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Statement of CFPB Director Rohit Chopra
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Regarding the Proposal to Strengthen the Resilience of America's Largest Banks

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Today, federal banking regulators are voting to propose a rule regarding the resilience of banks with $100 billion or more in assets. These very large firms are chartered by federal and state governments and enjoy the privilege of federal deposit insurance and other public subsidies. The rule would reduce the chance of failures, bailouts, and disruptions in the offering of credit and banking services to businesses and households.

The rule would require owners of the banks to have more skin in the game, so that they are the ones that lose when they take undue risks, rather than taxpayers and the public.

Critical Infrastructure Resilience

Our financial system is critical infrastructure for the country. Like telecommunications, transportation, and energy infrastructure, finance and banking power the economy. The financial system must work at all times. Just as power outages, highway closures, and cellular tower failures can be highly disruptive to everyday life, financial crises can paralyze the economy in ways that are difficult to repair. The costs of systemically important bank failures, especially too-big-to-fail Wall Street banks, are extraordinary, with the pain disproportionately felt by those who bear no responsibility for the crash. Businesses can't finance their operations and workers lose their jobs. People can't finance a car, a new home, or everyday expenses. The economy can rapidly contract and it can take a long time to turn the lights back on. Some of the social and economic scars may never fully heal.

Sometimes, increasing the resilience of our critical infrastructure is hard. To make our telecommunications infrastructure less prone to cyberattacks, we leverage the latest computer science methods and emerging technologies. To make our transportation networks less vulnerable to natural disasters, we deploy cutting-edge engineering techniques. But when it comes to increasing the resilience of our financial system, fortunately, it's much easier. The owners of these large financial firms simply need to put more of their own money at risk, rather than relying so heavily on other people's money. This makes them less likely to fail and reduces the risk of contagion throughout the financial system.

In March, two systemically important banks failed. Most people had never heard of either bank, and both banks were a mere fraction of the size of the very largest Wall Street banks. Nevertheless, the FDIC Board of Directors and Federal Reserve Board of Governors unanimously recommended to the Secretary of the Treasury that the government needed to step in to protect uninsured depositors or there could be a potential meltdown. If shareholders, rather than taxpayers, shoulder more risk, we'll reduce the likelihood of much larger catastrophes.

Calibrating Resilience Requirements

Because big bank failures impose such massive pain on the economy and banks themselves prefer to rely on other people's money to fund their operations, we are proposing a rule that requires their shareholders to have more skin in the game.[1] The rule utilizes a principle referred to as "risk-weighting." The requirements are tailored to the estimated riskiness of the bank's loans and investments.

I am generally skeptical of "risk-weighting" since it can be very complex, create difficulties in enforcement, and lead to market distortions.[2] Bright-line rules and simple ratios, including a measure called the leverage ratio, are easier to follow and enforce. However, the proposed rule is drawn from international standards that seek to make the global financial system more resilient, increase cross-border consistency, and limit regulatory gamesmanship.[3]

The proposed rule seeks to close loopholes previously exploited by banks to evade their obligations. For example, the proposal would close the loophole that enabled Silicon Valley Bank and others to ignore certain unrealized losses on their bond portfolios as interest rates increased.[4] It would also ban banks from relying on in-house models to determine risks of lending activities, which has been a roadmap for abuse, and would add more rigor to the formulas used to judge the riskiness of trading and derivatives activities.

To ensure a smooth transition to the new requirements, owners of these banks would be effectively given four years to increase their skin in the game to the new required levels. Over the past four years, big banks paid out more than $500 billion in dividends and share buybacks to their owners.[5] This is just a fraction of what they'll need to take on a bit more of the risk that is currently shouldered by taxpayers and the public.

Benefits of Increased Resilience Requirements for Megabanks

Increased resilience requirements will generate a wide range of economic benefits. They support long-term economic growth, given fewer interruptions in the availability of credit and financial services. Banks that fund their operations with more of their own money lend more to businesses and households, especially in times of stress.[6] Many studies conclude that the economy would greatly

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[1] The proposed rule would increase the binding capital requirements by roughly 20% for Wall Street banks, 14% for large foreign banks in the U.S., and 6% for U.S. domestic systemically important banks.

[2] Thomas M. Hoenig, *Why 'Risk-Based' Capital Is Far Too Risky* (2016), https://www.fdic.gov/about/learn/board/hoenig/op-ed-081216.html.

[3] Basel Committee on Banking Supervision, *Governors and Heads of Supervision finalise Basel III reforms* (2017), https://www.bis.org/press/p171207.htm.

[4] Board of Governors of the Federal Reserve System, *Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank*, p.89 (2023), https://www.federalreserve.gov/publications/files/svb-review-20230428.pdf; Martin J. Gruenberg, *Remarks by Chairman Martin J. Gruenberg on the Basel III Endgame at the Peterson Institute for International Economics* (2023), https://www.fdic.gov/news/speeches/2023/spjun2223.html.

[5] Analysis of FR-Y9C data for banks with $100 billion or more in assets over the previous sixteen quarters ending Q4 2022.

[6] Leonardo Gambacorta and Hyun Song Shin, *Why bank capital matters for monetary policy,* Bank for International Settlements (2016), available at http://www.bis.org/publ/work558.pdf. ("...we have found that higher bank capital is associated with greater lending, and that the mechanism involved in this channel is the lower funding costs associated with better capitalised banks."); Mark Carlson et. al., *Capital Ratios and Bank Lending: A Matched Bank Approach,* Federal

benefit from an even more significant increase in capital requirements than we are proposing today.[7] Struggling banks limit their lending. Failed banks don't lend at all. We've never endured an economic calamity because our largest banks were too stable.

The requirements also reduce some of the competitive disadvantages faced by smaller, local banks. Shareholders of local banks typically bear more risk than investors in the biggest banks.[8] That's because the market believes that the government will step in with a bailout when big banks fail.[9] These requirements begin to level the playing field.

Path Forward

Of course, regulators understand that no bank wants to face higher capital requirements. Particularly for top executives of the largest banks, higher capital makes it a bit more difficult to generate bigger bonuses and send more cash out the door to shareholders. But right now, those bonuses and shareholder payouts are essentially subsidized by the public, and this simply can't continue.

The FDIC welcomes comments on these proposed resilience requirements. I am especially interested in ways to simplify the methodologies used to calculate the requirements.

Our effort today must be complemented by further actions to increase resilience and end too-big-to-fail in both the banking sector, as well as the nonbank financial sector, where many other risks to the financial system are lurking in the shadows.[10]

Reserve Board Finance and Economics Discussion Series (2011), https://www.federalreserve.gov/pubs/feds/2011/201134/index.html. ("Our main results indicate that banks that had higher actual capital ratios tended to have stronger loan growth over the next year.").

[7] *See for example*, Jihad Dagher et. al., *Benefits and Costs of Bank Capital*, IMF Staff Discussion Note (2016), https://www.imf.org/external/pubs/ft/sdn/2016/sdn1604.pdf; 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 Board Finance and Economics Discussion Series (2017), http://www.federalreserve.gov/econres/feds/files/2017034pap.pdf. The economic impact analysis in the proposed rule characterizes the literature: "On balance, this literature concludes that there is room to increase capital requirements from their current levels while still yielding positive net benefits."

[8] At the end of Q4 2022, banks with $10 billion or less in assets had an average leverage ratio of 10.31%, while global systemically important banks had an average supplementary leverage ratio of 5.94% and large banking organizations with $100 billion or more in assets had a supplementary leverage ratio of 7.4%. Sabrina Pellerin, *Bank Capital Analysis Semiannual Update*, Federal Reserve Bank of Kansas City (2022), https://www.kansascityfed.org/Banking/documents/9499/Bank-Capital-Analysis-Kansas-City-Fed-Q4-2022.pdf.

[9] Financial Stability Board, *Evaluation of the effects of too-big-to-fail reforms: Final Report* (2021), https://www.fsb.org/wp-content/uploads/P010421-1.pdf. ("The funding cost advantages of systemically important banks have fallen since the implementation of reforms, but remain at least as high as they were before the 2007-08 crisis."); Asani Sarkar, *Did Subsidies to Too-Big-To-Fail Banks Increase during the COVID-19 Pandemic?*, Federal Reserve Bank of New York (2021), https://libertystreeteconomics.newyorkfed.org/2021/02/did-subsidies-to-too-big-to-fail-banks-increase-during-the-covid-19-pandemic/. ("A regression analysis shows a statistically significant increase in subsidies of between 50 and 80 basis points between March and August of 2020, from a pre-COVID-19 average of about 100 basis points between January 2012 and February 2020.")

[10] Statement of CFPB Director Rohit Chopra on the 2022 Annual Report of the Financial Stability Oversight Council (2022), https://www.consumerfinance.gov/about-us/newsroom/statement-of-cfpb-director-rohit-chopra-on-the-2022-annual-report-of-the-financial-stability-oversight-council/; Statement of CFPB Director Rohit Chopra on the Proposed Restoration of the Financial Stability Oversight Council's Authority and Regulatory Credibility (2023), https://www.consumerfinance.gov/about-us/newsroom/statement-of-cfpb-director-rohit-chopra-on-proposed-restoration-of-financial-stability-oversight-council-authority-regulatory-credibility/.