## The Daily Dish

# Bank Capital and the Fed

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Yesterday Michael Barr, Federal Reserve Vice Chairman for Supervision, gave remarks at the Bipartisan Policy Center that foreshadowed proposals to increase bank capital requirements the Fed will likely propose later this year at the conclusion of its "holistic review" of large bank capital standards. "I'm here to report on my holistic review of capital for large banks and to outline steps that I believe are appropriate to update our capital standards so that banks can continue to serve our communities, households, and businesses," Barr said. "The review was a top priority because capital is fundamental to safety and soundness."

The short version? A bigger pox on more houses: Bank capital requirements will go up for all banks and the number of banks subject to the most draconian standard will increase. This is the case despite the fact that the Fed itself recently completed the stress tests on the 23 largest banks and concluded: "The 2023 stress test shows that the 23 large banks subject to the test this year have sufficient capital to absorb more than $540 billion in losses and continue lending to households and businesses under stressful conditions." In other words: no problem found.

As Thomas Kingsley explains in his review of Barr's proposals:

> *Barr recommends that existing risk-based capital requirement standards be updated to better reflect credit, trading, and operating risks, and that these updates be entirely consistent with international standards, namely Basel III. Perhaps the most significant of these requirements is ending a system of reliance on a bank's own individual estimates of risk via internal risk models. Rather than assume that the bank itself is best placed to judge the risks it and its unique portfolio faces, the Fed may propose a one-size-fits-all internal model that will significantly reduce the sensitivity of these models – and presumably lead to a significant expansion of the Fed's supervisory role.*

> *Barr also recommends that the new capital framework should apply to all banks and bank holding companies with more than $100 billion in assets, summarily stripping away the bank tailoring efforts of his predecessor. In particular, these banks would become subject to long-term debt requirements. In his rationale Barr points to the failure of SVB [Silicon Valley Bank], a better example of a supervisory failure than a capital one. SVB made a series of strategic, investment, and reporting errors that are unrepresentative of America's mid-size banks – and it is disappointing that the Fed would paint them all with the same brush. Barr estimates that under the new framework, banks will have to hold an additional 2 percentage points in capital, an astonishing increase where many banks hover between 8 and 14 percentage points.*

In sum, the Fed will likely raise the capital requirements on the largest banks even though there is no evidence of any need for the increase. And it will expand to the regional banks the same requirements because of the failure of SVB, even though there is zero evidence that capital requirements or risk models led to its problems. And how does it conclude that this is a good idea? By ignoring costs.

Sure, there are benefits to regulations, but there are also costs and not all regulatory expansions will pass a benefit-cost test. The Fed seems to have forgotten about half of the issues in capital requirements.