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Under a proposed regulatory overhaul, US banks face tougher capital requirements

Article

The news: New rules would **require US banks to set aside billions of dollars more in capital** to guard against a repeat of the regional bank collapses that happened earlier this year.

Historically, holding $250 billion in assets has been the threshold for applying the toughest rules. **Under the proposed guidance, institutions with at least $100 billion in assets will come within scope, too**—and might have to meet the new standard.

What's changing: It's one of the most sweeping overhauls of how lenders are regulated since the 2008 financial crisis. If the rules proposed jointly by the Federal Reserve, Federal Deposit Insurance Corp. and Office of the Comptroller of the Currency go into effect, **the impact will differ from bank to bank, depending on their size and operations**.

- **The eight global systemically important US banks**, such as **JPMorgan** and **Bank of America**, would see a roughly 19% increase in the amount of capital they'd have to hold.
- **Banks with between $250 billion and $1 trillion** in assets face an increase of about 10%.
- **Banks with $100 billion to $250 billion** would see a 5% increase. Banks of that size have operated under relaxed rules since 2019, but they'd now also have to account for unrealized gains and losses on available-for-sale securities, as well as adhere to a stricter leverage requirement.

Generally, banks would have to hold an additional two percentage points of capital, or an additional $2 of capital, for every $100 of risk-weighted assets.

Changes in risk weighting: The proposed rules also change the way banks calculate risk-weighted assets. These assets can range from Treasuries and mortgages to derivatives and crypto. Higher "risk weights" will apply to certain assets banks hold. The riskier the assets, the higher the weights—requiring banks to set aside more capital to absorb any future losses.

Changes in how banks assess future risks: Banks won't be able to rely solely on internal models to estimate how much they could lose on loans—and how much capital they should hold against assets like mortgages. Regulators fear that internal bank models could underestimate these risks. Instead, regulators want banks to use two different methodologies to obtain the figure:

- The standard methodology banks in the US currently use, which considers general credit and market risk; and
- A separate, standardized methodology that takes into account operational risk and credit valuation adjustment.

To figure out their capital ratios, banks would have to use whichever methodology calculated a higher level of risk-weighted assets.

Risk modeling at desk level: Regulators also worry about how banks evaluate the risks posed by market swings, trading losses, and unexpected operational developments, such as litigation. They want banks to model market risks at the level of individual trading desks for particular asset classes, instead of at the firm level.

As a result, banks with big trading desks—which could be considered to add operational risk, due to flawed internal processes or external threats—could face higher capital requirements.

Why is this happening? The proposed changes are part of the US version of the Basel III international accord, developed back in 2017 by the Basel Committee on Banking Supervision to set global regulatory capital standards. The COVID-19 pandemic delayed plans for a US rollout, then the banking crisis this past spring gave the debate fresh relevance.

Officials argue the changes are needed to make lenders stronger, more resilient, and better prepared for shocks like the bank runs that collapsed several regional lenders in March. The OCC's acting chief, Michael Hsu, compared the new capital requirements to building codes that help "the public ... rest assured that banks, like buildings, are safe and resilient to stress." His fellow regulators say the increase would primarily affect the largest banks, and that most have enough capital already to comply.

What's the timeline? The FDIC and Fed held open meetings Thursday to discuss the proposal. Regulators said they would accept public comments on it through Nov. 30, with the aim of issuing a final rule next year. Some parts of the proposal would be phased in over three years, starting in July 2025. All rules would be in place by July 1, 2028.

Our take: Annual Fed stress tests already account for some of these elements. They've helped make lenders far more resilient than they were during the 2008 financial crisis. And the post-mortems held on recent bank failures show they were caused primarily by poor risk management and lack of supervision—not by a lack of capital.

The US banks deemed "too big to fail" don't need to become even larger and further boost their capital reserves. But the banks that will feel the changes most acutely are the midsize firms, like **Citizens Financial Group, Fifth Third, Huntington** and **Regions**—a sector where many balance sheets are hurting due to the challenges of the higher rate environment. Further distress could lead to mergers that reduce healthy competition. And banks of all sizes may also react to the new requirements by restricting lending to low-income or first-time borrowers, reducing services, and raising fees—which will counterproductively push more consumers to non-banks within the “shadow” banking system, where there fewer safeguards for their money.