July 13, 2022

TO: Honorable Michael S. Barr
Vice Chair for Supervision
Board of Governors of the Federal Reserve System

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Re: An Agenda for Supervision and Regulation

After four years of dangerous deregulations during the Trump administration[1] and the weaknesses in the financial system revealed by the 2020 pandemic-caused market and economic stress (2020 pandemic), it is imperative that banking regulation and supervision be materially strengthened. Adding to this urgency, the bank and nonbank too-big-to-fail (TBTF) problem targeted by the Dodd-Frank Act and other post-2008 global financial crisis (2008 Crash) banking reforms is not only alive and well, but is growing larger, more dangerous, and harder to address.[2]

Those challenges should be addressed by:

1) performing a comprehensive, all-inclusive review of: the post-crisis reforms, the deregulatory actions that affected them, and the current and emerging threats to the

[1] *See* Better Markets white paper, Tim Clark and Dennis Kelleher, *Federal Reserve Actions Under the Trump Administration Have Significantly Weakened Post-Crisis Banking Protection Rules* (December 3, 2020), https://bettermarkets.org/wp-content/uploads/2021/07/Better_Markets_WhitePaper_Fed_Actions_Under_Trump_Administration_12-03-2020_0.pdf

[2] *See* Better Markets report, Dennis Kelleher and Phillip Basil, *The Increasing Dangers of the Unregulated "Shadow Banking" Financial Sector* (March 24, 2022), https://bettermarkets.org/wp-content/uploads/2022/03/BetterMarkets_Report_Dangers_of_the_Shadow_Banking_System_March2022.pdf; *see also* Dennis Kelleher and Phillip Basil, *Fed shouldn't have to remind large banks about managing obvious risks,* American Banker (March 11, 2022), https://www.americanbanker.com/opinion/fed-shouldnt-have-to-remind-large-banks-about-managing-obvious-risks; Michael J. Hsu, *Financial Stability and Large Bank Resolvability,* Office of the Comptroller of the Currency (April 1, 2022), https://www.occ.gov/news-issuances/speeches/2022/pub-speech-2022-33.pdf; Dennis Kelleher, The Too Big to Fail Problem is Alive, Well and Getting Worse, FSB Presentation (Sept. 16, 2019), https://www.bettermarkets.org/sites/default/files/documents/Better_Markets_Too-Big-To-Fail_FSB_Conference-9-16-2019.pdf.

banking system – including those from the nonbank financial sector that were highlighted by the 2020 pandemic and recently reiterated in the May 2022 report on supervision and regulation;[3]

2) reducing the likelihood of large bank failure through the strengthening of capital and liquidity standards;
3) enhancing requirements around bank resolution preparedness so large banks can be shut down and/or be taken apart and sold off piece-by-piece more easily in the event they do fail;
4) assessing emerging risks and putting in place supervisory programs and regulations that address those risks;
5) refocusing supervisory efforts to prioritize safety, soundness and financial stability rather than "efficiency"; and
6) strengthening incentives for appropriate conduct by those responsible for the largest banks.

These action items are not sequential and must be pursued simultaneously and rapidly, particularly given the dramatically changing circumstances of the financial system and the ongoing policy changes.

This memo outlines an agenda of priorities that should be pursued by the Vice Chair for Supervision to address the challenges noted above and secure a safer financial system that supports the productive economy for the benefit of all Americans.

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[3] Board of Governors of the Federal Reserve System, *Supervision and Regulation Report* (May 6, 2022), https://www.federalreserve.gov/publications/files/202205-supervision-and-regulation-report.pdf.

Performing an All-Inclusive Review

The 2020 pandemic and the Federal Reserve's actions in response can be thought of as the foundation of and motivation for the agenda for the Vice Chair for Supervision. That's because the pandemic was a live stress test of the post-Dodd Frank financial architecture, and it highlighted and exposed existing weaknesses in both the banking sector and the nonbank "shadow banking" financial sector.[4] The result was that the Federal Reserve had to provide unprecedented support to large banks by:

- directly providing banks with much-needed liquidity at the onset of the pandemic-induced market stress through the Federal Reserve's emergency facilities;
- indirectly supporting bank capital levels and earnings through Federal Reserve actions to support the markets and the economy including the Treasury and MBS purchases and emergency facilities; and
- directly providing capital relief through the temporary change to the calculation of the supplementary leverage ratio.

The Federal Reserve also supported financial markets and the financial system by:

- purchasing over $4 trillion in U.S. Treasury securities and mortgage-backed securities;
- conducting massive repurchase agreement operations; and
- creating and implementing numerous emergency facilities that backstopped markets for asset backed securities, commercial paper, and even corporate debt as well as backstopped the operations of money market funds and primary dealers.

Given the tremendous uncertainty during the 2020 pandemic, and the rapid and severe way in which financial markets were deteriorating and thereby threatening the economy, the Federal Reserve was left with little choice but to err on the side of doing too much rather than too little (which isn't to suggest we agree with all that it did). Combined with the tremendous fiscal support provided by the government, the Federal Reserve's massive and widespread support for financial markets also served as a backdoor bailout for large banks and other financial firms,[5] protecting them from what may otherwise have been disastrous deterioration.

While some have argued that the ostensible strength of the banking system throughout the pandemic is evidence of banks' robust financial condition and the sufficiency of the regulatory regime, such an argument ignores the trillions of dollars of essential support provided by the Federal Reserve, as well as by taxpayers through fiscal measures. That isn't to say that the banks didn't enter the 2020 pandemic from a position of strength, particularly relative to the perilous state the banks were in prior to the 2008 Crash.[6] However, the strength heading into the 2020 pandemic was in significant part from regulators'

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[4] *See* Better Markets report, Dennis Kelleher and Phillip Basil, *The Increasing Dangers of the Unregulated "Shadow Banking" Financial Sector* (March 24, 2022), https://bettermarkets.org/wp-content/uploads/2022/03/BetterMarkets_Report_Dangers_of_the_Shadow_Banking_System_March2022.pdf

[5] Bill Dudley, *Federal Reserve's Coronavirus Rescues Invite Bigger Bailouts* (June 5, 2020), Bloomberg, https://www.bloomberg.com/opinion/articles/2020-06-05/federal-reserve-s-coronavirus-rescues-invite-bigger-bailouts?sref=mQvUqJZj.

[6] Given that was a time when the banks were at their lowest levels of resilience since the Great Crash of 1929, that, of course, cannot be the standard by which the sufficiency of resilience is measured today. *See* Better Markets

aggressive efforts to require banks to increase their capital and liquidity levels and their resiliency more broadly. Regardless, the swiftness and magnitude of the 2020 pandemic would have easily overwhelmed those strengths, while exposing weaknesses in the banking and nonbank financial sectors.

Of course, given the unexpected and unprecedented 2020 pandemic, some level of support, likely quite substantial, would have been necessary in any event. However, the need appears to have been greater than it otherwise might have been if sufficiently robust and effective regulations were in place across the financial sector, an issue that was compounded by the deregulation of the prior several years. The fact that the short-term money markets and the nonbank financial sector required nearly identical bailouts and rescues as in the 2008 Crash would seem to provide significant support for such a conclusion. Indeed, many of the Fed's programs were just pulled off the shelf from actions they took in 2008, which alone should be cause for very serious concern regardless of precipitating causation. Not only that, in the 2020 pandemic a facility was added to support the corporate bond market, showing that issues in the nonbank financial sector have only grown since the 2008 Crash. Additionally, the Federal Reserve felt compelled to provide the largest banks with regulatory relief, particularly capital relief though the supplementary leverage ratio, as the risks from the nonbank financial sector spilled over into and posed a systemic threat to the banking sector.

That is why now is the time to undertake a thorough review of the unprecedented Federal Reserve support and the continuing weaknesses in the financial system that put financial markets and the Federal Reserve in such a precarious position. The Federal Reserve is the institution that is charged with maintaining financial stability and structured to do so quickly and overwhelmingly when needed by flooding the financial system with liquidity at the first sign of trouble as well as ensuring the safety and soundness of the banking sector. Therefore, it should be the agency in the lead in assessing what material issues have been exposed by this experience and what needs to be done to address them. This is the first step to ensuring that the banks and financial system do not require such massive Federal Reserve and taxpayer support in the next downturn regardless of causation.

For example, weaknesses in the regulatory regime for nonbank financial institutions exacerbated the level of stress in the financial system and put pressure on the banking sector during both the 2008 Crash and the 2020 pandemic. These increased stress levels required a response from the Federal Reserve that was more substantial, and in the case of the pandemic much broader, than would have been the case if those weaknesses had not existed.

This amplification and exacerbation of stress that comes from the non-bank financial sector and the massive support required to address it increases the resulting effects on the lives of all Americans, especially low-income and economically marginalized Americans. It increases the likelihood of making recessions deeper and longer when exacerbated financial stress becomes exacerbated economic stress,[7]

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presentation, Dennis Kelleher, *The Too Big to Fail Problem Is Alive, Well and Getting Worse* (September 16, 2019), https://www.bettermarkets.org/sites/default/files/documents/Better_Markets_Too-Big-To-Fail_FSB_Conference-9-16-2019.pdf.

[7] *See* Jonathan Bridges, Georgina Green and Mark Joy. "Credit, Crises and Inequality." *Bank of England* Staff Working Paper No. 949 (November 2021). https://www.bankofengland.co.uk/-/media/boe/files/working-paper/2021/credit-crises-and-inequality.pdf?la=en&hash=9FC00E0CEA234D1E2C7C34A589A64183294F8FD6

and it contributes to inflated asset prices that can increase wealth gaps when the Federal Reserve has to take more substantial market-supporting actions than it otherwise would have to.[8]

Many of the issues that should be covered in such an assessment are discussed in more detail below, but the report should seek to answer the following questions:

- Why did so many parts of the financial system shut down so quickly or experience disruptive panic (i.e., short-term funding, treasury markets, corporate bonds, etc.), and what specific problems in the system were exposed?
- What might have happened had the same scale of support not been provided, including an analysis of the impact of that on the banking sector and funding markets?
- What have been the effects of the scale and scope of the facilities and open market operations on financial markets and the economy, especially considering the now-greater expectations that the Federal Reserve will always stand behind financial markets (i.e., increased moral hazard)?
- What needs to be done to make the system more resilient and reduce the need for and scope of taxpayer-supported government intervention every time there is a significant problem facing the financial sector and the banks?

The Federal Reserve Bank of New York published a set of research articles regarding each of the 2020 pandemic facilities that describe the market conditions that resulted in standing up the facilities, the purpose and design of the facilities, and their immediate effects on each of the markets they were designed to support.[9] However, these research articles fail to fully address the issues that led to the heightened market stress, providing only little detail around the issues and offering almost no possible solutions. Also, they do not address the broader impacts and implications of the facilities, only focusing on their immediate effects.

A comprehensive analysis and ultimately a public report is required to provide the information, analysis, and perspective necessary to map out much needed solutions. It also will provide long overdue transparency that the American people deserve regarding the deployment of trillions of dollars.

Issues Affecting the Safety and Soundness of Banks and Bank Holding Companies

Too-Big-To-Fail Must Be More Fully Addressed

While progress was made by the post-2008 Crash reforms, the challenges of TBTF were never fully addressed even though that was an explicit goal of the Dodd-Frank Act. Given the incompleteness of these efforts, the deregulatory actions of the last four years, and a variety of emerging risks (e.g., growing importance of non-bank financial institutions, climate change-related risks, etc.), addressing TBTF challenges has only become more difficult. The potential consequences of the failure of a large

[8] Batty, Michael, Ella Deeken, and Alice Henriques Volz (2021). "Wealth Inequality and COVID-19: Evidence from the Distributional Financial Accounts," FEDS Notes. Washington: Board of Governors of the Federal Reserve System, August 30, 2021, https://doi.org/10.17016/2380-7172.2980.

[9] The complete set of research articles were published by the Federal Reserve Bank of New York in a special release of its *Economic Policy Review* journal in June 2022. *See* Federal Reserve Bank of New York, *Economic Policy Review* 28, no. 1 (June 2022). https://www.newyorkfed.org/research/epr/index.html#2022.

bank continue to be devastating to the entire economy,[10] which is why banks were directly bailed out in 2008, and likely would have had to be again in 2020 if not for the trillions of dollars of economic and market support provided by the Federal Reserve and the U.S. government to address the 2020 pandemic.

Because of the size, complexity, interconnectedness, and provision of essential financial services of TBTF firms, their failure would almost certainly result in economic catastrophe, and stopping that would require gigantic taxpayer-backed bailouts as they have in the past. That is why it remains essential to minimize to the greatest extent possible the TBTF problem. This involves increasing the likelihood that large banks won't fail, or, if they do, that their failure can be handled in a non-disruptive way with as little contagion as possible. Making each of these goals more likely can be achieved by:

> (1) strengthening capital and liquidity standards and supporting them with assertive banking supervision that leads to meaningful negative consequences for banks when they are being dangerously or poorly run; and
>
> (2) enhancing requirements around bank resolution preparedness so large banks can be shut down and/or be taken apart and sold off piece-by-piece more easily in the event they do fail.

Reducing the Likelihood of Failure through Strengthening Capital and Liquidity Standards

As Better Markets has said many times before, the only thing standing between a bank in financial distress and a taxpayer bailout is the quality and size of the capital cushion available to absorb losses. Additionally, inadequate liquidity can serve as an accelerant towards failure in times of stress, rapidly exacerbating the deterioration of a bank's financial condition.

The strengthening of capital and liquidity regulation and supervision was foundational to post-2008 Crash reforms, reducing the likelihood of failure and increasing market and consumer confidence in individual banks, which allows them to continue operations and better serve consumers and clients in periods of stress. These requirements were weakened under the Trump administration and must be re-strengthened. But in this process, the goal is not simply to be better than the failed capital regime that existed before the 2008 Crash. It should be to further increase confidence that the very largest banks can survive difficult periods without needing taxpayer funded support by strengthening capital requirements beyond the post-2008 Crash reforms.

Further increasing confidence that the largest banks can survive severe stress without any kind of direct or indirect taxpayer-funded support is the appropriate objective in the public interest. And despite industry arguments that higher capital requirements lead to a higher cost and lower availability of

[10] This is, of course, also true for the failure of a systemically significant nonbank, but that is beyond the scope of this memo. However, it should not be beyond the scope of the Federal Reserve and the Vice Chair for Supervision given the financial stability mandate and the inevitable spillover effects from nonbanks to banks. *See* Board of Governors of the Federal Reserve System, *Supervision and Regulation Report* (May 6, 2022), https://www.federalreserve.gov/publications/files/202205-supervision-and-regulation-report.pdf.

credit, strong requirements in fact have the effect of making these banks more resilient and financially stronger, which reduces the cost and increases the availability of funding for them.[11]

Capital requirements determined through the supervisory stress test and implemented through the stress capital buffer (SCB) must be strengthened and made more dynamic.[12] Two key elements that had made the pre-Trump era version of the stress test effective and meaningful must be reinstated:

> (1) the assumption that banks will make all planned capital distributions over the full nine quarter stress test timeframe, rather than the current assumption they will only payout four quarters of dividends and will suspend all stock buybacks, and
>
> (2) the assumption that banks' balance sheets can grow under stress.

These changes would help increase the likelihood that banks have sufficient capital to withstand severe unexpected stress that could come at any time[13] and would align with the observed reality that balance sheets can grow tremendously during stress, as they did during the 2020 pandemic for many large banks. In fact, the balance sheets of the six largest banks grew by an aggregate 23% between the end of 2019 and the first quarter of 2021. These assumptions should be reinstated no later than for next year's stress test.

Complementing those assumptions, the "stress" in the test must be restored and the scenarios used should be made more dynamic to capture varying salient and emerging risks. Based on recent results, the stress test and associated capital requirements have become too predictable for banks and not stressful enough.[14] Indeed, in 2021 many of the largest banks' capital requirements were not dictated by the stress test results at all but rather by the minimum 2.5 percent floor required in the SCB rule.[15] The result of insufficiently rigorous and increasingly less dynamic stress tests is to give the public a false sense of security that the largest banks are strong enough to withstand extreme stress when actually they are not. Compounding that, it also creates an unacceptably higher likelihood that TBTF banks will

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[11] Belkhir, Mohamed and Ben Naceur, Sami and Chami, Ralph and Samet, Anis, "Bank Capital and the Cost of Equity" (December 2019). IMF Working Paper No. 19/265, https://www.imf.org/en/Publications/WP/Issues/2019/12/04/Bank-Capital-and-the-Cost-of-Equity-48751

[12] *See* Better Markets fact sheet, *The Federal Reserve's 2021 Stress Test Results: All Bark and No Bite* (June 28, 2021), https://www.bettermarkets.org/sites/default/files/documents/BetterMarkets_Fed_Stress_Test_FactSheet_07-28-21.pdf.

[13] It has been shown that capital exceeding 10% of assets significantly reduces the probability of failure, whereas leverage ratios among the largest banks remain in the 6-7% range. *See* Barth, James R. and Stephen Matteo Miller. "Benefits and Costs of a Higher Bank 'Leverage Ratio'." *Journal of Financial Stability* vol. 38 (October 2018): 37-52. https://doi.org/10.1016/j.jfs.2018.07.001.

[14] *See* Better Markets press release by Phillip Basil, *The Federal Reserve's Latest Stress Capital Buffers Are Further Proof the Stress Tests Neither Stress nor Test the Biggest Banks* (August 9, 2021), https://bettermarkets.org/newsroom/federal-reserve-s-latest-stress-capital-buffers-are-further-proof-stress-tests-neither/.

[15] The stress capital buffer replaced the capital conservation buffer, which was a fixed 2.5 percentage point buffer to the common equity tier 1 capital requirement. That 2.5 percentage point amount serves as the floor to the stress capital buffer to ensure its associated capital requirement is at least the size of the capital conservation buffer.

fail under stress and have to get bailed out by taxpayers yet again. Starting next year, the scenarios must be more stressful, more dynamic, and more inclusive of any financial and economic complexities.

Additionally, a stress-based leverage requirement once again should be included among the stress-based capital requirements. While so-called risk-sensitive capital requirements are meant to serve as the primary binding constraint for banks, rather than leverage ratios, minimum leverage requirements based on the losses of the stress test also have the benefit of dynamic risk sensitivity on a bank-by-bank basis. Prior to its removal, the post-stress leverage requirement had at times resulted in the highest level of required capital for many large banks compared to the post-stress risk-based capital requirements that remain in place. Restoring a post-stress leverage requirement could be done relatively easily this year by re-proposing and finalizing the previously proposed -- but never finalized or implemented -- stress leverage buffer.

Outside of capital requirements related to the stress test, there are two items related to capital requirements on which the Federal Reserve currently is working that could have consequential impacts.

First, the reforms laid out by the Basel Committee on Banking Supervision (BCBS) to the Basel III capital framework (Basel III reforms) should be implemented in a way that emphasizes conservatism. With the Federal Reserve as the lead, the banking regulatory agencies should maintain or strengthen places in which the U.S. standards are currently more conservative than the BCBS Basel III reforms – at least for the largest, most systemically important institutions – unless there is compelling, well-supported rationale for doing otherwise. Conversely, BCBS Basel III reforms that lead to more conservative requirements, in particular for the so-called trading book, should be implemented or made more conservative as necessary. Work on the rulemaking may be well underway, and comments by the previous Vice Chair for Supervision suggest he may not have taken such a conservative approach when directing staff on his preferred implementation.[16] As such, work on this must begin immediately considering the proposal is scheduled to be issued by 2023.

Second, current and previous members of the Board have indicated that consideration is being given to adjusting the supplementary leverage ratio more permanently to account for the current high-reserve, high-Treasury-holdings environment in the banking system. This issue should be resolved only after an inclusive public discussion that maximizes the likelihood that intended and unintended consequences are identified and considered before action is taken. For example, former Vice Chair Quarles raised the potential concerns that "excluding only central bank reserves would exacerbate a structural preference for reserves over Treasuries in bank portfolios, which could have perverse consequences for the operation of the Treasury market" and "excluding both reserves and Treasuries could result in a significant lowering of capital levels and exacerbate the incentive for the banking system to prefer

[16] In his final speech as a Governor of the Federal Reserve Board, Randal Quarles cautioned against "excessively high capital levels [that] constrain the ability of the banking system to provide credit to the real economy" when implementing Basel III reforms and that policymakers must "determine whether adjustments to other parts of the capital framework are necessary to ensure that we do not unduly increase the level of required capital in the system." *See* Governor Randal K. Quarles, *Between the Hither and the Farther Shore: Thoughts on Unfinished Business* (December 2, 2021), Board of Governors of the Federal Reserve System. https://www.federalreserve.gov/newsevents/speech/quarles20211202a.htm.

funding the government to funding private enterprise."[17] The reported ongoing deliberations should be open for public consumption, feedback, and input as soon as possible.

As for liquidity requirements, the unnecessary weakening of liquidity requirements for large banks with between $250 and $700 billion in assets should be reversed.[18] The reduced liquidity requirements were based on unsupported claims of "tailoring" requirements to make them strongest for the banks designated as globally systemically important, but banks in the $250 to $700 billion size range are also systemically important (remember the size of Lehman Brothers when it imploded in 2008), and sufficient liquidity for them is necessary to prevent an accelerated decline into failure in times of stress. Since this largely would only require a reversal of the "tailoring" – i.e., once again making the liquidity requirements applicable as they were before – this modification to the rules could be proposed and finalized this year.[19]

During your nomination hearing with the Senate Committee on Banking, Housing, and Urban Affairs,[20] you stated that your approach on capital and liquidity would be to "look at capital and liquidity in the system, broadly speaking, to look at the [supplementary leverage ratio], to look at the Basel III so-called endgame rules that need to be proposed and…look at this as a whole rather than piece by piece." You also stated in that hearing that capital and liquidity in the banking system is "quite strong," which is similar to former Vice Chair Quarles' assessment that capital in the system is "more than ample"[21] and Chair Powell's statement that it is "about right."[22]

We strongly agree with your view regarding a wholistic approach, but caution that conclusions reached about the adequacy of capital levels in the banking system and capital requirements for banks of all sizes, especially the largest banks, must be supported by substantial evidence that is publicly disclosed in

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[17] Governor Randal K. Quarles, *Between the Hither and the Farther Shore: Thoughts on Unfinished Business* (December 2, 2021), Board of Governors of the Federal Reserve System, https://www.federalreserve.gov/newsevents/speech/quarles20211202a.htm.

[18] *See* statements by Governor Lael Brainard objecting to a reduction of the liquidity coverage ratio for banks with assets of $250 billion to $700 billion (available at https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20191010.htm) and a reduction of the net stable funding ratio for banks with assets of $250 billion to $700 billion and an outright elimination for almost all banks with assets between $100 to $250 billion (available at https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20201020a.htm).

[19] In addition, the Net Stable Funding Ratio liquidity regulation should be returned to its originally proposed form, prior to the exclusions, limitations, and other unnecessary modifications included in the final rule passed in the Trump era. *See* Better Markets comment letter to the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the Federal Deposit Insurance Corporation on the originally proposed net stable funding ratio (August 5, 2016), https://www.bettermarkets.org/sites/default/files/FDIC%20FRS%20OCC%20-%20CL%20-%20Net%20Stable%20Funding%20Ratio%20-%20(Searchabe%20Text%20Version)_0.pdf; *also see* Better Markets press release by Dennis Kelleher, *A Dangerous Trump-Era Banking Deregulation Becomes Effective Tomorrow* (June 30, 2021), https://bettermarkets.org/newsroom/dangerous-trump-era-banking-deregulation-becomes-effective-tomorrow/.

[20] *See* Senate Committee on Banking, Housing, and Urban Affairs nomination hearing on May 19, 2022, available at https://www.banking.senate.gov/hearings/05/12/2022/nomination-hearing.

[21] *Supra* note 16.

[22] *See* Senate Committee on Banking, Housing, and Urban Affairs hearing on July 15, 2021, available at https://www.banking.senate.gov/hearings/07/07/2021/the-semiannual-monetary-policy-report-to-the-congress

sufficient detail for independent analysis. That is, if levels of capital and liquidity are "quite strong," "more than ample," or "about right," the support for those opinions need to be publicly detailed and, as important, benchmarked in a granular and robust way. For example, "quite strong" relative to what? The benchmark cannot simply be to have capital in the system that is higher than existed before the 2008 Crash, which, of course, was when it was dangerously low and, therefore, any amounts above those deficient levels would be an improvement however inadequate.[23]

Any wholistic assessment of capital and liquidity should be a key part of the all-inclusive review discussed above and it must consider all the aspects that we highlight in this memo regarding the necessity for stronger capital requirements, including especially those related to the nonbank financial sector discussed in greater detail further below.

Enhancing Preparedness for Resolution in the Case of Large Bank Failure

Making large banks prepare for their possible resolution is critical to addressing the TBTF problem.[24] The submission of so-called "living wills" should return to a two-year cycle from the four to six-year cycle currently required under the weakened regulation. This would increase their relevancy. It is important to remember that in 2008 Bear Stearns was around $400 billion in assets when it required a Federal Reserve-brokered (and materially supported) fire sale and Lehman Brothers was around $640 billion at the time it collapsed. Had living wills been required for these firms, they would have been essentially useless if they were six years old as is provided for under the Federal Reserve's current rules for banks between $250 billion to $700 billion. This reversal of submission timing could be proposed this year.

Even more importantly, many of the Federal Reserve's resolution plan expectations – particularly those for certain capital and liquidity needs, as well as for simpler bank structure – should be made part of legally binding rules, rather than only being articulated through non-binding "supervisory guidance,"[25] as is currently the case.

That is, large banks should have to bear the costs associated with simplifying their possible resolution in advance by making them take actions now so that they can be more easily resolved should they fail. A

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[23] Similarly, the claims that the banking industry's performance during the 2020 pandemic purportedly proves that they are well capitalized ignores that facts that the Fed flooded the financial system with liquidity and reinstituted the panoply of rescue programs created in 2008. Indeed, the Fed's balance sheet grew by approximately $3 trillion in about 90 days, between March and June 2020. And, of course, the multiple multi-trillion fiscal actions also materially benefited the financial system and banks as did the regulatory relief provided by the Fed and the loan forbearance granted by Congress. Thus, while the banks may or may not have performed well during the 2020 pandemic (however measured), it says nothing about whether they were or were not well capitalized. *See*, Nick Timiraos, Trillion Dollar Triage (Little Brown) (2022); Christopher Leonard, The Lords of Easy Money (Simon & Schuster) (2022): Federal Reserve, Balance Sheet Trends, available at https://www.federalreserve.gov/monetarypolicy/bst_recenttrends.htm.

[24] *See* Better Markets policy brief by Dennis Kelleher and Frank Medina, *Ending Too-Big-to-Fail by Breathing Life into "Living Wills"* (January 2016), https://www.bettermarkets.org/sites/default/files/Breathing%20Life%20Into%20Living%20Wills_0.pdf.

[25] *See* Better Markets comment letter to Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, and Bureau of Consumer Financial Protection regarding the proposed rule to codify the role of supervisory guidance in the supervisory process (January 4, 2021), https://www.bettermarkets.org/sites/default/files/Better%20Markets%20Comment%20Letter%20on%20Notice%20of%20Proposed%20Rulemaking%20-%20Role%20of%20Supervisory%20Guidance.pdf.

key component of this would be clarifying through regulation any requirements for capital and liquidity. This could include requiring large banks to pre-capitalize and pre-fund certain material subsidiaries and affiliates rather than assuming capital and liquidity can be moved wherever needed during times of stress with no frictions. As proved during the 2008 Crash, in times of severe stress, capital and liquidity likely will not be able to be easily moved from one affiliate/ subsidiary to another, especially across jurisdictions. Given the importance of making large banks more resolvable, relying on supervisory guidance for these critical elements of resolution preparedness is not enough. A binding rules-based approach is needed, which could be developed and proposed by mid-2023.

Assertive Supervision Must Be Restored Along with Meaningful, Public Consequences

Assertive supervision is a necessary complement to strong regulations. It is critically important to assess risk management and governance processes at banks and to take supervisory actions to require banks to fix identified weaknesses in those processes. Unfortunately, public statements by the former Vice Chairman for Supervision—quoted by the Wall Street Journal in an article entitled "Banks Get Kinder, Gentler Treatment Under Trump: Regulators are asking examiners to adopt less aggressive tone when flagging risky practices"— reflected the exact wrong attitude for supervision:

> "Changing the supervision culture 'will be the least visible thing I do and it will be the most consequential thing I do,' … the Fed's vice chairman for supervision and regulatory point person said…"[26]

Such "kinder, gentler treatment" and a purported focus on efficiency rather than safety, soundness and financial stability appear to have resulted in serious risk management failures at the largest banks. This was proved by the Archegos fund explosion and subsequent supervisory examination of large banks' counterparty and derivatives activities, which resulted in an unprecedented public rebuke from the Fed to Wall Street's biggest firms. The fact that the Fed had to send a letter to "remind firms of the supervisory expectations" around what are basic, fundamental, and well-known risk management practices was a clear indication that the Fed found widespread deficiencies across a number of large banks and provides a strong case for more robust and assertive bank oversight.[27]

The effective elimination of the so-called "CCAR qualitative objection" to bank capital distributions also significantly weakened large bank supervision by getting rid of a meaningful negative consequence that could be used when large banks exhibited dangerously bad practices.[28] The ability to limit or prevent dividends and share buybacks directly and appropriately affected shareholders and thereby provided a strong incentive for boards of directors and senior management to prioritize risk management and governance practices, as evidenced by the early success of the CCAR program. This type of tool should be used more often not less, and its usage should be restored as soon as possible.

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[26] Lalita Clozel, *Banks Get Kinder, Gentler Treatment Under Trump* (Dec. 12, 2018), Wall Street Journal, https://www.wsj.com/articles/banks-get-kinder-gentler-treatment-under-trump-11544638267.

[27] Dennis Kelleher and Phillip Basil, *Fed shouldn't have to remind large banks about managing obvious risks,* American Banker (March 11, 2022), https://www.americanbanker.com/opinion/fed-shouldnt-have-to-remind-large-banks-about-managing-obvious-risks.

[28] *See* Tim P. Clark, *Is the Fed in Retreat?* (April 9, 2019), Politico, https://www.politico.com/agenda/story/2019/04/09/federal-reserve-stress-tests-banks-000889/.

More generally, formal enforcement actions, rather than the often-used informal enforcement actions, should be used more often. Formal, public enforcement actions – both for safety and soundness issues and for issues related to compliance with other rules and laws, including consumer protection rules – enhance transparency and provide incentives that support the effectiveness of bank supervision. Even where formal actions are not used, at a minimum more information should be publicly disclosed about the Federal Reserve's supervisory assessments of the largest banks. The use of more public enforcement actions for large banks with material problems should begin immediately, whereas the shift toward greater public disclosure of certain aspects of supervisory assessments of the largest banks could be phased in over a period of a couple years. That would provide strong incentives for banks to address current weaknesses now, before they are disclosed to the public.

The Federal Reserve's supervisory assessments should be expanded at the largest banks to include a greater explicit focus on the effectiveness of boards of directors. Boards of directors are ultimately responsible for ensuring banks have strong and effective management that works to prevent dangerous practices and comply with existing laws and rules. While proposed guidance from 2017 on the responsibilities of boards of directors[29] was quietly finalized last February (notably in a weaker form than was proposed), it suffers from the same issues as living wills of being too weak and reliant on non-binding guidance. Also, consideration should be given to requiring independent board chairs rather than allowing CEOs to also be board chairs. This is a glaring conflict of interest that, at best, weakens the ability of the board to fulfill its primary duty to hold senior management accountable. Further, an assessment of boards, or actions taken to hold ineffective boards accountable, should be made public in some form.

Risks to Financial Stability Must be More Fully Addressed in the Assessment of Bank Mergers

Decades of bank mergers have resulted in a banking system that is highly concentrated not only in size but also in business activities. Such concentration has resulted in a systemic risk posed by the largest banks that can cause significant damage to the financial system and the economy, as experienced in the 2008 Crash. Risk to the financial system can be posed by large banks even if they are not officially designated as being of global systemic importance, and it is necessary to recognize and address this in the assessment process of applications for bank mergers. Governor Lael Brainard recognized this issue in a statement made after her abstention from voting on the PNC acquisition of the U.S. operations of BBVA:

> "The increases in banking concentration in the $250 to $700 billion asset size category, where common-sense safeguards have been weakened, raise some concerns, and it might be helpful to undertake a broader review of our framework, since we know from experience even noncomplex banks in this size range can pose risk to the financial system when they encounter financial distress."[30]

[29] *See* Better Markets comment letter to the Board of Governors of the Federal Reserve System on their proposed guidance on supervisory expectation for boards of directors (February 15, 2018), https://bettermarkets.org/sites/default/files/FRS-%20CL-%20BoD%20Supervison%20Expectations%202-15-18.pdf.

[30] Governor Lael Brainard (May 14, 2021), *Statement on PNC/BBVA Application by Governor Lael Brainard*, Board of Governors of the Federal Reserve System, https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20210514.htm.

There has been an unending race to create ever-bigger banks. The Federal Reserve currently is considering two merger applications that would create the seventh and eighth largest bank holding companies.[31] These applications follow on from two merger approvals that created the ninth and tenth largest banks over the last three years.[32] Allowing this race to continue without appropriate consideration for financial stability would be a disservice to the American people.

A review of merger approval documentation for larger mergers that have been assessed by the Federal Reserve and the OCC shows that the financial stability/systemic risk review simply involves an analysis of the factors that are used to determine the score assigned to systemically important banks and an accompanying subjective determination. Even the subjective assessments lack the type of robust justification that would be expected for something as significant as stability of the U.S. financial system. A more robust analysis and assessment must be performed.[33]

First, for mergers that result in an institution above $250 billion, the agencies should require the submission of a combined resolution plan for the merged entity. Such a plan would provide great insight into the complexity of the merged entity and its operations and allow for a more involved and appropriate assessment of the implications of its failure. After all, that is exactly the purpose of the resolution plan requirements, and so a combined plan should be required to be submitted and utilized for assessment in the merger review process.

Second, for mergers that result in an institution above $250 billion, more analysis must be conducted to assess risk to financial stability other than simply utilizing the GSIB surcharge metrics. The Federal Reserve's Division of Financial Stability should conduct and provide a public assessment of the financial stability concerns the merged entity could raise on its own and in the context of the banking system and greater financial system. At the very least, an assessment should be conducted of the potential impact to funding markets that would be caused by serious distress or failure of the merged bank. Bear Stearns and Lehman Brothers would not have been classified as systemically important, but their distressed financial condition in the 2008 Crash significantly contributed to stress in short-term funding markets, which are critical to the functioning of the financial system.

Risks from the Nonbank Financial Sector

[31] U.S. Bancorp has applied to acquire MUFG Union Bank, which would result in a bank of $736 billion in total assets and the seventh largest bank holding company by current figures. Also, TD Group US Holdings has applied to acquire First Horizon Corporation, which would result in a bank of $613 billion in total assets and the eighth largest bank holding company by current figures.

[32] BB&T and SunTrust banks merged in 2019 (renamed Truist Financial) to become the tenth largest bank holding company at over $500 billion in assets. PNC Bank acquired the US operations of BBVA in 2021 to be the ninth largest bank holding company with around $560 billion in assets.

[33] *See* Better Markets comment letter to the Federal Deposit Insurance Corporation regarding the Request for Comment on Rules, Regulations, Guidance, and Statement of Policy on Bank Merger Transactions (May 31, 2022), https://bettermarkets.org/wp-content/uploads/2022/05/Better_Markets_Comment_Letter_Request_for_Comment_Bank_Merger_Transactions.pdf; *also see* Better Markets comment letter to the Department of Justice regarding the Request for Comment on Whether and How the Antitrust Division Should Revise the 1995 Bank Merger Competitive Review Guidelines (February 15, 2022), https://bettermarkets.org/wp-content/uploads/2022/02/Better-Markets-Comment-Letter-Bank-Merger-Guidelines.pdf.

The 2020 pandemic led to large-scale support from the Federal Reserve through non-traditional monetary policy actions and emergency facilities. As a result, the Federal Reserve's balance sheet has grown rapidly and massively, more than doubling since then, and the level of reserves in the banking system and liquidity in financial markets has increased significantly. The Vice Chair for Supervision should play a key role in the identification and management of any existing risks this currently poses for the banking system and any developing risks that unfold as the accommodative monetary policy and balance sheet are unwound.

For the long-term safety and soundness of the banking system and financial stability, there must be a focus on the risks within and from the nonbank financial sector, the effects of which were made very apparent during the 2020 pandemic-related market stress.[34] These risks must be studied and appropriate changes to the regulatory framework implemented to protect the banking system from spillover risks.

For example, in both the 2008 Crash and the 2020 pandemic short term money markets, and especially money market funds (MMFs), proved to be a source of fragility and material risk to financial markets and the banking system. Many MMFs are sponsored by large banks, and some have repeatedly provided their MMFs with funding and other critical support during periods of stress.[35] But large bank-sponsored MMFs – like non-bank-sponsored MMFs – are not required to hold sufficient levels of loss-absorbing capital. That has materially contributed to the MMF industry having to be bailed out both times, and this needs to change.[36]

Such issues also highlight that capital requirements for large banks should be higher and that the Federal Reserve should be rethinking its capital requirements more broadly. Risks from the nonbank financial sector should be studied as well as their implications for banks with respect to capital, liquidity, resolution planning, and other aspects of the regulatory framework. For example, bank lending to nonbank financial institutions has been growing for many years and is increasing in pace. Annual growth in such lending has increased from 8% in 2017 to 22% last year.[37] The share of these loans is also increasing across banks of all sizes – increasing to 8.4% of total loans last year from just 1% in 2010 for banks above $50 billion in assets but also to 4.2% from 0.5% for banks between $5 and $50 billion over the same time.[38] The work to study these linkages should begin as soon as teams can be assembled.

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[34] These risks were also highlighted in the Federal Reserve's May 2022 report on supervision and regulation. *See* Board of Governors of the Federal Reserve System, *Supervision and Regulation Report* (May 6, 2022), https://www.federalreserve.gov/publications/files/202205-supervision-and-regulation-report.pdf.

[35] *See* Tim McLaughlin, *Goldman injects $1 billion into own money-market funds after heavy withdrawals* (March 21, 2020), https://www.reuters.com/article/us-health-coronavirus-goldman-mny-mkt-ex/exclusive-goldman-injects-1-billion-into-own-money-market-funds-after-heavy-withdrawals-idUSKBN21810A; *also see* Richard Henderson and Robert Armstrong, *BNY Mellon steps in to support money market fund after outflows* (March 20, 2020), Financial Times, https://www.ft.com/content/8222c5a2-6ad3-11ea-800d-da70cff6e4d3.

[36] *See* Better Markets comment letter to the Securities and Exchange Commission regarding their recent proposed money market fund reforms (April 11, 2022), https://bettermarkets.org/wp-content/uploads/2022/04/Better_Markets_Comment_Letter_SEC_MMF_Reforms.pdf.

[37] *See* Board of Governors of the Federal Reserve System, *Supervision and Regulation Report* (May 6, 2022), https://www.federalreserve.gov/publications/files/202205-supervision-and-regulation-report.pdf.

[38] *See* Michael J. Hsu, *When the Tide Goes Out* (May 17, 2022), Office of the Comptroller of the Currency, https://occ.gov/news-issuances/speeches/2022/pub-speech-2022-54.pdf.

The regulatory agencies and the Financial Stability Oversight Council have discussed individual issues such as MMFs, hedge funds, and markets involving U.S. Treasury securities and implemented working groups for them. However, these issues are being discussed separately, whereas they should be studied in conjunction with each other to obtain an overall view of financial stability. In the study and design of solutions, the Vice Chair for Supervision should work with the Securities and Exchange Commission and any other relevant regulatory agencies to address identified issues related to the nonbank financial sector, particularly how they spill over into and affect the banking sector and how they can threaten financial stability.

Since the Federal Reserve is tasked with maintaining financial stability, it has the duty to study and address these issues directly through the banking system and indirectly by working with other agencies. Additionally, the Federal Reserve has the data access and expertise to thoroughly study these issues in collaboration with other agencies. Where there are data gaps, the Vice Chair for Supervision should work with the Office of Financial Research to obtain the necessary data as soon as possible.

Emerging Risks That Must be Addressed

In addition to more fully addressing the risks that have been the focus since the 2008 Crash, particularly as highlighted by the 2020 pandemic, the Federal Reserve must modify existing supervisory and regulatory frameworks, or even develop new frameworks, that are specific to multiple emerging risks.

Addressing banks' financial risks related to climate change must be a priority. The Federal Reserve should join the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) and begin the process of formally integrating climate risks into its supervisory assessment process. This includes integrating climate risks into its supervisory guidance, as the OCC and FDIC have proposed, but also into its formal assessment and ratings process. This is important to create appropriate incentives for banks to fully consider their climate-related risks and should be done immediately. Additionally, scenario analysis should be run by both the Federal Reserve and the banks themselves this year to understand where the U.S. banking system stands regarding climate risks, including against its global peers.

The ever-present and increasing risks related to cybersecurity also should be a priority. The number and scope of banking products and services available online has expanded significantly over the last several years and are being offered by banks of all sizes. This puts the finances and personal information of virtually every American at risk of cyber-attacks. The Federal Reserve – along with the OCC and FDIC – must be extremely vigilant in ensuring banks are executing timely reporting of cyber incidents and must be assertive in their supervisory reviews that relate to cyber security processes and procedures at banks, especially for the largest banks.

The rise of financial technology (FinTech) companies has altered the dynamics of the banking system and introduced competition that is broadly unregulated. And where some rules may constrain activities, FinTech companies often seek to partner with banks (or apply for their own bank charters) to avoid what may be more stringent regulations that are state-specific or include limiting thresholds. For example, FinTech companies have been partnering with smaller banks to offer debit cards, banks that are small enough to avoid the regulatory limit on debit card interchange fees, which could eventually

drive up interchange fees overall if such debit cards gain broader usage.[39] As individual FinTech companies partner with more and more banks, this also creates a new form of concentration risk where one FinTech's technology and processes are being used by many banks and the risk that once was spread among the many banks is now concentrated in the FinTech company.

The presence of these companies can provide benefits, such as increased access to financial products and services, but they also raise consumer protection issues as well as potentially create market distortions and increase systemic risk, including risks from cyber-attacks. For cases in which special purpose bank charters have been granted, access to Federal Reserve master accounts and financial services also can introduce risks to Reserve Banks, the payments system, and the execution of monetary policy.[40] The banking regulatory agencies, with the Federal Reserve as lead, must study the risks and market distortions arising from the growth in FinTech in a closely coordinated way and implement regulatory and supervisory frameworks targeted at such institutions – those with bank charters and those in partnerships with banks – to reduce potential risks and maximize potential benefits to hardworking Americans.

Additionally, the presence and materiality of cyrptocurrencies have been rapidly increasing, and the banking system must be sufficiently protected from the unique risks they could introduce.[41] The banking agencies should finalize the work they have begun to create a robust oversight framework that is appropriate to the unique risks posed by these assets.[42] As identified in the recent executive order enacted by President Biden,[43] this includes risks to consumers and, notably, financial stability.[44] Capital requirements must also be considered given the likely event that cryptocurrencies eventually end up on

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[39] *See* Better Markets comment letter to the Board of Governors of the Federal Reserve System regarding their proposal to amend Regulation II (August 11, 2021), https://www.bettermarkets.org/sites/default/files/Better_Markets_Comment_Letter_Debit_Card_Interchange_Fees_and_Routing.pdf.

[40] *See* Better Markets comment letter to the Board of Governors of the Federal Reserve System regarding their proposed master account application assessment guidelines (April 22, 2022), https://bettermarkets.org/wp-content/uploads/2022/04/Better_Markets_Comment_Letter_Guidelines_For_Evaluating_Accounts_and_Services_Requests.pdf.

[41] Those material risks have been made painfully clear during the crypto volatility – referred to by several as "carnage" - during the early weeks of May 2022. *See* Better Markets comment letter to the Commodities Futures Trading Commission regarding the FTX request for amended DCO registration order (May 11, 2022), https://bettermarkets.org/wp-content/uploads/2022/05/BetterMarkets_Request_for_Comment_FTX_Request_for_Amended_DCO_Registration_Order.pdf.

[42] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, *Joint Statement on Crypto-Asset Policy Sprint Initiative and Next Steps* (November 23, 2021), https://www.federalreserve.gov/newsevents/pressreleases/files/bcreg20211123a1.pdf.

[43] *See* White House fact sheet, *President Biden to Sign Executive Order on Ensuring Responsible Development of Digital Assets* (March 9, 2022), https://www.whitehouse.gov/briefing-room/statements-releases/2022/03/09/fact-sheet-president-biden-to-sign-executive-order-on-ensuring-responsible-innovation-in-digital-assets/.

[44] *See* Better Markets fact sheet, *Cryptocurrencies: The Next Big Thing or the Next Goldrush?* (March 9, 2022), https://bettermarkets.org/wp-content/uploads/2022/03/BetterMarkets_FactSheet_Cryptocurrencies_3-9-2022.pdf.

bank balance sheets. The related consultative document from the Basel Committee on Banking Supervision[45] is a good starting point.

Issues Affecting the Availability and Provision of Banking Products and Services to More Americans

The Vice Chair for Supervision must work both within the Federal Reserve and with the other federal banking agencies to ensure we have a banking system that better serves all Americans. Achieving greater equality in our banking system for low-income communities, especially economically marginalized communities of color, is more than simply the right thing to do. It would help millions of people that are poorly served by banks and other institutions in the financial services industry. It could also provide a boost to the U.S. economy more broadly while taking at least a small step on the path toward greater economic equality.[46]

Although not directly the responsibility of the Vice Chair for Supervision, this effort begins in large part with modernizing and strengthening the rule implementing the Community Reinvestment Act (CRA). Work on this is well underway, with a proposed rulemaking having been recently released,[47] and should not be slowed down. But the Vice Chair for Supervision must be an influential member of the Board on the rulemaking considering the unique knowledge and perspective of the banking system that would be brought by that position and the staff of the Division of Supervision and Regulation. That would help to ensure the rulemaking process considers and incorporates the most important factors prior to a rule being finalized. This includes making the assessment process and final ratings less subjective, more closely linking community reinvestment to the sources of funding, especially for online banking, and making the data used in the assessment process more available and accessible to the public. Also, explicit consequences based on the CRA examination ratings in the application approvals process should be in place that impact a bank's business activities or ability to engage in mergers and acquisitions. Otherwise, the CRA rule will continue to lack appropriately strong incentives.

Additionally, the Vice Chair for Supervision should influence the provision of banking products more directly. Smaller, community-focused banks empirically have been shown to be better at providing credit to lower-income households, communities of color, and small businesses,[48] and certain efforts would only enhance that fact. To start, while the usage of alternative sources of data and assessment methodologies in the determination of consumer creditworthiness has yet to have a long history, the Vice Chair for Supervision should be promoting their usage by smaller, more community focused banks,

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[45] Basel Committee on Banking Supervision, *Prudential treatment of cryptoasset exposures* (June 2021), https://www.bis.org/bcbs/publ/d519.pdf.
[46] *See* Better Markets report, Tim P. Clark and Phillip Basil, *Addressing Racial Economic Inequality Through the Banking System* (December 2, 2021), https://bettermarkets.org/wp-content/uploads/2021/12/BetterMarkets_Banking_And_Racial_Justice_Dec-2021.pdf.
[47] 87 FR 33884
[48] *See* Erik J. Mayer, *Big Banks, Household Credit Access, and Intergenerational Economic Mobility* (September 21, 2020), Southern Methodist University, https://www.communitybanking.org/~/media/files/communitybanking/2020/session3_paper1_mayer.pdf; ***also see*** Michael Neal, *To Significantly Increase Access to Capital for Communities of Color, We Need to Support Black Banks and All CDFIs* (July 31, 2020), Urban Institute https://www.urban.org/urban-wire/significantly-increase-access-capital-communities-color-we-need-support-black-banks-and-all-cdfis; ***also see*** Carlos Cordova, Joey Samowitz, and Thomas F. Siems, *Community Banks Play Outsized Role in PPP Lending* (December 11, 2020), https://www.csbs.org/newsroom/community-banks-play-outsized-role-ppp-lending.

in accordance with proper risk management practices. The banking regulatory agencies released a statement acknowledging the potential benefits, but they must go further and directly encourage smaller, community focused banks to use alternatives that have been shown to be effective. This could not only help provide more or larger lending to those already engaging with smaller banks but also could lead to loans being provided to those with insufficient traditional credit histories or even limited bank engagement. Additionally, the Federal Reserve should independently study alternative credit assessment methodologies and their efficacy and publish the findings for public consideration.

In conjunction, the Federal Reserve – along with the other banking agencies – should promote healthy partnerships between smaller, community focused banks and FinTech firms. This would allow these smaller banks to compete against larger banks and to more efficiently and effectively provide banking products and services to more individuals in LMI communities and economically marginalized communities of color. Being unbanked or underbanked leads to a heavier reliance on nonbank alternative financial services that come with punitive costs and predatory practices, such as payday loans.

There are also punitive costs to products and services within the banking system. Fees charged by banks for various financial services and other factors that prevent ready access to financial services, such as required charges when a customer fails to maintain minimum deposits levels for checking accounts, have been shown to affect low-income households and communities of color disproportionately.[49] The federal banking agencies should investigate such wealth-extracting practices to determine whether they are the result of legitimate business needs and work with the CFPB and other regulators to design rules that make banking fairer and accessible to all Americans.

Conclusion

The Federal Reserve must not take comfort from how well many believe the banks supposedly did during the 2020 pandemic, particularly given the lack of a comprehensive, data driven, robust, 360-degree analysis of what happened, what worked, what were the intended and unintended consequences, etc. Similarly, it must not allow the growing complacency around supervision and regulation to prevent it from taking necessary actions to ensure greater safety and soundness of the banking system. Financial crises and the actions taken to address them distort financial markets and increase moral hazard in markets, place a tremendous burden on taxpayers, harm the economy and the livelihoods of hardworking Americans, and widen the wealth gap. Attempting to minimizing the occurrence and depth of financial crises must be an imperative for the Fed.

There is no doubt the complexity and scope of the supervision and regulation agenda has been compounded by the deregulatory actions undertaken during the Trump administration, making immediate and quick action necessary. There is a substantial agenda to undertake over the coming years. The right set of actions are needed now to get supervision and regulation of the U.S. banking system back on the path to finishing the job started by Dodd-Frank to address the TBTF problem, help to promote greater resiliency of our financial system, and promote an economy that works better for all Americans. At the same time, it is imperative that the Vice Chair for Supervision address the new and

[49] *See* Financial Health Network, *The FinHealth Spend Report 2021* (June 2021), https://s3.amazonaws.com/cfsi-innovation-files-2018/wp-content/uploads/2021/04/19180204/FinHealth_Spend_Report_2021.pdf.

emerging risks that are and will continue to threaten the financial system and stability in the years to come.

Sincerely,

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President and CEO

Phillip Basil
Director of Banking Policy

Tim P. Clark
Distinguished Senior Banking Adviser

Cc:
The Honorable Jerome H. Powell
Chair

Dr. Lael Brainard
Vice Chair

Michelle W. Bowman
Governor

Dr. Lisa D. Cook
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