Proposed US Bank Capital Regulations

July 28, 2023

On July 27, 2023, the Federal Reserve, in concert with other US bank regulators, issued a broad set of proposed capital regulations for large US banks – those with assets >$100 billion. ***These proposed regulations will result in tighter risk controls and higher capital levels, which Spectrum believes will provide even stronger support for large US banks' preferred stock.*** Fed Vice Chair for Supervision Michael Barr stated, "the goal of our actions today is simple: to increase the strength and resilience of the banking system by better aligning capital requirements with risk." The public comment period for these proposed regulations has commenced, to be followed by final regulations in about a year, with a prudent, measured phase-in period.

According to Vice Chair Barr, "The proposal would raise [banks'] capital on average by 16 percent. One can think of the proposal's more accurate risk measures as equivalent to requiring the largest banks to hold about an additional 2 percentage points of capital, or an additional $2 of capital for every $100 of risk-weighted assets." However, Fed staff notes that the largest banks would see their capital needs rise by 19%, while large regional banks' capital needs would rise by 6%. Capital charges for trading activity would likely rise substantially, more than doubling for some banks. Mr. Barr affirms this by noting that these proposed regulations "would principally raise capital requirements for G-SIBs [global systemically important banks]—the largest, most complex banks—better reflecting the risks their activities pose to financial stability. Increases would be small for large banks that are not G-SIBs." Furthermore, Vice Chair Barr notes that "most banks already have enough capital today to meet the new requirements. For the banks that would need to build capital to meet new requirements — assuming that they continue to earn money at the same rate as in recent years — we estimate that banks would be able to build the requisite capital through retained earnings in less than two years, even while maintaining their current dividends." **In Spectrum's view, this indicates that large US banks are facing new, even tougher, regulations from a position of distinct strength.** The proposed regulations, once definitively determined, would be phased in over three years starting in mid-2025.

Specific proposed changes include:

- Moving to standardized, risk-based measures of risk, and away from most internal models
- Making all banks with more than $100 billion in assets follow preponderantly the same regulations that the largest banks follow. This would mean, *e.g.*, including any mark-to-market losses on available-for-sale (AFS) securities in capital computations. This will affect larger regional banks.
- Implementing an expanded risk-based approach, which includes risk-weighted assets for credit, equity, operational, market, and credit valuation adjustment risk
- Revising the risk-based capital surcharge applicable to G-SIBs

Spectrum believes that these proposed changes to capital regulations for large US banks will enhance the cushion underpinning banks' preferred stock, resulting in even greater safety of dividends, and a lower chance of default.

John J. Kriz, Senior Vice President
Joe Urciuoli, Head of Research