth in those segments of banks' balance sheets. If the Agencies believe the US GIBs are over-allocating to high-risk activities, that should be the subject of this proposal.

VII. The Agencies fail to clearly state a problem with UST intermediation but appear focused on bolstering demand for UST.

This brings us to the second rationale: that reducing the bindingness of the SLR could improve the functioning of financial markets and of the UST market in particular. The proposal identifies two primary functions of banking organizations in the UST market: as intermediaries and as investors. The bank's broker-dealer subsidiaries perform the lion's share of intermediation and hold most of the UST held as trading assets. In contrast, the IDIs hold most of the UST as investment securities.

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[25] Federal Reserve; Federal Deposit Insurance Corporation; Office of the Comptroller of the Currency. "Regulatory Capital Rules; Regulatory Capital Revisions to the Supplementary Leverage Ratio." Federal Register 79, no. 186 (September 26, 2014): p57727, 57729. Available at: https://www.federalregister.gov/d/2014-22083/p-22. "Regardless of which framework is binding, banking organizations could potentially increase their holdings of assets whose risks are not adequately addressed by the binding framework. In this regard, the agencies note the importance of the complementary nature of the two frameworks in counterbalancing such incentives. Moreover, the agencies observe that banking organizations choose their asset mix based on a variety of factors, including yields available relative to the overall cost of funds, the need to preserve financial flexibility and liquidity, revenue generation and the maintenance of market share and business relationships, and the likelihood that principal will be repaid, in addition to regulatory capital considerations."

[26] See the proposal at page 61-62, Table 6.

[27] See the proposal at page 49, Table 2.

Reducing the SLR would *permit* both broker-dealers and IDIs to hold more UST, which is supposed to facilitate intermediation. Again, there are several problems with this rationale.

1) The proposal offers no basis for expecting that new balance sheet capacity will be directed towards UST market intermediation instead of higher-yielding activities with low-risk weights like lending through a prime brokerage.
2) Expanding IDI capacity for UST exposure appears geared at bolstering demand for UST without considering risks related to creating a "sovereign subsidy" or manipulating the reference rate for a broad range of financial products. Again, we would stress that the purpose of bank capital rules is to protect the US banking system rather than help finance budget deficits.
3) The analysis of broker-dealer balance sheet capacity ignores the impact of netting under new treasury clearing requirements, which may reduce or even obviate the need for additional capacity at broker dealers.
4) The discussion of the UST exclusion during the COVID crisis ignores the fact that by providing capital flexibility now, it will not be available in the event of another genuine emergency.

First, a central benefit of the proposal – that it will support UST market intermediation – depends on the unsupported assumption that GSIBs and their IDIs will allocate a substantial portion of their newfound balance-sheet capacity towards that activity. UST exposure might typically be expected to offer a ~4% rate of return while banks might be trying to meet an internal hurdle rate of closer to 12%.[28] The prime brokerages of the GSIBs, on the other hand, have been major growth drivers for the firms.[29] Hedge fund borrowing in particular has more than doubled over the last decade[30] and typically is not captured by the RBC rules.[31] A far more reasonable assumption, then, would be to expect a large portion of the balance sheet capacity created by the proposal to be directed to lending to hedge funds through the GSIBs' prime brokerages.

Insofar as *this* is the intermediation activity that the proposal does anticipate, it failed to fulfil its obligation to consider the attendant costs and benefits of such activity. The Agencies must analyze and consider the risks associated with the relationships between GSIBs' prime brokerages and their clients. Recent research shows that prime brokerages have a range of vulnerabilities related to their hedge fund lending, including wrong-way risk, a lack of visibility into their counterparties, and poor risk management by their counterparties.[32]

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[28] We may infer a typical internal hurdle rate from the publicly disclosed return on equity targets and typical cost of equity.

[29] Rupak Ghose, "Hedge funds > private equity: Wall Street has a new captain" *Financial Times,* (May 2, 2025). Available at: https://www.ft.com/content/9777f1b2-fc62-4f62-aad0-f0e3022a22f3

[30] "Hedge Fund Monitor" *Office of Financial Research*. Available at: https://www.financialresearch.gov/hedge-fund-monitor/categories/leverage/chart-23/.

[31] The RBC rules generally do not capture repo transactions that typically accounted for are off balance sheet.

[32] Cohen, Kiarelly Godoy de Araujo, Tracol, "The prime broker–hedge fund nexus: recent evolution and implications for bank risks" *Bank for International Settlements,* (March 4, 2024). Available at: https://www.bis.org/publ/qtrpdf/r_qt2403y.htm

Second, the largest implied benefit of adding approximately $1.1 trillion in balance sheet capacity (or more in the case of the Alternatives) is bolstering demand for UST at a time of expected heightened issuance. Regulators assigning a low/zero risk to their own debt has led to considerable risk in the past[33] and may create a "sovereign subsidy".[34] Additionally, USTs provide the reference rate for countless financial products including mortgage-backed securities, corporate debt and municipal bonds. UST rates are also treated as the "risk free rate" in most financial models. Manipulating demand and therefore rates on UST could have knock on effects for the broader economy far beyond what is contemplated in the proposal.

Furthermore, deploying the bank capital rules is at odds with the stated purpose of bank legislation and regulation which generally works to protect US citizens and the financial system from bank failure. We question whether it is prudent or legal to use the bank capital rules to support the market for US government debt. We note that the Federal Reserve has declined to lower interest rates due to concerns about inflation. Yet this proposal would appear to pursue the same end – lowering borrowing costs – through regulatory policy rather than monetary policy.

Third, the analysis of primary dealer capacity to hold UST appears to ignore other regulatory changes currently being implemented. According to the proposal, the changes would yield $2.1 trillion of additional capacity for holding UST at GSIBs' broker dealer subsidiaries. It is unclear if or how the analysis considers the impact of the treasury clearing requirements. Recent research estimates that the balance-sheet netting benefits of those requirements could provide up to $700 billion of balance sheet capacity for primary dealers.[35] Furthermore, the proposal does not refer to the CBO estimates of $49.6 trillion UST outstanding in 2034. If the broker dealer subsidiaries maintained their relative exposure of 2.5% of UST outstanding as they have over their past decade, they would only need to maintain a $1 trillion UST exposure. This is only approximately $400 billion of additional exposure. Thus the proposal provides GSIBs far more opportunity for leverage that would be necessary to maintain the intermediation functioning of their broker dealer subsidiaries.

Finally, insofar as the cited research on the impact of the Covid measures is accurate, the proposal fails to recognize that by deploying the capital cushion in a period of relative market strength it will be unavailable in the event of a crisis. As discussed above, market actors are likely to respond to these changes dynamically. There is no reason to expect that they will preserve this balance sheet capacity to use in case of a market emergency. That is precisely the role of prudential regulation.

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[33] See discussion of the Eurozone sovereign debt crisis in Section II above.

[34] Steffen, Sascha. "A 'Sovereign Subsidy' – Zero Risk Weights and Sovereign Risk Spillovers." VoxEU.org, September 7, 2014. Available at: https://cepr.org/voxeu/columns/sovereign-subsidy-zero-risk-weights-and-sovereign-risk-spillovers

[35] Liang, Nellie, and Haoxiang Zhu. "Clearing the Path for Treasury Market Resilience." Brookings, July 29, 2025. Available at: https://www.brookings.edu/articles/clearing-the-path-for-treasury-market-resilience/.

Conclusion

In closing, the core rationales for this proposal do not hold water and the proposal fails to adequately consider, estimate or analyze significant costs and risks associated with the proposed changes.

We believe the most prudent course of action would be to withdraw the proposal. Failing that, we believe the agencies must repropose the changes contemplated here alongside a full consideration of other pending changes to the capital framework for US banks. Further, such reproposal should also include a consideration of the risks and data overlooked by the original proposal, including those highlighted in this letter.

The Council appreciates this opportunity to share its views on the proposal and would welcome any follow-up conversation that might be helpful.

Sincerely,

Simon Johnson — Erkki Liikanen

Co-Chair, — Co-Chair

Note: The views expressed herein represent the collective views of the SRC and not all members may agree with all aspects of this comment letter.

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