

**Paul A. Volcker Lecture Series
Yale School of Management
Program on Financial Stability**

Lecture 2:

**What Would Paul Volcker Think?
Weakening Banking Regulation –
Failing to Learn the Lessons of the Past**

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Introduction

I concluded yesterday's lecture with the following quote from Chairman Volcker's memoir,

"We have learned time and again that years of financial stability and economic growth tend to involve easing of regulations and supervisory discipline. We see that at work as I write in 2018, with pleas for reduced capital standards for banks and a narrowing of the number of mega-financial institutions subject to more intrusive surveillance. Can we learn to do better?"¹

It is clear that the answer to that question at this moment is no. Over the past year, the current Administration has undertaken an effort to drastically weaken regulation, supervision, and enforcement across all of the federal banking regulators - the Federal Reserve, the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), and the Consumer Financial Protection Bureau (CFPB) – which will be the focus of my remarks today. I would note that the market regulators - the SEC and CFTC, the credit union regulator, NCUA, and the GSE regulator, FHFA - have been treated similarly.

As Chairman Volcker noted, this has happened before. There have been three financial crises in the post-World War II period – the thrift and banking crisis of the late 1980s and early 1990s, the Global Financial Crisis of 2007-2009, and the regional bank failures of 2023. Each of those crises was preceded by a period of deregulation and lax supervision.

As it happens, over the course of my career, I have had the opportunity to participate in the response to each of those crises – the first as a member of the staff of the Senate Banking Committee, the second as Vice Chairman of the FDIC, and the third as FDIC Chairman. For me, this is a matter of personal experience.

In addition to the weakening of regulation, supervision, and enforcement, current deregulatory efforts have two distinct characteristics that go well beyond what has occurred previously – the assertion of explicit political control over financial regulation, and large-scale reductions in staff and senior leadership at the financial regulatory agencies.

In today's lecture I would like to begin to tell the story of the current episode, which of course is still a work in progress, as it has affected the federal banking agencies.

¹ Paul A. Volcker, *Keeping at It: The Quest for Sound Money and Good Government* (New York: PublicAffairs, 2018), 219.

In order to place current developments in context, I'll start with an overview of the experience of the three financial crises of the post-World War II period.

I'll then review the performance of the banking industry since the Global Financial Crisis of 2007-2009, the passage of the Dodd-Frank Act in 2010, and improvements to capital standards since the crisis, and ask the question – what is the problem that this effort is seeking to solve?

I'll then discuss the most obvious and consequential actions being taken – the imposition of political control over the financial regulatory agencies, deep workforce reductions at the agencies, severe narrowing of the scope and weakening of safety and soundness banking supervision, and the weakening of capital requirements for the largest, most systemically important banking organizations.

Taken together, as I indicated yesterday, this is a multi-pronged attack on the foundations of financial regulation in the United States at a time of great economic uncertainty and downside risk for the U.S. economy.

While public attention has been paid to the political attacks on the Federal Reserve and the efforts to dismantle the Consumer Financial Protection Bureau, I don't think there has been an appreciation of how the entire financial regulatory infrastructure is being severely eroded at great risk to financial stability.

As I also indicated yesterday, if this extreme deregulation and the broader undermining of financial regulatory institutions is not reversed, then at some point we will face a financial crisis as a result. Further, the institutions we rely on to manage such crises will not have the staff experience, expertise, and resources needed to limit the costs to the financial system, the economy, and the public.

I will begin by placing current developments in recent historical context because what we are seeing now is not new.

Three Financial Crises

Thrift and Banking Crisis of the 1980s

I'll start by going back to 1980, when the banking and thrift industries had experienced more than four decades of stability.

The banking collapses of the Great Depression, marked by widespread bank runs and failures, led to foundational reforms under the Banking Act of 1933 and related legislation. These included the creation of the FDIC, the separation of commercial and

investment banking through the Glass–Steagall Act, and overall stronger federal oversight of banking activities.²

After the reforms of the Great Depression, banking became a steady, perhaps even boring, business. From the end of World War II to 1979, only 160 depository institutions failed, or fewer than five per year. This stability was in large part due to a combination of laws that heavily restricted competition in banking, including caps on deposit rates, restrictions on branching and interstate banking, and restrictions on what types of products could be offered.³

Beginning in the late 1970s, banks and thrifts were facing a new type of competition – from what we would later call “shadow banking” or nonbank financial institutions, a highly relevant issue today. Newly formed money market mutual funds (MMMFs) offered deposit-like products that paid higher interest rates than banks were allowed.

Rising inflation and interest rates exposed the vulnerabilities of banks and thrifts which were facing regulatorily imposed interest rate caps. In this competitive environment, thrifts institutions, or savings and loans as they were called, faced particular difficulties. Their large portfolios of long-term, fixed-rate mortgage loans fell sharply in value as interest rates rose, making many or most thrifts technically insolvent. Congress responded in 1980 by removing deposit rate caps to help them compete.⁴ While this allowed banks and thrifts to raise deposit rates, it didn’t solve the underlying solvency problem.

In 1982, Congress passed the Garn-St. Germain Act, which removed many of the safeguards on thrifts to try to help improve their competitiveness and profitability. The Act let thrifts expand into areas where they had little experience, including commercial real estate and consumer loans.⁵ Many thrifts “gambled for resurrection” by expanding rapidly and taking on risk in an attempt to earn their way back to solvency. Regulators also lowered the bar on new bank and thrift applications.

² Banking Act of 1933 (Glass-Steagall Act), Pub. L. 73-66, 48 Stat. 162 (June 16, 1933); Federal Deposit Insurance Act, 12 U.S.C. § 1811 et seq.; Federal Deposit Insurance Corporation, *A Brief History of Deposit Insurance in the United States* (Washington, DC: FDIC, 1998), <https://www.fdic.gov/bank/historical/brief/brhist.pdf>.

³ Federal Deposit Insurance Corporation, *Historical Statistics on Banking: Failed Bank List*, <https://www.fdic.gov/bank/individual/failed/banklist.html>; see also FDIC, *Managing the Crisis: The FDIC and RTC Experience, 1980–1994*, vol. 1 (Washington, DC: FDIC, 1998), chap. 1, <https://www.fdic.gov/bank/historical/managing/>.

⁴ Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. 96-221, 94 Stat. 132 (Mar. 31, 1980).

⁵ Garn-St. Germain Depository Institutions Act of 1982, Pub. L. 97-320, 96 Stat. 1469 (Oct. 15, 1982).

These developments were of great concern to Paul Volcker, then at the Fed. While he supported the gradual lifting of deposit rate caps, he opposed broader efforts by Congress and the Reagan administration to ease regulation and supervision of banks and thrifts. He argued that the response to competition from money market funds should not be to weaken standards for banks but to ensure that similar risks in other financial institutions were subject to adequate oversight.⁶

The agency that supervised the thrifts, the Federal Home Loan Bank Board, was largely ineffective. It allowed forbearance for thrifts in meeting capital standards, and accounting manipulations that allowed them to hide their true financial condition.⁷

These deregulatory measures had catastrophic effects. Approximately 1,300 thrifts – or almost one-third of the industry – failed between 1980 and 1994. The Federal Savings and Loan Insurance Corporation, or FSLIC, the deposit insurance fund for the thrifts, went broke.⁸

In 1989, Congress, abolished the thrift regulator - the Federal Home Loan Bank Board - and FSLIC, transferred the deposit insurance responsibilities for thrifts to the FDIC, and appropriated an estimated \$132 billion to satisfy claims on deposit insurance.⁹

A brief anecdote may be warranted here.

Chairman Volcker told me that he warned Senator Garn, who was the Chairman of the Senate Banking Committee, against deregulating the thrifts, but Senator Garn did not take his advice. Chairman Volcker said that Senator Garn called him each year after the Garn-St. Germain Act passed – in 1983, 1984, and 1985 – to tell him that there were no problems in the thrift industry. After 1985 Senator Garn stopped calling.

As the thrift crisis unfolded, banks also were encountering their own challenges. Many of them had over-invested in commercial real estate and the energy sector and were severely affected by a series of regional recessions in the early 1990s. Between 1980 and 1994, more than 1,600 banks failed. In 1990, for the first time, the FDIC's deposit insurance fund balance went negative.¹⁰

⁶ Volcker, *Keeping at It*, 120-137.

⁷ Volcker, *Keeping at It*, 128-130.

⁸ Federal Deposit Insurance Corporation, *Managing the Crisis: The FDIC and RTC Experience, 1980-1994*, vol. 1 (Washington, DC: FDIC, 1998), chap. 4, <https://www.fdic.gov/bank/historical/managing/>; FDIC, *History of the Eighties: Lessons for the Future*, vol. 1 (Washington, DC: FDIC, 1997), <https://www.fdic.gov/bank/historical/history/>.

⁹ Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. 101-73, 103 Stat. 183 (Aug. 9, 1989); FDIC, *Managing the Crisis*, vol. 1, chap. 4; see also Timothy Curry and Lynn Shibut, "The Cost of the Savings and Loan Crisis: Truth and Consequences," *FDIC Banking Review* 13, no. 2 (2000): 26-35, https://www.fdic.gov/bank/analytical/banking/2000dec/brv13n2_2.pdf.

¹⁰ FDIC, *Managing the Crisis*, vol. 1, chap. 3; FDIC, *Historical Statistics on Banking*.

In response to both crises, Congress passed the Federal Deposit Insurance Corporation Improvement Act of 1991, or FDICIA, which reined in the use of forbearance by the regulators on both large and small banks. It also created the Prompt Corrective Action framework, which forces regulators and banks to take corrective and remedial actions when capital ratios fall.¹¹

Global Financial Crisis of 2007-2009

After this turbulent period, the industry recovered and expanded in the mid-1990s.

When I joined the FDIC Board in 2005, there had not been a bank failure in the U.S. in more than two years, the longest such period in the FDIC's history at that time. The number of problem banks was approaching historic lows. Strong loan growth helped insured banks set six consecutive annual earnings records from 2001 through 2006.

Banking conditions seemed so favorable that friends asked me at the time if I really wanted to become a member of the FDIC Board—after all, nothing was happening in the banking industry and I might be bored.

Unfortunately, this tranquility masked an enormous increase in risk-taking that would soon lead to the deepest financial crisis since the Great Depression.

I'd like to flag five developments that led to the crisis.

First, the Gramm-Leach-Bliley Act of 1999 allowed the largest bank holding companies (BHCs) to become major players in investment banking by establishing or acquiring securities firms as subsidiaries, repealing the separation of these activities by the Glass-Steagall Act.¹²

This had significant consequences. The risk-taking culture of Wall Street impacted the more conservative culture of the banking industry. Further, as the scope of financial institutions' activities grew, Gramm-Leach-Bliley limited regulators' ability to directly examine or require reports from subsidiaries regulated by other agencies. No single regulator could see the entirety of a financial firm's activities. In addition, regulatory mandates primarily focused on risks to individual institutions, rather than on risks that develop across and between markets and institutions.

Second, lending standards in the U.S. mortgage market collapsed, and regulators failed to respond adequately in the midst of a historic, nationwide housing expansion.

¹¹ Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. 102-242, 105 Stat. 2236 (Dec. 19, 1991); 12 U.S.C. § 1831o (Prompt Corrective Action).

¹² Gramm-Leach-Bliley Act, Pub. L. 106-102, 113 Stat. 1338 (Nov. 12, 1999).

Mortgage origination became less of an income-based credit decision and more reliant on continued appreciation in housing prices. Particularly notable was the growth in subprime mortgages, mortgages which by definition were made to borrowers with impaired credit histories. This growth was facilitated by the rapid growth in the securitization of these mortgages by Wall Street firms.

Modest attempts by bank regulators to curtail risky lending activities through regulatory guidance were met with significant resistance from the industry and Congress. Opponents of these regulatory efforts described them as stifling innovation.

Relatively unchecked, subprime mortgages grew from 8.2 percent of mortgage originations in 2003 to 23.5 percent in 2006.¹³

Third, as the demand for securitized mortgage products increased, the capital held against these exposures was entirely inadequate.

Rules for risk weights, combined with inflated credit ratings, allowed banks to reduce the capital they held against risky mortgages. Capital requirements outside of commercial banking – the investment banks, for example - were even weaker and institutions were more highly levered. Accounting rules enabled institutions to mask exposures and losses.

Fourth, financial firms used “innovative” derivative financial products to repackage the risks of low-quality non-prime mortgages into supposedly high-quality securities as the mortgage market became over-extended. New products – such as collateralized debt obligations (CDOs) and credit default swaps (CDS) – fueled investors’ demand for non-prime mortgage-backed securities and encouraged mortgage originators to keep extending bad mortgage loans even after the house price bubble had burst. At the time this financial engineering was considered a form of innovation.

Finally, and decisively, was interconnectedness.

When Lehman Brothers, a leading investment bank, failed in the fall of 2008, the financial crisis deepened. Investors and counterparties struggled to understand the opaque distribution of mortgage-related losses across the financial system.¹⁴

¹³ Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report: Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States* (Washington, DC: U.S. Government Printing Office, 2011), 70, <https://www.govinfo.gov/app/details/GPO-FCIC>.

¹⁴ Rosalind Z. Wiggins, Thomas Piontek, and Andrew Metrick, “The Lehman Brothers Bankruptcy A: Overview,” *Journal of Financial Crises* 1, no. 1 (2019): 39–62, <https://doi.org/10.17132/2693-3179.1000>.

The nature and size of exposures, particularly derivative exposures, combined with the heightened leverage embedded in the system, resulted in a dramatic seizing up of credit markets as market participants looked to minimize or eliminate exposure to potentially vulnerable counterparties.

In 2008 we saw the collapse and bailout of major investment banks, bank holding companies, and the largest insurance company in the U.S. The two government sponsored housing enterprises were placed into a public conservatorship. In addition to the failure of these large, “too-big-to-fail” institutions, almost 500 smaller community banks failed. They, of course, were not bailed out.

The financial crisis triggered what became known as the Great Recession, the most severe U.S. recession since the Depression of the 1930s. The economic and human cost was enormous - almost nine million lost jobs, 12 million homeowners faced foreclosure, and an estimated \$10 to 15 trillion in lost GDP.¹⁵

The Dodd-Frank Act, enacted in 2010, addressed many of the regulatory gaps that surfaced in the crisis and expanded the options for crisis management.¹⁶

Title I of the Dodd-Frank Act subjected large bank holding companies (BHCs) to heightened prudential standards including higher risk-based capital requirements and leverage limits, liquidity and risk management requirements, and resolution planning. Title II provided broad new authorities to manage the orderly failure of systemically important financial institutions without a government bailout. Title VII required the clearing of standardized derivatives through central clearing counterparties and established significantly strengthened margin requirements for most over-the-counter-derivatives.

The enhanced prudential standards implemented pursuant to the Dodd-Frank Act are the target of some of the current deregulatory agenda.

Finally, it is important to recognize that the implementation of Basel III, which I will discuss later, was an effort by the U.S. banking agencies to strengthen the banking system because our nation’s largest, most systemically important financial institutions were found to be woefully undercapitalized and over-leveraged in 2008.¹⁷

¹⁵ Financial Crisis Inquiry Commission, *Financial Crisis Inquiry Report*, xv–xvi.

¹⁶ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (July 21, 2010); 12 U.S.C. §§ 5311–5374 (Title I, Financial Stability); 12 U.S.C. §§ 5381–5394 (Title II, Orderly Liquidation Authority).

¹⁷ Basel Committee on Banking Supervision, *Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems* (Basel: Bank for International Settlements, December 2010, rev. June 2011), <https://www.bis.org/publ/bcbs189.htm>.

The early round of Basel III changes significantly improved the quantity and quality of capital held by internationally active banks. The remaining phase of Basel III, which addresses four critical areas of risk - credit risk, market risk, operational risk, and risk associated with financial derivatives – is a direct response to the experience of 2008.

Regional Bank Failures of 2023

Finally, let me turn to the regional bank failures in 2023.

In 2018, Congress passed the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA).¹⁸ This rolled back some of the safeguards for regional banks that the Dodd-Frank Act had put in place after the Global Financial Crisis by granting the Federal Reserve discretion to increase the asset threshold for many prudential requirements from \$50 billion to \$250 billion. Capital, liquidity, and stress-testing requirements were substantially reduced for banks in that range.

In addition, the Fed raised the threshold for submitting Title I resolution plans, or “living wills,” to \$250 billion under the authority given it by the Congress.¹⁹ The FDIC also placed a moratorium on its bank-level resolution plans for regional banks, which the FDIC had imposed under its Federal Deposit Insurance Act authority in 2012.²⁰

On Thursday, March 9, 2023, Silicon Valley Bank (SVB), a state chartered bank in California with over \$200 billion in assets, then the sixteenth largest bank in the U.S., experienced a bank run. SVB relied on a deposit base with approximately 90 percent uninsured deposits, invested in long-term government securities, and had expanded rapidly, tripling in size in the preceding two years. As interest rates rose, the market value of the bank’s assets fell sharply. When the bank sold a portion of its portfolio of securities at a large loss to raise liquidity, it recorded a big reduction in its capital and uninsured depositors ran. On Friday, March 10, Silicon Valley Bank was closed by the State of California and turned over to the FDIC as receiver.²¹

¹⁸ Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub. L. 115-174, 132 Stat. 1296 (May 24, 2018).

¹⁹ Board of Governors of the Federal Reserve System and Federal Deposit Insurance Corporation, “Resolution Plans Required,” *Federal Register* 84, no. 212 (November 1, 2019): 59194–59228, <https://www.federalregister.gov/documents/2019/11/01/2019-23967/resolution-plans-required>.

²⁰ See Federal Deposit Insurance Corporation, “Resolution Plans Required for Insured Depository Institutions With \$100 Billion or More in Total Assets; Informational Filings Required for Insured Depository Institutions With at Least \$50 Billion but Less Than \$100 Billion in Total Assets,” *Federal Register* 89, no. 131 (July 9, 2024): 56620–56836, Background 56621, <https://www.govinfo.gov/content/pkg/FR-2024-07-09/pdf/2024-13982.pdf>.

²¹ Board of Governors of the Federal Reserve System, *Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank* (Washington, DC: Board of Governors, April 2023), i–iv, <https://www.federalreserve.gov/publications/files/svb-review-20230428.pdf>.

The prospect that uninsured depositors at SVB would experience losses alarmed uninsured depositors at several other regional banks, and depositors began to withdraw funds. In particular, Signature Bank of New York with over \$100 billion in assets and also a 90 percent reliance on uninsured deposits, experienced heavy withdrawals, and was closed on Sunday, March 12, 2023.

Faced with growing contagion in the financial system, the FDIC and the Fed, with the concurrence of the Treasury Secretary, invoked an emergency authority under the law, called the systemic risk exception (SRE), for both SVB and Signature Bank. This allowed the FDIC to use the Deposit Insurance Fund to protect uninsured depositors in order to maintain financial stability. This bought the FDIC some time to organize bridge banks to maintain the operations of the failed institutions and to find potential buyers. The Fed also established a special liquidity facility to fund banks' Treasury securities.²²

These actions calmed the market. When First Republic Bank of California, which had 70 percent uninsured deposits, failed on May 1, 2023, the FDIC was able to resolve the bank using its ordinary processes without recourse to the SRE.²³ These bank failures were the second, third and fourth largest in U.S. history. It is, however, worth pointing out that this is because when some of our largest institutions were at risk of failure in 2008, they were bailed out.

It is also worth noting that Silicon Valley Bank would not have been in compliance with the full Liquidity Coverage Ratio as it had been applied prior to the implementation of the 2018 law. It was not required to undertake company-run stress testing, and the transition rules under the 2018 law delayed its supervisory stress test despite its rapid growth. Its holding company was not large enough to require a Title I resolution plan. The 2018 law and a change in supervisory policy also had a chilling effect on supervisors at the time, as documented in the Federal Reserve's analysis of the SVB failure.²⁴ This is also highly relevant to the current moment.

²² 12 U.S.C. § 1823(c)(4)(G) (systemic risk exception); FDIC, "FDIC Establishes Signature Bridge Bank, N.A., as Successor to Signature Bank, New York, New York," press release PR-021-2023 (Mar. 12, 2023), <https://www.fdic.gov/news/press-releases/2023/pr23021.html>; FDIC, "FDIC Creates a Deposit Insurance National Bank of Santa Clara to Protect Insured Depositors of Silicon Valley Bank," press release PR-016-2023 (Mar. 10, 2023), <https://www.fdic.gov/news/press-releases/2023/pr23016.html>.

²³ FDIC, "JPMorgan Chase Bank, National Association, Columbus, Ohio Assumes All of the Deposits and Substantially All of the Assets of First Republic Bank, San Francisco, California," press release PR-034-2023 (May 1, 2023), <https://www.fdic.gov/news/press-releases/2023/pr23034.html>.

²⁴ Board of Governors of the Federal Reserve System, *Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank* (April 2023), iii, <https://www.federalreserve.gov/publications/files/svb-review-20230428.pdf>; FDIC, *FDIC's Supervision of Signature Bank* (Washington, DC: FDIC, April 2023), <https://www.fdic.gov/reports/fdics-supervision-signature-bank>.

What Is the Problem?

My purpose in reviewing this history is to make the point that what we are seeing now is not new. I'm afraid it is history repeating itself.

The argument put forward by the current Administration is that while the reforms made in the Dodd-Frank Act were necessary, they went too far. In their view, the stronger capital and liquidity requirements, the enhanced prudential supervision, and the strengthened consumer protection are now impeding the banking industry's ability to provide credit, discouraging innovation, impairing competitiveness, and constraining economic growth, which is critical to financial stability. A correction is necessary, so the argument goes.²⁵

Before reviewing the specifics of what is being done and what is being proposed, it is worth taking a moment to review the condition of the U.S. banking industry and its performance since the 2008 Crisis and the passage of the Dodd-Frank Act in 2010 in light of the concerns being raised.

Banking Industry Performance, 2010 to 2025

Since the enactment of the Dodd-Frank Act in 2010, the U.S. banking industry has experienced sustained and substantial growth across all major balance sheet categories. The total assets of the industry have remained at 80 percent of GDP, the same as the period before the crisis,²⁶ which was a period of rapid industry growth.

Total assets grew from \$12 trillion to \$25 trillion as of September 30, 2025, an increase of 109 percent.²⁷ Total loans grew from \$9 trillion to \$19 trillion, an increase of 111 percent.²⁸ Domestic deposits more than doubled, growing from \$8 trillion to \$18 trillion, an increase of 130 percent.

²⁵ Scott Bessent, *Remarks before the American Bankers Association*, Washington, DC, April 9, 2025, U.S. Department of the Treasury, <https://home.treasury.gov/news/press-releases/sb0078>; and Michelle W. Bowman, *Liquidity Resiliency, Financial Stability, and the Role of the Federal Reserve*, remarks at the Roundtable on Liquidity and Lender of Last Resort, Washington, DC, March 3, 2026, Board of Governors of the Federal Reserve System, <https://www.federalreserve.gov/newsevents/speech/files/bowman20260303a.pdf>

²⁶ Board of Governors of the Federal Reserve System, "Assets and Liabilities of Commercial Banks in the United States (H.8)," Statistical Release, <https://www.federalreserve.gov/releases/h8/>; Federal Deposit Insurance Corporation, *Quarterly Banking Profile*, Third Quarter 2025, <https://www.fdic.gov/analysis/quarterly-banking-profile/>; International Monetary Fund, World Economic Outlook Database (GDP data accessed via Federal Reserve Bank of St. Louis, FRED), <https://fred.stlouisfed.org>; Moritz Schularick and Alan M. Taylor, "Credit Booms Gone Bust: Monetary Policy, Leverage Cycles, and Financial Crises, 1870–2008," *American Economic Review* 102, no. 2 (2012): 1029–1061, <https://doi.org/10.1257/aer.102.2.1029>.

²⁷ Federal Deposit Insurance Corporation, *Quarterly Banking Profile*, Third Quarter 2025, Table I-A (Total Assets of FDIC-Insured Institutions), <https://www.fdic.gov/analysis/quarterly-banking-profile/>.

²⁸ FDIC, *Quarterly Banking Profile*, Third Quarter 2025, Table I-A (Total Loans and Leases).

The trajectory indicates that the post-crisis regulatory framework has coexisted with sustained balance sheet growth across the industry – Global Systemically Important Banks (GSIBs), regional banks, and community banks.

In terms of profitability, return on equity for the U.S. banking industry averaged 9.7 percent from 2010 through 2024, and stood at 11.7 percent through the third quarter of 2025.²⁹

U.S. banks outperformed their European counterparts in every single year of this period. European banks' return on equity averaged 3.9 percent over the same period, a gap of more than 5 percentage points. While this gap has narrowed in recent years, the long-term record demonstrates that the U.S. regulatory framework has not impaired the competitiveness of American banks relative to their international peers.³⁰

The domestic evidence is corroborated by the international record. Research by the European Central Bank (ECB) demonstrated that higher bank capitalization actually improves profit efficiency.³¹ The Bank for International Settlements (BIS) reached a similar conclusion in its December 2022 evaluation of the Basel III reforms, finding that the post-crisis framework delivered material benefits in bank resilience without impairing credit supply.³²

Bottom line - at year-end 2024, before the current Administration took office, the U.S. banking system was one of the most well-capitalized and liquid banking systems in the world. By nearly every major prudential metric—capital, liquidity, earnings, asset quality, and loss reserves—the system was strong.

That strength was not accidental – it was the direct result of the regulatory framework that policy makers are now weakening.

²⁹ FDIC, *Quarterly Banking Profile*, Third Quarter 2025, Table III-A (Performance and Condition Ratios); FDIC, *Statistics at a Glance: Historical Trends* (annual series), <https://www.fdic.gov/bank/statistical/stats/>.

³⁰ European Banking Authority, *Risk Dashboard*, Q3 2025 (return on equity for EU/EEA banks), <https://www.eba.europa.eu/risk-analysis-and-data/risk-dashboard>; European Central Bank, *Supervisory Banking Statistics, 2010–2025*, <https://www.bankingsupervision.europa.eu/banking/statistics/supervisory-statistics/html/index.en.html>.

³¹ Markus Behn and Alessio Reghezza, *Capital Requirements: A Pillar or a Burden for Bank Competitiveness?* (Occasional Paper Series No. 376, European Central Bank, 2025), <https://www.ecb.europa.eu/pub/pdf/scpops/ecb.op376.en.pdf>.

³² Basel Committee on Banking Supervision, *Evaluation of the Impact and Efficacy of the Basel III Reforms* (Basel: Bank for International Settlements, December 2022), <https://www.bis.org/bcbs/publ/d544.htm>.

The Deregulatory Agenda

A discussion of the deregulatory agenda of the current Administration should begin where I left off in yesterday's lecture – with Executive Order 14215, titled "Ensuring Accountability for all Agencies", issued on February 18, 2025.³³ It subjects all federal agencies, including agencies that are statutorily and historically independent, to an unprecedented level of political control.

Executive Order 14215 – Political Control of Financial Regulation

The scope of this executive order is transformational for financial regulation in the United States.

It states that all executive power is vested in the President and that the order is "to ensure Presidential supervision and control of the entire executive branch", including independent agencies. The order requires all executive branch agencies, including independent agencies, to submit for review all proposed and final significant regulatory actions to the Office of Management and Budget (OMB).³⁴

This executive order places all federal financial regulatory agencies, including the Federal Reserve in its regulatory capacity, under the explicit direction of the executive branch.³⁵

The order provides that the OMB Director shall establish performance standards and management objectives for independent agency heads. In addition, the OMB Director shall, on an ongoing basis, review independent agencies' obligations for consistency with the President's policies and priorities, and adjust such agencies' apportionments (that means funding) by activity, function, project, or object to advance the President's policies and priorities.³⁶

Under the order, independent regulatory agency chairmen shall regularly consult with and coordinate policies and priorities with the Directors of OMB, the White House Domestic Policy Council, and the White House National Economic Council.³⁷

In addition, independent regulatory agency chairmen shall submit agency strategic plans to OMB for clearance. The President and Attorney General shall provide authoritative interpretations of law for the executive branch, controlling on all employees.³⁸

³³ Executive Order No. 14215, *Ensuring Accountability for All Agencies*, 90 Fed. Reg. 10,447 (Feb. 24, 2025).

³⁴ Exec. Order No. 14215, *Ensuring Accountability for All Agencies*.

³⁵ Exec. Order No. 14215, *Ensuring Accountability for All Agencies*.

³⁶ Exec. Order No. 14215, *Ensuring Accountability for All Agencies*.

³⁷ Exec. Order No. 14215, *Ensuring Accountability for All Agencies*.

³⁸ Exec. Order No. 14215, *Ensuring Accountability for All Agencies*.

We should be clear about the implications of this executive order. Under its terms every aspect of an agency's functioning may be subject to political direction by the executive branch. That may include not just broad policy decisions implemented through rulemakings and guidance. It has already affected budget and staffing decisions of the agencies. It may also relate to decisions regarding individual institutions such as supervisory determinations of safety and soundness and consumer protection; enforcement actions for violations of rules or laws; applications for charters, mergers, or permission to engage in new activities. Confidential supervisory information relating to institutions and individuals could be demanded. Interpretations of the laws governing an agency would be controlled by the executive branch.

In sum, every aspect of a federal financial regulatory agency's operations could be subject to political direction.

In my experience, there has always been a certain degree of give and take between the financial regulatory agencies and the executive branch on broad agency policy that may affect the financial system and the economy. But there has also been a general line of respect for an agency's ability to make independent judgments in the long-term public interest. Under the terms of this executive order, that no longer exists.

The potential risks of these changes are not abstract. As I noted yesterday, financial supervisors must be willing and able to take action to address emerging systemic risks. Those measures may be unpopular in the short term, for example, requiring banks to raise capital or insisting that they reduce their exposures to risky markets. If those decisions become subject to political direction, there is a risk that necessary but difficult actions will be avoided. Even without this extreme order, we saw examples of that in all three of the financial crises previously discussed.

Workforce Reductions

An early indication of the executive order to come imposing political control over independent agencies was the so-called "Fork in the Road" email sent by the Office of Personnel Management on January 28, 2025. The email was sent directly to all employees of the U.S. federal civil service, including the employees of the federal financial regulatory agencies. There was no clearance of the email with the managements of the agencies.³⁹

³⁹ Office of Personnel Management, email to federal employees re: "Deferred Resignation Program" ("Fork in the Road"), January 28, 2025, OPM.gov; see also Eric Katz, "OPM Offers Federal Workers Deferred Resignation," *Government Executive*, January 28, 2025, <https://www.govexec.com/>.

The email introduced the “deferred resignation program”. According to the email, employees who agreed to participate in the program would be placed on administrative leave, retain all employment benefits, and be paid in full through September 30 2025, but have no work duties. For employees who chose not to accept the offer, the email stated, “we cannot give you full assurance regarding the certainty of your position or agency.”⁴⁰

The email was a clear signal to federal employees and the agencies of the Administration’s expectations.

Over the course of 2025 there were significant workforce reductions or announcements of workforce reductions at the Federal Reserve, the OCC, the FDIC, and the SEC. The CFTC was already severely understaffed.

In May, the Federal Reserve Board announced it was reducing its system-wide workforce by 10 percent – approximately 2400 employees, across the entire Federal Reserve System, including the Federal Reserve Board in Washington and the twelve regional banks.⁴¹ The expectation was to achieve these targets through natural attrition, retirements, as well as voluntary deferred resignation programs.

In addition, in October the Federal Reserve announced a plan to reduce the Washington-based Board’s supervision and regulation division by 30 percent – from 500 to approximately 350 employees – by the end of 2026.⁴² It is not clear at this time how this will affect the Federal Reserve Banks.

The FDIC’s operating budget for 2026 proposed staffing levels approximately 20 percent below the 2025 level – a reduction of 1337 positions. This includes a 13 percent reduction in financial risk examiners and a 21 percent reduction in consumer compliance examiners.⁴³

⁴⁰ Office of Personnel Management, email to federal employees, “Deferred Resignation Program”; Katz, “OPM Offers Federal Workers Deferred Resignation.”

⁴¹ Federal Reserve System, “Federal Reserve will reduce staff by 10 percent in coming years,” statement described in memorandum from Chair Jerome H. Powell to Federal Reserve employees, May 16, 2025, as reported by CNBC, May 16, 2025, <https://www.cnbc.com/2025/05/16/federal-reserve-will-reduce-staff-by-10percent-in-coming-years-powell-memo-says.html>.

⁴² Federal Reserve Vice Chair for Supervision Michelle W. Bowman, email to Supervision and Regulation Division staff outlining planned workforce reductions, October 2025, as reported in Reuters, “Fed’s Bowman moves to reduce bank-supervision unit by about 30%,” October 30, 2025, <https://finance.yahoo.com/news/feds-bowman-moves-reduce-bank-200220274.html>.

⁴³ Federal Deposit Insurance Corporation, *2026 Operating Budget* (Washington, DC: FDIC, 2025), <https://www.fdic.gov/financial-reports/fdic-budget>.

The Federal Reserve's report on the failure of Silicon Valley Bank and the FDIC's report on the failure of Signature Bank both highlighted shortages of bank examiners impacting supervision.⁴⁴

The 2026 Budget Request of the OCC proposed a 30 percent staffing reduction for the agency, a reduction of 1117 staff. This includes a 30 percent reduction in bank supervision staff.⁴⁵

The SEC's proposed budget for 2026 includes a nearly 17 percent reduction from 2024 – a loss of 819 positions. This includes a reduction of 170 positions in examinations and 246 positions in enforcement.⁴⁶

The most egregious downsizing attempts have been at the CFPB, where the administration has actively worked to eliminate the bureau or, absent elimination, to leave the bureau unable to fulfil the mandate given it under the Dodd-Frank Act.

According to the Government Accountability Office (GAO) report on the CFPB released on January 27, 2026, there was a planned reduction in force of approximately 88% (1482 staff released out of 1689 staff) of the CFPB's workforce, including 90% of the supervision division and 80% of the enforcement division. The CFPB headquarters has been temporarily closed and all regional office leases have been terminated.⁴⁷ A federal district court decision may constrain the Administration's effort, but the intent is clear.

The loss of thousands of career staff include large numbers of retirements and departures of division directors and other senior executives at all of the federal financial regulatory agencies. The loss of experienced leadership with institutional history and judgment is particularly impactful, especially if the financial system should come under stress.

⁴⁴ Board of Governors of the Federal Reserve System, *Review of SVB* (April 2023); FDIC, *FDIC's Supervision of Signature Bank* (April 2023).

⁴⁵ Office of the Comptroller of the Currency, *Congressional Budget Justification and Annual Performance Plan, Fiscal Year 2026* (Washington, DC: U.S. Department of the Treasury, May 2025), <https://home.treasury.gov/system/files/266/20.-OCC-FY-2026-CJ.pdf>.

⁴⁶ Securities and Exchange Commission, *Fiscal Year 2026 Congressional Budget Justification and Annual Performance Plan* (Washington, DC: U.S. Securities and Exchange Commission, May 30, 2025), <https://www.sec.gov/about/reports-publications/secfy26congbudgjust>; see Heather Ayers, "Fewer exams, enforcement in SEC budget," *Regulatory Compliance Watch*, June 6, 2025, <https://www.regcompliancewatch.com/fewer-exams-enforcement-in-sec-budget/>.

⁴⁷ Government Accountability Office, *Consumer Financial Protection Bureau: Status of Reorganization Efforts*, GAO-26-108448 (Washington, DC: GAO, January 27, 2026), <https://www.gao.gov/assets/gao-26-108448.pdf>.

The FDIC’s Inspector General, for example, released a report in March which highlighted workforce challenges, the 20 percent reduction in staff in 2025, and noted, “The impact of staff attrition extends beyond numbers; it can affect institutional knowledge, readiness for resolution and receivership activity, and the ability to respond to crises.”⁴⁸

One final point. The administration in February finalized the Schedule F (Policy/Career) authority at OPM. Under this authority, virtually all federal workforce protections will be removed for career federal employees that have a “policy-influencing” role. They would be subject to “at will” removal, effectively treating them as political appointees.⁴⁹

Weakening Banking Supervision

In October 2025, the Federal Reserve circulated a memo to staff entitled “Statement of Supervisory Operating Principles.”⁵⁰

The memo stated, “Board Supervision and Regulation and Reserve Bank staff should take note of the significant shift in direction and implement the changes necessary to align our supervisory work and messaging with this new approach. As a guiding principle, staff should not assume that our current or past operating practices should continue going forward.”⁵¹

The thrust of the 3-page memo is captured in the following directive:

“Examiners and other supervisory staff should prioritize their attention on a firm’s material financial risks. They should not become distracted from this priority by devoting excessive attention to processes, procedures, and documentation that do not pose a material risk to a firm’s safety and soundness.”⁵²

While this change in focus may seem sensible on the surface, it reflects a fundamental misunderstanding of the purpose of supervision. Supervision is not about reacting to material financial risks, it’s about preventing them. In practice, setting a material

⁴⁸ Federal Deposit Insurance Corporation, Office of Inspector General, *Top Management and Performance Challenges Facing the Federal Deposit Insurance Corporation* (Memorandum to the Board of Directors, March 26, 2026), 4, https://fdicoig.gov/sites/default/files/reports/2026-03/TMPC_Final_March%202026.pdf.

⁴⁹ Executive Office of the President, “Restoring Accountability to Policy-Influencing Positions Within the Federal Workforce,” *Federal Register* 90 (January 31, 2025): 8625, <https://www.federalregister.gov/documents/2025/01/31/2025-02095/restoring-accountability-to-policy-influencing-positions-within-the-federal-workforce>.

⁵⁰ Board of Governors of the Federal Reserve System, “*Federal Reserve Board releases information regarding Enhancements to Bank Supervision*,” press release, November 18, 2025, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20251118a.htm>.

⁵¹ Board of Governors of the Federal Reserve System, *Enhancements to Bank Supervision* (Nov. 18, 2025).

⁵² Board of Governors of the Federal Reserve System, *Enhancements to Bank Supervision* (Nov. 18, 2025), attachment, 2.

financial risk standard significantly narrows the scope of supervisory oversight and undermines its value.

Material financial risks are, by definition, risks that are already large enough to threaten the failure of a bank, a loss to the FDIC's Deposit Insurance Fund, or instability in the banking system. The goal of supervision is to identify and address risks before they become material. Focusing attention narrowly on material financial risks impedes forward looking supervision that is essential to deterring the development of material risks.

For example, the Fed's memo will discourage examiners from looking at financial risks that may not be material on their own, but may collectively signal a lack of competent oversight or management. Further, it discourages examiners from looking at policies, procedures, or controls unless they are related to a financial risk that is material at the present time.

Decades of supervisory experience, evidenced in the three financial crises previously discussed, teach us that weaknesses in governance and lack of internal controls are often the earliest leading signals of emerging problems. The international standards that I mentioned yesterday emphasize the importance of forward-looking supervision that identifies weaknesses before they result in material losses. Failing to examine the whole governance process now risks overlooking issues that could be remediated before a material financial risk arises and manifests into actual losses. These governance issues and the risks they pose were raised prominently in the Federal Reserve and FDIC reports on the 2023 bank failures.

The Fed memo contains a second directive that is particularly troubling:

“Examiners and other supervisory staff need to change the way they decide whether an MRA (Matter Requiring Attention) or MRIA (Matter Requiring Immediate Attention) or a requirement in an enforcement action can be terminated because the underlying deficiency has been fully remediated. They should not perform their own duplicative validations... Instead, they should rely on an institution's internal audit for validations when that function is rated satisfactory.”⁵³

This directive turns over to the bank rather than the examiner the responsibility for determining if a supervisory deficiency or requirement in an enforcement action has been addressed. It is a form of self-regulation that would undermine the credibility of the entire supervisory process.

⁵³ Board of Governors of the Federal Reserve System, *Enhancements to Bank Supervision* (Nov. 18, 2025), attachment, 2.

Taken together, these two directives represent a fundamental weakening of banking supervision. It is a clear signal to bank examiners – tread lightly.

I should note that there are other problematic provisions in the memo. They include discouraging the use of horizontal reviews that may provide insight into how a given risk may be impacting a number of institutions and its potential to have broader impact on the system. This was a key lesson earned from the 2008 crisis.

The memo also cautions examiners against overemphasis on the management components of the CAMELS supervisory rating system that examiners use to evaluate banks. Substantial research has shown that CAMELS ratings, and especially the management components of those ratings, have significant predictive power for future bank performance. Examiners' evaluation of a bank's management can often be a key to identifying other risks to the institution.⁵⁴

Also in October, the OCC and the FDIC issued a joint notice of proposed rulemaking in line with the Federal Reserve memo. The introduction to the proposed rulemaking stated, "the agencies believe it is critical that examiners and institutions prioritize material financial risks over concerns related to policies, process, documentation, and other nonfinancial risks and that their enforcement and supervision standards further that prioritization." Both the Federal Reserve and the FDIC reports on the 2023 bank failures emphasized the role of poor bank management, describing it as the "root cause" of the failures even though the bank run was the proximate cause.⁵⁵

The proposal by the OCC and FDIC raises many of the same concerns as the Federal Reserve memo. While it does not seem to include the provision on deference to the bank's internal audit function to validate if a supervisory deficiency or requirement in an enforcement action has been addressed, it does invite specific comment on "the ways in which the agencies can improve their respective MRA verification policies and procedures."⁵⁶

⁵⁴ Board of Governors of the Federal Reserve System, *Enhancements to Bank Supervision* (Nov. 18, 2025); Rebel A. Cole and Jeffery W. Gunther, "Predicting Bank Failures: A Comparison of On- and Off-Site Monitoring Systems," *Journal of Financial Services Research* 13, no. 2 (1998): 103–117, <https://doi.org/10.1023/A:1007954718966>.

⁵⁵ Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation, "Agencies Issue Proposal to Focus Supervision on Material Financial Risks," joint notice of proposed rulemaking, October 7, 2025, <https://www.fdic.gov/news/financial-institution-letters/2025/agencies-issue-proposal-focus-supervision-material>; Federal Reserve Board, *Review of the Federal Reserve's Supervision and Regulation of Silicon Valley Bank* (Washington, DC, April 28, 2023); Federal Deposit Insurance Corporation, *Signature Bank Failure: Summary of Key Findings* (April 28, 2023).

⁵⁶ Office of the Comptroller of the Currency and Federal Deposit Insurance Corporation, "Unsafe or Unsound Practices, Matters Requiring Attention," *Federal Register* 90, no. 206 (October 30, 2025): 48835–48853, <https://www.federalregister.gov/documents/2025/10/30/2025-19711/unsafe-or-unsound-practices-matters-requiring-attention>.

Weakening Capital

Bank capital - the difference between the value of a bank's assets and liabilities - is the foundation of the stability of the banking system. Strong capital supports the ability of a bank to lend and to absorb losses if the loans go bad.

There are two complementary measures of capital for U.S. banks. Risk-based capital is a measure of the ratio of a bank's capital to the risk-adjusted value of the bank's assets. In other words, a low risk asset, such as a U.S. Treasury security, would have a lower risk weight and a lower capital charge than a higher risk asset such as a commercial real estate loan. In contrast, leverage capital is a simple measure of the ratio of a bank's capital to the assets of the bank, unadjusted for risk.

While the risk-based requirement is sensitive to the riskiness of the assets in an institution's portfolio, experience has shown that determining risk-weights carries uncertainty and is also subject to manipulation by the institutions. Leverage capital is not sensitive to the risk of assets but is a simple, more transparent measure of loss absorbing capital that with certainty will be available in a stress environment. As a result, this was the measure of capital given the most credibility by financial markets during the 2008 crisis. Together they make for the strongest foundation of capital for the most systemically important financial institutions.

As previously discussed, in 2008 the U.S. suffered the most severe financial crisis since the Depression, in part because our largest, most systemically important financial institutions were severely undercapitalized. The threshold post-crisis reform was to strengthen both the risk based and leverage capital of those institutions.

There is currently underway a systematic effort to weaken both risk-based and leverage capital for the most systemically important financial institutions in the United States. When fully implemented it will seriously undermine the resilience of the U.S. financial system and make it more vulnerable to systemic stress.

Let me briefly describe what is being done.

Weakening Stress Tests

The Dodd-Frank Act requires the Federal Reserve to conduct an annual stress test of the largest bank holding companies to determine if they are sufficiently capitalized to lend even in a severe stress scenario.⁵⁷

⁵⁷ Dodd-Frank Wall Street Reform and Consumer Protection Act § 165(i), Pub. L. 111-203, 124 Stat. 1376, 1426-1427 (July 21, 2010); 12 U.S.C. § 5365(i).

This requirement was the result of the use by the Federal Reserve and the Treasury of a stress test during the Global Financial Crisis to determine the capital adequacy of the largest bank holding companies. The public release of the results of the test informed the public and the financial markets about the condition of the institutions and played a pivotal role in gradually restoring confidence in the banking system.⁵⁸

In October 2025, the Federal Reserve issued a proposal that would make two fundamental changes to weaken the stress test. The proposal would make public the models used for the stress test and seek public comment on them, and make public and publish for public comment the supervisory stress test scenarios.⁵⁹

This may seem like simple transparency. In practice, however, informing the banks about the details of the models allows the firms to game the test to minimize the capital consequence. It also undermines the risk management value of the test for the banks. Further, subjecting the test to a public notice and comments process makes for a lengthier and more cumbersome process. It impacts the timeliness of the test and creates an incentive for banks to criticize aspects of the test that may raise capital and support or not identify aspects that may lower capital. The Federal Reserve estimates that the proposed changes to the stress test will lower bank capital by 2.4 percent for the GSIBs.⁶⁰

Weakening Leverage Capital - Enhanced Supplementary Leverage Ratio

In response to the 2008 Global Financial Crisis and the capital inadequacy of the largest banks, the federal banking agencies adopted the Basel III capital rule, which for the largest institutions became effective in 2014.⁶¹ The rule strengthened the quality of bank

⁵⁸ Board of Governors of the Federal Reserve System, "The Supervisory Capital Assessment Program: Overview of Results," press release (May 7, 2009), <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20090507a.htm>.

⁵⁹ Board of Governors of the Federal Reserve System, "Enhanced Transparency and Public Accountability of the Supervisory Stress Test Models and Scenarios; Modifications to the Capital Planning and Stress Capital Buffer Requirement Rule, Enhanced Prudential Standards Rule, and Regulation LL," 90 Fed. Reg. 51856 (Nov. 18, 2025).

⁶⁰ Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, and Federal Deposit Insurance Corporation, "Regulatory Capital Rule: Category I and II Banking Organizations, Banking Organizations With Significant Trading Activity, and Optional Adoption for Other Banking Organizations," 91 Fed. Reg. 14952 (Mar. 27, 2026).

⁶¹ Office of the Comptroller of the Currency and Board of Governors of the Federal Reserve System, "Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-Weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule," *Federal Register* 78 (October 11, 2013): 62018; Federal Deposit Insurance Corporation, "Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-Weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule," *Federal Register* 78 (September 10, 2013): 55340 (interim final rule); Federal Deposit Insurance Corporation,

capital and the level of risk-based capital requirements. However, in the U.S., the increase in capital requirements under Basel III did not make a significant change in leverage capital requirements.

That disparity led the banking agencies to adopt an enhanced supplementary leverage ratio (ESLR) for the eight U.S. GSIBs that had been at the center of the 2008 crisis because of a buildup of leverage. The ESLR was 5 percent at the GSIB holding company level and 6 percent at FDIC-insured GSIB banks, establishing rough comparability with the increase in risk-based capital.⁶²

A rule finalized by the federal banking agencies in November 2025 and effective April 1, 2026 would make drastic reductions in the ESLR at the GSIB-bank level and less extreme reductions at the holding company level. At the bank level, the final rule would reduce the ESLR at the bank level by 28 percent, approximately \$219 billion. At the holding company the decline is less than 2 percent, or \$13 billion. This change dramatically weakens the resilience of the largest, most systemically important banks in the United States.⁶³

The technical argument is made that even if the capital is released at the bank level, it will be trapped at the holding company level. There are two points here. First, the bank is the most systemically important institution in the holding company. Significantly reducing its capital carries serious risk. Second, there is no assurance in the current regulatory environment the capital will be trapped at the holding company, particularly with the proposed reductions in risk based capital at the holding company that I will discuss next.

“Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Capital Adequacy, Transition Provisions, Prompt Corrective Action, Standardized Approach for Risk-Weighted Assets, Market Discipline and Disclosure Requirements, Advanced Approaches Risk-Based Capital Rule, and Market Risk Capital Rule,” *Federal Register* 79 (April 14, 2014): 20754 (final rule adopting interim final rule with no substantive changes).

⁶² Office of the Comptroller of the Currency; Board of Governors of the Federal Reserve System; and Federal Deposit Insurance Corporation, “Regulatory Capital Rules: Regulatory Capital, Enhanced Supplementary Leverage Ratio Standards for Certain Bank Holding Companies and Their Subsidiary Insured Depository Institutions,” *Federal Register* 79 (May 1, 2014): 24528, <https://www.federalregister.gov/documents/2014/05/01/2014-09367/regulatory-capital-rules-regulatory-capital-enhanced-supplementary-leverage-ratio-standards-for>.

⁶³ Office of the Comptroller of the Currency; Board of Governors of the Federal Reserve System; and Federal Deposit Insurance Corporation, “Regulatory Capital Rule: Modifications to the Enhanced Supplementary Leverage Ratio Standards for U.S. Global Systemically Important Bank Holding Companies and Their Subsidiary Depository Institutions; Total Loss-Absorbing Capacity and Long-Term Debt Requirements for U.S. Global Systemically Important Bank Holding Companies,” *Federal Register* 90 (December 1, 2025): 55248, <https://www.federalregister.gov/documents/2025/12/01/2025-21626/regulatory-capital-rule-modifications-to-the-enhanced-supplementary-leverage-ratio-standards-for-us>.

In addition, it is argued that reducing leverage capital requirements will be an incentive for these banks to support the market in Treasury securities since Treasury securities will now have a lower capital charge. However, there is nothing in the rule requiring this, and the banks may use their newly freed resources to invest in higher return assets than Treasury securities.

Weakening Risk-Based Capital - Basel III and the GSIB-Surcharge

Last month, on March 19, the federal banking agencies jointly proposed a rule that would implement the Basel III risk-based capital agreement. In addition, the Federal Reserve proposed a rule that would make changes to the capital surcharge imposed on the Global Systemically Important Banks in recognition of the risks they pose to the overall financial system. While these rules are highly complex, I would like to highlight proposed changes that would significantly weaken risk-based capital requirements for the largest banks.⁶⁴

Let me begin with the so-called GSIB surcharge. The GSIB surcharge is an additional capital requirement for the largest, most complex banks because of the risks they pose to the financial system. It is based on a number of risk factors including size, interconnectedness, complexity, cross-border activity, substitutability, and wholesale funding.

Without going into all of the details, the changes in the proposed rule to the GSIB surcharge would reduce common equity tier 1 capital requirements – the narrowest and highest quality measure of risk-based capital – by 3.8 percent, or \$30 billion, for the largest, most systemically important banks.⁶⁵

The implementation of Basel III, as mentioned during the earlier discussion of the Global Financial Crisis, was an effort by the federal banking agencies to strengthen the banking system because our nation's largest, most systemically important financial institutions were found to be woefully undercapitalized and over-leveraged in 2008.

The early round of Basel III changes significantly improved the quantity and quality of capital held by internationally active banks. The final phase of Basel III that is the subject of the current proposed rulemaking addresses four specific areas of risk that

⁶⁴ Board of Governors of the Federal Reserve System, "Regulatory Capital Rule (Regulation Q): Risk-Based Capital Surcharges for Global Systemically Important Bank Holding Companies; Systemic Risk Report (FR Y-15)," *Federal Register* 91 (March 27, 2026): 14908.

⁶⁵ Board of Governors of the Federal Reserve System, *Basel III Proposal, GSIB Surcharge Proposal, and Standardized Approach Proposal* (staff memorandum to the Board of Governors, March 19, 2026), <https://www.federalreserve.gov/aboutthefed/boardmeetings/files/board-memo-basel-gsib-standardized-approach-20260319.pdf>.

contributed to the 2008 Crisis - credit risk, market risk, operational risk, and risk associated with financial derivatives.

Of particular consequence is the provision of Basel III dealing with market risk. During the Global Financial Crisis banks incurred significant losses in their trading books – their portfolio of instruments traded over the short-term. This included the derivative instruments - collateralized debt obligations and credit default swaps - that I mentioned previously, which exposed weaknesses in the existing market risk capital framework.

The market risk provision of Basel III was a significant attempt to improve the market risk framework. A key element of the market risk provision of Basel III was a so-called “output floor” to ensure that a firm’s use of its own internal models for market risk did not result in excessive reductions in risk-based capital. The Basel III proposal approved in March does not include the output floor. Instead, it uses it as a cap on a firm’s market risk capital requirements and significantly reduces capital for market risk.⁶⁶

The banking agencies estimate that the overall effect of the Basel III proposal will increase common equity tier 1 capital by 1.4 percent. When combined with the 3.8 percent decrease due to the GSIB surcharge proposal and the proposed stress testing changes, the agencies expect a reduction of 4.8 percent of common equity tier 1 capital for the largest most systemically important banks. The broader tier 1 capital measure would be reduced by 6.0 percent.⁶⁷

The joint press release by the banking agencies on these risk-based capital proposals, while acknowledging a “modest” capital reduction, noted that “capital levels would still be substantially higher than they were before the financial crisis.”⁶⁸

That strikes me as cold comfort. It is worth noting that while the 28 percent reduction in leverage capital has been finalized, the risk-based capital rules with a “modest” capital reduction have only been proposed. In my experience, proposed capital rules tend to be the high-water mark for capital requirements. We may see larger reductions in risk based when the final rule is released.

⁶⁶ Michael S. Barr, Governor, Board of Governors of the Federal Reserve System, “Statement on Bank Capital Proposals,” March 19, 2026, <https://www.federalreserve.gov/newsevents/pressreleases/barr-statement-20260319.htm>.

⁶⁷ Board of Governors of the Federal Reserve System, *Basel III, GSIB Surcharge, and Standardized Approach Proposals* (Mar. 19, 2026).

⁶⁸ Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; and Office of the Comptroller of the Currency, “Agencies Request Comment on Proposals to Modernize the Regulatory Capital Framework and Maintain the Strength of the Banking System,” joint press release, March 19, 2026, <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20260319a.htm>.

Conclusion

My purpose today has been to provide an overview of the most critical measures that have been implemented or are underway to drastically weaken financial regulation – and in particular banking regulation - in the United States.

There are many other actions that warrant attention including proposals that have been floated to weaken liquidity and resolution plan rules for the banks, actions to weaken consumer compliance supervision in addition to safety and soundness supervision, and the withdrawal of large numbers of enforcement actions by all of the financial regulatory agencies.

What we are seeing today not only seems to be a failure to learn the lessons of the past but in some measure to go beyond what has been done before. I don't think there has been adequate public appreciation of the dimensions of these efforts.

I have no doubt that Chairman Volcker would be dismayed by what is transpiring but also resolute in taking the long view that the system can be brought back into balance.

In tomorrow's third and final lecture I will focus on the key steps that will need to be taken to repair the damage that has been done, as well as discuss other key risks to U.S. financial stability that need to be addressed.