BASEL III ENDGAME: SHOULD WE STRENGTHEN CAPITAL REQUIREMENTS FOR BANKS?

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Policymakers, agencies such as the Federal Reserve and other regulators, and financial institutions all have a vested interest in the health of the American financial system. And the health of the banking system largely depends on the level of bank capital. Therefore, since the Global Financial Crisis of 2008, regulators have been working on a supervisory framework—aptly named "Basel III endgame"—that would strengthen capital requirements for banks. An initial proposal was released in July 2023, followed by a re-proposal in September 2024. Both have generated a lot of discourse and vehement support and opposition. Supporters argue that strengthening capital requirements would mitigate risk and help prevent financial panics, but critics are quick to point out that doing so would hurt banks' profitability while raising borrowing costs. After analyzing policy arguments on both sides, this piece will make a normative argument that Basel III endgame should be further rolled back and will also briefly explore the future (or lack thereof) of Basel III endgame under President Trump's second administration.

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Introduction

The Global Financial Crisis ("GFC") of 2008 rattled the world economy, disrupted both Wall Street and Main Street, and revealed a number of fragilities in our global financial system.[1] After the panic, economists and policymakers alike were quick to point out that lending standards were insufficient, banks' balance sheets were vulnerable, and levels of capital in the economy were simply too low.[2] Since 2008, the U.S. government and the Federal Reserve ("Fed") have realized the critical role of sufficient bank capital[3] in strengthening the banking system's resilience against macroeconomic, health, and geopolitical shocks.[4] Many post-GFC reforms have been specifically crafted to regulate bank capital; specifically, as a result of the capital, liquidity, and stress testing requirements mandated by these reforms, U.S. banks have substantially increased their capital.[5] Even in 2024, these reforms continue—as *Basel III endgame*.[6]

A. *The Importance of Bank Capital*

It is no accident that bank capital has been scrutinized and subjected to many different types of regulations. In short, ensuring that there are sufficient levels of bank capital is critical to maintaining a healthy financial system because capital is an indispensable buffer against unexpected losses and insolvency brought by widespread financial instability or panics.[7]

It is helpful to have a rough understanding of the mechanics behind the role that bank capital plays in our financial systems in order to appreciate its importance. Banks generate profit by making loans ("assets" on the banks' balance sheet) and raise the funds needed to make these loans by attracting customers' deposits ("liabilities").[8] In order to remain solvent, banks' assets must be greater than liabilities, so they also raise funds from another source—which is referred

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[1] Randall S. Kroszner, *White Paper on Basel III Endgame Proposal* 3 (2024) https://www.federalreserve.gov/SECRS/2024/February/20240209/R-1813/R-1813_020724_158313_294423925299_1.pdf [https://perma.cc/Q9LX-RKKH].

[2] *Id.* at 3.

[3] The terms "capital" and "bank capital" are commonly used interchangeably in the context of bank regulation. They will also be used interchangeably in this article, with "capital" specifically referring to "bank capital."

[4] Kroszner, *supra* note 1, at 32.

[5] *Id.* at 6.

[6] Michael S. Barr, Vice Chair for Supervision, Board of Governors of the Fed. Rsrv. Sys., Remarks at the Brookings Institution: The Next Steps on Capital (Sept. 10, 2024).

[7] Fed. Rsrv. Bank of Kansas City, *Understanding the Bank Capital Analysis* (2022), https://www.kansascityfed.org/ten/understanding-the-bank-capital-analysis/ [https://perma.cc/398V-V2SG].

[8] Andrew P. Scott & Marc Labonte, *Bank Capital Requirements: A Primer and Policy Issues*, Cong. Rsrch. Serv. (Mar. 9, 2023) https://crsreports.congress.gov/product/pdf/R/R47447 [https://perma.cc/UHQ4-QH92].

to as "capital."[9] Therefore, bank capital can be roughly defined[10] as the stock or equity that bank shareholders have in the bank.[11] In other words, capital is a measure of shareholders' investment in the bank.[12] Having sufficient capital allows a bank to cover customers' deposits even if borrowers fail to make payments, and thereby serves as a financial cushion for the bank.[13] This is the key behind capital regulation. Mandating higher minimum levels of capital reduces the likelihood of bank failure, which subsequently reduces the risk of widespread financial instability.[14]

B. The Role and Impact of Regulation

Although Congress has at times intervened, the vast majority of capital requirements are set by federal bank regulators—the Federal Deposit Insurance Corporation ("FDIC"), the Fed, and the Office of the Comptroller of the Currency ("OCC").[15] In simple terms, capital-requirement regulations mandate that a bank hold a certain amount of capital, which is usually calculated as a specific percentage of a bank's total assets.[16]

However, this simplified formula masks a world of complexity. First, not all banks are the same—larger banks are bound by more stringent requirements and are required to follow higher capital ratios than smaller banks, with the argument being that the failure of a large, nationwide bank will bring more systematic risk to economic stability than a local community-oriented bank with only a handful of branches.[17] Therefore, any capital regulation needs to not only establish tiered capital ratios, but also classify every bank into one these tiers—which is no easy feat.

Second, realizing that it would be unconstructive to treat all bank assets as a monolith, bank regulators have adopted the notion of "risk-weighted assets" to account for the fact that certain bank assets are riskier than others.[18] For example, it would not make much sense to treat a U.S. AAA Treasury bond on a bank's balance sheet as carrying the same risk as a subprime loan. As a result of certain assets having more or less credit risk than others, capital requirements

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[9] *Id.*

[10] The actual regulatory definition of "capital" is much more complex in that it accounts for various other types of financial instruments.

[11] Fed. Rsrv. Bank of Kansas City, *supra* note 7, at 5.

[12] David Wessel, *What is bank capital? What is the Basel III Endgame?*, BROOKINGS (Mar. 7, 2024), https://www.brookings.edu/articles/what-is-bank-capital-what-is-the-basel-iii-endgame/#:~:text=The%20final%20set%20of%20rules,market%20riskiness%20of%20their%20business [https://perma.cc/82Y9-SC6F].

[13] *Id.*

[14] *Id.*

[15] Fed. Rsrv. Bank of Kansas City, *supra* note 7, at 6.

[16] *Id.* at 7.

[17] *Id.* at 14.

[18] *Id.* at 8.

are thereby "risk-weighted" in that banks are required to hold more capital against riskier assets and less capital against safer assets.[19] Regulators and banks thereby need to not only carefully manage the operational complexities of risk-weighting different assets but also anticipate how changes to the risk factors of any individual asset class may impact a bank's entire portfolio of assets.

The practical impact of more stringent capital requirements is that it raises costs for banks—capital is a more expensive form of financing than taking customers' deposits or even borrowing money.[20] Therefore, unsurprisingly, banks have lashed out at any proposal that requires higher capital ratios, and prefer to have the lowest amount of capital legally possible. Economists disagree on the extent, but agree that more stringent bank capital requirements inevitably lead to higher borrowing costs across the economy and lower economic output.[21]

I. What is the Basel III Endgame?

A. What is the Basel Committee on Banking Supervision?

The Basel Committee on Banking Supervision ("BCBS") was established in 1974 to enhance worldwide financial stability and serve as a forum for its member countries to coordinate on matters concerning banking regulation.[22] Since 1974, the BCBS has rolled out three different supervisory frameworks—Basel I (Basel Capital Accord) in 1998, Basel II (the new capital framework) in 2004, and most recently Basel III (responding to the GFC) in 2009, with each subsequent framework building upon the former.[23] Notably, the BCBS has no legal authority itself to impose any standards that its members agree on; it is the individual responsibility of each member government to adopt any such rule.[24]

B. What is the Basel III Endgame?

As mentioned above, this article will focus on Basel III, the most recent supervisory framework, and specifically Basel III's final set of rules—dubbed

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[19] *Id.*

[20] *Id.* at 24.

[21] Sean Campbell, *Fixing What Ain't Broken: The Real and Hidden Costs of Excessive Bank Capital Regulation*, Fin. Serv. F. (Jan. 29, 2023), https://fsforum.com/news/fixing-what-ain-t-broken-the-real-and-hidden-costs-of-excessive-bank-capital-regulation [https://perma.cc/RQL5-ZK9F]. *But see* Anat Admati et al., *Fallacies, Irrelevant Facts, and Myths in the Discussion of Capital Regulation: Why Bank Equity is Not Expensive*, Preprints of the Max Planck Institute for Research on Collective Goods, No. 2010 (2010) (arguing that high leverage is not necessarily privately optimal for banks).

[22] *History of the Basel Committee*, Bank for Int'l Settlements, https://www.bis.org/bcbs/history.htm [https://perma.cc/KK9D-7PHN] (last visited Nov. 6, 2024).

[23] *Id.*

[24] *Basel Committee Charter*, Bank for Int'l Settlements, https://www.bis.org/bcbs/charter.htm [https://perma.cc/FS4C-B6T8] (last visited Nov. 6, 2024).

"Basel III endgame."[25] A key objective of Basel III endgame is to standardize the calculations of credit, market, operational, and financial derivative risk.[26] Responding in part to the banking crisis[27] that unfolded in March 2023,[28] bank regulatory agencies presented an initial proposal in July 2023 ("initial proposal") that would implement most of Basel III endgame's provisions and thereby strengthen capital requirements for larger banks with $100 billion or more in total assets, while smaller banks such as community banks would not be impacted.[29] Besides adjusting capital requirements, the proposal also standardized frameworks related to other forms of risk—for instance, credit, market, operational, and financial derivative risk.[30]

The initial proposal was far-reaching and included a range of technical adjustments that, though facially inconsequential, could have a profound impact on the American economy. To name just a few examples of some of the more substantial proposed changes: 1) large banks would need to increase their highest-grade capital by an average of 16-19%; 2) banks would be forbidden from using internal models for measuring capital requirements; and 3) banks would need to adopt more risk-averse approaches in their calculations.[31] As a whole, the initial proposal would require larger banks to adopt a much more conservative approach in assessing and managing risk.

Defending the markedly conservative approach behind the initial proposal, the regulators ultimately argued that the proposal's benefits still outweighed the costs as it would facilitate "'better alignment between capital requirements and risk-taking . . . to ensure that banks internalize the risks of their operations.'"[32] Perhaps unsurprisingly, many banks and other financial institutions responded very negatively to the initial proposal: over 97% of

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[25] Joint Press Release, Bd. Of Governors of the Fed. Rsrv. Sys., Agencies request comment on proposed rules to strengthen capital requirements for large banks (July 27, 2023), https://www.federalreserve.gov/newsevents/pressreleases/bcreg20230727a.htm [https://perma.cc/98R3-XCKC].

[26] *Id.*

[27] Emma Charlton, *What's the 'Basel Endgame' – and can it help us avoid another financial crisis?*, World Econ. F. (July 9, 2024), https://www.weforum.org/stories/2024/07/basel-endgame-bank-capital-financial-crisis/ [https://perma.cc/E8UF-3YXG] (explaining how the failure of SVB in Q1 of 2023 catapulted Basel III reforms back into the spotlight).

[28] Jan-Peter Siedlarek, *The Evolution of US Bank Capital around the Implementation of Basel III*, Fed. Rsrv. Bank of Cleveland (2024), https://www.clevelandfed.org/publications/economic-commentary/2024/ec-202407-evolution-of-us-bank-capital [https://perma.cc/EJ48-SVXN].

[29] Marc Labonte & Andrew P. Scott *Bank Capital Requirements: Basel III Endgame*, Cong. Rsrch. Serv. (2023), https://crsreports.congress.gov/product/pdf/R/R47855 [https://perma.cc/32GP-W79Y].

[30] *Id.*

[31] Bd. Of Governors of the Fed. Rsrv. Sys, *Proposals that would amend capital requirements for large banking organizations in line with the Basel III accord and modify risk-based capital surcharges applicable to U.S. GSIBs.*, https://www.federalreserve.gov/aboutthefed/boardmeetings/gsib-memo-20230727.pdf [https://perma.cc/ABS7-HJQ5] (July 18, 2023).

[32] Labonte & Scott, *supra* note 29, at 12.

comment letters opposed the proposal and expressed substantial concern.[33] For example, Marcie Forst, the CEO of the California Public Employees' Retirement System (CalPERS), wrote a letter expressing strong concern about the proposal's conservative risk calculations for pension funds.[34]

C. September 2024 Re-proposal

In response to these negative comments and widespread opposition, the Fed announced a re-proposal in early September 2024. The re-proposal largely backs down on the initial proposal's stringent capital requirements.[35] Most importantly, the re-proposal only requires large banks to increase their highest-grade capital by 9%, as opposed to the 16-19% demanded by the initial proposal.[36] In other words, the re-proposal roughly halves the initial increase-in-capital requirement. Besides the changes to capital requirements, the re-proposal also loosens other provisions: the re-proposal 1) reduces operational risk capital requirements for investment management activities; 2) lowers the risk weight for equity funding structures and corporate exposures to certain regulated entities; and 3) extends more flexibility to banks in adopting standard testing models.[37]

The loosened requirements of the re-proposal have nonetheless continued to receive resistance and opposition. For example, FDIC Vice Chair Travis Hill expressed serious concern with the re-proposal's assessment of banks' market risks.[38] On the other hand, and not surprisingly, the banking industry overwhelmingly responded favorably to the re-proposal.[39] Mortgage Bankers Association President and CEO, Bob Broeksmit, declared that "it appears

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[33] Arthur S. Long et al, *Comments on the Basel III Endgame Proposal*, Latham & Watkins LLP (Feb. 2, 2024), https://www.lw.com/en/news/2024/02/comments-on-the-basel-iii-endgame-proposal [https://perma.cc/CWZ4-TH7Y].

[34] Marcie Frost, *Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity*, CalPERS (Dec 22, 2023), https://www.calpers.ca.gov/docs/legislative-regulatory-letters/comment-federal-frs-12-22-2023.pdf [https://perma.cc/6QAP-FEKF].

[35] Pete Schroeder and Michelle Price, *US Fed's relaxed bank capital plan faces pushback from regulator, sources say*, Reuters (Sept. 20, 2024, 1:34 PM), https://www.reuters.com/markets/us/feds-relaxed-bank-capital-plan-faces-fdic-pushback-bloomberg-news-reports-2024-09-20/ [https://perma.cc/9RSA-A5P5].

[36] Barr, *supra* note 6.

[37] *Id.*

[38] *New Basel Endgame draft still has problems, US FDIC Vice Chair Hill says*, Reuters (Sept. 20, 2024, 2:06 PM), https://www.reuters.com/business/finance/new-basel-endgame-draft-still-has-problems-us-fdic-vice-chair-hill-says-2024-09-30/ [https://perma.cc/UYG8-786H].

[39] Dan Ennis, *9 crucial reactions to the capital requirements preview*, banking dive (Sept. 11, 2024), https://www.bankingdive.com/news/fed-barr-capital-requirements-bofa-moynihan-jpmorgan-pinto-mckernan-warren-scott-mchenry-fdic-powell/726750/ [https://perma.cc/6NMK-5L6U].

that common sense has prevailed with the decision to re-propose the flawed Basel III Endgame proposal."[40]

D. Next Steps

While the next steps federal regulators will take are uncertain, there are two broader influences that may be impactful. First, the Supreme Court's ruling in *Loper Bright Enterprises v. Raimondo* is likely on the minds of all regulatory agencies. While courts have previously applied a judicial "principle of deference to administrative interpretations"[41] that would give agencies such as the Fed more leeway in enacting capital regulations, after *Loper Bright*, courts now "may not defer to an agency interpretation of the law."[42] Furthermore, the Supreme Court has also more liberally applied the "major questions doctrine" in recent cases when striking down agency action, arguing that Congress could not reasonably have granted such sweeping and consequential powers to agencies.[43] Such judicial skepticism may partially explain the Fed's September 2024 rollback of many of the initial proposal's stringent provisions, and may further disincentivize regulators from proposing overly exacting requirements going forward. In fact, at the very end of 2024, the Fed directly cited this "evolving legal landscape" behind its announcement allowing lenders more leeway in conducting annual bank stress tests.[44] Furthermore, *Loper Bright* has emboldened banks to sue the Fed.[45] Not content with the relaxed bank stress tests, U.S. banking lobby groups filed a lawsuit against the Fed a day after its announcement, arguing for even more transparency.[46]

Next, any proposal to adjust capital requirements is inevitably—and perhaps, unfortunately—an inherently political decision. President Trump has expressed his dissatisfaction with the Fed and its current chairman, Jerome

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[40] Adam DeSanctis, *MBA Agrees with Fed Vice Chair Barr on Re-Proposing Basel III Endgame*, MORTGAGE BANKERS ASS'N (Sept. 10, 2024), https://www.mba.org/news-and-research/newsroom/news/2024/09/10/mba-agrees-with-fed-vice-chair-barr-on-re-proposing-basel-iii-endgame [https://perma.cc/3XAV-79DH].

[41] Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 844 (1984).

[42] Loper Bright Enterprises v. Raimondo, 144 S.Ct. 2244, 2273 (2024).

[43] *E.g.*, West Virginia v. Environmental Protection Agency, 597 U.S. 697, 724 (2022); Biden v. Nebraska, 143 S.Ct. 2355, 2373 (2023).

[44] Pete Schroeder, *US Fed floats major changes to bank stress tests in light of legal rulings*, REUTERS (Dec. 23, 2024, 5:06 PM), https://www.reuters.com/business/finance/fed-announces-changes-bank-stress-tests-boost-transparency-trim-volatility-2024-12-23/. [https://perma.cc/NS8V-E6S3]

[45] *Id.*

[46] Joshua Franklin, *US banking lobby sues Federal Reserve over stress test framework*, FIN. TIMES (Dec. 24, 2024), https://www.ft.com/content/56def327-dbf7-42f1-8aba-218259ebd4a1 [https://perma.cc/7XUJ-6P34]

Powell, on many different occasions.[47] While neither Trump nor his campaign has thus far expressed any specific view on Basel III endgame, with his return to the White House in 2025 and a potential shakeup in the Fed's leadership, the future of these existing proposals definitely remains in doubt.[48] Indeed, industry leaders such as Bruce Richards, CEO of Marathon Asset Management, have expressed glee at Basel III endgame's likely death under President Trump's second administration.[49] Financial markets have also signaled the expectation that Basel III endgame will be rolled backed, if not outright cancelled, with the large-cap bank index rising by nearly 11% and outperforming broader markets in the days after President Trump's election victory.[50] Wall Street law firms have also begun advising their clients that Basel III endgame "almost certainly will not move forward in the form they were proposed."[51] President Trump's past statements and policy preferences do not bode well for the future of Basel III endgame, and regardless of the final form of Basel III endgame, President Trump will attempt to exert as much influence as possible over the Fed and challenge its independence.[52]

II. Policy Arguments

Both the Basel III endgame initial proposal and re-proposal have caused much furor among the banking and finance industry leaders, policymakers, regulators, economists, and even informed customers. As mentioned above, banks have bemoaned any stringent capital requirements; however, policymakers and economists have been split on not only how stringent the endgame capital requirements should be, but also if such requirements are even needed to begin with. The amount of economic literature analyzing the effects of higher capital requirements is vast and much of it is beyond the direct scope of this Column.

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[47] Michael C. Bender et al., *Trump Steps Up Attacks on Fed Chairman Jerome Powell*, Wall St. J. (Oct. 23, 2018, 8:39 PM), https://www.wsj.com/articles/trump-steps-up-attacks-on-fed-chairman-jerome-powell-1540338090 [https://perma.cc/3XP8-EJEU] (Trump expressing regret for nominating Powell).

[48] Joel Mathis, *Will Trump fire Fed Chair Jerome Powell?*, The Week US (Nov. 15, 2024), https://theweek.com/politics/trump-fire-fed-chair-jerome-powell-rates [https://perma.cc/J6K8-4DUP] (expressing the possibility that Trump may demote Powell by installing somebody else as chair).

[49] Will Kubzansky, *Basel III Endgame is Dead, Marathon CEO Says*, Bloomberg (Dec. 18, 2024, 11:45 AM), https://www.bloomberg.com/news/articles/2024-12-18/basel-iii-endgame-is-dead-marathon-s-bruce-richards-says?embedded-checkout=true.

[50] Niket Nishant, Manya Saini, and Nupur Anand, *US banks to gain from looser capital, merger policies under Trump*, Reuters (Nov. 8, 2024, 5:42 AM), https://www.reuters.com/business/finance/us-banks-gain-looser-capital-merger-policies-under-trump-2024-11-07/ [https://perma.cc/GWK7-GM3L].

[51] Greg D. Andres et al., *What to expect from the second Trump presidency: 2025 and beyond,* DavisPolk LLP, https://www.davispolk.com/insights/client-update/what-expect-second-trump-presidency-2025-and-beyond [https://perma.cc/YWL6-R76T] (last visited Dec. 20, 2024).

[52] Mathis, *supra* note 48.

This Part will instead highlight a few key themes, both in favor of and against the proposals, that have emerged and been discussed at length in the broader discourse concerning Basel III endgame's more stringent capital requirements.

A. Arguments in Favor of Basel III Endgame

There are many credible arguments in favor of more stringent capital requirements. As mentioned previously, capital is a buffer that serves as one of the most robust protections possible against bank failures.[53] Therefore, some argue that a rational profit-maximizing bank should actually not eschew having higher levels of capital, as doing so would enable them to better weather economic downturns.[54] Indeed, in September 2023, the OCC released a statement affirming the same, arguing that Basel III endgame and more stringent capital requirements would "better reflect the risks of these banking organizations' exposures."[55] In essence, the OCC argues that the Basel III endgame accomplishes two goals, both of which banks should welcome: 1) by establishing universal standards, Basel III endgame reduces operational cost and uncertainty; and 2) by having more capital, banks are empowered to make more loans to riskier borrowers that they would not have been able to before.[56] Although having more capital increases costs for banks, it also affords them other business advantages and opportunities.

Besides the direct and positive economic effects of a higher capital requirement, economists such as Stephen Cecchetti and Kermit Schoenholtz have also argued that Basel III endgame is needed because it makes the regulatory framework more resilient against policymakers' subjective political views and reduces banks' incentives for risk shifting.[57] Consequently, the consistency and standardization that Basel III endgame will facilitate will also harmonize bank funding costs and homogenize lending standards.[58] Therefore, Basel III endgame and its higher capital requirements are needed in order to protect customers, the government, and the taxpayer by preventing financial crises.[59] Ultimately, the only way to achieve this is through more heavy-handed government regulation.

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[53] Fed. Rsrv. Bank of Kansas City*, supra* note 7.

[54] *Id.* at 216.

[55] Regulatory Capital Rule: Large Banking Organizations and Banking Organizations With Significant Trading Activity, 88 Fed. Reg. 64,028 (Sept. 18, 2023).

[56] *Id.*

[57] Stephen Cecchetti & Kermit L. Schoenholtz, *Making banks safe*, Vox EU (Aug 11, 2023), https://cepr.org/voxeu/columns/making-banks-safe [https://perma.cc/LCW4-S57M].

[58] Phong T. H. Ngo & Harry Scheule, *Lending Standards Dispersion*, SSRN, 1, 28 (2024) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4943643#:~:text=We%20construct%20a%20novel%2C%20rate,aggregate%20lending%20standards%20on%20investment.

[59] Cecchetti & Schoenholtz, *supra* note 57.

B. Arguments against Basel III Endgame

While Basel III endgame and enacting more stringent capital requirements may help safeguard the health of our financial system, among other benefits, there are also a range of other costs from such regulation. Primarily, the banking industry has argued that strengthening capital requirements is simply unnecessary as the American financial system remains resilient, and doing so would cause a "'significant, permanent reduction in GDP and employment.'"[60] Other critics argue that Basel III endgame is simply too risk-averse.[61] In fact, many pro-bank advocates, including Fed Governor Waller, have instead argued that, rather than protecting the financial system, strengthening capital requirements would directly hurt the average borrower by increasing borrowing costs, which would then dampen economic activity and investor confidence.[62] In addition, Fed Governor Waller also expressed concern that Basel III endgame's proposal would unfairly disadvantage US banks relative to international banks.[63]

Furthermore, an adjacent concern that arises from increases in the cost of both capital and borrowing is the fact that many borrowers may subsequently resort to seeking capital from riskier sources outside the regulated banking system.[64] As a result, even more risk is introduced into the broader economy and financial system. Furthermore, since these alternative risky sources of capital are not subject to the usual banking regulations, this added risk is arguably more "invisible" and harder for economists and policymakers to gauge. This would therefore be a self-defeating outcome that completely runs counter to the intent of Basel III endgame.[65]

C. Basel III endgame Should be Rolled Back

The September 2024 re-proposal was a step in the right direction. The initial proposal was needlessly stringent, without providing the comparative benefits to offset its costs. Specifically, the initial proposal was stricter than the

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[60] Emily Flitter, *Why Big Banks (and Some Odd Allies) Oppose a Plan to Protect Banks*, N.Y. Times (Jan 20, 2024).

[61] Shankar Parameshwaran, *Why Banks Are Worried About the 'Basel III' Endgame*, Knowledge at Wharton (May 14, 2024), https://knowledge.wharton.upenn.edu/article/why-banks-are-worried-about-the-basel-iii-endgame/ [https://perma.cc/T762-222M].

[62] *Statement by Governor Christopher J. Waller*, Board of Governors of the Fed. Rsrv. Sys. (July 27, 2023), https://www.federalreserve.gov/newsevents/pressreleases/waller-statement-20230727.htm [https://perma.cc/E4WF-CU4Q].

[63] *Id.*

[64] Parameshwaran, *supra* note 61.

[65] Ngo & Scheule, *supra* note 58.

globally agreed standard.[66] Therefore, it is no surprise that large U.S. banks have strongly pushed back on the provisions of the initial proposal. Fed Governor Waller's arguments are thereby convincing, as the initial proposal would disproportionately hurt U.S. banks and American consumers, by extension.[67] International banks are unfairly rewarded[68] without having paid the requisite cost. In other words, the initial proposal is arguably a loose American subsidy to international financial markets at large. This then may in fact facilitate perverse incentives—since large U.S. banks are mandated to follow higher capital ratios, less regulated non-bank institutions may fill in the gap and introduce even more risk into financial markets.[69]

Since the initial proposal could potentially introduce more unforeseen risks, on the net, the overall benefits may be smaller than expected. And these relatively small benefits may not be enough to justify the costs of complying with the initial proposal's draconian requirements. As Fed Governor Waller summarized by analogy, the initial proposal's requirements are akin to individuals establishing an emergency fund sufficient to cover shocks to their income, such as unemployment, homes burning down, cars breaking down, etc. *all at the same time*.[70] The probability of these shocks all happening simultaneously is so miniscule that it is an unreasonable decision to set aside the sufficient funds to cover all these catastrophes.

In addition, higher capital requirements may broadly discourage investment, particularly in green infrastructure projects.[71] Due to tax equity schemes, banks account for more than 80% of the $20 billion annual tax equity market, and Basel III endgame would largely disincentivize banks from investing in billions of dollars of solar and wind investments.[72] As a result, higher capital requirements directly threaten the U.S. energy transition.[73] It may be an unwise policy choice to delay or threaten the adoption of clean energy in order to prevent the most improbable financial crises from occurring.

Ultimately, the benefits of the initial proposal pale in comparison to its immense costs. The re-proposal alleviated the costs, without arguably sacrificing the benefits of the initial proposal. Although some industry advocates argue that the re-proposal should also be scratched—as it likely will under President Trump's second administration—perhaps requiring some degree of

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[66] Laura Noonan, Claire Jones, and Joshua Franklin, *The US pushback against 'Basel Endgame'*, Fin. Times (Mar. 18, 2024), https://www.ft.com/content/48555d55-ca6d-4ab8-ae29-aba4d4f10f13 [https://perma.cc/5L9E-KPK7].

[67] *Statement by Governor Christopher J. Waller*, *supra* note 62.

[68] *Id.*

[69] Ngo & Scheule, *supra* note 58.

[70] *Statement by Governor Christopher J. Waller*, *supra* note 62 at 28–29.

[71] Huw van Steenis, *The Unintended Consequences of the Basel Endgame*, OliverWyman, https://www.oliverwyman.com/our-expertise/insights/2024/jan/unintended-consequences-of-the-basel-endgame.html [https://perma.cc/SVA4-GHEP] (last visited Dec. 20, 2024).

[72] *Id.*

[73] *Id.*

higher capital ratios may still be preferable. Any policymaker will need to engage in a careful line-drawing exercise to ensure that the benefit-to-cost ratio is as high as possible—a task perhaps much easier said than done.

Conclusion

Every stakeholder in the banking industry recognizes the importance of ensuring sufficient levels of capital, and the Basel III endgame proposals thereby seek to strengthen capital requirements in order to safeguard the economy and prevent financial panics. While banks and some economists have expressed concern that such strengthened capital requirements would dent bank profitability and increase borrowing costs, regulators have argued that the costs of complying with these strengthened requirements are minimal and are nonetheless needed in order to best serve the interests of American depositors and the American economy. All this being said, it remains uncertain whether President Trump's second administration will continue to pursue Basel III endgame in some form or abandon it completely.