
Warren Buffet warned, “[Y]ou only find out who is swimming naked when the tide goes out.” When the tide rolled out during the last global financial crisis, some large banks were swimming naked without adequate capital. The Basel Committee, a group of banking supervisory authorities from over twenty countries responsible for setting global capital standards, put forth capital regulatory reforms known as Basel III to address banking failures from the financial crises. While most of Basel III has been implemented, the latest proposals by the Basel Committee to reduce reliance on internal-risk based (IRB) models for credit, market, and operational risks are deeply contested.

Under Basel III, certain banking institutions may use IRB models developed by the bank and approved by regulators to calculate capital ratios. Basel Committee empirical studies have shown that banks using IRB models, however, are inconsistent in how they measure risk-weighted assets (RWAs) for capital ratios. The Basel Committee is concerned with not only the lack of uniformity in RWA measurement, but also the possibility that banks are using IRB models

595 See Anat R. Admati, The Missed Opportunity and Challenge of Capital Regulation 7 (Stanford Univ.’s Rock Ctr. for Corp. Governance, Working Paper No. 216, 2015) (arguing that the capital retained by banks provided “misleading reassurances” and were “entirely inadequate”).
to reach favored outcomes, such as holding less capital than would be required under other models. To address this problem of banks gaming the capital regulatory framework by using IRB models, the Basel Committee issued proposals for banks to reduce reliance on IRB models and to adopt standardized models when appropriate as part of the final Basel III implementation. Standardized models are uniform ways to measure credit, market, or operation risks across all banks that do not depend on internally developed formulas. Banking regulators in the United States, under the leadership of Daniel Tarullo, member of the Board of Governors of the U.S. Federal Reserve Board and chairman of the Federal Financial Institutions Examination Council, supported these measures, while European regulators opposed them due to the heightened capital requirements the measures would impose on European banks. The election of President Trump and departure of Mr. Tarullo, however, cast into doubt U.S. support for the Basel Committee’s reforms. Accordingly, the Basel Committee has put the final Basel III reforms on hold until 2019, giving the new U.S. administration time to reach a position.


601 BCBS Credit Reform, supra note 6, at 2.


603 Verlaine & Colchester, supra note 4 (explaining the disagreement between U.S. and European regulators).


605 Caroline Binham, Basel Puts New Banking Policy Initiatives on Hold Un-
This article discusses the proposed Basel III reforms and their likely impact on U.S. banks. Section A provides a broad overview of the evolution from Basel I to Basel III. Section B explains the major elements of the proposed reforms to Basel III with respect to credit, market, and operational risks. Next, Section C discusses the likely impact of these proposed reforms on large U.S. banks. Finally, Section D examines European resistance to the Basel III reforms and explains how the Trump administration may either continue or cease support for the reforms.

A. Evolution from Basel I to Basel III

Banks need capital to absorb losses and lower the risk of insolvency. The more capital that a bank is required to hold, however, the more restricted it is in its ability to invest or lend money. Thus, capital requirements attempt to balance a bank’s need for capital without unduly undermining a bank’s growth and profitability. Basel I in 1988 resulted in internationally agreed upon minimum capital standards for the first time. The purposes of Basel I were to ensure that banks hold sufficient capital to cover their respective level of risk, to promote uniform capital measures and standards to level the playing field globally, and to facilitate global comparisons of bank capital positions. Basel I only accounted for credit risk, i.e., “the risk of counterparty failure” when borrowers default on loan payments, and prescribed a standardized approach for determining risk-weighted assets (RWAs). Under this approach, each asset is placed in “different categories” based on the asset type and “weighted according to broad categories of relative riskiness.” Basel I failed to capture the risk sensitivity of assets, because all assets belonging

---


607 See id.

608 See id.

609 See BASEL I, supra note 9.

610 Id. at 1–2.

611 Id. at 8.

612 Id. at 7.
to the same category were weighted equally, without regard to the individual risk profiles of assets and counterparties.\textsuperscript{613}

As banks became more complex and developed risk modeling techniques with computers, Basel I’s standardized approach evolved. The market risk amendment in 1996 ushered in a new era of capital regulation by allowing banks to use their own value-at-risk (VaR) models to calculate market risk,\textsuperscript{614} “the risk of losses in on- and off-balance sheet positions arising from movements in market prices.”\textsuperscript{615} VaR models measure the risk of investments in a given period so that a bank can gauge the amount of assets needed to cover possible losses.\textsuperscript{616} In 2004, Basel II expanded the use of internal credit risk models for banks.\textsuperscript{617} The IRB approach allowed the largest banks to use their own empirical models, subject to regulatory approval, to quantify required capital for credit risk.\textsuperscript{618} This involved large banks using IRB models to calculate their respective probability of default (PD), exposure at default (EAD), and loss given default (LGD) as inputs into a formula developed by supervisors for calculating minimum capital requirements.\textsuperscript{619} The new approach sought to address Basel I’s failure to capture risk sensitivity.\textsuperscript{620} Basel II also required banks to hold capital for operational risk events, the losses “resulting from inadequate or failed internal processes, people and systems or from external events.”\textsuperscript{621} Basel II’s advanced measurement approach


\textsuperscript{615} Id. at 1.

\textsuperscript{616} Id. (“The objective in introducing this significant amendment to the Capital Accord is to provide an explicit capital cushion for the price risks to which banks are exposed, particularly those arising from their trading activities.”).

\textsuperscript{617} Basel II, supra note 20, ¶ 211.

\textsuperscript{618} See id. (“Subject to certain minimum conditions and disclosure requirements, banks that have received supervisory approval to use the IRB approach may rely on their own internal estimates of risk components in determining the capital requirement for a given exposure.”).

\textsuperscript{619} Id. ¶¶ 285–317.

\textsuperscript{620} Id. ¶ 10.

\textsuperscript{621} Id. ¶ 644.
(AMA) allowed banks to use their own models, subject to regulatory approval, to calculate how much capital they needed to set aside for operational risk. When the last financial crisis occurred, large bank failures exposed Basel II’s weakness: it did not require banks to hold enough high quality capital and failed to account for systemic risk.

Basel III was approved in 2010 and increased requirements concerning the quantity and quality of capital. With respect to quantity, Basel III increased the overall amount of Tier 1 capital that banks must hold from 4 percent to 6 percent. Tier 1 capital is considered to be the best quality capital consisting of common equity and retained earnings. Tier 2 capital, in contrast, consists of less reliable debts and loans. Additionally, Basel III introduced capital conservation and countercyclical buffers that require banks to hold up to an additional 2.5 percent of common equity Tier 1 capital to withstand future periods of financial stress.

Regarding the quality of capital, Basel III established more stringent qualifications for what qualifies as Tier 1 and Tier 2 capital. It required that the best quality capital, common equity Tier 1, be increased from 2 percent to 4.5 percent. Basel III introduced a minimum leverage ratio of 3 percent that divides a bank’s Tier 1 capital by total non-risk weighted assets. This leverage ratio “reinforce[d] the risk based requirements with a simple, non-risk based ‘backstop’ measure.” Further, Basel III introduced liquidity requirements known as the liquidity coverage ratio (LCR) and the net stable funding

---

622 Id. ¶¶ 655–56.
624 Basel III, supra note 3, at 2.
625 Id. at 2.
626 Id. at 13.
627 Id. at 17.
628 Id. at 54–60.
629 Id. at 15.
630 Id. at 12.
631 Id. at 61.
632 See id. at 60–61.
ratio (NSFR). LCR requires a bank to hold sufficient liquid assets to cover thirty days of net cash outflows and the NSFR requires a bank to retain stable funding to cover a one-year period of extended stress.

Despite these improvements to the quality and quantity of banking capital, Basel III did not improve the use of IRB approaches to calculating RWAs. Banks use IRB approaches for calculating RWAs because they are more sensitive to capturing the risks behind each individual asset than a standardized approach that assigns the same risk weight to assets within a particular class. Some banks, however, are required to hold less capital under the IRB approach than under the standardized approach. The Basel Committee’s 2013 studies concluded that IRB approaches lead to different capital results for similar portfolios. The Basel Committee found “significant variation” across banks in the calculation of market risk and operational risk and “considerable variation” in the calculation of credit risk.

633 Id. at 9.
634 See id.
635 Lee Reiners, Basel Committee is on the Clock, FinReg Blog (Dec. 12, 2016), https://sites.duke.edu/thefinregblog/2016/12/12/basel-committee-is-on-the-clock/[https://perma.cc/X6KC-YWWW].
637 Reiners, supra note 42.
638 See Basel Comm. on Banking Supervision, Consultative Document: Standards, Revisions to the Standardised Approach for Credit Risk 4 (2015) [https://perma.cc/H5WT-AFEC] ("Moreover, given the level of variability in risk-weighted assets across banks using the IRB approach (with respect to portfolios with similar risk profiles), the Committee is proposing to impose a standardised approach floor on modelled credit risk capital requirements with the aims of constraining variation in risk-weighted assets . . . .").
639 Press Release, Bank for Int’l Settlements, Second Report on the Regulatory Consistency of Risk-Weighted Assets in the Trading Book Issued by the Basel Committee (Dec. 17, 2013), https://perma.cc/29B9-9SHJ]. ("[T]he results show significant variation in the outputs of market risk internal models used to calculate regulatory capital."); Reiners, supra note 42 ("A similar study of RWAs for credit risk also identified ‘considerable variation’ across banks, and that this variation cannot be explained simply by differences in the risk composition of assets. Significant variation has also been found in operational risk RWAs.").
B. Proposed Reforms to Basel III

To address the wide variation of capital calculations based on IRB approaches and to improve the simplicity and comparability of capital ratios, the Basel Committee has released a series of consultative documents with proposed reforms to the current Basel III framework. Critics call these proposals Basel IV. In particular, the Basel Committee hopes to reform requirements for credit risk, market risk, and operational risk.

1. Credit Risk

To reduce variation in credit risk calculations, the Basel Committee has proposed reforms to eliminate the use of IRB approaches for certain exposures. For example, banks would need to use the standardized approach instead of IRB approach to calculate credit risk from portfolios belonging to “banks and other financial institutions; large corporates (defined as corporates belonging to consolidated groups with total assets exceeding EUR50bn); and equities.” This standardized approach for credit risk would be more risk-sensitive and rely less on external ratings than previous standardized models.

For the other exposures that may be calculated using the IRB approach, the Basel Committee introduced parameters and formulas to determine PD, EAD, and LGD in an effort to reduce the variability of these measurements among banks. Although the proposed reforms

---

642 See BCBS Credit Reform, supra note 6, at 2.
643 Id.
645 BCBS Credit Reform, supra note 6, at 7–10.
do not eliminate the use of IRB approaches, the Basel Committee is considering the adoption of an “aggregate output floor, which could be calibrated in the range of 60% to 90%.” The output floor would operate as a minimum floor that banks would need to meet when calculating RWAs under a standardized approach. For example, if the output floor is 60 percent, a bank using the IRB approach to calculate credit risk RWAs cannot come up with a value that is below 60 percent of what the credit risk RWAs would be under the standardized approach. The percentage of the output floor has not yet been determined because a higher percentage floor and corresponding increased capital requirement must be balanced against the resulting decrease in lending by banks.

2. Market Risk

The Basel Committee’s proposed reforms to market risk are known as the Fundamental Review of the Trading Book (FRTB). The financial crisis revealed that banks were engaging in arbitrage by placing capital in the banking book instead of the trading book. Assets on the banking book are held to maturity whereas assets in the trading book are regularly traded. Because market risk charges are higher for trading book assets, arbitrage occurred when banks placed assets in the banking book. The FRTB attempts to resolve this issue of arbitrage by drawing a more distinct boundary between the trading and banking books. Under FRTB, more assets will be placed in the

---

646 Id. at 2.
647 Id. at 1.
648 See id.
649 BCBS Market Risk, supra note 47 (detailing the proposals that constitute the Fundamental Review of the Trading Book).
650 Id. at 1, 3–4.
651 See id. at 7.
652 See id. at 10.
653 Id. at 7–8 (“The following instruments must be assigned to the banking book, unless specifically provided otherwise in this framework: (a) unlisted equities; (b) instrument designated for securitisation warehousing; (c) real estate holdings; (d) retail and SME credit; (e) equity investments in a fund, including but not limited to hedge funds, in which the bank cannot look through the fund daily or where the bank cannot obtain daily real prices for its equity investment in the fund; (f) derivative instruments that have the above instrument types as underlying assets; or (g) instruments held for the purpose of hedging a particular risk of a position in the types of instrument above.”).
trading book, as the Basel Committee provided a list of instruments that are presumed to be in the trading book.\textsuperscript{654}

In addition, the FRTB proposal encourages banks to adopt a standardized approach to calculating market risk instead of an internal model approach.\textsuperscript{655} Internal model approaches would no longer use VaR models to calculate market risk.\textsuperscript{656} Instead, banks must use an Expected Shortfall measure that better captures tail risk, the risk that an asset moves more than three standard deviations from its current price.\textsuperscript{657} Further, all internal model approaches must undergo Profit and Loss (P&L) attribution testing to ensure the model captures the material drivers of actual P&L and backtesting to determine how well the risks in the internal model are captured.\textsuperscript{658} The result of these changes to the internal model approach under FRTB is to encourage banks to use a standardized approach for calculating market risk.\textsuperscript{659}

3. Operational Risk

Since Basel II, banks have used the advanced measurement approach (AMA) to calculate operational risk.\textsuperscript{660} The AMA allows banks to rely entirely on their own models, subject to regulatory approval, when determining how much capital to hold for operational risk events.\textsuperscript{661} Because there has been significant variation between banks with similar portfolios, the Basel Committee’s proposal prohibits the use of the AMA approach.\textsuperscript{662} Instead, banks would be required to use a standardized measurement approach (SMA) to

\textsuperscript{654} Id. at 7 (“Any instrument a bank holds for one or more of the following purposes must be designated as a trading book instrument: (a) short-term resale; (b) profiting from short-term price movements; (c) locking in arbitrage profits; (d) hedging risks that arise from instruments meeting criteria (a), (b) or (c) above.”).

\textsuperscript{655} Id. at 13.

\textsuperscript{656} Id. at 1.

\textsuperscript{657} Id. at 53.

\textsuperscript{658} Id. at 52.

\textsuperscript{659} See id. at 14.

\textsuperscript{660} BCBS OPERATIONAL RISK, supra note 47, at 1.

\textsuperscript{661} See id.

\textsuperscript{662} Id. (“The inherent complexity of the AMA and the lack of comparability arising from a wide range of internal modeling practice have exacerbated variability in risk-weighted asset calculations . . . . The Committee has therefore determined that the withdrawal of internal modelling approaches for operational risk regulatory capital from the Basel Framework is warranted.”).
calculate operational risk,\textsuperscript{663} which uses a combination of financial statement information and banks’ internal loss experience to calculate operational risk.\textsuperscript{664} The SMA reflects the past operational losses of a particular bank as a proxy for future operational capital needs.\textsuperscript{665}

C. U.S. Reaction to Basel III Proposals

1. Credit Risk

Under the Obama administration, the U.S. regulatory representative to the Basel Committee’s Group of Governors and Heads of Supervision, the Federal Reserve, strongly supported the proposed Basel III reforms to credit risk.\textsuperscript{666} Daniel Tarullo, who resigned from the Federal Reserve System’s Board of Governors in April 2017, supported the credit risk reforms to place constraints on IRB models and to implement an output floor.\textsuperscript{667} With his departure from the Board of Governors and President Trump’s pending appointment of three individuals to the seven-member body, however, it is uncertain whether the Federal Reserve will continue to push for more stringent regulation of credit risk.\textsuperscript{668} Given President Trump’s general deregulatory outlook on Dodd-Frank and banking regulations,

\textsuperscript{663} Id. at 3.
\textsuperscript{664} Id.
\textsuperscript{665} See id.
\textsuperscript{667} See Tarullo, \textit{supra} note 7, at 15 (“But, in light of all that has happened in the last decade, I see little reason to maintain the requirements of the IRB approach for our largest banks.”); John Kehoe, Opinion, \textit{Donald Trump Can Shake Up Global Banking}, \textit{Australian Fin. Rev.} (Feb. 13, 2017), http://www.afr.com/opinion/columnists/donald-trump-can-shake-up-global-banking-20170212-gub9d0 [https://perma.cc/MSJ5-6HU2] (“Under Tarullo, the US is pushing for a capital floor that is at least 75 per cent of the standard approach.”).
it would not be surprising if his appointments to the Federal Reserve oppose the current proposals on credit risk.669

For U.S. banks, the impact of the proposed reforms to credit risk under Basel III would not be significant.670 First, U.S. banks with under $250 billion in assets already use a standardized approach to calculate credit risk, and thus would not be impacted by the removal of IRB approaches.671 For those U.S. banks with assets over $250 billion that use an IRB approach for credit risk, the proposals would not be a significant change,672 because U.S. banks that use an IRB approach are already subject to additional credit risk capital requirements under the Collins Amendment to the Dodd-Frank Act “that are more stringent than the [Basel Committee’s] proposal’s restrictions on the use of internal models.”673 Under the Collins Amendment,674 U.S. banks must calculate credit RWAs under both the IRB and standardized approach and are bound by the approach that yields a higher value for RWAs.675 Thus, U.S. banks are already subject to an output floor of 100 percent of RWAs.676 Therefore, the Basel III proposed reforms would help “narrow the gap between US and non-US banking entities” so that U.S. banks are not at such a competitive disadvantage.677

669 See Hamilton & Schmidt, supra note 74 (“On the campaign trail, Trump frequently argued that government red tape was stifling the economy, and his official transition website says the incoming administration wants to dismantle Dodd-Frank.”).


672 Ryan et al., supra note 77.

673 Id.

674 See 12 U.S.C. §5371(b)(2) (2012) (“[T]he minimum risk-based capital requirements established under this paragraph shall not be less than the generally applicable risk-based capital requirements, which shall serve as a floor for any capital requirements that the agency may require, nor quantitatively lower than the generally applicable risk-based capital requirements that were in effect for insured depository institutions as of July 21, 2010.”).

675 See id.

676 Ryan et al., supra note 77.

677 Id.
2. Market Risk

The FRTB proposals to place more instruments on the trading book and to restrict and tighten the internal models for calculating market risk would affect U.S. banks. An interim quantitative impact study (QIS) from the Basel Committee on the FRTB revealed that the average increase in the total market risk capital requirement would be 41 percent, which would increase the overall Basel III minimum capital requirements for banks by 4.7 percent. In addition to the extra capital that may be required under the FRTB proposal, the P&L attribution testing and backtesting may lead to additional compliance costs in the short term for banks that use an internal model approach.

3. Operational Risk

The proposal to replace the AMA approach with the SMA approach will likely have a minimal impact on U.S. banks, although the extent of the impact remains unknown until the Basel Committee’s QIS is finalized. Most large U.S. banks that use an AMA approach measure operational risk using a loss distribution approach that is similar to the proposed SMA. Under the loss distribution approach, banks quantify the frequency and severity of operational risk losses for each business line or event type over a one-year horizon. On average, the five largest U.S. banks report operational risk at 28 percent of RWAs, which is considerably higher than similarly situated

---

680 Id. at 2.
681 See Deloitte, supra note 85, at 12.
683 See Lyons et al., supra note 48, at 3.
European banks that report operational risk at 12 percent of RWAs. Thus, the SMA change for operational risk will likely have a greater impact on non-U.S. banks that rely more on scenario-based models to calculate operational risk than U.S. banks that use the loss distribution approach.

**D. Reaching Consensus on Basel III’s Proposed Reforms**

1. **European Resistance**

European banks and regulators have been most critical of the proposed reforms to Basel III. Since European banks are heavily dependent upon IRB approaches for credit, market, and operational risk, movement towards standardized approaches will require them to hold more capital. One study estimates that European banks in aggregate will need to hold an additional €860 million in capital. One important structural difference between the United States and Europe is the ability of U.S. banks to securitize mortgages and off-load them to government agencies such as Fannie Mae and Freddie Mac. Since European banks must retain mortgages, this greatly increases the size of their RWAs under a standardized approach. Further, Europe’s economy is far more dependent on banks for financing than

---

685 Lyons et al., supra note 48, at 3.
686 See id.
688 See id. (explaining how major European banks such as HSBC, Deutsche Bank, Societe General, and Credit Agricole rely on IRB approaches).
689 Lyons et al., supra note 48, at 2.
690 Id. at 3; Frédéric Oudéa, *New Basel Banking Rules’ Impact on European Economy*, Fin. Times (Nov. 28, 2016), https://www.ft.com/content/6b2642b4-b54d-11e6-961e-a1acd97f622d [https://perma.cc/DYM9-QHK2].
691 Oudéa, supra note 97 (“[F]avourable weights for well-rated and well-secured credits have encouraged EU banks to keep these [residential mortgage] loans on their balance sheets.”); Lyons et al., supra note 48, at 3 (“European banks tend to retain mortgages originated by them . . . .”).
the U.S. economy. For example, banks in Europe account for 70 percent of financing for businesses while banks in the U.S. account for 30 percent. The increased capital requirements would impede the ability of European banks to lend to businesses and therefore have a much bigger macroeconomic impact than in the United States where capital markets supply funding and loans for businesses. The European Union will not implement any of the Committee’s final rules according to European Commission Vice President Vladis Dombrovskis, because “when [Europe is] focused on supporting investment, [Europe] want[s] to avoid changes which would lead to a significant increase in the overall capital requirements shouldered by Europe’s banking sector.”

2. Consensus and Trump’s Impact

The Basel Committee has put its proposals to strengthen credit, market, and operational risk requirements on hold until 2019, and the results of the Basel Committee’s QIS for proposed revisions to credit and operational risk have yet to be released. The United States and Europe are having difficulty reaching consensus on the proposed output floor for credit risk. U.S. regulators have lobbied for a high output floor so that it has a meaningful impact, while Europe has lobbied for either a low output floor or no floor at all. The election of President Trump further complicates the ability to reach a consensus.

---

692 See Lyons et al., supra note 48, at 3 (“[I]n the European Union SMEs are more reliant upon bank funding compared to the United States, where there is better access to capital markets to provide debt financing.”).

693 Id.

694 Brush, supra note 94 (“A solution we could not support is one which would weigh unduly on the financing of the broader economy in Europe[].”) (internal quotes omitted).

695 Id.

696 Binham, supra note 12.

697 Reiners, supra note 42.

698 Caroline Binham & Emma Dunkley, Basel Postpones Banks Reform Vote Amid Policy Differences, FIN. TIMES (Jan. 3, 2017), https://www.ft.com/content/589f1ce0-d1a1-11e6-9341-7393bb2e1b51 [https://perma.cc/PJ9B-D979].

699 See id. (“The US has pushed for output floors but European banks—and recently, some policymakers—have argued the measure will force some banks to significantly increase their capital at a time when they are already subject to headwinds such as historically low interest rates and low profitability.”).
consensus. The Vice Chairman of the Financial Services Committee has instructed the Federal Reserve to halt all negotiations on Basel III until the new administration provides guidance.

The new Trump administration will either continue or cease U.S. support for the Basel III reforms. President Trump’s administration may continue U.S. support for the Basel III reforms, especially if Thomas Hoenig replaces Tarullo as the Head of Supervision on the Federal Reserve. Janet Yellen, the Chairman of the Federal Reserve until January 2018, will likely exert her influence to support the Basel III reforms regardless of who replaces Tarullo. Further, the Trump administration may support the Basel III reforms to bring about competitive equality between U.S. and non-U.S. banks. Since U.S. banks are already subject to more stringent capital requirements under Dodd-Frank, supporting the Basel III reforms would require non-U.S. banks to be held to similar standards.

On the other hand, the Trump administration may effectively cease support for Basel III reforms. First, Trump will influence the Federal Reserve System’s Board of Governors with three new appointments. Large U.S. banks are hopeful that the new Federal

---

700 Id.
703 See Kehoe, supra note 74.
704 Hamilton & Schmidt, supra note 73.
705 Id. (“While the Fed supervision chief would likely be a key role for regulating banks under Trump, the job still doesn’t carry the clout that Janet Yellen wields as chairman. So if Trump’s vice chairman tried to weaken Dodd-Frank, the official could face a tough first year should Yellen fulfill her promise to stick around until January 2018.”).
706 See Ryan et al., supra note 77.
707 See id.
709 See Appelbaum, supra note 75 (addressing Republican pressure for Trump
Reserve of Supervision will not share Tarullo’s views in imposing strict capital requirements on banks.\textsuperscript{710} Second, the Trump administration may support efforts of Republicans in Congress to withdraw from international banking agreements in favor of national regulation.\textsuperscript{711} Gary Cohn, Trump’s chief economic advisor, supports this sentiment that international competition through national regulation is better than international cooperation.\textsuperscript{712} Thus, even if the Federal Reserve supports and implements the proposed Basel III reforms, these efforts could be undermined by new legislation in the United States.\textsuperscript{713}

For example, Republicans’ Financial CHOICE Act proposes for making significant changes to Dodd-Frank.\textsuperscript{714} If enacted in its current state, the Financial CHOICE Act creates an “off-ramp” for banks to exempt them from all Basel III regulations.\textsuperscript{715} Under the Financial CHOICE Act, banks would need to have a one or two Capital adequacy, Asset quality, Management, Earnings, and Liquidity score (CAMELS) and a Tier 1 leverage ratio that exceeds 10 percent to be exempted from Basel III regulations.\textsuperscript{716} The eight largest U.S. banks do not currently have a leverage ratio in excess of 10 percent, and the average is approximately 5.75 percent.\textsuperscript{717} Unless these banks are effective at lobbying to change the proposed legislation, they would not be able to take advantage of the Basel III exemptions without to fill the vacant seats on the Federal Reserve Board of Governors with individuals supportive of deregulatory efforts and lower capital standards).

\textsuperscript{710} See Hamilton & Schmidt, supra note 73.

\textsuperscript{711} See McHenry, supra note 108 (emphasizing the importance of placing a higher value on America’s self-interests than “secretive” international agreements among “global bureaucrats”).


\textsuperscript{713} See DELOIOTTE, supra note 85, at 12.


\textsuperscript{715} Id.

\textsuperscript{716} See DELOIOTTE, supra note 85, at 12.

\textsuperscript{717} The Economist, supra note 115.
acquiring additional capital.\textsuperscript{718} Thus, a retreat from Basel to national solutions will still place strict capital requirements on U.S. banks.\textsuperscript{719}

E. Conclusion

During the financial crisis and beyond, banks under the Basel III regulatory framework used IRB models to calculate RWAs to their own advantage.\textsuperscript{720} In an effort to thwart the use of IRB models, the Basel Committee released proposals to encourage the use of standardized approaches and to greatly restrict the use of IRB models for calculating credit, market, and operational risks.\textsuperscript{721} While U.S. banks would not be severely impacted by these proposals, European banks will likely struggle to implement the new proposals due to additional capital requirements.\textsuperscript{722} President Trump and a Republican-controlled Congress leave the future uncertain for further Basel III reform implementation.\textsuperscript{723} The United States could continue to support the proposed Basel III reforms so that European banks are held to higher capital standards,\textsuperscript{724} or the United States could effectively abandon its commitment to the Basel III reforms with legislation exempting qualified large U.S. banks from Basel III requirements.\textsuperscript{725} Still, even under this second scenario, U.S. banks will likely be subject to high leverage ratios and capital requirements.\textsuperscript{726}

Steven Brouillard\textsuperscript{727}


\textsuperscript{719} Id.


\textsuperscript{721} See discussion supra Section B.

\textsuperscript{722} Lyons et al., supra note 48, at 2–3.

\textsuperscript{723} See Kehoe, supra note 74.

\textsuperscript{724} See Ryan et al., supra note 77.

\textsuperscript{725} See Deloitte, supra note 85, at 12.

\textsuperscript{726} See Onaran, supra note 125.

\textsuperscript{727} Student, Boston University School of Law (J.D. 2018).