BETTER MARKETS

Fact Sheet: Ten False Claims About Bank Capital

July 25, 2023

Well capitalized banks are essential for a strong banking sector, financial system, and economy where Main Street families and businesses can thrive. That's because appropriately capitalized banks are strong enough to continue providing credit through the economic cycle, in good times and bad, which keeps the economy growing, creates jobs, and reduces the depth, length, and cost of recessions that large bank failures usually cause. Remember, the only thing standing between a failing large bank, taxpayer bailouts, and an economic downturn if not catastrophe is the amount of capital that a large bank has to absorb its own losses.

If large banks do not have enough capital to absorb their own losses and prevent their failure (i.e., if they are undercapitalized), then taxpayers end up providing that capital after the fact in the form of bailouts to prevent their failure and a collapse of the economy and a second Great Depression. This is not an opinion; it is a proven fact. That's what happened recently with the failures and bailouts of Silicon Valley Bank, Signature Bank, and First Republic Bank and what happened in 2008 with virtually all the giant Wall Street banks. That's why these large banks are called "too-big-to-fail": if they were allowed to fail, they would cause the collapse of the financial system and economy. (It's important to remember that the dangers to the country created by undercapitalized banks only arise from the largest, systemically important banks, which are those with more than $100 billion in assets or just 33 out of the nearly 4,700 banks in the country.)

Because history proves that undercapitalized large banks pose such grave and grievous threats to the country, policymakers and financial regulators must require those banks to have sufficient capital to absorb the losses that their profit-making activities might cause. That's why completion of the so-called Basel Endgame and other capital measures are so important, as recently discussed by Federal Reserve (Fed) Vice Chair for Supervision Michael Barr.

Unfortunately, what's good for Main Street (well capitalized banks) isn't very good for Wall Street, especially for Wall Street CEOs and executives. While increased bank capital is essential to protect banks, the financial system, and Main Street families' jobs, homes, and businesses, it reduces the size of bankers' bonuses, which are greatly increased by having as little capital as possible. That's because bankers' bonuses are based largely on what's called return on equity (ROE) which is amplified by low capital and high leverage. Thus, the lower the capital a bank has the higher the ROE and the higher the executive bonuses.

This perverse anti-capital incentive is made worse by the threat posed by too-big-to-fail banks. The CEOs of those banks don't really have to worry about having enough capital or their banks collapsing into bankruptcy because, if they get into trouble, they won't be allowed to fail and will be bailed out (as happened in 2023 and 2008). This is a moral hazard that incentivizes banks to engage in very high risk, highly leveraged activities that generate outsized returns and bonuses because if they fail, they get to shift their losses to taxpayers who fund the bailouts while the executives get to keep their bonuses. Think of the Silicon Valley Bank CEO, who had pocketed tens of millions of dollars in the years before it collapsed and who jetted off to his mansion in Hawaii literally as the FDIC was bailing out his bank to prevent its failure at a cost of $16.1 billion (which was an injection of capital that the bank itself should have had to prevent its failure in the first place).

Put differently, if a bank CEO really doesn't have to worry about his bank failing, then he really doesn't care if his bank has enough capital to absorb losses and prevent a failure that won't happen anyway. And, if that CEO's bonus is bigger the less capital his bank has, then he wants to have the least amount of capital that he can get away with. This is what is known as privatizing gains (the bankers get their bonuses no matter what) and socializing losses (the American people get stuck with the bailout bill).

Unsurprisingly, Wall Street's CEOs, trade groups, lobbyists, PR firms, and allies never mention any of this. Instead, they make baseless, often hysterical, and exaggerated if not fabricated claims about capital requirements hurting lending, jobs, economic growth, and competition, basically anything to avoid talking about their own bonuses. They are claiming that the real danger to Americans is from overcapitalized not undercapitalized banks. However, that is a smokescreen to conceal their self-interest in keeping the amount of capital as low as possible to keep their bonuses as high as possible. There is no evidence banks have ever been overcapitalized and there has never been a banking or financial crash caused by banks that had too much capital.

That's why the industry is engaged in a comprehensive, coordinated, and extremely well-funded two-part disinformation campaign. The first part is to deceive the public and elected officials into believing that higher capital hurts rather than protects them. The second part is to prevent regulators from requiring large banks to have enough capital to absorb their own losses and prevent failure, crashes, and contagion. The core of this campaign are dangerous and baseless false claims about capital requirements that are repeated endlessly but too rarely questioned much less scrutinized. This Fact Sheet addresses ten of the most common false claims that Wall Street banks and their allies have long been making.

The ten false claims addressed in detail below:

1. **Higher capital requirements will increase the cost of credit, cause banks to reduce lending, hurt the economy and Main Street families.**
2. **The only way to implement changes to capital requirements is through the years-long rulemaking process.**
3. **Capital standards have been increased from 2008 levels and are therefore adequate.**
4. **Large banks were a source of strength during the COVID-19 pandemic which proved they do not need to have stronger capital standards.**
5. **If bank capital requirements are increased, financial activity will shift from banks to the unregulated "shadow banks," which Jamie Dimon claims will be "dancing in the streets."**
6. **Banks' analysis allegedly support their arguments against stronger capital requirements.**
7. **It is unfair for U.S. bank capital standards to be higher than standards for foreign banks.**
8. **The stress tests as currently designed are sufficient for assessing capital needs for the banking industry.**
9. **Banks with less than $250 billion in total assets are not systemic and do not need to be subject to higher capital levels.**
10. **The recently proposed "reverse stress tests" will improve the stress testing process.**

First False Claim: Higher capital requirements will increase the cost of credit, cause banks to reduce lending, hurt the economy and Main Street families.

TRUTH: Higher capital requirements promote financial system stability, bank lending, and economic growth while protecting Main Street from bank failures, crashes, and bailouts. Higher capital levels also reduce the cost of capital for banks over time.

- The biggest threat to Main Street families comes from ***under***capitalized banks, which incentivizes banks to engage in high-risk activities and increase the likelihood and severity of bank failures, devastating crashes, and taxpayer bailouts, as happened in 2008 and 2023. However, Wall Street's misinformation campaign is based on the false claim that adequate capital would result in ***over***capitalized banks that would harm the economy.

- There is no compelling evidence to support the argument that increased capital requirements reduce lending – indeed, the evidence is to the contrary. For example, according to data from the Bank for International Settlements, both the amount of lending and the share of lending coming from banks to the non-financial sector has increased since 2013, years when significantly higher capital requirements were imposed on banks because they were so undercapitalized leading up to and causing the devastating 2008 global financial crash.

- Moreover, not only has there been no meaningfully negative effect on bank lending and economic support in normal, non-stress periods, it has been shown that higher capital requirements reduce the impact of economic and financial downturns. For example, a review of academic literature on the effects of capital requirements by the Bank for International Settlements, containing bank data going back to 1870, concludes that higher bank capital "significantly lower[s] the cost of a crisis by sustaining bank lending during the resulting recession."

- The evidence and data from academic studies come to similar conclusions. For example, in their analysis of empirical data from 2013 to 2019, the period when increased post-2008 crash capital standards were being fully implemented, economists Steven Cecchetti and Kermit Schoenholtz state:

  > To be as clear as we can possibly be, ***higher capital requirements have not hurt banks, they have not hurt borrowers,*** and, if there was any macroeconomic impact, it was probably offset by monetary and fiscal policy. In other words, ***it is difficult to find any social costs associated with increasing capital requirements*** and improving the resilience of the financial system.

- Finally, the evidence shows that any negative financial effects for large banks of requiring them to have more capital***, if any***, are much less than banks try to make the public and policymakers believe. While it may be true that capital funding is marginally more expensive than some other sources of bank funding (such as deposits), a bank that has more capital as a share of its funding is also viewed as more creditworthy because it is less likely to fail. Therefore, investors would likely accept a lower rate of return on the capital funding they provide for a bank with a higher capital funding that results in a higher credit rating and less risk which will reduce the cost of capital funding for those banks over time. For example, a review of academic literature by the Bank for International Settlements showed that the reduction can be as much as 50% for banks that have higher capital ratios.

Second False Claim: The only way to implement changes to capital requirements is through the years-long rulemaking process.

TRUTH: The financial industry uses and abuses the rulemaking process to protect their profits at the expense of protecting the American people by needlessly delaying and then weakening or killing essential rules. The Fed must not allow that to continue and must act as decisively to prevent the next banking crisis as it does when reacting to a crisis after it happens by enacting immediately effective Interim Final Rules ("IFRs") to address well-known, well-documented, and objectively proven regulatory weakness.

- The traditional rulemaking process was intended to enable and ensure that agencies received ample public comment to ensure that the best rules were adopted. However, the financial industry repeatedly abuses the rulemaking process to delay, weaken, or kill as many rules as possible to protect their profits regardless of how necessary those rules are to protect the public. The evidence for this is overwhelming and already present here regarding the capital rules:
    - CNN reported on July 19, 2023, that Wall Street's CEOs are opposing the capital rules sight unseen: "Bank CEOs are already complaining about new regulations they haven't even seen yet." That's because they don't have to see the proposed capital rules; they are already against the rules no matter the merits or how necessary.
    - The five most powerful financial industry trade groups representing the country's largest banks sent a letter to Chairman Powell on July 12, 2023, asking for a comment period of 120 days, rather than the typical 60- or 90-day comment period, to respond to the proposed changes to bank capital requirements. These trade groups, with vast if not unlimited resources, influence, and access, including hundreds of lawyers, lobbyists, and staff, are fully capable of responding within any time period to any proposed rules. This is just the latest example of an attempt to abuse the rulemaking process and obtain delay for delays sake.
    - These actions followed the financial industry's failed attempt through their political allies to prevent even the proposal of capital rules. For example, ten Republican members of the Senate Banking Committee, clearly on behalf of Wall Street's biggest banks, wrote to Fed Chair Powell on March 3, 2023, in a preemptive strike on Vice Chair for Supervision Barr's then-ongoing holistic capital review. Better Markets sent a letter to Chair Powell rebutting the Senators' premature, unwarranted, unnecessary, unfair, and baseless claims and suggestions against VCS Barr and potential capital increases.
        - Proving how wrong those Senators were, their March 3, 2023, letter was literally just one week before Silicon Valley Bank collapsed on March 10, 2023, due to a lack of capital which required an FDIC bailout of $16.1 billion, i.e., the FDIC injected $16.1 billion of capital to cover the lack of capital the bank should have had to prevent its collapse in the first place.
    - But even being proved objectively wrong with concrete, specific evidence of bank failures due to undercapitalization isn't enough to stop Wall Street and its allies from blindly fighting any and all capital:

- On July 25, 2023 – two days BEFORE the banking regulators scheduled an open meeting to discuss, vote on, and, if approved, release their Basel III endgame proposal - all the Republican members of the Senate Banking Committee sent yet another letter to Fed Chair Powell attempting to prevent capital increases by raising baseless and unsubstantiated claims. The letter could have been – was? – written by the Wall Street banks themselves or their lobbyists.

- This is just more undeniable evidence that the banks' many false claims are just a smokescreen and part of a comprehensive and relentless disinformation campaign to stop any capital increase no matter how reasonable and necessary. It is also more evidence of how Wall Street's banks and their allies use and abuse the rulemaking process, frustrating its true public purpose, solely to advance their profit and bonus maximizing goal of remaining undercapitalized.

- That's why acting decisively and with urgency through the IFR process now could avoid the next bank failure, expensive clean up, extraordinary actions, and use of taxpayer money. There is no justification for delay and gambling on a multi-year rulemaking process to address long overdue, well known, and abundantly demonstrated weaknesses, including insufficient capital.

- The Fed stated in the June 2023 Monetary Policy Report that regulators, "to prevent broader spillovers in the banking system, took decisive actions to protect bank depositors and support the continued flow of credit…." The Fed's May Financial Stability Report also repeatedly emphasized how "decisively" regulators acted once the crisis happened.

- That is in stark contrast to the months and years of inaction by regulators before the most recent crisis (as detailed by the Fed in its report on Silicon Valley Bank and the FDIC's report on Signature Bank), and to regulators plans to now engage in a multi-year rulemaking process where the very industry that caused those bank failures will fight every enhancement for years.

- Those reports detail and document egregious regulatory and supervisory weaknesses that caused or contributed to the banking failures and crisis.

- Additionally, the banking agencies already have substantial administrative records, including public comment, assembled throughout the Trump administration for each one of the rules they proposed. The agencies rejected the evidence submitted in that process that weakening rules was dangerous, including those related to capital, and finalized weaker rules. Those administrative files, combined with the objective evidence provided by the recent bank failures, contagion, turmoil, and bailouts (or "rescues" if you prefer) provide an ample basis for the agencies to now strengthen those same rules (which Fed Governor Brainard, FDIC Director Gruenberg and Better Markets detailed at the time).

That record and evidence fully justifies the agencies to promulgate IFRs, which only require a finding of "good cause" and become effective immediately. Obviously, if merited, regulators could still modify the rule after receiving public comment, should any compelling reasons to do so come to light.[1]

[1] The Office of the Federal Register describes the use of Interim Final Rule (IFR) flexibility at: https://www.federalregister.gov/uploads/2011/01/the_rulemaking_process.pdf.

Third False Claim: Capital standards have been increased from 2008 levels and are therefore adequate.

TRUTH: Banks were extremely undercapitalized in 2008, which was a primary cause of the devastating 2008 crash, required trillions of dollars in bailouts, and resulted in the Great Recession that put tens of millions of Americans out of work and crippled the U.S. economy for years. Of course, capital requirements were increased after that, but the starting point for determining adequate capital levels now cannot be when they were historically and catastrophically low in 2008. The key issue is not how much higher they are now than 2008; it's how high they should be to protect the American people. Furthermore, key changes were made during the Trump Administration that significantly weakened the post-2008 crash improvements, making the need for enhanced capital even more imperative.

- Between 2001 and 2006, capital levels for the largest banks in the country (GSIBs) were around 7 percent and fell to a low of 4.8 percent in fourth quarter 2008.

- Although the post-2008 crash reforms increased capital relative to banks' risks, regulators stopped well short of requiring as much capital as many academics, public interest groups, regulators, and even banks' own risk managers have argued is needed.
  - The largest banks' capital must minimize the potential that they could once again contribute to a devastating financial crisis and require massive taxpayer-funded bailouts.

- As detailed in our Report "Protecting Our Economy by Strengthening the U.S. Banking System Through Higher Capital Requirements" (Dec. 22, 2022), many independent parties have determined that substantially stronger capital standards are both necessary and would be beneficial:
  - The Federal Reserve Bank of Minneapolis, in its "Plan to End Too Big to Fail", estimates that increasing bank capital requirements to 23.5% of risk-weighted assets and 15% of total assets (leverage-based requirement) would substantially reduce the likelihood of future taxpayer-funded bailouts while strengthening the economy by making the banking and financial system more resilient.
  - The Federal Reserve Board in one of its own proposals regarding so-called convertible long-term debt requirements discussed analysis it conducted that showed the most severe loss of a bank holding company during the 2008 Crash to be 19% of risk weighted assets – far higher than capital requirements. This figure would have been even larger without all the government support that had been provided at that time.
  - Economists at the International Monetary Fund have estimated the benefits of capital for large banks set at 23% of risk weighted assets would outweigh the costs, and that if such a requirement had been in place prior to 2008, it would have substantially reduced the need for taxpayer funded bailouts to address the 2008 crash in the US and Europe.
  - Economists Anat Admati and Martin Hellwig, in their 2013 book *The Banker's New Clothes*, determined that capital leverage requirements of at least 20% - 30% of total assets (leverage-

based requirement) would make the banks substantially stronger without sacrificing economic growth.

- The Basel Committee on Banking Supervision (BCBS), in its 2010 paper "An Assessment of the Long-term Economic Impact of Stronger Capital and Liquidity Requirements," estimated risk-based capital requirements of 16% would be appropriate, substantially higher than the requirements the BCBS itself ultimately agreed upon for even the largest banks for post-Crash global standards.
- A 2019 survey of bank risk management professionals showed that nearly half of respondents felt that the bank leverage capital ratio requirement should be 15%. In other words, professional that manage bank risk for a living believe that current capital minimums are insufficient and should be significantly increased.
- Unsurprisingly, none of the claimed "studies" and "analysis" conducted by the banks or their allies arguing otherwise are independent or credible. Those are little more than purchased propaganda (with the conflicts of interest often undisclosed or actively concealed) that have not been peer-reviewed or subjected to independent analysis and confirmation. Indeed, most of those materials do not disclose the data underlying their baseless claims which prevents third parties from subjecting those claims to independent analysis.

Fourth False Claim: Large banks were a source of strength during the COVID-19 pandemic which proved they do not need to have stronger capital standards.

TRUTH: The COVID-19 pandemic did not prove that banks were a source of strength. Instead, the scope and scale of U.S. government's fiscal policy and unprecedented actions taken by the Fed to support financial markets served as a back-door bailout of the banking system during the pandemic. Without those trillions of dollars to support the financial system and economy, numerous banks would undoubtedly have failed almost certainly causing a financial crash.

- Large banks only had to be a "source of strength" for about two weeks after the onset of pandemic-caused market stress in early March 2020. That's because the Fed began providing enormous support to the financial system in mid-March via direct capital injections, monetary policy (zero interest rates and quantitative easing), and innumerable rescue programs aimed at almost every financial market. For example, within just the first 90 days of the pandemic, the Fed injected $3 trillion into the markets to prop up the financial system -- in which the largest banks are the dominant participants – and provided massive funding to banks and bank-owned securities dealers. On top of that, the government provided the economy with more than $5 trillion of fiscal support, which also dramatically helped banks by reducing the level of business and consumer loan defaults.
- The banks and their advocates consistently fail to mention much less credit the immense Fed and taxpayer-funded support they received throughout the COVID 19 pandemic, without which many of them would have faced catastrophic losses and certain failure. In fact, this support was so massive that

it not only prevented losses, but it also led to increased bank earnings. For example, net income at the four largest banks in the middle of the pandemic in 2021 was 120% higher than their net income in 2019.

- The Federal Reserve's own analysis says that claims the 2020 pandemic somehow proved banks were sufficiently capitalized and thus a "source of strength" are wrong. While the capital requirements for the largest banks did make them more resilient entering the crisis than they otherwise would have been, those requirements simply bought the Fed a little time to roll out programs that prevented the banks from failing. Thus, the banks' capital levels did not prevent their collapse; that was due to the trillions of dollars of fiscal and Fed financial market support as well as regulatory relief and related actions.
- In a December 2022 speech, Vice Chair Barr reinforced the point that the strength of banks was not truly tested in the 2020 pandemic because of huge government (i.e., taxpayer) support: "…we didn't get a real test of resilience because Congress, the President, and the Federal Reserve rightly stepped in with massive assistance to avert an economic disaster."

Fifth False Claim: If bank capital requirements are increased, financial activity will shift from banks to the unregulated "shadow banks," which Jamie Dimon claims will be "dancing in the streets."

TRUTH: Systemically significant large banks, which are deeply interconnected with the shadow banking system, need to have enough capital to protect the financial system, the economy, and Main Street families from devastating economic crashes. If activities migrate from those banks to systemically significant shadow banks, then the solution is not to undercapitalize banks; it's to properly regulate those shadow banks. This false claim is really based on an argument that both systemically significant large banks and shadow banks should be undercapitalized, but that would be the worst of all worlds. Properly regulating systemically significant financial firms of all types would eliminate Dimon's dancing concerns.

- There is no question that the systemically significant nonbanks are un- and under-regulated. But the response to a poorly regulated non-bank financial sector is not to allow banks to operate with too little capital; it is to better regulate the nonbank sector.
- In fact, the absence of sufficient standards for shadow banking firms and activities, banks actually need more capital specifically to protect themselves from the threats poorly regulated shadow banking firms can pose to the banks. That's because, as was evidenced in the crashes of 2008 and 2023, banks are deeply interconnected with nonbanks and, when nonbanks get into trouble, they can and do endanger banks.
    - If interconnected shadow banks were properly regulated, including facing adequate capital requirements, then large banks may have less risky exposures to them and might need relatively less capital to absorb potential losses than would otherwise be the case.
- Regardless of the imperative that banks be appropriately capitalized, the Financial Stability Oversight Council ("FSOC") must use its power to identify, assess, and address the full range of financial risks that can threaten the country by systemically significant nonbanks. FSOC must designate and properly regulate systemically significant nonbanks. It is dereliction of duty that there is not one financial firm designated as a systemically significant nonbank in the United States today, especially in light of the

many significantly significant nonbanks that received extraordinary support from the Fed in 2008 and again in during the 2023 pandemic-caused crash.

Sixth False Claim: Banks' analysis allegedly supports their arguments against stronger capital requirements.

TRUTH: As discussed above, banks are incentivized to hold as little capital as possible to increase returns on equity (ROE). This allows them to shower shareholders and bank executives with massive stock buybacks, high dividends, and executive bonuses, all of which are ejections of capital that would otherwise be available to the bank. They do that even when the banks' own risk managers believe that higher capital requirements are needed to make them sufficiently resilient to withstand stressful conditions and continue to operate support the economy (as noted above).

- Public policy choices should not be made based on considerations of what is best for banks, their shareholders or executives (private benefits), but rather they must be based on what is best for society as a whole (social benefits). The regulators' job is not to ensure banks have a high rate of profitability or give large rewards to their shareholders and executives. It is to promote a safe and stable banking and financial system that prevents crashes and supports a growing economy in good times and bad.
- Since 2013, the four largest banks have paid out $584 billion to shareholders through share buybacks and dividends, representing 80% of their net income over that period. If they had instead paid out – for example – "just" 70% of their earnings (still a sizable sum), they would have had $58 billion more in capital funding available to make loans that support the economy.

Seventh False Claim: It is unfair for U.S. bank capital standards to be higher than standards for foreign banks.

TRUTH: Higher capital standards for U.S. banks have not resulted in a competitive disadvantage relative to foreign banks. In fact, U.S. banks dominate the world's banking system where there is little if any genuine competition. Moreover, even if there was some competitive disadvantage, that would not justify threatening the U.S. financial system and economy with undercapitalized banks.

- Indeed, U.S. banks have consistently outperformed their foreign counterparts since U.S. capital standards were strengthened following the 2008 Crash, due at least in large part to the greater financial strength that resulted from regulatory requirements they had fought so hard against.
- Since the 2008 Crash, US banks have far outperformed their global counterparts. One striking study compares two equal investments of $100 in a US bank index fund and €100 in a European banking index fund, beginning in January 2008. By January 2019, the US banking index investment would have been worth approximately $170 (a return of 70 percent) while the European fund investment was only worth €40 (a return of negative 60 percent). The study breaks down performance in three periods.

- 2008- 2010: Both the US and European banking sectors struggled during this period, recovering from the 2008 crisis, with comparable losses in index value.
- 2011 – 2015: US banks began to outperform their European counterparts in 2011. Europe was weighed down by a variety of factors including the euro crisis, doubts about the viability of a single currency, and concerns about specific countries such as Greece while US banks enjoyed a period of recovery and growth.
- 2016 – 2018: Growth continued for US banks while European banks continued to suffer because of political risk, largely driven by Brexit and the Italian elections, and negative interest rates that resulted from European Central Bank monetary policy.

- London has lost ground in its ranking as the world's top financial centre, according to the latest (2023) study by the City of London Corporation comparing London to other global cities across a range of competitiveness factors. On the overall scale, London lost ground and tied New York, but New York far outperformed on the "Reach of Financial Activity" measure.
  - The US increased its share of worldwide lending and with 18 percent of the global total overtook the UK, which has 16 percent of lending, in the global financial ecosystem.
  - The US also far exceeds all global asset manager competitors with the most assets under management (£37 trillion), more than three times the UK with (£11.6 trillion).

Eighth False Claim: The stress tests as currently designed are sufficient for assessing capital needs for the banking industry.

TRUTH: The current stress tests were significantly weakened during the Trump administration and are really stressless stress tests that provide false comfort. That's proved by the fact that all the large banks keep passing these so-called "tests" with flying colors each time. When everyone gets an A+ on a test it means that the tests are far too weak, and claims based on those results are unreliable if not misleading. The stress tests simply must be strengthened to recognize the actual risk of the largest banks, which will inevitably lead to the need for stronger capital to achieve appropriate capitalization.

- Capital requirements determined through the supervisory stress test and implemented through the so-called stress capital buffer ("SCB") must be strengthened and made more dynamic. Three key elements that had made the initial version of the stress test (i.e., prior to changes made under the Trump administration) more rigorous, effective, and meaningful must be reinstated:
  1. the assumption that banks will make all planned capital distributions – through dividends and stock buybacks – over the full nine-quarter stress test timeframe, rather than the current assumption they will only payout four quarters of dividends and will suspend all stock buybacks;
  2. the assumption that banks' balance sheets can grow under stress; and

3. the requirement to meet a minimum leverage ratio after accounting for stress losses.

- These changes would increase the likelihood that banks will have sufficient capital in normal times to be able to withstand severe unexpected stress that could come at any time. It would align with the evidence that balance sheets grow tremendously in a crisis, and that banks often continue to distribute capital to shareholders (and thus deplete capital) during periods of stress. In fact, the balance sheets of the six largest banks grew by an aggregate 23% during COVID, between the end of 2019 and the first quarter of 2021.
- Additionally, although large banks voluntarily suspended stock buybacks at the onset of the 2020 pandemic (purportedly in response to the expectation that regulators would require this if not instituted voluntarily), they continued dividend distributions and almost certainly would have reinstated stock buybacks sooner if not prevented from doing so by the Fed. In aggregate, banks paid nearly $400 billion in dividends from 2020 through 2022, more than half of their total net income.
- The Fed's stress tests and associated capital requirements have become too predictable for banks and not stressful enough. An explicit goal during the Trump administration was to ensure that stress test-based capital requirements were not changing much year to year. Such an objective substantially diminished the important role of stress testing and ran counter to a key reason stress testing is useful for assessing bank capital – things can change quickly, and traditional static measures of bank capital proved to move to slowly to address a rapidly evolving financial system.

Ninth False Claim: Banks with less than $250 billion in total assets are not systemic and do not need to be subject to higher capital levels.

TRUTH: As objectively proved by the failures of and contagion from Silicon Valley Bank, Signature Bank, and First Republic Bank, banks with less than $250 billion in total assets can be systemic and that risk must be mitigated by adequate capital requirements. Moreover, basing determinations of the systemic risk a bank may pose primarily on asset size misses many banks that will turn out to require taxpayer funded support when they falter.

- In March 2023, in consultation with the President, the U.S. Department of Treasury, Federal Reserve, and FDIC issued a joint decision to declare a systemic risk exception for both Silicon Valley Bank and Signature Bank. This decision was supported by the belief that the failures of these institutions posed grave danger to the U.S. economy and financial system. As of December 31, 2022, Silicon Valley Bank had total assets of approximately $209 billion and Signature Bank had total assets of $110.4 billion.
- In addition to the FDIC protecting all depositors at these failed banks, the Fed created and implemented a new lending facility called the Bank Term Funding Program ("BTFP") to provide liquidity to reduce if not prevent the crisis contagion precipitated by the failures. That also proves the risk that banks with less than $250 billion present to the overall banking system. Bank size was not a limitation for BTFP borrowing, as any U.S. federally insured depository institution (including banks, savings associations, and credit unions) was eligible to participate.

Tenth False Claim: The recently proposed “reverse stress tests” will improve the stress testing process.

TRUTH: However helpful they might be, “reverse stress tests” are not a panacea. They will take a long time to implement with confidence and could result in even more unreliable information about bank capital levels.

- Motivated by the surprise failures of Silicon Valley Bank, Signature Bank, and First Republic Bank in spring 2023, Vice Chair Barr said in June that the Fed is exploring the use of “reverse stress testing” as a tool to help regulators understand institution-specific risks that would result in bank failure.
- However, while they might be helpful as one tool providing some information, reverse stress testing comes with several challenges that would make results unclear and difficult to act upon.
    - If every bank determines a unique set of factors that lead to its failure, it would be near impossible to compare results to one another or to a standard set of capital levels.
    - Determining a remedy to bank-specific risks and resulting capital levels would also be challenging, relative to the current stress tests which have a standard stress capital buffer that results from the scenario presented to all banks.
- Moreover, implementing such a novel new tool will take time to design, roll out, test, evaluate, refine, and finalize.
    - With the current threat posed by a fragile, undercapitalized banking system, the American people don’t have the luxury of time for the regulators to get all that right, particularly when well know and proven remedies like stronger capital are readily available.

Better Banks | Better Businesses
Better Jobs | Better Economic Growth
Better Lives | Better Communities

Better Markets is a public interest 501(c)(3) non-profit based in Washington, DC that advocates for greater transparency, accountability, and oversight in the domestic and global capital and commodity markets, to protect the American Dream of homes, jobs, savings, education, a secure retirement, and a rising standard of living.

Better Markets fights for the economic security, opportunity, and prosperity of the American people by working to enact financial reform, to prevent another financial crash and the diversion of trillions of taxpayer dollars to bailing out the financial system.
By being a counterweight to Wall Street's biggest financial firms through the policymaking and rulemaking process, Better Markets is supporting pragmatic rules and a strong banking and financial system that enables stability, growth, and broad-based prosperity. Better Markets also fights to refocus finance on the real economy, empower the buyside and protect investors and consumers.

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