

Michelle W Bowman: Capital rules for the real economy

Speech by Ms Michelle W Bowman, Vice Chair for Supervision of the Board of Governors of the Federal Reserve System, at the Cato Institute Policy Forum "Basel III and bank capital rules", Washington DC, 12 March 2026.

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Good morning. It's good to be here with you at the Cato Institute to discuss our approach to bank capital requirements.¹ Capital requirements form the foundation of our prudential regulatory framework, and in the coming weeks we will propose rules to implement the final phase of Basel III in the United States. These changes to the capital framework eliminate overlapping requirements, right-size calibrations to match actual risk, and comprehensively address long-standing gaps in our prudential framework. The result is more efficient regulation and banks that are better positioned to support economic growth, while preserving safety and soundness.

Following the 2008 financial crisis, regulators implemented reforms that substantially increased bank capital and strengthened financial system resilience. While these initial reforms were necessary, experience shows requirements that overly calibrate low-risk activities produce unintended consequences. It constrains credit availability, pushes activity into the less-regulated nonbank sector, and layers on complexity and costs without meaningfully enhancing safety and soundness.

Requirements like the global systemically important bank (G-SIB) surcharge, which has increased in such a way that it has become disassociated from actual risk, illustrate this problem. Continuously increasing capital levels without a specific purpose imposes real economic cost. When capital requirements become excessive, they impair the banking system's fundamental function of providing credit to the real economy. The price is paid in forgone economic growth, reduced job creation, and lower standards of living.

In our work to modernize the capital framework, we evaluated changes in the aggregate while taking a bottom-up approach to ensure that the overall framework is appropriate.

We did not begin by setting an aggregate "target" and working backward. Instead, each requirement is evaluated on its merits-examining whether it is properly calibrated to risk, achieves its intended purpose, and avoids creating unintended outcomes.

We have developed proposals to modify each of the four pillars of our regulatory capital framework for the largest banks: stress testing, the supplementary leverage ratio, the Basel III framework for risk-based capital requirements, and the G-SIB surcharge.

The Federal Reserve is taking steps to modernize our capital requirements and is working together with the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation to propose joint rulemakings. The proposals take into account the aggregate impact of revisions already introduced to the enhanced supplementary leverage ratio (eSLR), which would restore it to its role as a backstop to risk-based capital requirements, and to the stress testing framework.² The Federal Reserve has already proposed a number of changes to the stress testing framework

and process to enhance transparency and public accountability. In addition, the outstanding stress testing proposals reduce excessive volatility while providing a robust analysis of bank conditions under a hypothetical stress scenario.³

The proposals to address the remaining two pillars, Basel III and the G-SIB surcharge, streamline the risk-based capital framework using a single set of calculations, improve alignment between requirements and risk, and revise the G-SIB surcharge to better capture the risks of our largest and most complex banks.

We are also updating capital requirements for smaller and less complex banks. Last November, the banking agencies proposed enhancements to the community bank leverage ratio. These revisions reduce regulatory burden and increase flexibility for qualifying community banks, while preserving strong capital levels.⁴ A new "standardized approach" will also revise the risk-based capital requirements for non-G-SIB banks.

Together, these proposals will better align requirements with risk and allow banks to engage in lower-risk, traditional banking activities. Collectively, they reduce incentives for activities like mortgage origination, mortgage servicing, and lending to businesses to migrate outside of the regulated banking sector. Importantly, the capital framework remains robust. Under the new framework, banks maintain their capacity to absorb losses while continuing to provide credit and financial services to households and businesses across a wide range of economic conditions.

Basel III Proposal

The Basel III proposal builds on the 2017 Basel agreement while incorporating targeted adjustments to reflect U.S.-specific aspects of banking and financial markets. Finalizing these reforms will provide the industry greater certainty for planning and management. It will also promote broadly consistent international capital standards.

An important feature of this proposal is the elimination of duplicative capital calculations for the largest banks. Today, these banks must maintain two sets of risk-based capital ratios—one using the standardized approach and another using internal model-based advanced approaches. Experience shows this duplication creates burden without providing corresponding benefits. Therefore, the proposal establishes a single approach to calculate the risk-based capital requirements for the largest banks.

Credit risk

To better support the flow of credit to households and businesses, the revised framework improves the risk sensitivity of requirements for lending activities. The proposal recognizes loan-to-value ratios in mortgage capital requirements and reflects repayment history in retail lending. Importantly, it does not add new capital penalties for mortgages or consumer lending and seeks public feedback on the appropriate role of private mortgage insurance. The proposal also differentiates requirements based on the credit quality of businesses, ensuring that capital treatment is aligned with risk.

Operational risk

The new framework includes standardized requirements for operational risk, consistent with international standards, but tailored to large U.S. banks. Activities that produce fee-

based revenues and expenses, like credit cards, would have those revenues and costs accounted for on a net basis, rather than separately as in the Basel standard. Staff analysis also indicates that certain activities, like wealth management and custody services, have historically exhibited lower levels of operational risk, and the proposed requirements are calibrated to reflect those differences.

Market risk

The proposal also strengthens capital requirements for banks' trading activities in a manner calibrated to unique U.S. capital markets. The methodology better captures losses under stressed conditions and reflects the risk of less liquid positions. It introduces a standardized calculation that applies consistently across firms, while reducing burden for banks with simple trading activities. Relative to the Basel standard, the proposal better recognizes diversification across positions and extends the use of bank internal models where data are sufficiently robust, ensuring capital requirements are commensurate with risk.

CVA risk

The proposal also introduces a capital requirement for credit valuation adjustment (or CVA), which is the risk of losses on derivative positions from counterparty credit risk. This requirement applies to banks with significant trading activity and material derivative portfolios, consistent with international standards. Importantly, the requirement focuses on bilateral transactions among large financial firms, avoiding unintended costs for commercial end users of derivatives including farmers and manufacturers.

Overlaps with stress testing

Stress testing, and the resulting stress capital buffer, complement the risk-based framework by adding granularity and risk sensitivity. However, overlaps between the stress test and the risk-based framework can produce excessive requirements for some activities. In developing the Basel III proposal, we were mindful of these overlaps and evaluated the combined effect of the requirements in our impact analysis. In line with international standards and with a view toward improving risk sensitivity, the Basel III proposal increases capital requirements for operational risk and market risk.

Separately, recently proposed changes to stress testing models are expected to improve the reliability of the operational risk model and the coherence of the global market shock scenario. In doing so, it reduces requirements for operational risk and trading positions. The overall calibration of these risks should remain largely unchanged, while individual components of the framework are meaningfully improved.

Standardized Approach Proposal

While implementing Basel III requirements for large and internationally active banks are long overdue, it is equally important to update risk-based capital requirements for all banks. The approach leverages a similar rationale-to reduce redundancy, simplify where possible, achieve better calibration of requirements relative to risk, and remove incentives for activities to migrate out of the banking system. The standardized approach proposal modifies risk-based capital calculations for most banks, improving risk alignment while preserving a simple framework.

The proposed changes address critical categories of bank lending, including mortgages, consumer lending, and business lending. These changes moderately reduce requirements and align the standardized approach with the Basel III proposal. This ensures greater consistency and a level playing field among all banks. The changes better align requirements with risk, increasing efficiency, and ensure the availability of credit to households and businesses. At the same time, all U.S. banks would remain subject to robust capital standards.

Both the standardized approach and the Basel III proposals remove any requirement to deduct mortgage servicing assets from regulatory capital. Instead, they assign a 250 percent risk weight to these assets while seeking public feedback about the appropriate risk weight. This should reduce disincentives for participating in mortgage markets and servicing their mortgage originations, thereby addressing the mortgage activity migration to nonbanks over the past 15 years.

The standardized approach proposal also requires large banks to include elements of accumulated other comprehensive income (AOCI) in common equity tier 1 capital. This aligns with the treatment of these assets for the largest institutions. The proposal also invites public comment on the appropriate scope of mandatory AOCI recognition and sets a five-year phase in for this change to avoid a material immediate increase in capital requirements.

G-SIB Surcharge Proposal

I will now turn to a discussion of the G-SIB surcharge proposal. Under our current framework, the largest, most complex banks are subject to a G-SIB surcharge, which is a capital requirement intended to mitigate the systemic risk posed by these banks. This proposal strengthens and modernizes the calculation of this requirement in several ways.

First, the proposal updates the parameters-or coefficients-that determine the impact of firms' activities on the G-SIB surcharge. This better reflects recent changes in the financial system. When the G-SIB surcharge was introduced in 2015, the Board committed to regularly review the surcharge coefficients. This practice would have ensured that the coefficients account for changes in the price level and economic growth.⁵

More than 10 years later, the Board has yet to complete a review. Over time, the surcharges have continued to escalate, even when the size of the largest banks has grown roughly in line with the broader economy. In addition, our surcharges have increasingly diverged from the international method for setting G-SIB surcharges. The proposal addresses this divergence by realigning our surcharge with the international method. And to ensure that surcharges do not unintentionally increase, the proposal indexes the surcharge to economic growth going forward. These changes keep this additional capital requirement calibrated to the systemic risks of our largest, most complex banks over time.

Second, the proposal revises the surcharge component that accounts for risk associated with short-term funding, which was originally intended to represent 20

percent of the surcharge. Instead, it represents roughly 30 percent. Revising this element of the surcharge would bring it into better alignment with other elements of the calculation.

Third, to reduce incentives to make year-end adjustments to balance sheets, the proposal requires G-SIBs to calculate certain systemic risk indicators as an average of their daily or monthly values, rather than the year-end value.

Fourth, to reduce cliff effects and increase sensitivity to changes in a firm's risk profile, the proposal assigns surcharges in increments of 10 basis points rather than 50 basis points.

Finally, the proposal improves the measurement of certain systemic indicators, aligning it with international standards.

These adjustments reduce capital requirements. Most of this reduction comes from fulfilling the Board's commitment to adjust for economic growth and correct excessive requirements associated with the short-term wholesale funding component.

Impact on Capital Requirements

We expect the Basel III proposal to result in a small increase in requirements for the largest banks, similar to what is expected in the UK. The G-SIB surcharge proposal would result in a modest decrease in the surcharges, which addresses the recent increases in this requirement that deviated from risk. Together, these proposals would decrease the requirements by a small amount.

These changes should be viewed as part of a broad, careful review of capital requirements undertaken over the past nine months. We have carefully considered the overlaps between Basel III and stress testing to ensure that, when combined, capital requirements appropriately capture risk rather than being overly punitive. The resulting cumulative effect on the largest banks' capital requirements is modest.

Recent changes to capital rules and accounting standards have significantly increased requirements for large U.S. banks. They are now subject to new and generally higher requirements for potential credit losses and derivative exposures. Stress test losses also increase capital requirements, and balance sheet expansion in line with economic growth and inflation has increased G-SIB surcharges. Changes to the G-SIB surcharge based on underlying risk are appropriate but increases driven mainly by real economic growth and inflation do not reflect increases in systemic risk. In addition, they are contrary to the Board's long-standing commitment to update the methodology.

Our capital proposals, including the 2025 stress test improvements, maintain capital requirements above the 2019 rules. The cumulative impact serves as a sensible recalibration reflecting the recent growth of regulatory capital requirements for the largest banks.

Smaller banks, which are more focused on traditional lending activities, will see slightly larger reductions in capital requirements. These changes will maintain resilience and provide flexibility to provide credit to U.S. households and businesses.

Closing Thoughts

Crafting these reforms is no easy task, and over time there have been many attempts to address some of the individual components of the framework. The proposals that will be published in the coming week will bring us closer to fulfilling the U.S. commitment to implement the 2017 Basel III agreement and will complete the first step of our comprehensive review of the capital framework. We look forward to publishing all of these proposals and receiving public comments.

1 The views expressed here are my own and are not necessarily those of my colleagues on the Federal Open Market Committee or the Board of Governors of the Federal Reserve System.

2 See [Regulatory Capital Rule \(PDF\)](#), 90 Fed. Reg. 55,248 (December 1, 2025).

3 See [Modifications to the Capital Plan Rule and Stress Capital Buffer Requirement \(PDF\)](#), 90 Fed. Reg. 16,843 (April 22, 2025); and [Enhanced Transparency and Public Accountability of the Supervisory Stress Test Models and Scenarios \(PDF\)](#), 90 Fed. Reg. 51,856 (November 18, 2025).

4 See [Regulatory Capital Rule \(PDF\)](#), 90 Fed. Reg. 55,048 (December 1, 2025).

5 See [Regulatory Capital Rules \(PDF\)](#), 80 Fed. Reg. 49,082 (August 14, 2015).