FINANCIAL SERVICES FORUM

Bank Leverage Capital Requirements

Reforms needed urgently to support U.S. taxpayers, capital markets, consumers, businesses, & the economy.

What is Leverage Capital?

Banks must maintain capital to withstand financial challenges and support the economy. Leverage-based capital requirements apply the same capital charge to all assets, regardless of risk. This means low-risk assets like cash and Treasuries get the same capital charge as higher-risk assets like business loans or stocks.

The Problem

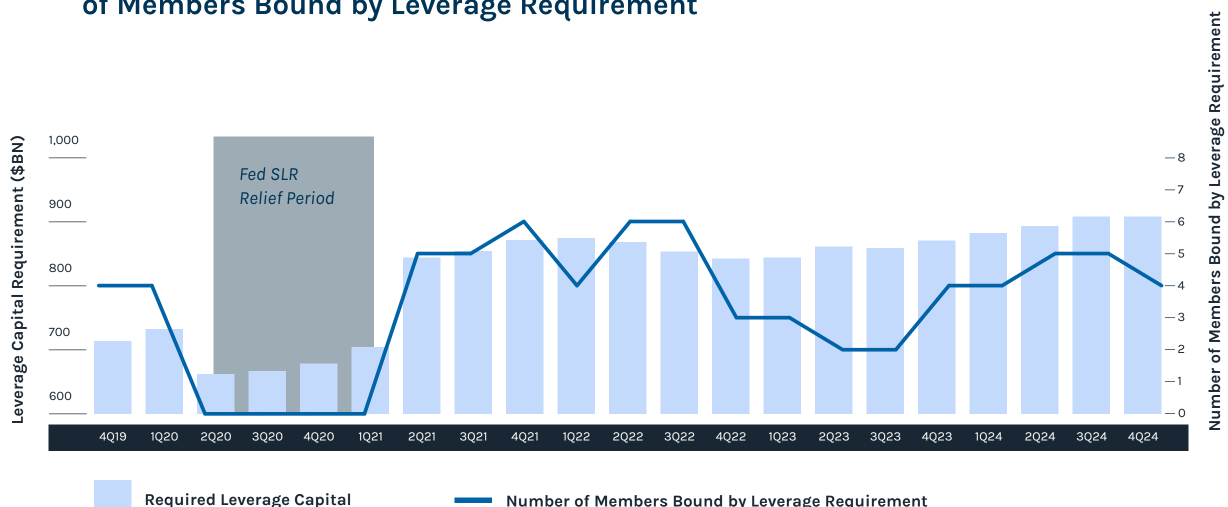
Increased costs for businesses, consumers, taxpayers. Leading banks act as primary dealers, helping the government issue Treasury debt. Like all investors, banks aim to maximize returns and minimize costs. If holding a Treasury is as costly as a business loan, banks are forced to choose higher-returning assets, reducing the likelihood of holding Treasures. This harms market functioning and liquidity, leading to higher interest rates and increased costs across the economy as businesses, consumers, and taxpayers are forced to pay those higher rates.

"It's time to move" on reforming leverage capital requirements, Federal Reserve Chair Powell told members of the House Financial Services Committee in February. "We proposed doing so several years ago, we just didn't follow through on it. So I do think it's time."

Problem is just getting bigger. The problem and the need for reform have increased for two main reasons:

- First, the Federal Reserve's balance sheet since COVID-19 has nearly doubled, increasing banking sector assets. As a result, leverage capital requirements, meant only to be a backstop to risk-based requirements, have become more restrictive for leading U.S. banks, their customers, and the economy at large.

Leverage Capital Requirement and Number of Members Bound by Leverage Requirement



- Second, the U.S. government is facing ever greater costs to finance its debt due to the increasing debt burden. For the first time ever, the government is spending more to service the federal debt than it is for national defense. That's why economists at the Federal Reserve Bank of Boston last year cautioned, constraints on primary dealers may prevent them from absorbing additional federal government debt.

"As Treasury debt continues to grow rapidly and market-making capacity remains limited and concentrated, the Treasury market almost surely remains highly susceptible to dysfunction under stress, and potential sources of stress are forbidding."

Working Group on Treasury Market Liquidity from The Group of 30, a bipartisan group of former central bankers and other experts in the field

Leverage Requirements Must be Reformed

Ultimately, taxpayers are paying for the increasing costs of higher government borrowing as long as common sense reforms are delayed. In 2020, the banking agencies made a temporary change in recognition of the issues caused by the leverage ratio, but let that fix expire in March 2021. Even though the Federal Reserve then committed to shortly move to enact a more permanent change, no action has been taken.

Potential solutions:

- **Exclude Treasury securities and deposits at Federal Reserve banks from leverage requirements, as done during the pandemic.**
- **Reform one measure, the enhanced Supplementary Leverage Ratio, to replace it with a measure based on risk-based requirements.**
- **Enact reforms to minimum leverage requirements through Congressional action.**

Learn More: *The Evidence is Conclusive: Treasury Market Liquidity Has Deteriorated Significantly*