STATEMENT OF

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RIGHT-SIZING THE U.S. BANK CAPITAL FRAMEWORK: A RETURN TO TAILORING, ECONOMIC GROWTH, AND COMPETITIVENESS

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My name is Margaret E. Tahyar, known as Meg, and I lead the Financial Institutions Group at Davis Polk & Wardwell LLP where I have been a partner for 28 years and where I have toiled in the field of banking regulation for 35 years. I am one of the co-authors of the law school textbook, *Financial Regulation and Policy* (Jackson, Tahyar, 4th Edition, Foundation Press 2025). I represent a large range of financial institution clients, but I am here today in my individual capacity and not on behalf of any client. The views I express are my own, and not necessarily those of Davis Polk, any client or any other organization with which I am or have been affiliated.

Introduction

Chairman Barr, Ranking Member Foster and members of the Subcommittee, thank you asking me to testify today on this crucially important topic.

Capital is complex and multi-layered. Capital regulation is long overdue for a rethinking, and this Subcommittee should be encouraging the federal banking regulators to move promptly to appropriately implement the Basel III Endgame. In the short time I have today, I would like to leave you with three thoughts. First, capital is very important but is not the only tool in the regulatory kit. Second, choices about the calibration of capital requirements and risk weights are political economy choices that involve credit engineering and can change the regulatory perimeter. Third, our economy and our banking sector are complex. Tailoring is the solution so that we do not treat large banks the same as community banks. At its core, capital is not only financial stability insurance but is also about competitiveness and credit in the real economy.

I. Capital Is An Important Thing, But It Is Not Everything

Capital regulation is critically important, but we need to keep in mind that it is one part of a multi-faceted regulatory and supervisory system. We cannot expect capital to be the sole tool against financial instability. We should see capital as part of a system that also includes liquidity regulations, early intervention tools, resolution planning, credit concentration limits, contingency planning, risk management, loss-absorbing debt requirements, deposit insurance and hands-on supervision.[1]

Let's be clear about the difference between capital and liquidity. There is a common misconception that a banking organization's capital is a pile of cash that the banking organization holds or sets aside that could be used if there is a run on the banking organization. Capital is not that; it is a measure of a banking organization's ability to

[1] The entire *ex ante* and *ex post* regulatory and supervisory systems work together in the cause of financial stability. *See* Randall D. Guynn, *Are Bailouts Inevitable?*, 29 YALE J. ON REG. 121, 130-35 (2012).

absorb losses.[2] Capital does not protect against bank runs. Liquidity requirements[3] and deposit insurance work together to give comfort to depositors and discourage runs on banking organizations. It is important to keep these two concepts, and their function, separate even though they are symbiotic.

Capital is a lagging indicator, which is why prompt corrective action has not worked while bank runs happen at ever-increasing speeds. Many banking organizations have failed while well capitalized.[4] So, we cannot rely on capital alone for financial stability. That is why, for example, it is important for banking supervisors to be laser focused on material financial risks and not distracted by check-the-box compliance exercises.

As a result, this Subcommittee, as part of its oversight activities, should be supporting the core federal banking regulators in the full breadth of the agenda they have laid out in restoring tailoring and helping credit to flow where the economy needs it as well as bringing more transparency and accountability into the supervisory system.

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[2] A banking organization's capital can be thought of as a proxy for the equity on its balance sheet—that is, the difference between its assets and its liabilities. This portion of the balance sheet is shareholders' investment in the banking organization. In addition to balance sheet equity, capital also includes qualifying subordinated debt (a balance sheet liability), which by its terms ranks below other debt of the banking organization and is therefore an equity-like obligation. If losses occur, capital shrinks first. The more a banking organization uses equity to fund its assets, the higher its capital ratios will be. And the higher these ratios, the more losses a banking organization and its shareholders and subordinated debtholders could suffer without impairing its obligations to its creditors, including depositors. For additional background, see also David Wessel, Brookings Institution, *What is bank capital? What is the Basel III Endgame?* (Mar. 7, 2024), https://www.brookings.edu/articles/what-is-bank-capital-what-is-the-basel-iii-endgame/; Douglas J. Elliott, Brookings Institution, *A Primer on Capital* (Jan. 28, 2010), https://www.brookings.edu/wp-content/uploads/2016/06/0129_capital_primer_elliott.pdf.

[3] Large banking organizations are required to maintain a minimum amount of cash and other high-quality liquid assets to meet their short-term obligations. See the liquidity coverage ratio rules at 12 C.F.R. Part 50 (OCC), 12 C.F.R. Part 249 (Federal Reserve) and 12 C.F.R. Part 329 (FDIC). Smaller banking organizations are not subject to specific liquidity requirements, but their liquidity resources and planning are a key focus of banking regulators' supervision and examinations.

[4] "Regulatory capital ratios for SVB Financial [Group] and [Silicon Valley Bank] exceeded minimum federal regulatory guidelines under the Capital Rules as well as for a 'well capitalized' bank holding company and insured depository institution, respectively, as of December 31, 2022." SVB Financial Group, *Report on Form 10-K for the fiscal year ended December 31, 2022*, https://www.sec.gov/Archives/edgar/data/719739/000071973923000021/sivb-20221231.htm. Silicon Valley Bank failed on March 10, 2023. Also in 2023, Swiss regulators declared that "Credit Suisse meets the capital and liquidity requirements imposed on systemically important banks" four days before announcing that UBS would take over Credit Suisse. Swiss Financial Market Supervisory Authority, *FINMA and the SNB issue statement on market uncertainty* (Mar. 15, 2023), https://www.finma.ch/en/news/2023/03/20230315-mm-statement/; Swiss Financial Market Supervisory Authority, *FINMA approves merger of UBS and Credit Suisse* (Mar. 19, 2023), https://www.finma.ch/en/news/2023/03/20230319-mm-cs-ubs/.

II. Political Economy Choices Are Embedded in the Regulation of Bank Capital

Capital regulation involves political economy choices at macroeconomic and microeconomic scales. The macroeconomic question is how much financial stability insurance a banking organization should be required to purchase, given the benefits and costs. Any increase in the stringency of bank capital requirements, whether through an increase in minimum ratios or buffers or changes to the numerator or denominator of the ratios, increases the cost of funding for banks. Higher capital requirements are not costless. I think we can all agree that capital levels were too low going into the global financial crisis, but we may now have reached the point where we have to ask whether current capital levels also come at a cost to the real economy, as banking organizations may reduce lending in response to their heightened funding costs. They may also diminish the financial stability benefits of capital regulation, as lending activity moves to the less-regulated nonbank sector.

Since opinions legitimately differ about the optimal level of capital, that implies, I believe, several insights that should be taken into account as policymakers think about recalibration of the capital standards.[5]

First, we should acknowledge that the overall calibration of capital requirements inherently involves a judgment call about the appropriate weighing of financial stability benefits and economic costs.[6]

Second, we should acknowledge that capital regulation involves political economy choices at a microeconomic scale. Risk weighting for purposes of risk-based capital requirements is a form of credit engineering. In making choices about the risk weighting of different categories of exposures, regulators encourage or discourage banking

[5] As a recent literature review by the Bank of England shows, studies attempting to determine the optimal level of bank capital based on economic costs and benefits have yielded a broad range of results. Bank of England, *Financial Stability in Focus: The FPC's assessment of bank capital requirements* (Dec. 2, 2025), at 52-56, https://www.bankofengland.co.uk/financial-stability-in-focus/2025/fsif-the-fpcs-assessment-of-bank-capital-requirements. For other reviews of academic literature on optimal bank capital levels, see also, e.g., FDIC, Federal Reserve and OCC, *Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity*, 88 Fed. Reg. 64028, 64169 (proposed Sept. 18, 2023); Francisco Covas and Bill Nelson, Bank Policy Institute, *U.S. Bank Capital Levels: Aligning With or Exceeding Midpoint Estimates of Optimal* (Sept. 18, 2023), https://bpi.com/u-s-bank-capital-levels-aligning-with-or-exceeding-midpoint-estimates-of-optimal/.

[6] Notably, just last week, the Bank of England's Financial Policy Committee (FPC) reduced its judgment on the "appropriate benchmark level for system-wide Tier 1 capital requirements" from 14% of risk-weighted assets (RWA) to around 13% of RWA. Bank of England, *Financial Stability in Focus: The FPC's assessment of bank capital requirements* (Dec. 2, 2025), at 3-4, https://www.bankofengland.co.uk/financial-stability-in-focus/2025/fsif-the-fpcs-assessment-of-bank-capital-requirements. The FPC wrote that "[t]his 13% benchmark for Tier 1 capital requirements comprises an underlying optimal level of 11%, inclusive of the neutral rate for the UK CCyB, and an additional 2 percentage points to account for outstanding gaps and shortcomings in the measurement of RWAs." *Id.* at 4. The FPC noted that the 13% benchmark "remains close to the bottom end of the range of optimal capital estimates" identified in its review of academic studies. *Id.* at 48.

organizations from taking those exposures. If risk weights accurately reflect the relative risks of exposures, market forces will predominate. But if risk weights do not reflect the true risk of loss for a category of exposures, banking organizations will have incentives to under- or over-invest in that category. Three examples illustrate this point.

Most residential mortgages have long been assigned a 50% risk weight under the standardized approach, compared to a 100% risk weight for commercial loans.[7] I believe that encouraging home ownership in the United States was a clear driver of this policy choice. The international Basel III standard reflected a view that the risk weighting of mortgages should be more risk-sensitive.[8] In the Basel III Endgame proposal, the federal banking regulators proposed significant amendments to the risk-weighting treatment of mortgage exposures that went above and beyond the international standard.[9] In doing so, they made the political economy choice not to prioritize encouraging U.S. home ownership.[10] To provide another example, since Basel I the standard risk weight for U.S. Treasuries and sovereign debt of other developed countries has been 0%.[11] This choice was driven by a view about the lack of credit risk in these forms of sovereign debt, but also has the effect of encouraging active markets in such instruments. Finally, the Basel Committee recently adopted a 1,250% risk weight for certain exposures to cryptoassets.[12] If implemented at the national level, this would strongly discourage banking organizations from holding such exposures. The political economy choices behind this risk weighting seem at odds with the recent GENIUS Act.

Third, we should realize that any capital framework will need updating and renewal from time to time as markets and technology change. The recent changes to the enhanced supplementary leverage ratio (eSLR) buffer requirement are welcome and wise but were

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[7] Bank for International Settlements, *International Convergence of Capital Measurement and Capital Standards* (1988), at 18, https://www.bis.org/publ/bcbsc111.pdf. For the current risk weights for residential mortgage exposures, see 12 C.F.R. §§ 3.32(g) (OCC), 217.32(g) (Federal Reserve) and 324.32(g) (FDIC).

[8] See Bank for International Settlements, *Calculation of RWA for Credit Risk*, CRE 20.82 (effective Jan. 1, 2023), https://www.bis.org/basel_framework/chapter/CRE/20.htm.

[9] FDIC, Federal Reserve and OCC, *Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity*, 88 Fed. Reg. 64028, 64048 (proposed Sept. 18, 2023).

[10] The federal banking regulators stated, however, that the proposed risk weights for residential real estate exposures "are intended to appropriately reflect differences in credit risk of these exposures" and invited comment noting that "the agencies are supportive of home ownership and do not intend the proposal to diminish home affordability or homeownership opportunities." *Id.*

[11] Bank for International Settlements, *International Convergence of Capital Measurement and Capital Standards* (1988), at 17, https://www.bis.org/publ/bcbsc111.pdf. For the current risk weights for sovereign exposures, see 12 C.F.R. §§ 3.32(a) (OCC), 217.32(a) (Federal Reserve) and 324.32(a) (FDIC).

[12] Basel Committee on Banking Supervision, *Prudential treatment of cryptoasset exposures* (Dec. 2022), https://www.bis.org/bcbs/publ/d545.pdf.

discussed for many years and, in the meantime, many believe they had an impact on the functioning of the Treasury markets. Markets, technology and geopolitics aren't waiting around for the Basel III Endgame. Congress should encourage the federal banking regulators to finalize the Basel III Endgame as soon as possible.

In fact, calling the latest round of rulemaking "Basel III Endgame" is a misnomer, implying that, once this round of rules takes effect, we are done with capital standards. But this isn't a Marvel movie with a tidy ending—the economy and financial system will remain in constant flux, and the federal banking regulators should periodically review the entire capital framework to ensure that it continues to support the financial system and the real economy.[13]

III. The Complexity of Bank Capital Regulation Should Be Tailored to the Complexity of a Banking Organization

The complexity of capital regulations should be tailored to the risk and complexity of a banking organization. This principle is especially critical in the United States given the complexity and geographical spread of the largest economy in the world. In the United States we have a banking sector whose structure is very different from most other countries with our many different sizes of banks. A certain level of complexity in capital regulation is necessary to account for differences in the risks of different assets, particularly for the largest, most internationally active banking organizations. But for banking organizations with less complex activities, the federal banking regulators should avoid imposing unnecessarily complex rules, which require intense technology and talent investments.

The capital framework understandably evolved over decades as new banking activities created new risks, new technologies made it possible to measure risks more accurately and financial crises occurred, prompting regulators to revisit their past choices or consider new approaches. The result of this evolution is an undeniably complex capital framework, featuring multiple parallel ratio requirements, calculation methods designed to capture particular risks in more sophisticated ways and variable buffer requirements based on an individual banking organization's particular risk profile.

Wisely, the federal banking regulators did not impose every new complexity on every banking organization, regardless of its size or activities. The resulting framework is indeed tailored. But it is fair to question whether it is appropriately tailored. In my view, there is room to improve the tailoring, especially for medium-sized banking organizations. Indexing thresholds as the economy grows is one concept to consider.

[13] In fact, the federal banking regulators are required by statute to review all of their regulations, including the capital rules, at least once every ten years to identify outdated, unnecessary or unduly burdensome requirements. *See* 12 U.S.C. § 3311.

The smallest, least complex U.S. banking organizations are, appropriately, subject to the least complex bank capital requirements. Banking organizations with less than $10 billion of consolidated assets that otherwise meet the criteria to be a qualifying community banking organization may elect to comply with the community bank leverage ratio (CBLR) framework.[14] Under that framework, if a qualifying community banking organization complies with a single 9% leverage ratio requirement, it is considered to have satisfied any other leverage and risk-based capital requirements to which the banking organization is subject and to be well capitalized for purposes of the prompt corrective action framework.[15] The federal banking regulators recently proposed to reduce the CBLR requirement to an 8% leverage ratio and to implement a longer grace period for banks that grow beyond $10 billion.[16]

The very largest, most internationally active U.S. banking organizations—the global systemically important banking organizations (G-SIBs)—are subject to additional requirements that increase both the complexity of the framework and the amount of capital they are required to hold. G-SIBs are subject to the advanced approaches requirements, effectively requiring them to calculate many of their capital requirements twice, and comply with the most binding requirement. They are subject to stress testing and the related stress capital buffer (SCB) requirements. They are subject to a potential counter-cyclical buffer (CCyB) that can be deployed at the discretion of the Federal Reserve, although it has never been deployed. They are required to calculate a G-SIB surcharge under two methods, one of which is gold-plated as compared to international standards, and comply with the higher of the two.[17] They are also subject to the eSLR buffer requirement, above and beyond the supplementary leverage ratio requirement that applies to the G-SIBs as well as Category II and III banking organizations.[18] It makes

[14] 12 C.F.R. §§ 3.12 (OCC), 217.12 (Federal Reserve) and 324.12 (FDIC).

[15] *Id.*

[16] FDIC, Federal Reserve, OCC, *Regulatory Capital Rule: Revisions to the Community Bank Leverage Ratio Framework* (proposed Dec. 1, 2025), 90 Fed. Reg. 55048.

[17] 12 C.F.R. § 217.403; Bank for International Settlements, *SCO40: Global systemically important banks*, https://www.bis.org/basel_framework/chapter/SCO/40.htm?inforce=20211109&published=20211109.

[18] 12 C.F.R. §§ 3.10(a)(1)(v) (OCC), 217.10(a)(1)(v) (Federal Reserve) and 324.10(a)(1)(v) (FDIC); 12 C.F.R. § 217.11(c)(4). The FDIC, Federal Reserve and OCC recently issued a final rule "intended to help ensure that the enhanced supplementary leverage ratio standards serve as a backstop to risk-based capital requirements rather than a frequently binding constraint." FDIC, Federal Reserve and OCC, *Regulatory Capital Rule: Modifications to the Enhanced Supplementary Leverage Ratio Standards for U.S. Global Systemically Important Bank Holding Companies and Their Subsidiary Depository Institutions; Total Loss-Absorbing Capacity and Long-Term Debt Requirements for U.S. Global Systemically Important Bank Holding Companies*, 90 Fed. Reg. 55248 (Dec. 1, 2025).

sense to ask whether this gold plating remains appropriate, as the Bank of England recently did.[19]

U.S. banking organizations in Category IV and above (i.e., with $100 billion or more in total assets) are subject to the SCB requirement that is determined individually on an annual basis for each such banking organization based, in part, on the results of the Federal Reserve's supervisory stress test, subject to a minimum of 2.5%.[20] This requirement introduces volatility in the total Common Equity Tier 1 capital requirement to which each such banking organization is subject, and recent proposals designed to decrease that volatility make sense.[21]

The range of banking organizations that are not small enough to be eligible for the CBLR framework, but also not large enough to be required to compute their capital under the advanced approaches or comply with the SLR or SCB, are subject to both leverage requirements and to risk-based capital requirements under the standardized approach. Banking organizations with $11 billion in total assets are subject to the same standardized approach as banking organizations with $99 billion in total assets.

In the Basel III Endgame proposal, the federal banking regulators proposed major changes to the capital framework, including significant refinements to the standardized risk weights that would make them more sensitive to risk and, as a result, more complex. The federal banking regulators proposed applying the enhanced risk-based capital requirements, a new standardized approach that would have operated in parallel to the existing standardized approach, to all banking organizations with $100 billion or more in total assets.[22] The proposal also would have introduced operational risk capital requirements within that new standardized approach, whereas to date operational risk requirements have only been considered under the advanced approaches.[23]

I recommend that the federal banking regulators consider whether all of these new requirements are worth imposing on the wide range of mid-sized U.S. banking organizations, or whether higher thresholds are more appropriate for the Basel III Endgame version of the standardized approach in general and its operational risk

[19] The Bank of England recently revisited its assessment of the appropriate calibration of capital requirements, lowering its recommended benchmark capital ratio from 14% to 13%. *See supra* n. 6.

[20] 12 C.F.R. § 225.8. For the SCBs effective October 1, 2025, see Federal Reserve, Large Bank Capital Requirements (Aug. 2025), https://www.federalreserve.gov/publications/files/large-bank-capital-requirements-20250829.pdf.

[21] Federal Reserve, *Modifications to the Capital Plan Rule and Stress Capital Buffer Requirement*, 90 Fed. Reg. 16843 (proposed Apr. 22, 2025).

[22] FDIC, Federal Reserve and OCC, *Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity*, 88 Fed. Reg. 64028, 64032 (proposed Sept. 18, 2023).

[23] *Id.* at 64082.

component in particular. The federal banking regulators should also consider adopting higher asset thresholds for the SCB and CBLR frameworks.

Conclusion

As the federal banking regulators work towards a welcome update in capital regulation, I hope that we can keep in mind that capital regulation and its close cousin, liquidity regulation, have a direct impact on what the banking sector does in the economy. All policy choices have trade-offs, but our focus should be on the impact on the real economy, jobs and wealth creation. This is not a red team/blue team issue. We should approach it in a spirit of bipartisanship as a purple issue.