

AUGUST 23, 2021

Should Federal Reserve Chairman Jay Powell Be Reappointed?

BY DENNIS KELLEHER, TIM P. CLARK, AND PHILLIP BASIL

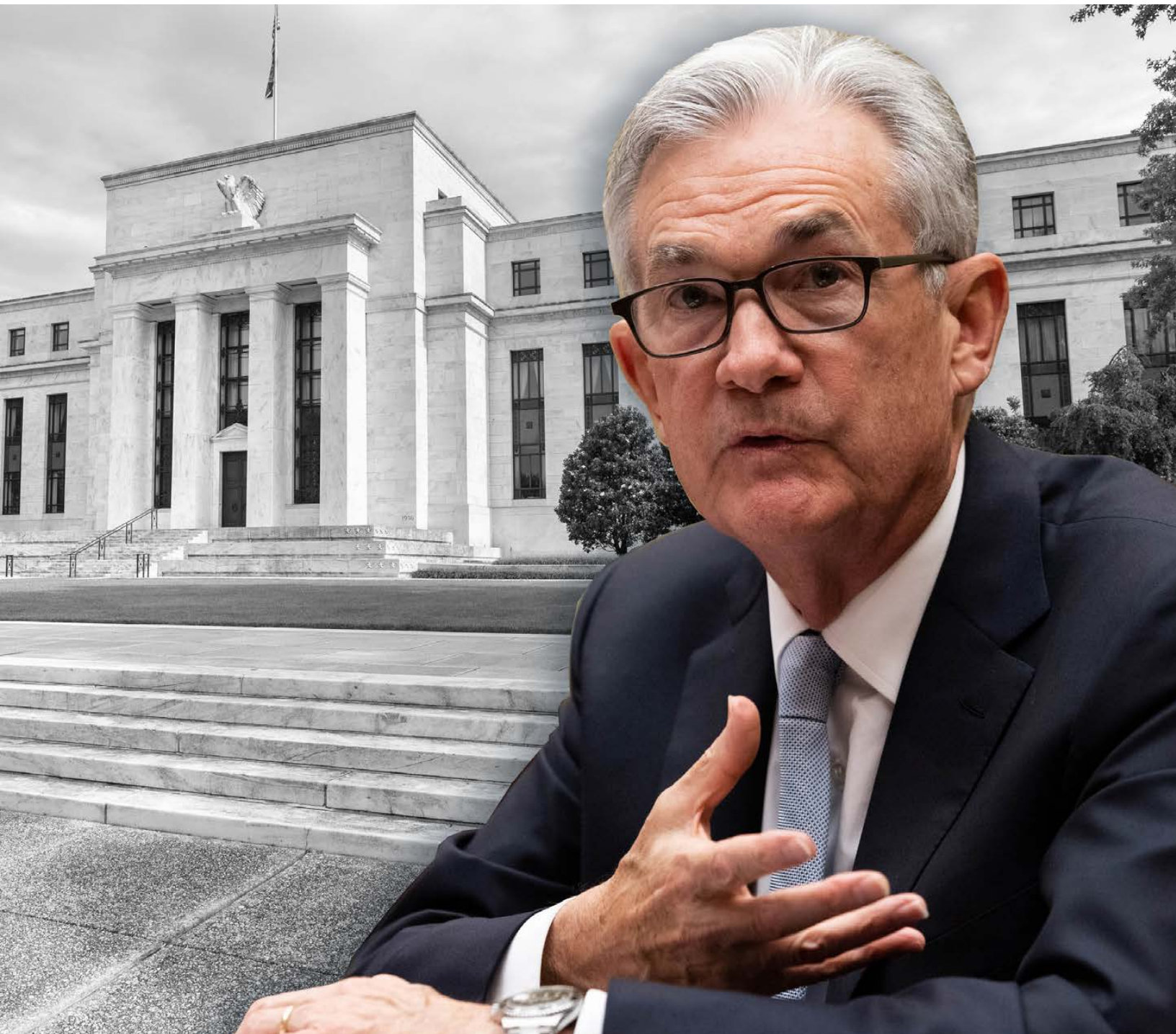


Table of Contents

Introduction	3
– The Fed Is the Supreme Court of Economic and Financial Policymaking	
– The Fed Chair Is More Powerful Than the Chief Justice of the Supreme Court	
– The Selection Process Must Be as Rigorous as Supreme Court Nominees	
– The Record of Powell’s Fed Chairmanship	
The Fed’s Response to and Role in the 2020 Pandemic Caused Economic and Financial Crash	12
– The Scope and Scale of the Powell Fed’s Pandemic Response Was Necessary, in Part, Due to Pre-existing Weaknesses in the Financial System	
The Fed’s Responsibility for Financial Stability, Regulation, and Supervision	29
– Powell’s Fed Deregulated and Dangerously Weakened Banking Supervision Before the Pandemic	
The Fed’s Monetary Policy Dual Mandate	36
– The New Monetary Policy Approach Appropriately Prioritizes the Labor Market	
The Fed’s Role in Racial Justice	38
– The New Monetary Policy Approach Could Help to Achieve Greater Equity, but Access to Credit is Key and More Communication is Necessary	
The Fed’s Role in Climate Change	41
– The Fed Has Lagged Behind Every Other Developed Country and Has Yet to Make Progress	
The Fed’s Role in Consolidations, Mergers and Acquisitions	43
– Large Mergers Under Powell Deserved More Scrutiny and Reforms to the Process Are Necessary	
The Fed’s Communications and Transparency Policies and Actions	47
– Communication has Improved but More Needs To Be Done	
Conclusion	49

The past four years have been a tumultuous time for the Federal Reserve (the “Fed”), from navigating the dynamics of an impulsive, erratic U.S. President with an appetite for uninformed meddling and driven by short-term political considerations rather than policy outcomes, to helping steer the economy through the worst global pandemic in over 100 years. In a number of ways, the Fed under Chairman Jerome (Jay) Powell is to be commended for how it has handled these difficult times, and the Chairman himself deserves a substantial amount of credit for his leadership, particularly in protecting the independence of the Fed and taking aggressive action quickly as the pandemic unfolded. However, the record of the “Powell chairmanship,” which started in February 2018¹ when he was elevated from being a Governor of the Federal Reserve Board, is mixed. That record is the subject of this report.

The Fed Is the Supreme Court of Economic and Financial Policymaking

The Fed is, in key respects, the Supreme Court of financial and economic policymaking, given its Governors’ 14-year terms and the institution’s independence. Indeed, with the acknowledged impact of Fed policy, actions and personnel on the successes or failures of Presidents, one could argue that it is more important. That is all the more the case considering its actions and decisions affect literally every single American through the Fed’s power and influence over interest rates, economic growth, financial stability, asset prices, and income and wealth distribution, among many other things.²

That is why the current and coming openings at the Fed—as many as four³ of the seven⁴ members of the Fed Board⁵—are so critically important. This presents President Biden with a rare opportunity to put his imprint on the Fed, the economy, and the financial system for years to come.

¹ Jay Powell was nominated by President Obama and confirmed by the Senate in May 2012 to be a Governor of the Fed, filling the unexpired term of Frederic Mishkin. In January 2014, he was nominated for a subsequent full term and confirmed by the Senate in June 2014 for a 14-year term ending January 2028. President Trump nominated him to replace Chair Janet Yellen in November 2017 and the Senate confirmed him as Chair in January 2018. His term as Chair expires in February 2022.

² Nothing illustrates this more, regarding financial stability, than the \$20 trillion in lost GDP from the 2008 financial crash, caused in part by the failure of the Fed to properly regulate and supervise the country’s largest banking institutions. See Better Markets publication *The Cost of the Crisis: \$20 trillion and counting* (July 2015), https://bettermarkets.com/sites/default/files/Better%20Markets%20-%20Cost%20of%20the%20Crisis_1.pdf.

³ There is currently one open position. The term for the current Vice Chairman for Supervision, Randy Quarles, expires in October 2021 (although he could remain on the Board as a Governor until the end of his term in January 2032, but few believe he will). The term for the current Vice Chairman, Richard Clarida, expires in November 2021. The term for the current Chairman, Jay Powell, expires in February 2022.

⁴ Two of the three, Michelle Bowman and Christopher Waller, were nominated by President Trump and one, Lael Brainard, was nominated by President Obama.

⁵ For those unfamiliar with the structure of the Fed, it has a handy introduction [here](#).



As Former U.S. President Trump looks on, Jerome Powell speaks during a press event in the Rose Garden at the White House announcing his selection as Trump's nominee as the Chair of the Federal Reserve on November 2, 2017 in Washington, D.C.

Photo by Drew Angerer/Getty Images.

This is particularly true because one of the upcoming openings is the Chairman's position. In some respects, the Chairman of the Fed may be more powerful than the Chief Justice of the Supreme Court. The importance of the Chairman's position simply cannot be overstated. That is true in the ordinary course, but even more so now: the current extraordinary circumstances facing the country, including those regarding financial and economic policy, greatly increase the importance, influence, and power of the Fed's Chairman.

That is the context within which nominees for the position of Chair of the Federal Reserve Board should be understood and evaluated. Anything less than a searching, comprehensive, and thorough review of any candidate's record—similar to the selection process for a Supreme Court Chief Justice—would be a disservice to the American people and, indeed, President Biden himself. Therefore, such an important decision should not turn on some short-term and short-sighted view of the status quo, stability or continuity or short-term political considerations. Worst of all would be the view that "market happiness" with the selection should be the deciding or even an important contributing factor. Similarly, while it is important, the fact Chair Powell is a smart, decent, thoughtful, and genuine person with a solid record of commitment to the Fed and the country should not be decisive. Put differently, the current apparent bias in favor of the status quo or inertia simply must be rejected and a full assessment carried out.

None of this is to say that Chair Powell should or should not be reappointed as Chairman. Regardless of anyone's view on that, a robust, thorough review should be undertaken before any decision is made. As detailed below, such a review will reveal a decidedly mixed record for Chair Powell. For example, his record on handling the attacks on the Fed's independence by Donald Trump is exemplary. However, his record on regulating the banking industry or, more accurately, deregulating it, is very poor. A truly thorough vetting process for his possible nomination would require not only the identification and review of the key issues, but also Chair Powell's response to them as well as a consideration of nonpublic information relating to, for example, bank supervision actions and decisions, which are not known to the public and thus beyond the possible scope of this report.

The Record of Powell's Fed Chairmanship

Many think that the Fed Chair should be largely if not solely evaluated on monetary policy and the so-called "dual mandate" of maximum employment and stable prices. That, however, fundamentally misunderstands the scope and role of the Fed as well as the interconnectedness between monetary policy and the Fed's other critical responsibilities. Thus, in addition to monetary policy, anyone being considered for Fed Chair must also be evaluated on their actions and views regarding financial regulation, the climate change crisis, racial justice issues, bank merger and acquisition approvals, transparency and accountability, including importantly with respect to Chair Powell, the Fed's actions regarding the pandemic-caused 2020 financial crash.



“Pandemic, good faith and effective emergency actions aside, the need for the Fed to bailout virtually every aspect of the financial system with trillions of dollars of support cannot be considered a sign of success.”

The Fed’s Response to the 2020 Pandemic-caused Financial Crash

Given the cataclysmic economic and financial crises caused by the pandemic, any evaluation of the Fed or its Chair must start with the many actions undertaken in response to that historic event. That analysis must include not just the Fed’s immediate response, but also a thorough analysis of the consequences of that response.

The Powell Fed deserves a lot of credit for much of its response to the rapidly unfolding 2020 pandemic. It quickly provided massive support to reduce the chance of even more severe financial deterioration spreading throughout the economy and correctly took the approach that the risks of doing too little were greater than the risks from doing too much. There is no doubt that the speed and breadth of the Fed response was effective at reducing the panic that had erupted across global financial markets. However, although this has yet to be sufficiently acknowledged by the Fed, the unprecedented breadth and scope of Fed actions were also effective at starkly exposing the continuing dangerous fragility of the financial system.

Put differently, while many of the actions taken since the pandemic hit may have been necessary to prevent the collapse of the financial system, the need for the **Fed’s unconditional, undifferentiated flood of liquidity** into and support for virtually every aspect of the financial system in a matter of weeks and months raises serious questions. Those actions, combined with the zero-interest rate policy and \$120 billion of discretionary monthly bond/treasury purchases, have not just supported the functioning of the financial system. Those actions have also contributed to market distortions, influenced the direction of capital allocation, engendered moral hazard, ignited debt, equity and real estate market booms, while contributing to a substantial increase in what was already massive wealth inequality.

Of course, no one would dispute that the pandemic-caused shutdown required the Fed to act and act quickly and forcefully. It would also be unfair to argue with the Fed’s impulse to do more rather than less given the unprecedented nature of the crisis and the uncertainty it created. However, it appears that many of the actions taken by the Fed were necessitated by the potential for imminent collapse of the shadow banking system, and the knock-on effects this could have on the banking system, which was similar to the collapse in 2008. That is proved by the Fed’s resurrection of the very same emergency programs it created in response to the global financial crisis of 2007-09 (the “2008 Crash”).

Thus, while many of the Fed’s actions were necessary due to the pandemic, it appears that was in no small part the result of a needlessly fragile and unstable financial system (and Fed actions have in themselves created potentially new financial stability issues). The benefits of the pandemic-related actions should not obscure the many structural deficiencies in the financial system highlighted by the need for these actions. Pandemic, good faith and effective emergency actions aside, the need for the Fed to bailout virtually every aspect of the financial system with trillions of dollars of support cannot be considered

a sign of success of the financial regulatory framework and indeed highlighted the dangerous lack of resiliency of the financial and banking systems.

That is why it is essential that the Fed undertakes an unbiased, comprehensive, data-driven, 360 degree “after action” analysis of its actions in response to the 2020 pandemic⁶ and the reasons they were required, apart from the pandemic itself. Moreover, the pandemic-caused economic shut down and financial crash was the first live stress test of the financial regulatory system since the 2008 Crash and since the Dodd-Frank financial reform law was implemented, which is reason alone for the Fed and others to seize this opportunity to evaluate what worked, what didn’t work, and why.

The Fed’s failure to have already committed publicly to a thorough and comprehensive review is deeply unfortunate. That analysis must be done ASAP, be transparent and include public input. Moreover, it must result in a report that includes detailed recommendations to reduce if not eliminate the potential future need for many of the extraordinary actions taken by the Fed, including, for example, bailing out the short-term money markets and corporate bonds, including junk bonds, and supporting private equity and other intentionally highly leveraged companies and high-risk financial activities.

The Fed’s assessment must address many questions, including: 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.), requiring such a massive response? What specific problems in the system were exposed by the rapid and near-total meltdown? What might have happened had the Fed not stepped in to the extent it did, including an analysis of the potential impact on specific sectors of the markets? 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? Who benefited most from the Fed’s actions? Did everyone who received Fed support actually need Fed support and, even if needed, did it serve a valid public purpose? And, perhaps the biggest question of all, how will the Fed address the damage caused by it creating now-greater expectations that it will always stand behind financial markets?

“...the pandemic-caused economic shut down and financial crash was the first live stress test of the financial regulatory system since the 2008 Crash...”

That is particularly important now because one result of the Fed once again bailing out every part of the financial system **regardless of risk or irresponsibility** is renewed concerns about the so-called “Fed put.” Indeed, one could think that Chair Powell has replaced the so-called Greenspan and Bernanke “puts” with a **permanent “Fed put”**—*i.e.*, that the Fed will always bailout the financial system, insulating many market participants from any material losses. That is dangerous, destabilizing, and existential for capitalism as it is supposed to be practiced. That’s why it is imperative to prioritize understanding the need for those extraordinary actions, the consequences of them, and how to try to ensure to the greatest extent possible that they are never needed again.

⁶ While it is true that some analyses have been undertaken, they have been incomplete and piecemeal. For example, the Fed and others looked at the role of hedge funds and their so-called basis trade. Similarly, others have looked at the role of money market funds and the performance of the Treasury markets. However, there has been no thorough, comprehensive, data driven study, analysis or report, which the Fed is uniquely qualified, equipped and positioned to do.



“At this point the too-big-to-fail problem targeted by the Dodd-Frank Act and other post-2008 Crash banking reforms is not only alive and well, it has grown even larger, more dangerous, and harder to address.”

Chair Powell’s Deregulation Record

Those extraordinary pandemic-related actions followed years of deregulation by the Fed under Powell’s leadership and with his support. Those actions needlessly and dangerously made the financial system significantly less safe, including the weakening of key post-2008 Crash banking standards and oversight practices for large banks during Powell’s chairmanship.⁷

Standards and oversight of the banking system had been substantially strengthened following the 2008 Crash. However, the work of making the system safer was not even close to being finished when, under the Trump administration and in line with Trump’s other financial regulatory agencies, forward progress lost all momentum, and the Fed began rolling back important post-crisis financial protection rules. Those rules had been proving their value at making the system stronger and were the main reason the banking system entered the 2020 pandemic-related economic shutdown in a relatively strong financial position.

Indeed, the post-2008 Crash financial protection rules, particularly related to capital and liquidity, helped prevent a **banking** crisis when the pandemic hit, which is in sharp contrast to the collapse of much of the nonbank “shadow banking” part of the financial system (Nonbanks).⁸ Those rules and standards should have been strengthened further, not weakened as they were under Chairman Powell’s leadership. At this point the too-big-to-fail problem targeted by the Dodd-Frank Act and other post-2008 Crash banking reforms is not only alive and well, it has grown even larger, more dangerous, and harder to address.

It is tempting to take some satisfaction from the realization that Fed deregulation could have been even worse—and it definitely could have been—and from Powell’s commendable job of navigating the politics of the Trump Administration years. The latter certainly weighs on the positive side of the scale in considering the Powell-chairmanship era. However, on the other side, the “it could have been worse” argument should not be used to downplay the very real dangers created and the critical importance of strong financial regulation and supervision.

More fundamentally, the Fed’s actions over the past few years indicate a philosophy of banking regulation and oversight that leans so strongly on the assumption that banks will tend to do the right thing as to seem disconnected from observable reality. This is particularly disappointing regarding Chair Powell, who no doubt understands the contributing factors to the 2008 Crash (which objectively disproved this benighted thinking), is familiar with the reprehensible bank practices that contributed to the 2008 Crash, and joined with those who demanded the re-regulation of the industry prior to 2017. Frankly, Chair Powell’s support for deregulation since then seems to indicate a willful blindness and failure to apply many of the lessons of the 2008 Crash, lessons which he knows quite well.

⁷ 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 2020), https://bettermarkets.com/sites/default/files/Better_Markets_WhitePaper_Fed_Actions_Under_Trump_Administration_12-03-2020.pdf.

⁸ See Better Markets white paper, Dennis Kelleher and Tim Clark, *No Financial Crash Yet Thanks to Dodd-Frank and Banking Reforms* (June 24, 2020), https://bettermarkets.com/sites/default/files/Better_Markets_White_Paper_Dodd-Frank_Banking_Reforms.pdf.

Under the chairmanship of Jay Powell, albeit led by the Vice Chair for Supervision, Randal Quarles, the Fed Board seems to have forgotten that the role of the Fed's banking regulators and supervisors is not to try to make the entities they oversee happy. It is to protect the jobs, savings, homes, retirements, and economic prosperity of the American people by promoting a stable and resilient financial system that supports the productive economy rather than threatens it, as was so painfully experienced during and after the 2008 Crash. Contrary to an apparent belief that a more cooperative and harmonious relationship with banks should be a key goal,⁹ the nature of the relationship between banks and their regulators should be and will of necessity at times be confrontational. They do not share the same goals. The incentives of the banks are different from the incentives of the regulators, particularly so in areas that, on the one hand, can cost the banks and their shareholders money (*i.e.*, reduce profits, albeit marginally), while on the other can make the system safer and protect Americans' jobs, homes, savings and much more. That's why tension and conflict between bankers and regulators is inevitable, healthy and, indeed, a sign of success that the public interest is in fact being protected.¹⁰

“...the role of the Fed’s banking regulators and supervisors is not to try to make the entities they oversee happy. It is to protect the jobs, savings, homes, retirements, and economic prosperity of the American people...”

That has not been the case during Powell's chairmanship, by choice. His chairmanship has seen a number of changes that weakened post-crisis reforms in ways that aligned quite closely with the largest banks' desires. Yes, banks will still complain about the Fed's (and any other) regulations and oversight because they do create some constraints on the banks' actions. However, that should not distract from the fact that, to a large extent, those banks have been getting from Powell's Fed most of what they want and virtually none of what they don't want, and this has made the system less safe.

Alarming, Chair Powell's recent statements highlighting the supposed strength of the banks and their contribution to the economy through the pandemic seem designed to take a victory lap and to indicate that current regulations are more than enough:

“the banking system and . . . most parts of the financial system made it through quite a stress test last year when we lost . . . 25 percent of GDP and 30 million jobs in the space of a couple of months. . . ultimately, the work that we did in Dodd-Frank and in Basel to strengthen the banking system over the last decade, I think it showed up pretty well in what was a pretty good stress test.”¹¹

“The level of loss absorbing capital in the system is about right. I think the experience of the pandemic bears that out.”¹²

⁹ Vice Chair for Supervision Randal Quarles discussed the desire for “fairer” supervision in a speech at the Federal Reserve Board, Harvard Law School, and Wharton School Conference: Bank Supervision: Past, Present, and Future (December 11, 2020), *The Eye of Providence: Thoughts on the Evolution of Bank Supervision*, <https://www.federalreserve.gov/newsevents/speech/quarles-s20201211a.htm>.

¹⁰ See opening remarks by Dennis Kelleher from the Federal Reserve Board of Governors conference “Stress Testing: A Discussion and Review” Panel One “Stress Tests as a Policy Tool” (July 9, 2019), <https://www.bostonfed.org/-/media/Documents/events/2019/stress-testing/stress-tests-and-policy-paper-kelleher.pdf?la=en>.

¹¹ Jerome Powell (April 11, 2021) Interview with Scott Pelley, *60 Minutes*, transcript available at <https://www.cbsnews.com/news/jerome-powell-full-2021-60-minutes-interview-transcript/>; See also, Pam Martens and Russ Martens, *Fed Chair Jerome Powell Goes on 60 Minutes to Present a False Narrative on Mega Banks He Supervises Loaning Out their Balance Sheets to Hedge Funds*, WALL STREET ON PARADE (April 12, 2021), <https://wallstreetonparade.com/2021/04/fed-chair-jerome-powell-goes-on-60-minutes-to-present-a-false-narrative-on-mega-banks-he-supervises-loaning-out-their-balance-sheets-to-hedge-funds/>.

¹² This quote is a portion of Chair Powell's response to a questions by Senators Sherrod Brown during the hearing on July 15, 2021, with the Senate Committee on Banking, Housing, and Urban Affairs “The Semiannual Monetary Policy Report to the Congress.”



“The income and wealth gaps in America have been growing steadily for decades, and the policies of the past clearly have not managed to close them.”

Among the things missing in those statements, Powell’s remarks ignore the fact that the banks were forced to have significantly more capital and liquidity over their relentless lobbying against the provisions of the Dodd-Frank Act.¹³ Additionally, it ignores the fact that those Dodd-Frank Act regulations have been significantly weakened under his chairmanship, including stress testing-based capital requirements which became effective just last Fall. The Board’s own final rule showed that these new requirements reduce overall capital for banks in the \$100 to \$750 billion range. They also reduce stress-based capital if not overall capital for the largest, most complex banks. Therefore, the level of loss absorbing capital that banks had heading into the pandemic will no longer be the same. This lack of recognition of the deregulation he has supported over the last several years is perhaps designed to forestall any future attempts to reinvigorate financial protection reforms in a way that large banks may not like. That would be extremely dangerous.

These statements also fail to give sufficient weight to—and sometimes even fail to acknowledge—the impact of the trillions of dollars that the Fed had to deploy to support the financial markets as the pandemic unfolded. Without those trillions of Fed dollars, and the fiscal support provided by taxpayers through the CARES Act, the financial viability of many of the largest banks would quite likely have been in grave doubt. Rather than claiming victory, the Chair and the Fed should be thoroughly reviewing and analyzing its actions and the implications of those actions as referenced above.

Chair Powell’s Record on Monetary Policy, Climate Change, Racial Justice, and Bank Consolidation

While the Fed’s response to the pandemic and its considerable deregulation should be carefully evaluated in connection with any reappointment analysis, those are just two aspects of a much broader set of considerations when assessing his term as Fed Chair.

Regarding monetary policy, the Fed’s new monetary policy approach, which was outlined by Powell last summer,¹⁴ appropriately prioritizes the labor market even in the face of recent elevated inflation figures and criticism that it is exacerbating the wealth gap. The updated policy puts greater focus on maximum employment levels and a “broad and inclusive” conception of employment by pursuing more symmetrical instead of absolute inflation targeting. This allows inflation to run above the Fed’s target to make further gains in employment than it would with strict targeting.

The income and wealth gaps in America have been growing steadily for decades, and the policies of the past clearly have not managed to close them. While these gaps have increased over the course of the pandemic, the progress that was made in closing employment gaps prior to the pandemic, such as the lowest Black unemployment rate on record at the end of 2019, indicate that prioritizing employment over strict inflation targeting may work to close employment gaps. This in turn could support upward

¹³ Dennis Kelleher and Tim Clark (n 8).

¹⁴ See speech by Chair Jerome Powell, *New Economic Challenges and the Fed’s Monetary Policy Review* at “Navigating the Decade Ahead: Implications for Monetary Policy,” an economic policy symposium sponsored by the Federal Reserve Bank of Kansas City, Jackson Hole, Wyoming (August 27, 2020), <https://www.federalreserve.gov/newsevents/speech/powell20200827a.htm>.

movement of incomes across the population and reduce the income gap. Combined with increased access to credit, people from more segments of the population, including communities of color, would eventually be better able to purchase wealth-generating assets, including houses and financial assets, helping to close the wealth gap in the long run. Such progress would take time, and so the new monetary policy approach cannot be judged on short-term metrics.

If successful, this monetary policy approach would be an integral component to achieving greater racial equity in our economy. However, the Fed has yet to provide the public with a full picture of what greater focus on racial equity and inclusivity looks like in practice. For example, only the employment metric is reported by race in the Fed's Monetary Policy Report. The Fed should be communicating more metrics more often to show they are truly prioritizing an inclusive economy, more clearly indicating its view of what inclusivity means in our economy, and discussing the possible range of long-term benefits from achieving it. The Fed also has not provided a full picture of its views on the linkages between employment, income, credit, and wealth. A key component to making the policy a success is ensuring the financial system is working for all Americans, especially low-income Americans and communities of

color. The Fed must ensure that banks are sufficiently meeting the credit needs of those communities, and, in particular, leverage existing laws such as the Community Reinvestment Act to promote better access to credit in concert with other agencies.

“Regarding the climate crisis, the Fed under Chair Powell has failed to take adequate steps, especially in comparison to other developed countries.”

Regarding the climate crisis, the Fed under Chair Powell has failed to take adequate steps, especially in comparison to other developed countries. Thus far, Powell's Fed has only acknowledged that climate change poses risks to the economy and financial stability. Powell has made it clear in public venues that he does not feel climate change effects are currently material enough to be a consideration in monetary policy. Instead, he has directed the Fed's focus to remain tightly cabined within its

mandates for financial stability and banking oversight.¹⁵ Even in those regards the Fed seemingly has not gone much further than talking, only having begun the initial development of some related programs.

As the key supervisory agency of the banking system and the agency charged with maintaining financial stability, the Fed must move these efforts along substantially in the coming months, even in the complex political environment it currently faces on this issue. At the very least it should be publicly communicating to banks that their ability to appropriately identify, measure, control, and monitor all of their material climate-related risks will be an important part of the Fed's supervisory assessments.

Regarding bank consolidation, the Fed and other banking regulatory agencies have overseen and approved mergers that have led to (if not encouraged and incentivized) massive and almost entirely unconstrained consolidation in the banking industry for more than three decades. This merger review and approval process (combined with other factors) has led to a reduction in the number of banks in the US by 70 percent since the mid-1980s. These mergers have continued apace under Chair Powell, including the two largest bank mergers since the 2008 Crash. The banks resulting from these two mergers fall into the \$100 to \$700 billion range, which has been affected the most by the deregulations that were approved under Powell's leadership. While the Powell Fed should have implemented a much

¹⁵ This is based on comments made by Chair Powell during Panel S (June 4, 2021), 2021 Green Swan Conference - Coordinating finance on climate and more recently based on testimony given by Chair Powell to the House Financial Services Committee on July 14, 2021 and to the Senate Committee on Banking, Housing, and Urban Affairs on July 15, 2021.

more robust review of large bank mergers in any event, the deregulatory impact of those actions on these banks made changes to the merger review process imperative.

Ultimately, the Fed's relationship to financial markets, and by extension the economy, is geared towards financial institutions, markets, and investors because all of the Fed's current tools are executed directly through the financial system. The Fed sets rates and executes market operations that affect the actions of the financial system. When markets are functioning properly, that is expected to translate into support for the real economy through increased lending and other economic activities.



But markets too often fail, and when they do, the Fed steps in with broad-based support for those markets. Huge benefits from this support accrue to financial institutions and the wealthy—who hold the great bulk of financial assets—and the benefits that accrue to the average American result from the economy performing better than it otherwise would have. Thus, the conversation about the Fed and its performance typically centers around what is best for markets and the financial system, with broader benefits stemming from economic and financial stability. These benefits to the broader public are often in the form of things not being as bad as they otherwise might have been, not the huge gains that often accrue to the wealthiest Americans when markets recover. A major shortcoming of the Fed over many years is the lack of leadership and engagement in public discussions of these realities and tradeoffs, including consideration of

how its actions and tools might be used to achieve different outcomes that more directly support the broader economy without bestowing so much unearned benefit on financial market participants.

This paper explores these topics and more in greater depth and provides an assessment of the Fed under Jay Powell's Chairmanship from the perspective of what is best for everyday Americans and not the financial system.



The Fed's Response to and Role in the 2020 Pandemic Caused Economic and Financial Crash

Pre-existing Fragilities in the Markets Made Stresses Caused by the Pandemic Worse. This Necessitated an Outsized Response from the Fed that is now Distorting Markets, Increasing Moral Hazard & the Risk of a Future Crash if Asset Bubbles Burst.

In the face of unprecedented uncertainty brought on by the pandemic and rapidly deteriorating markets, the initial pace, scale, and breadth of this support appears appropriate and certainly succeeded at stabilizing financial markets. The world and the Fed were facing truly unique circumstances—the first pandemic in 100 years leading to markets collapsing, funding sources drying up, and lockdowns threatening to close a complex, globally connected economy. Unquestionably the Fed had to act quickly and address the significant market issues it was able to using the tools that it has. And, considering this, it would be easy to move on and claim victory over a rare and unique set of circumstances. But the market stress and collapse caused by the 2020 pandemic exposed critical fragilities that already existed in the markets, *rather than being the reason for them*, and it is these fragilities that made the situation materially worse.

The Fed's actions achieved their immediate goals of restoring order and functioning to the markets by supplying trillions of dollars in liquidity, which almost certainly prevented further deterioration that may have rivaled the 2008 Crash. However, while that massive Fed support was necessary to keep the system from spiraling into full-blown financial crisis, it **also highlights the tremendous pre-pandemic vulnerabilities of the financial system** and underscores the need for substantial further reforms to increase its resilience. The failure of Chair Powell to publicly emphasize the importance of these vulnerabilities across the financial system, including in the bank and nonbank sectors, and to lead that reform effort as a priority for the Fed, financial regulators and for financial stability is troubling.¹⁶

¹⁶ Some may think that it would be inappropriate for the Fed to analyze and lead the reform of the nonbanking sector in addition to the banking sector because its mandates are focused on the banking sector. However, given that the Fed has been called on to stop a financial crash twice within twelve years, both of which necessitated Fed support in large part due to the nonbanking sector, the Fed should be in the lead of reforming both. Our view is that, if the Fed is the entity that gets the call to bailout both sectors, it should be the one that leads to prevent or lessen that from happening in the first place. Moreover, the banking and nonbanking sectors are inextricably interconnected, and it is somewhat misleading to talk about them as separate sectors. The country has one financial system, which has two large overlapping sectors which are really distinguished more by how they are regulated than by their activities, size, risk, or complexity. The Fed is best equipped, empowered and incentivized to lead in the study and reform of the system as a whole.

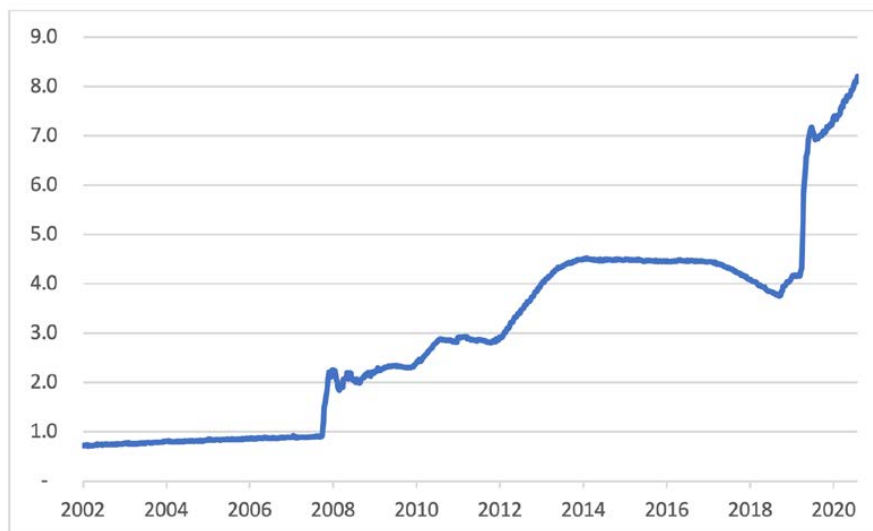
In response to the March 2020 market collapse and looming economic disaster from the pandemic, the Fed quickly took a number of actions, including:

- lowering the Fed Funds target rate to near zero;
- purchasing a massive amount of Treasury and agency-guaranteed MBS;
- reinstating numerous emergency lending programs created during the 2008 Crash;
- hugely expanding repurchase agreement (repo) operations to provide liquidity to short-term funding markets via Wall Street’s biggest banks’ securities firms; and
- creating new emergency facilities to support corporate bond markets.

The Fed’s balance sheet growth was not only massive but very rapid, with the Fed’s balance sheet growing by over \$2.5 trillion in about 60 days. In total since March 2020, the Fed has deployed around \$4.8 trillion and counting—\$3.8 trillion in purchases of Treasury securities and MBS, \$650 billion in peak deployment of the emergency programs (See Appendix 1 below for details), and an increase of \$300 billion in repo operations from pre-pandemic to the 2020 peak. These figures reflect the peak amounts deployed. If all this support is considered as a cumulative sum, including adding up each of the short-term lending operations over time, this total would be significantly larger.¹⁷

Alarming, the more than \$4 trillion in pandemic-related balance sheet growth has been on top of the expansion that occurred after the 2008 Crash, which the Fed had just started to attempt to unwind when the pandemic started. Currently, the Fed’s balance sheet is more than 8 times bigger than it had been prior to the 2008 crash.

Figure 1: Federal Reserve Total Assets (\$ Trillions)



Source: Federal Reserve statistical release H.4.1

This has left the Fed with a precarious path forward in unwinding its positions without causing severe market and economic disruptions. It also calls into question whether these markets would even be

¹⁷ The Economist estimates this to be \$23.5 trillion in their Special Report The Future of Banking (May 8, 2021 issue). There is a robust discussion about how best to accurately capture the size and scope of the bailouts in connection with the 2008 Crash and again with the 2020 Crash. Some think the highest total exposure at any given point in time is correct while others believe that the cumulative amount is correct, *i.e.*, aggregating each individual action over time (See CNBC article: <https://www.cnbc.com/id/45674390>). Still others think that the total potential amount available, *i.e.*, what has been committed vs. what has been deployed, is correct (see Levy Economics Institute paper: http://www.levyinstitute.org/pubs/wp_698.pdf).



“The substantial increase in credit held and facilitated through Nonbanks has made them increasingly important to the stability of the financial system and to the functioning of credit markets.”

able to function properly in the absence of the expectation among market participants that the Fed will always support them during disruptions. Notably, too many market participants apparently now consider a “market disruption” to be defined as any material decrease in the value of financial assets.

Post-2008 Crash reforms did increase resilience in the financial system, particularly the banking sector by forcing the largest banks to meet more stringent capital and liquidity requirements.¹⁸ However, those reforms clearly fell well short of what was needed, including leaving much of the non-bank financial sector un- or under-regulated. This allowed risks in the regulated banking system to migrate to the less regulated non-bank financial sector, which has grown in size and inter-connectedness with the markets. Indeed, since the 2008 Crash, non-bank financial activities have increased significantly, with the share of global financial assets held at non-bank financial institutions (Nonbanks) increasing from 42 percent in 2008 to close to 50 percent at the end of 2019.¹⁹

There has been a particularly large expansion in the role of Nonbanks in credit markets. For example, the holdings of bond funds and exchange traded funds (ETFs) that invest in corporate bonds as a share of total nonfinancial corporate bonds outstanding rose from less than 10 percent in 2010 to nearly 40 percent at the end of 2019.²⁰ In addition to investing in credit assets, Nonbanks have entered other businesses traditionally performed by banks such as lending and debt origination.²¹

The substantial increase in credit held and facilitated through Nonbanks has made them increasingly important to the stability of the financial system and to the functioning of credit markets. That, in turn, has increased the importance of the liquidity needs of these entities because those needs can become particularly acute in times of stress. Nonbanks—in the absence of appropriate requirements for capital buffers to cover their losses, and in the face of a rapid reduction in available funding from banks and other providers of liquidity—may be forced to sell assets into a declining market, as dramatically happened during the 2008 Crash. These “fire-sales” directly and indirectly reduce prices for numerous types of assets, causing or accelerating a downward spiral that can ignite a contagion that threatens the entire financial system and the economy.

¹⁸ Tim Clark and Dennis Kelleher (n 8).

¹⁹ Financial Stability Board, *Holistic Review of the March Market Turmoil* (November 2020), <https://www.fsb.org/2020/11/holistic-review-of-the-march-market-turmoil/>.

²⁰ Falato, A., I. Goldstein, and A. Hortacsu, *Fragility in the covid-19 crisis: The case of investment funds in corporate bond markets* (2020), <https://www.nber.org/papers/w27559>.

²¹ Financial Stability Board (n 19); also as recently reported, see Orla McCaffrey, *Nonbank lenders are dominating the mortgage market; nonbanks issued more than two-thirds of mortgages in 2020, the highest market share on record*, THE WALL STREET JOURNAL (June 22, 2021), https://www.wsj.com/articles/nonbank-lenders-are-dominating-the-mortgage-market-11624367460?st=ja8hhk58s8lth7a&reflink=article_email_share.

At the onset of stress in the beginning of the pandemic (similar to what happened during the 2008 Crash), a substantial need for liquidity contributed to pressure on markets when Nonbanks and other financial firms made a panicked “dash for cash” in the face of extreme uncertainty, leading to:

- falling asset values (with re-pricing leading to sales, causing asset prices to fall more, etc.);
- short-term funding markets seizing up, including the commercial paper and repo markets;
- rapid unwinding of highly leveraged positions at hedge funds and other leveraged investment vehicles;
- huge redemptions as investors rushed to exit funds invested in corporate credit markets, including investment grade and high yield bond mutual funds;
- runs on certain money market funds (MMFs); and
- significant pricing dislocations between cash and derivative positions.²²

All these factors resulted in some of the largest and most liquid markets seizing up as sellers vastly outnumbered buyers. This included everything from U.S. Treasury securities (Treasuries) and mortgage-backed securities (MBS) to corporate bonds and commercial paper, with many systemically significant Nonbanks finding themselves heading towards collapse.

While the pandemic-caused economic shutdown was the precipitating cause, the initial collapse of these markets and market intermediaries was due to structural issues that have existed for years and grown in importance since the 2008 Crash. For example, runs on MMFs were also an issue during the 2008 Crash, when panicked investors made substantial redemptions, negatively affecting asset prices.²³ Regulations were subsequently implemented in an attempt to prevent or diminish such runs, but they were grossly inadequate and certain provisions of those deficient regulations may have further exacerbated the issue in the 2020 pandemic. During both the 2008 Crash and the 2020 pandemic, the Fed established the MMF Liquidity Facility to provide much-needed liquidity to MMFs, which prevented further runs and the almost certain collapse of some funds if not the entire industry.

Such large-scale—and repeated—Fed support to prevent financial markets from collapsing has serious and ongoing consequences. Foremost among them, the breadth and scale of the Fed’s actions have resulted in market distortions and greatly amplified the moral hazard associated with the so-called “Fed Put.” A startling example of this has been in corporate bond markets. Since the support of these markets was a new addition to the Fed’s basket of emergency programs, the market reaction to this support especially highlights the effect of the Fed Put. The mere announcements of the Fed’s Corporate Credit Facilities in late March of 2020 virtually immediately reversed credit fund outflows²⁴ and pushed spreads on investment grade and high yield debt down by approximately two thirds²⁵—before the Fed even made its first purchases under these facilities on May 12.

²² Financial Stability Board (n 17); Specifically related to investment grade and high yield bond mutual funds, see Anil Kashyap, Donald Kohn, and David Wessel, *What is Swing Pricing?*, The Brookings Institution (August 3, 2021) <https://www.brookings.edu/blog/up-front/2021/08/03/what-is-swing-pricing/>; Steven Sharpe and Alex Zhou, *The Corporate Bond Market Crises and the Government Response*, FEDS Note from the Board of Governors of the Federal Reserve System (October 7, 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3711633.

²³ Marco Cipriani, Michael Holscher, Antoine Martin, and Patrick E. McCabe, *Money Market Funds and Systemic Risk*, Liberty Street Economics Blog at the Federal Reserve Bank of New York (June 11, 2012), <https://libertystreeteconomics.newyorkfed.org/2012/06/money-market-funds-and-systemic-risk.html>.

²⁴ Falato, A., I. Goldstein, and A. Hortacsu (n 20).

²⁵ Nina Boyarchenko, Anna Kovner, and Or Shachar, *The Impact of the Corporate Credit Facilities*, Liberty Street Economics Blog of the Federal Reserve Bank of New York (October 1, 2020), <https://libertystreeteconomics.newyorkfed.org/2020/10/the-impact-of-the-corporate-credit-facilities.html>.

This so-called “announcement effect” (illustrated in Figure 2) clearly shows the value the market attributes just to the knowledge the Fed is providing a backstop. In fact, despite committing \$750 billion to the two Corporate Credit Facilities, the Fed only had a maximum deployment of just over \$14 billion (see the table in the Appendix).

Figure 2: Investment Grade and High Yield Corporate Bond Spreads (basis points)



Source: ICE B of A Indices Option-Adjusted Spreads

In addition to the security from the knowledge that the Fed would continue to support the markets, the Fed’s massive liquidity injections and zero interest rate policy have contributed to higher asset prices across the board and investors’ decisions to invest in riskier assets. Notably, the Fed’s direct asset purchases of \$120 billion per month of Treasuries and MBS have been (1) pulling these securities out of the private markets across maturities, including short-dated, (2) driving up prices and pushing down yields on those securities, and (3) adding a substantial amount of liquidity to the markets that investors want to invest in assets that meet their return objectives. However, considering the reduced yields on Treasuries and MBS due to the Fed’s actions, those investors have been incentivized to look to riskier assets to obtain a desirable level of return.²⁶

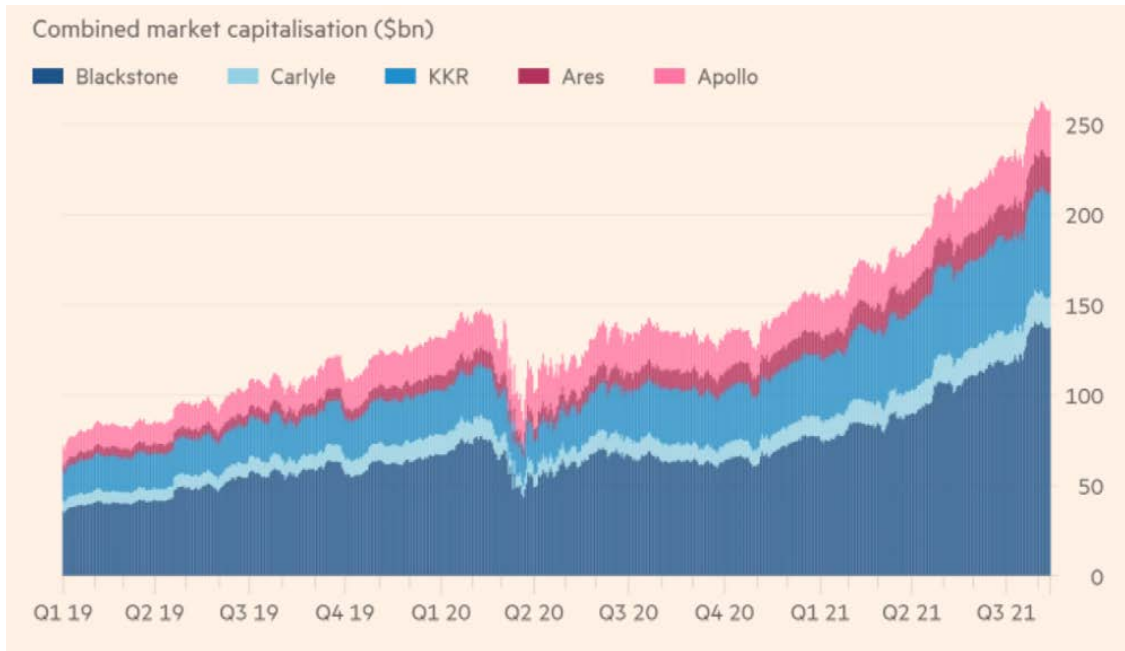
The effect has been seen across markets and was highlighted in the Fed’s own May 2021 Financial Stability Report, which tepidly noted that asset valuations “are generally high.”²⁷ What the report did not say was that those market conditions are in part a result of the actions the Fed has taken to address the pandemic. Not only have public equity market indices repeatedly hit all time highs in 2021, investors have flooded money into major private equity firms faster than the firms can invest it, leading to the highest levels of unspent investor capital on record, and pushing the combined market capitalization of these firms from a March 2020 low of \$80bn to about \$250bn this year.²⁸

²⁶ Among other things, this has seemed to push short-dated Treasury investors into long-dated Treasuries, long-dated Treasury investors into investment grade corporate bonds, investment grade investors into high yield, high yield investors into equities, and equity investors into cryptocurrencies. Put differently, the Fed’s policies have changed investors activities and appetite across the entire yield spectrum, breadth of asset classes, and global markets.

²⁷ Board of Governors of the Federal Reserve System, *Financial Stability Report* (May 2021), <https://www.federalreserve.gov/publications/files/financial-stability-report-20210506.pdf>.

²⁸ Robin Wigglesworth and Kaye Wiggins, *Private capital groups soar on boom in unlisted assets*, FINANCIAL TIMES (August 17, 2021), <https://www.ft.com/content/6d85c0a3-8f52-4b43-8fa7-36c0391562de>.

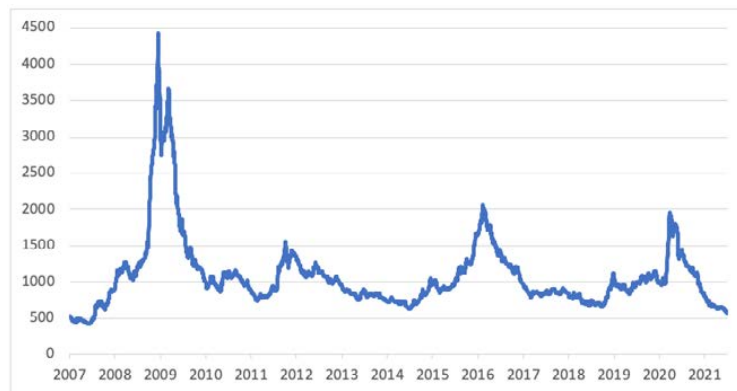
Figure 3: Market Capitalization of Large Private Equity Firms



Reprinted from *Private capital groups soar on boom in unlisted assets*, Robin Wigglesworth and Kaye Wiggins (August 17, 2021), FINANCIAL TIMES. Copyright 2021 Financial Times.

The corporate bond market has also been on an extended upward rally. As a result, spreads on corporate bonds have plunged dramatically, with junk bond spreads recently reaching their lowest level since 2007.²⁹ Leveraged finance generally, including junk bonds and leveraged loans, has reached a record \$3 trillion outstanding.³⁰

Figure 4: Spread on CCC and Lower Rated Corporate Bonds (basis points)



Source: ICE BofA CCC & Lower US High Yield Index Option Adjusted Spread

It is important to consider the implications of this Fed-induced market reaction: despite not yet having recovered from the pandemic and the potential slowdown or reversal of the recovery due to Coronavirus variants, the demand for credit assets has been so strong that it has pushed the so-called risk premium

²⁹ Based on the ICE BofA CCC & Lower US High Yield Index.

³⁰ Mayra Rodriguez Valladares, *The U.S. Leveraged Finance Market Is At A Record \$3 Trillion*, FORBES (August 10, 2021), <https://www.forbes.com/sites/mayrarodriguezvalladares/2021/08/10/the-us-leveraged-finance-market-is-at-a-record-3-trillion/?sh=177328337880>.



“These actions...have pushed the consequences of their actions beyond the simpler mechanics of the past and created distortionary effects that disproportionately benefit larger banks and corporations as well as the wealthy.”

on the debt of the riskiest companies to its lowest level in 14 years.³¹ This is reflective of investor decisions influenced by the massive amount of liquidity in the markets and the moral hazard created by the Fed’s actions as investors now increasingly expect to be supported by Fed actions.

By the end of June 2020, despite a devastating pandemic and a dramatic decline in economic activity with an associated increase in unemployment, corporations were able to issue more than \$700 billion of bonds, nearly double the amount issued by the same point in 2019.³² In total for 2020, U.S. nonfinancial companies issued \$1.7 trillion in bonds, nearly \$600 billion more than the previous high.³³

Figure 5: U.S. nonfinancial corporate bond issuance and the average U.S. investment-grade corporate bond yield, monthly



*2021 data through June 10; Reprinted from *Pandemic Hangover: \$11 Trillion in Corporate Debt*, Sam Goldfarb (June 14, 2021), WALL STREET JOURNAL. Copyright 2021 Wall Street Journal.

Fed’s Stress-Related Policies and Programs Are Making the Rich Much Richer

Under historic, standard economics and Fed practice, the Fed lowering interest rates should decrease the cost and increase the availability of credit, which is designed and undertaken to make economic activity less costly and, therefore, to spur the economy. According to this standard playbook, the Fed thereby incentivizes economic activity leading to an economic recovery because businesses and people are more willing and able to borrow money to start or expand businesses, build plants, and buy equipment, as well as hire more workers. That’s why the Fed says that its actions are in the service of the real, productive economy and Main Street Americans.

³¹ Recent reporting shows that credit rating agencies are cautioning against risks in the debt markets and potential asset bubbles, particularly for junk bonds. See Joe Rennison, *Rating agencies caution on corporate debt after US borrowing frenzy*, FINANCIAL TIMES (August 18, 2021), <https://www.ft.com/content/32a57864-d983-46b0-bbfa-85fd2d2361e5?shareType=nongift>.

³² Nina Boyarchenko, Anna Kovner, and Or Shachar (n 25).

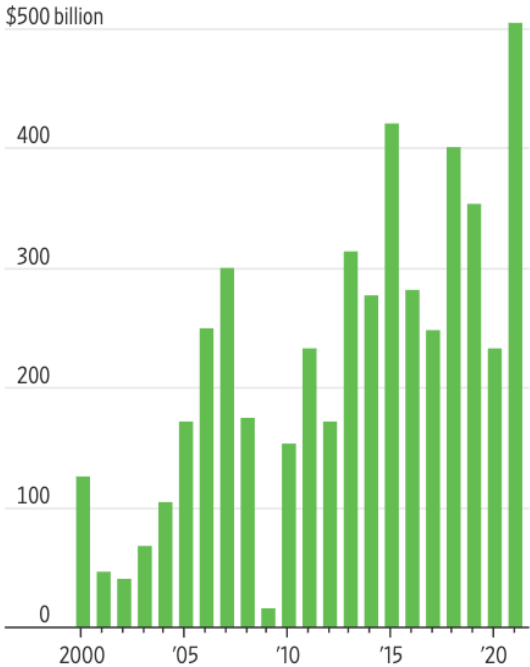
³³ Sam Goldfarb, *Pandemic Hangover: \$11 Trillion in Corporate Debt*, THE WALL STREET JOURNAL (June 14, 2021), <https://www.wsj.com/articles/pandemic-supercharged-corporate-debt-boom-record-11623681511>.

The Fed greatly expanded its traditional playbook during the 2008 Crash and further expanded it during the pandemic to include much more support for a broader array of financial markets. These actions (large-scale, direct Treasury and MBS purchases and numerous special market backstop programs) have pushed the consequences of their actions beyond the simpler mechanics of the past and created distortionary effects that disproportionately benefit larger banks and corporations as well as the wealthy.³⁴

For example, some of the extraordinary pandemic-related Fed programs directly support credit markets for corporations that are large enough to issue debt into bond markets, which are companies predominantly over \$1 billion in revenue.³⁵ This directly helps these larger companies to obtain cheaper funding from investors, but does not help businesses under the effective market-determined threshold, who must instead obtain bank loans. Small businesses account for over 99.9 percent of businesses in the US,³⁶ meaning they are not benefitting from Fed programs that support debt markets but rather on the willingness of banks to use the liquidity provided by the Fed to continue to provide credit even in a major downturn.³⁷

Many of these larger companies are not using all of the cash raised through their debt issuance to invest in the real economy, such as manufacturing plants, equipment and human capital; instead, they are buying back their stock and increasing their dividends,³⁸ which enriches the wealthiest Americans, because they own almost all of the value of the stock market.³⁹ According to Goldman Sachs Group data,

Figure 6: Repurchase authorizations through May 7 of each year



Reprinted from *Companies Are Flush With Cash—and Ready to Pad Shareholder Pockets*, Caitlin McCabe (May 16, 2021), WALL STREET JOURNAL. Copyright 2021 Wall Street Journal.

³⁴ Eric Rosengren, President of the Federal Reserve Bank of Boston, recently noted to the Financial Times that “undue leverage and price appreciation that could potentially be reversed down the road could undermine the ability to reach our full employment mandate over time.” See Colby Smith, *Top Fed official warns massive bond purchases are ill-suited for US economy*, FINANCIAL TIMES (August 18, 2021), <https://www.ft.com/content/bafad111-01e5-4600-b34c-13028c3826ea>.

³⁵ A 2020 Bulletin from the Bank for International Settlements reports that around 60 percent of borrowers in bond markets were businesses over \$1 billion in revenue, which increased to more than 70 percent by late May of 2020. It also reports that more than 70 percent of firms over \$1 billion in revenue had outstanding bonds at the onset of the pandemic as opposed to only one-third of firms that were below that amount. See Tirupam Goel and José María Serena, *Bonds and syndicated loans during the Covid-19 crisis: decoupled again?*, Bank for International Settlements Bulletin No 29 (August 14, 2020), <https://www.bis.org/publ/bisbull29.pdf>.

³⁶ The Small Business Administration reports that in 2020 small businesses accounted for 99.9 percent of US businesses in their 2020 Small Business Profile available at <https://cdn.advocacy.sba.gov/wp-content/uploads/2020/06/04144224/2020-Small-Business-Economic-Profile-US.pdf>.

³⁷ Banks issued billions in loans to small businesses through the CARES Act Paycheck Protection Program (PPP), but this was fiscal support that was funded by the US Treasury and facilitated by the Small Business Administration through the banking system. The Federal Reserve established the Paycheck Protection Program Liquidity Facility to ensure banks had enough liquidity to deploy the loans by extending credit to banks and taking PPP loans as collateral. The Federal Reserve also established the Main Street Lending Program. This program supported lending to small and medium-sized for-profit businesses and nonprofit organizations that were in sound financial condition before the onset of the COVID-19 pandemic by purchasing participations in loans originated by eligible lenders through a Special Purpose Vehicle set up by the Federal Reserve Bank of Boston. It terminated on January 8, 2021 with a peak deployment of \$16.5 billion.

³⁸ Caitlin McCabe, *Companies Are Flush With Cash—and Ready to Pad Shareholder Pockets*, The Wall Street Journal (May 16, 2021), <https://www.wsj.com/articles/companies-are-flush-with-cashand-ready-to-pad-shareholder-pockets-11621157406>.

³⁹ 89% of the wealth of the stock market is owned by the top 10% wealthiest of Americans, according to June 10, 2021 release of the Federal Reserve’s Financial Accounts of the United States (Release Z.I).

companies authorized \$504 billion of share repurchases as of May 7, 2021, the highest for a similar period in any year.⁴⁰

Many banks have also taken advantage of the Fed-created cheap debt environment—in April of this year, JP Morgan Chase and Bank of America had the largest-ever bank debt issuances of \$13 billion and \$15 billion, respectively, followed by Morgan Stanley and Goldman Sachs with a \$6 billion issuance each. Similar to the nonfinancial corporations, these banks have recently announced plans to distribute record levels of capital to shareholders through dividends and share buybacks. Some of these plans are in excess of the banks' projected net earnings,⁴¹ meaning they are spending all of their earnings plus

the money they have borrowed to enrich their shareholders while depleting their capital. In addition to not serving the purported purpose of these Fed actions, these banks are essentially taking advantage of the Fed's (taxpayer-backed) support of markets to borrow cheaply and, thereby, fund the depletion of their capital, making them less safe.⁴²

“The Fed’s pandemic-related programs and massive asset purchases have undoubtedly brought down the cost of credit...but have done so to an extent that has led to activity by corporations and financial firms that is unrelated to improving the real economy...”

The Fed's pandemic-related programs and massive asset purchases have undoubtedly brought down the cost of credit, which was the objective, but have done so to an extent that has led to activity by corporations and financial firms that is unrelated to improving the real economy and, indeed, may have no broader benefit to society. Junk bonds, referenced above, leveraged lending, private equity, and “zombie” companies⁴³ are other examples of those that benefit from the Fed's programs.

While it is true and appropriate that the Fed cannot directly dictate what companies do with private money they borrow in private markets, it's nonetheless important to recognize that ultimately when the Fed takes such large-scale, market-impacting actions, there will be perverse effects that result in activities that may have little or no social benefit. However well-intended it might be, it will often ultimately end up supporting a companies' shareholders and executives more than it does its workers or the broader economy.

Thus, while it is the case that benefits of the Fed's actions do accrue to most Americans eventually because they forestall further economic decline, tremendous direct benefits accrue to the wealthiest in

⁴⁰ Caitlin McCabe (n 38); See also Liz Ann Sonders, Chief Investment Officer of Charles Schwab, recently reported on her Twitter account updated Goldman Sachs data that shows companies authorized \$683 billion of share repurchases through July 2021, just short of the record in 2018 through the same period. Tweet available at <https://twitter.com/LizAnnSonders/status/1424679773251555328>.

⁴¹ This is based on (1) public announcements made by the US GSIBs shortly following the Fed's public announcement they were removing pandemic-related limitations on dividends and share buybacks on June 24, 2021 and (2) Wall Street analyst consensus earnings projections at that time.

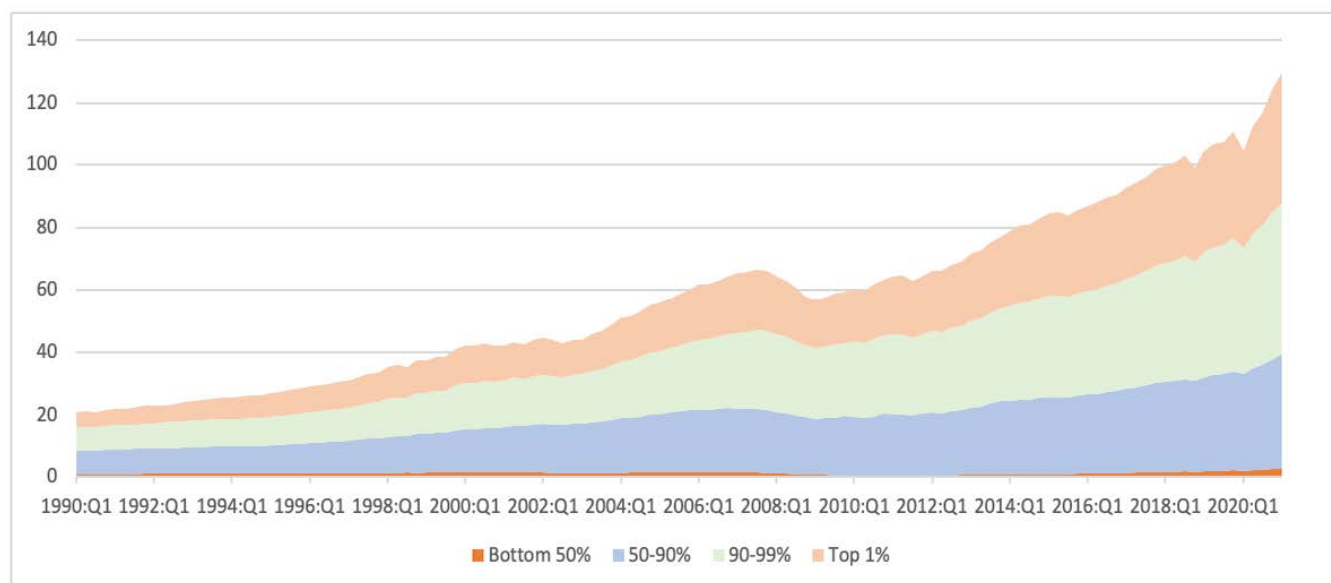
⁴² Despite these corporate actions on share buybacks, Chair Powell has stated it is not clear to him what they have to do with monetary policy and that “businesses make rational decisions generally about...when they should give money back to their shareholders” in response to a question from Representative Ritchie Torres during a hearing before the House Financial Services Committee on July 14, 2021 “Monetary Policy and the State of the Economy.”

⁴³ While there is an argument that many so-called “zombie” companies (insufficient revenue to even service the interest on their debt) will come back to life when the economy revives from the pandemic shutdown (a priority for and purpose of Fed and other government policies), there's little doubt that many other “zombie” companies will never recover and are only still barely “alive” due to Fed policies. In fact, a working paper from the Bank of International Settlements shows that the share of zombie firms was 15 percent in 2017, see Ryan Banerjee and Boris Hofmann, *Corporate zombies: Anatomy and life cycle*, BIS Working Papers No. 882 (September 2020), <https://www.bis.org/publ/work882.pdf>.

the recovery, contributing to a widening of the wealth gap.⁴⁴ Put another way, the benefit that wage-earning Americans or small businesses can expect is to be able to return to work potentially sooner than had Fed support not been in place or, in some cases, keep working when that ability otherwise would have been lost. These are of course very important benefits. But they are different than the eye-popping gains that may directly accrue to larger companies and the wealthy, who are able to take advantage of cheap debt and inflating asset prices to continue paying executive bonuses, distribute capital to shareholders, or significantly increase wealth through rising financial asset values.

Remarkably, between the market collapse in March 2020 and the first quarter of 2021, net worth across all Americans increased at the fastest rate on record, but net worth for the top 1 percent of Americans grew by \$10.3 trillion, and it grew by \$8.5 trillion for the 90 to 99 percent bucket.⁴⁵ That \$18.8 trillion for the top 10% compares to around \$5.7 trillion for the other 90% of Americans (~\$5 trillion for the 50 to 90 percent bucket *and only \$700 billion for the bottom 50 percent*), as illustrated here:

Figure 7: Distribution of Wealth in the United States (\$ Trillions)



Source: Federal Reserve release Financial Accounts of the United States

These facts illustrate a fundamental truth that should be more frequently and forcefully acknowledged by the Fed: it only directly supports banks and financial markets—Wall Street not Main Street. The support this promotes for Main Street is less direct and may be watered down by the actions of banks and others when it does not flow directly through them into the real economy. That is, by keeping banks and other financial institutions operating and in relatively stable condition, these institutions are more likely to continue their normal operations of supporting the economy. But it is not always the case that banks’ actions will in fact provide the support to the economy the Fed is trying to promote. The direct

⁴⁴ The growth of wealth during and after the 2020 pandemic has been highlighted in several articles, *such as* Alistair Gray, *More than 5m people become millionaires despite pandemic*, FINANCIAL TIMES (June 22, 2021), <https://www.ft.com/content/86b99144-ba71-441d-b297-ddcdc94ea7f2>; See also Chase Peterson-Withorn, *Nearly 500 People Became Billionaires During The Pandemic Year*, FORBES (April 6, 2021), <https://www.forbes.com/sites/chasewithorn/2021/04/06/nearly-500-people-have-become-billionaires-during-the-pandemic-year/?sh=425a04e725c0>.

⁴⁵ The disparity in net worth as a percentage of liabilities has also reached record levels. See Joe Rennison, *How the Fed’s fine intentions feed US wealth inequality*, FINANCIAL TIMES (July 26, 2021), <https://www.ft.com/content/57730688-aa49-4549-a127-4b2d625260a4?accessToken=zWAAAXs3Ka-gkc9XcwalqkIFsDohJ0stYIJgpA.MEQCICqR256x32JsX5iwDN-XNKTOlvzWxqTJiQY-JNEvAKpQAIb34Yhv0E4uR8DhbYwF8s7XSP5SFJyMtl0eNfhXbpGWXQ&sharetype=gif?token=9bfd13f3-4ac5-449a-82c8-3dd2e6d72f4d>.

gains associated with Fed actions often accrue mostly to banks, Nonbanks, and other investors, which can reap enormous profits as the markets recover thanks to the massive amounts of Fed and other government support. Thus, while the Fed’s claims that everything it does is ultimately for Main Street families and workers may be technically true, they paint a very incomplete picture.

Main Street Americans—those who are not among the top 10% in terms of wealth—are, at best, downstream and more indirect beneficiaries of the Fed’s actions. They remain hostage to the financial markets and those that profit both from the current market structure and Fed support programs. As a team of market analysts wrote earlier this year, “markets abhor equality to the extent that it stands in the way of rapid earnings and dividend growth.”⁴⁶ Indeed, inequality has been rising for decades as the cost of borrowing available to the wealthiest and corporations has been falling.^{47,48}

Figure 8: Levels of the 10-Year US Treasury Yield and the Gini Coefficient on Income Inequality in the US



Reprinted from *Forget Taper, Real Deal for Bonds at Jackson Hole Is Inequality*, Greg Ritchie (August 17, 2021), BLOOMBERG. Copyright 2021 Bloomberg.

Therefore, the Fed has a duty to act decisively to reduce the many unintended consequences⁴⁹ to the greatest extent possible. The Fed should undertake an analysis, including seeking public input, on how to tailor, target and calibrate its programs in a way that reduces these unintended consequences. It should also implement more targeted regulations or modify existing regulations of the banking system to help minimize non-productive risk-taking activities and maximize benefits to the real economy.

⁴⁶ Jamil Baz, Josh Davis, and Normane Gillmann, *Three Dogs That Did Not Bark: Risk Premia and Stock Market Shocks*, Allianz PIMCO Quantitative Research and Analytics (March 2021), https://www.pimco.com/handlers/displaydocument.ashx?fn=PIMCO_Research_Baz_Davis_Gillmann_Mar2021.pdf.

⁴⁷ Greg Ritchie, *Forget Taper, Real Deal for Bonds at Jackson Hole Is Inequality*, BLOOMBERG (August 17, 2021), <https://www.bloomberg.com/news/articles/2021-08-17/forget-taper-real-deal-for-bonds-at-jackson-hole-is-inequality?sref=mQvUqJZj>.

⁴⁸ It is critical to continue the momentum of furthering an economy that prioritizes workers not only for substantial shorter-term wage gains but also for long-term economic prosperity. See Martin Sandbu, *Class conflict is back at the core of economics*, FINANCIAL TIMES (August 17, 2021), https://www.ft.com/content/a91aa7dc-ac9f-4811-82e7-ce96bd2af99d?accessToken=zwAAAXtZkHblkdOpGqfcrJ9IEdOC586WvSr5nQ.MEUCIGL8SCDuWXoecuMhjtmtJpuvqQwkZo6DiTYsfF2sL14RAiEA_tyeqY8wWvS5BEKh1p80R9FLUKd9jpRTTbphK_fTdEo&sharetype=gif&token=8fad6801-81bb-4d4f-8782-f3c25acaf03a.

⁴⁹ Perhaps tellingly, the Fed unendingly claims an ability to do this when it comes to financial regulation but pleads utter powerlessness to do this regarding monetary policy and its emergency bailout programs. We submit that this is at least a lack of imagination, if not commitment and will.



“Had the banks been better prepared prior to the pandemic to withstand a stressful environment regardless of precipitating cause, such relief may not have been necessary, and certainly could have been smaller.”

The systemically significant Nonbank financial system, which is inextricably interconnected with the banking system, would likely have collapsed in 2020 (as it did in the 2008 Crash) had it not been supported by the Fed, as it was in 2008. As former Fed governor Jeremy Stein remarked:

“. . . if you’re an industry advocate, you might just be tempted to say, well, look it, you know, it wasn’t really all that bad. Yeah, it really wasn’t all that bad, A, because the Fed saved you. And, B . . . [the pandemic] was an alien invasion . . . that allowed [the Fed] to intervene in the corporate bond market in a way that they can’t in normal times.”⁵⁰

As discussed above, it is imperative that the Fed undertake a comprehensive “after action” analysis of its actions in response to the 2020 pandemic and the reasons they were required, apart from the pandemic itself. For example, the Fed simply must identify, analyze, and propose reforms (after public outreach and input) for all those parts of the financial system that remain fragile and prone to failure regardless of the precipitating cause. A failure to do so would be simply unacceptable. The Fed should have already been a leader in publicly discussing these systemic frailties and acting to ensure that they are addressed in a way that minimizes the likelihood the Fed ever has to bail them out again as part of their mandate to promote financial stability.

The Fed Provided Banks with Substantial “Regulatory Relief” in Response to the Pandemic. Relief That May Not Have Been Needed if Banks Were Properly Regulated in Normal Times.

In addition to the actions described above, the Fed under Chair Powell’s leadership also temporarily weakened a number of banking regulations in response to the pandemic, including relief on capital and liquidity requirements for the largest banks.⁵¹ The relief was justified by the Fed as necessary to promote lending, allow large banks to serve as a place for depositors to safely park their money, and encourage them to funnel liquidity back into the markets and the economy. On balance, while they may not have been very effective at prodding the largest banks to lend more, these actions were not particularly problematic and, in most cases, were intended to support the various Fed and CARES Act programs that were put in place (see Appendix 1).

However, taken together some of these temporary relief efforts contradict the many statements by senior Fed officials about the continuing financial strength of the banks throughout the pandemic. Indeed, some of these actions are simply hard to align with other Fed actions in a coherent way and support the view that many of the Fed’s actions represented an implicit bailout of the largest banks and their shareholders. It is noteworthy that, at the onset of the pandemic, the banking industry shamelessly

⁵⁰ Jeremy Stein, Task Force on Financial Stability, The Brookings Institution webinar (June 29, 2021), transcript available at https://www.brookings.edu/wp-content/uploads/2021/06/es_20210629_financial_stability_transcript.pdf

⁵¹ Those many actions were publicly tracked at a Better Markets microsite: *Tracker of Regulatory Agencies Coronavirus Emergency Responses* or *TRACER* for short. See the link at <https://www.bettermarkets-tracer.org/>.



“Under Chair Powell’s leadership, the Fed was inexplicably willing to increase the possibility of yet another taxpayer-supported bailout of too-big-to-fail banks in the face of unprecedented uncertainty in the outlook rather than telling banks to immediately stop all voluntary capital-depleting actions.”

used the pandemic as a pretext to further push for their longstanding deregulatory agenda.⁵² Had the banks been better prepared prior to the pandemic to withstand a stressful environment regardless of precipitating cause, such relief may not have been necessary, and certainly could have been smaller.

The largest banks benefitted directly and enormously from multiple Fed actions including:⁵³

- 1) directly providing banks with much-needed liquidity at the onset of the pandemic-induced market stress through the Fed’s emergency liquidity actions;
- 2) indirectly supporting bank capital levels and earnings through Fed actions to support the markets and economy including the zero interest rate policy, Treasury and MBS purchases, and emergency programs; and
- 3) directly providing capital relief through the temporary change to the calculation of the supplementary leverage ratio (SLR).⁵⁴

The temporary weakening of the SLR requirement, which prevents bank balance sheets from growing too large relative to their level of capital, was supposedly necessary to enable the banks to “support the economy.” However, at the same time, the Fed allowed large banks to continue to deplete capital and reward bank executives and other shareholders through bonuses, dividends and share buybacks.⁵⁵ If the largest banks actually needed direct capital relief from the SLR requirements to “support the economy,” then they could not have at the exact same time also have had enough capital to continue paying huge capital-depleting bonuses to executives and to distribute billions of dollars of capital to shareholders.

Allowing the largest banks to deplete capital at a time when no one had any idea how bad the economic and financial crises were going to get wasn’t just unwise, it was irresponsible. Under Chair Powell’s leadership, the Fed was inexplicably willing to increase the possibility of yet another taxpayer-supported bailout of too-big-to-fail banks in the face of unprecedented uncertainty in the outlook rather than telling banks to immediately stop all voluntary capital-depleting actions. This is exactly the same mistake the Fed made in the run up to the 2008 Crash when it allowed large banks to distribute tens of billions

⁵² For more on this see Better Markets press release by Dennis Kelleher, *Wall Street Biggest Banks Shamelessly Trying to Use Coronavirus to Get Federal Reserve to Weaken Rules* (March 2, 2020), <https://bettermarkets.com/newsroom/wall-street-biggest-banks-shamelessly-trying-use-coronavirus-get-federal-reserve-weaken>.

⁵³ Parts of the CARES act also directly supported the condition of the banking system, such as (1) mortgage forbearance, which allowed banks to avoid putting mortgages into default status and (2) substantial fiscal stimulus through enhanced unemployment benefits and the Paycheck Protection Program, which allowed borrowers to continue to make payments towards their loans. Additionally, the substantial fiscal stimulus helped to bolster the economy generally, which indirectly helped the banking system by preventing the economy from entering a recessionary period.

⁵⁴ 85 Fed. Reg. 20578; press release at <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200401a.htm>.

⁵⁵ Many large banks voluntarily and temporarily suspended share buyback programs (but not dividends) in March 2020. At the end of June 2020, the Fed suspended repurchases and put some modest restrictions on distributions starting in the third quarter of 2020. Stock buybacks were allowed starting in December 2020 and full restrictions were lifted in June 2021. However, these restrictions were woefully late and only capped dividends at their second quarter 2020 level and limited them based on average four quarter earnings. JP Morgan, for example, did not have to reduce its dividend during the restrictions.

of dollars of capital up to and, in some cases, even after they needed huge government bailouts to survive.⁵⁶

This is all the more perplexing because a specific post-crisis tool was created—by the *Federal Reserve Board*—so that this would never happen again.⁵⁷ Astonishingly, the Powell Fed declined to use this clear authority at a time when it was providing critical and massive support that benefitted the largest banks and while acknowledging the unprecedented uncertainty posed by the pandemic. Powell’s Fed allowed the biggest banks in the country to use the freed-up emergency pandemic capital to substitute for the capital the banks were voluntarily and needlessly ejecting. There is no legitimate justification for this and simply allowed banks to enrich shareholders while depleting their capital, making them less resilient, instead of supporting the economy through increased lending or other productive uses in the real economy. Allowing the banks to continue issuing distributions was effectively an acknowledgement by the Fed that it was providing a bailout of the industry **and** bank shareholders.

“Powell’s Fed allowed the biggest banks in the country to use the freed-up emergency pandemic capital to substitute for the capital the banks were voluntarily and needlessly ejecting.”

Moreover, Chair Powell, Vice Chair Quarles, other Fed officials, and the banking industry have all touted the resiliency of the banking system during the pandemic crisis and the significant levels of capital and liquidity at large banks in particular. For example, Vice Chair for Supervision Quarles testified to this continuing strength in both November of last year and May of this year:

“Liquidity and capital remain high and, indeed, have increased at our largest banks over the course of the COVID event. Firms have sharply increased their reserves, setting aside resources today against losses they may incur tomorrow. Banks are well positioned to serve as a bulwark against broader financial and economic stress.”⁵⁸

“Higher levels of capital and liquidity, better risk management, and more robust systems let [the banking system] absorb an unprecedented shock—while providing refuge from market instability, delivering essential public aid, and working constructively to support borrowers and communities. . . Today, the U.S. banking system is actually more liquid and better capitalized than it was a year ago, with over \$100 billion in additional loan loss reserves, leaving it well-positioned to weather future shocks.”⁵⁹

However, none of them has publicly acknowledged that the only reason that was the case was because banks were forced to build up their capital and liquidity against their strident objections and lobbying efforts. Put differently, if the banks’ lobbying army had been successful during consideration and

⁵⁶ See Dennis M. Kelleher and Jack Reidhill, *Stop Wall Street Payouts That Produce TARP Bailouts*, MEDIUM (October 3, 2018), <https://bettermarkets.medium.com/https-medium-com-bettermarkets-stop-wall-street-payouts-that-produce-tarp-bailouts-7647792b3246>.

⁵⁷ See the final Capital Plan Rule of 2011, 76 Fed. Reg. 74631; press release at <https://www.federalreserve.gov/newsevents/press-releases/bcreg20111122a.htm>.

⁵⁸ Randal K. Quarles, *Supervision and Regulation Report*, testimony before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Washington, D.C. (November 10, 2020), <https://www.federalreserve.gov/newsevents/testimony/quarles20201110a.htm>.

⁵⁹ Randal K. Quarles, *Supervision and Regulation*, testimony before the Committee on Financial Services, U.S. House of Representatives, Washington, D.C. (May 19, 2021), <https://www.federalreserve.gov/newsevents/testimony/quarles20210519a.htm>.

implementation of Dodd-Frank regarding what they argued were the right capital and liquidity rules (*i.e.*, as low as possible and filled with loopholes), some large banks may well have failed very quickly in March 2020 just as they had in the 2008 Crash.

Additionally, neither the banks nor the Fed have acknowledged that, without the massive Fed intervention, and fiscal support to consumers and businesses as well as mortgage forbearance through the CARES Act, banks might still have experienced the kind of deterioration in financial condition that could cause or exacerbate a deep financial crisis—even with the stronger post-2008 Crash requirements in place. At the very least, the condition of the banking system would have deteriorated substantially, not improved markedly as it did during the pandemic with the largest banks raking in record profits. Rather than taking a victory lap, the Fed must learn the lessons from the pandemic and use them as a catalyst to examine its regulatory regime and the current set of vulnerabilities the banking system is exposed to, including its increasingly inter-dependent connection to the nonbank financial sector. Moreover, it needs to address the system’s increasing reliance on the Fed to support financial markets.

The Fed Must Publish a Report that Details the Financial System Failures and Deficiencies that Led to its Unprecedented Actions During the Pandemic and the Effects of its Actions

Despite the tremendous support needed by banks and markets, and the perverse and likely very long-lasting effects on the markets of providing that support, the Fed has been lauding the successes of their emergency programs in testimony to Congress,⁶⁰ publications,⁶¹ and other venues. While praise for many of the Fed’s rapid and massive actions is largely well deserved, the underlying fundamental issues that caused many of these market problems have received much less public attention from Fed leaders. They have also not focused enough on the market distortions caused by their emergency pandemic-related actions, the distributional impacts, the policy path to return to “normal,” and how they are going to ensure the market failures highlighted by the pandemic do not occur again when market stress inevitably happens in the future.

Instead of touting the resiliency of the banking system and the strong levels of capital and liquidity—in an unqualified manner—large banks and the Fed should publicly acknowledge that this resiliency was due in large part to:

- the stronger pre-Trump financial protection rules, which the banks fought against;
- the pandemic-related support provided by Fed; and
- the pandemic-related support from taxpayers through the CARES Act and related fiscal actions.

And, instead of putting the primary focus on the programs restoring “smooth functioning of financial markets,” the Fed needs to perform a thorough, data-driven assessment of the market vulnerabilities that led, in significant part, to the need for these facilities—*i.e.*, why the markets needed so much support—and the potentially adverse structural effects of providing such large-scale and wide-ranging support.

⁶⁰ *Id.*

⁶¹ For example, see the Federal Reserve Bank of New York, *Open Market Operations During 2020* (May 2021), <https://www.newyorkfed.org/medialibrary/media/markets/omo/omo2020-pdf.pdf>.



“Congress did not require the Fed to ease standards for these large banks, but, with Chair Powell in charge and Vice Chair Quarles pursuing Trump’s deregulatory agenda, it nonetheless exercised its discretion to do so.”

Photographer: Andrew Harrer/Bloomberg via Getty Images.

Such a review should cover:

- 1) non-pandemic-specific factors that led the breakdown in March and April of 2020 to require massive emergency actions, not only covering the Treasury markets, MMFs and hedge funds, but also any other nonbank financial sector vulnerabilities as well as the role of the largest banks and their securities dealers;
- 2) the extent to which the Fed’s deregulatory efforts during the Trump administration, had they all gone into place prior to the pandemic, would have reduced the resiliency of the banking system and increased the need for support and regulatory relief in the context of the pandemic;⁶²
- 3) policy options for addressing those factors and the pros and cons of each, especially how each option will help to address the too-big-to-fail problem, ever-growing moral hazard and the market-distorting belief among market participants in the “Fed put”;
- 4) an assessment of the facilities used and actions taken by the Fed in response to the pandemic, including the degree to which their stated purposes were achieved, and any unintended negative consequences that have resulted; and
- 5) the complexities of and issues that could arise with unwinding its enormous balance sheet and how much of the current and post-2008 Crash support it assesses to be part of a “new normal.”

Having a public dialogue about these issues is of critical importance, because ultimately it is the taxpayers that are put at risk by these policy actions. Apparently, these critical and vital policy discussions are occurring in closed-door meetings to some unknown extent, and the only public information has been fairly cryptic language in the occasional speech or buried in meeting minutes.

One key example relates to the repo market, which was bailed out by the Fed during the 2008 Crash, in September 2019, and again in March 2020. The repo market is integral to the functioning of banks and the financial system, but it is also an early tripwire for financial crashes because it is “hot money,” moving quickly at the first sign of trouble and creating liquidity strains. The ongoing turmoil in this market has been used by the Wall Street’s biggest banks to pressure the Fed to ease leverage restrictions⁶³ and to backstop the industry’s repo activities. The Fed has now put in place the industry’s desired permanent backstop by recently announcing and implementing standing repo facilities through

⁶² Importantly, some of the Fed’s deregulatory measures had not taken effect prior to the pandemic, and so it was in fact the pre-Trump era post-2008 Crash capital standards that had made the banks more resilient. The Fed should also look at how the now-weaker standards would have reduced that resilience across the large banks.

⁶³ For more on this, see Tim Clark, *Don’t Use Repo Volatility as a Reason to Roll Back Bank Regulations*, BLOOMBERG (December 20, 2019) <https://www.bloomberg.com/opinion/articles/2019-12-20/don-t-use-repo-market-volatility-to-roll-back-bank-regulations>.

which the Fed would **always** stand ready to jump in when short-term funding markets are disrupted.^{64,65} These facilities could not only increase risk to taxpayers and put them on the hook when the repo market fails to function, but also inevitably increase moral hazard among market participants. Implementing the facilities is a clear indication by the Fed that the repo market is unable to operate without ongoing support from the Fed and permanently inserts the Fed into this private-sector market.

While it was clear some policy considerations were necessary to enhance the functioning of the Treasury repo market, the consideration of options and eventual decision to implement standing repo facilities failed to involve the public in any meaningful way. The only information shared with the public was high-level commentary in public forums or buried in meeting minutes. For example, the April 2021 meeting minutes from the Federal Open Market Committee (FOMC)⁶⁶ only noted that a “substantial majority of participants” felt the benefits outweighed the costs of the creation of a standing repo facility to alleviate “worrisome pressures” in the Treasury markets. These minutes and the June 2021 minutes discussed some of the costs and benefits at a high level, but the public was never presented with the analysis of costs and benefits, and so nobody from the public could ask, for example, how the Fed assessed the cost of the additional moral hazard that would certainly result. Moreover, the public was not made aware of the alternatives, and so was unable to assess which option is best for the public rather than for broker-dealers or other financial market participants. This asymmetrical non-transparency is dangerous: those very same financial market participants that will benefit from this program are frequently and routinely “consulted” by the Fed on such programs and considerations, while the broader public has virtually no information on and no voice in the discussions.

Chair Powell and Vice Chair Quarles have said they are considering other policy options related to Treasury markets, MMFs, and the SLR. However, again they have not yet shared details or sought input from the public on their thinking. The public has been left to speculate on what the Fed might do, having to rely on experts from academia, other government entities, and the private sector instead of the Fed. Moreover, Powell’s Fed would benefit from the many experts and interested parties who could participate in a robust public debate.

Chair Powell should announce that the Fed will take no further actions on these critical market issues until the public has been fully informed of the various alternatives and given an opportunity to provide meaningful input. Otherwise, it is just the Fed and market participants behind closed doors making decisions about the risks and costs to the country’s taxpayers, financial system and the economy itself. When such actions could risk privatizing profits and socializing losses by shifting them to the taxpayers, the Fed simply must have a maximum transparency policy, ensuring that there is not just input, but oversight and accountability. Anything less is a disservice to the public who are going to be sent the bill for the next bailout. Chair Powell should have already been leading these efforts, but better late than never: he can start now.

⁶⁴ See Board of Governors of the Federal Reserve System, *Statement Regarding Repurchase Agreement Arrangements* (July 28, 2021) available at <https://www.federalreserve.gov/newsevents/pressreleases/monetary20210728b.htm>.

⁶⁵ The two standing repurchase agreement facilities provide short-term funding in exchange for collateral. The only assets that are eligible to be provided to the Federal Reserve as collateral are Treasury securities, agency debt securities, and agency mortgage-backed securities.

⁶⁶ Federal Open Market Committee, *Minutes of the Federal Open Market Committee* (April 27-28, 2021), <https://www.federalreserve.gov/monetarypolicy/files/fomcminutes20210428.pdf>.



The Fed's Responsibility for Financial Stability, Regulation, and Supervision

The Fed's record under Chairman Powell on oversight of large banks since 2018 is not a good one.⁶⁷ With a Trump-appointed Vice Chair for Supervision leading the charge, Chairman Powell and all other members of the Federal Reserve Board but one voted time and again to weaken post-crisis reforms that the Fed had previously put in place from 2009 - 2017.⁶⁸ These were reforms that, although in some areas unfinished and/or not as strong as they should have been, had made the system significantly safer.

Starting in 2018, the Fed's approach to banking regulation and supervision shifted 180 degrees, with Chair Powell's support and votes. Rather than continuing to work to strengthen or at least maintain enhanced post-crisis standards to ensure large banks posed less risk to the system, the Fed's focus shifted to ostensibly being "fairer" to large banks and easing the strengthened post-crisis requirements. The Fed's to-do list began to look a lot like the large banks' extensive deregulatory wish-list.

Important post-2008 Crash reforms have been under attack by the industry from the start, but the prior administration and the pre-Chair Powell Fed resisted those baseless attacks and enacted a comprehensive set of reforms to protect Main Street families, homes, jobs, and savings from Wall Street's high risk and often not socially beneficial activities. Those reforms were severely weakened during the Trump administration's efforts to roll back regulations across multiple sectors.

For example, in 2018, Congress passed the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA). This law changed the Dodd-Frank Act definition of systemically important banks, raising the asset size-based threshold for the required application of stronger rules and standards for bank holding companies from \$50 billion to \$250 billion. It eliminated the legislative requirement that enhanced standards for large banks be applied to bank holding companies with between \$50 billion and \$100 billion in assets. In addition, EGRRCPA delegated to the Fed's discretion the determination of whether it should continue to apply the stronger standards to bank holding companies with assets of between \$100 billion and \$250 billion.

⁶⁷ See Tim Clark and Dennis Kelleher (n 7).

⁶⁸ Fed Governor Lael Brainard dissented on all of these actions to weaken the financial protection rules. Her detailed dissenting statements provided clear notice to Chair Powell and others as to how the rules were being weakened and why they were unwise and dangerous. None of the other governors on the Fed Board can claim that they did not hear about the foreseeable consequences of their deregulatory actions. See Better Markets blog, *Fed's Lael Brainard's Outstanding Record Fighting Wall Street and Protecting Main Street* (July 23, 2021), <https://bettermarkets.com/blog/fed-s-lael-brainard-s-outstanding-record-fighting-wall-street-and-protecting-main-street>.



“...The Fed under Chair Powell enacted the required provisions of EGRRCPA, but then exercised their discretion to go even further and give the industry much of what it has long wanted over detailed and appropriate dissents from Fed Governor Lael Brainard...”

Photographer: Zach Gibson/Bloomberg via Getty Images.

In efforts led by Vice Chair Quarles, the Fed under Chair Powell enacted the required provisions of EGRRCPA, but then exercised their discretion to go even further and give the industry much of what it has long wanted over detailed and appropriate dissents from Fed Governor Lael Brainard and public advocacy groups like Better Markets.⁶⁹ Most importantly, the Fed’s weakening of financial protections in six key areas—with Chair Powell voting for every one of them—went significantly further than was required by the law:

- 1) loosening capital standards, including the effective capital requirements for even the very largest banks that were built into the Fed’s supervisory stress testing program;
- 2) weakening what had been more assertive post-crisis banking supervision;
- 3) easing liquidity requirements for large banks with less than \$700 billion of assets;⁷⁰
- 4) reducing the frequency at which large banks must prepare resolution plans (“living wills”);
- 5) eliminating margin requirements for certain derivatives positions transacted between banks and their affiliates, increasing risks at the banks; and
- 6) making changes weakening the Volcker Rule and easing restrictions on banks’ proprietary trading and other risky investments, including in hedge funds and private equity funds.

Weakening Stress Tests, Capital Planning, and Supervisory Consequences: Snatching Defeat from the Jaws of Victory

The first two of those changes undermine the value of what is perhaps the most important post-crisis supervisory initiative: the supervisory stress testing program and related banking supervision efforts.⁷¹ In March 2020, the Federal Reserve Board changed its highly successful stress testing program and implemented the Stress Capital Buffer (SCB) in its capital rules. This change force fit the Fed’s previously standalone supervisory stress tests directly into the capital rules for the large banks subject to the Fed’s Comprehensive Capital Analysis and Review program (CCAR)—those with assets of over \$100 billion. In implementing the SCB, the Fed made major changes to various aspects of the CCAR program that

⁶⁹ For more on the Federal Reserve’s deregulation efforts and associated references to comment letters by Better Markets, see Better Markets’ Special Report, *Road to Recovery: Protecting Main Street from President Trump’s Dangerous Deregulation of Wall Street* (September 15, 2020), https://bettermarkets.com/sites/default/files/BetterMarkets_Road_To_Recovery_Sept_15_2020_0.pdf.

⁷⁰ It should be noted that although not an existing regulation when Powell was elevated to Chair, the final rule for the Net Stable Funding Ratio was significantly weakened under his leadership as compared to the proposed rule. The rule was proposed prior to his term as Chair, and that version was strongly supported by Better Markets. The final rule is full of exclusions, limitations, definition changes, and needless complexity, greatly weakening the rule and impairing its effectiveness.

⁷¹ For more information around the Federal Reserve’s stress testing program and the deregulatory changes, see Better Markets’ Fact Sheet, *The Federal Reserve’s 2021 Stress Test Results: All Bark and No Bite* (June 28, 2021), <https://bettermarkets.com/resources/federal-reserves-2021-stress-test-results-all-bark-and-no-bite>.

undermined its value and weakened both the effective capital requirements for, and the supervision of, the largest banks.

Stress-related capital requirements were significantly weakened through three important modifications to the stress test:

- 1) eliminating the requirement that banks meet minimum leverage ratio standards in the stress test—as noted above, the Fed weakened leverage requirements during the pandemic because the banks were not holding enough of a buffer in advance of pandemic;
- 2) changing the stress test assumptions to no longer require banks to capitalize for possible growth under stress—the largest six banks’ balance sheets did in fact grow by an aggregate 23% between the end of 2019 and the first quarter of this year;
- 3) reducing the amount of capital banks would need to fund their planned capital distributions in the stress test from 9 quarters of dividends and buybacks to just four quarters of dividends.

“It is inexplicable that the Fed would unilaterally empower the biggest banks to essentially ignore the plans that the Fed itself requires the banks to submit.”

In the final rule Fed staff estimated the transition to the SCB to increase capital across the largest banks by \$11 billion.⁷² However, the rule unquestionably reduced stress-based capital requirements from what they would have been absent the modifications above, including for the largest, most complex banks, and likely reduced capital requirements overall—Governor Brainard’s dissent noted that the rule could be expected to reduce capital requirements for large banks overall by roughly \$100 billion and nearly \$40 billion for the largest, most complex banks.^{73,74}

In addition, Powell’s Fed has undermined the forward-looking nature of the CCAR capital planning process, which required banks to sufficiently consider the risks to their institutions from future crises and to plan for a level of capital that would be sufficient to absorb the losses associated with those risks. The Fed’s stress test results have become more predictable, and the Fed has released more information about its stress test, allowing the banks to more easily manage to each year’s requirement and structure positions to reduce loss estimates. The SCB included stress-based capital requirements as part of the real-time capital requirement and eliminated the requirement that banks receive prior approval from the Fed before distributing more capital than stated in their annual capital plan submissions. And, almost as if to encourage banks to take the wrong actions at the wrong time, the Fed implemented a rule change that made it easier for banks to continue to erode capital through dividends and buybacks even when earnings were rapidly deteriorating and the outlook clearly indicated further severe stress on the horizon.⁷⁵

⁷² 85 FR 15576 press release at <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200304a.htm>.

⁷³ Governor Lael Brainard, *Statement by Governor Brainard, Board of Governors of the Federal Reserve System* (March 4, 2020), <https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20200304a.htm>.

⁷⁴ It should be noted that the estimate in the proposal and the estimate by Governor Brainard are based on past stress test results and perhaps other analysis that could lead to widely varying results that additionally would differ from outcomes in the future. Neither estimate has supporting material to indicate how they were computed.

⁷⁵ See Better Markets’ comment letter on the change in definition of eligible retained income and its impact on the stress capital buffer (SCB) distribution restrictions (May 4, 2020), https://bettermarkets.com/sites/default/files/Better_Markets_Comment_Letter_on_Regulatory_Capital_Rule-Eligible_Retained_Income.pdf.

It is inexplicable that the Fed would unilaterally empower the biggest banks to essentially ignore the plans that the Fed itself requires the banks to submit. This makes it easier for banks to deplete their capital even when clearly facing times of potential stress. Banks do not need any incentive in this regard, as they did not even hesitate to continue their dividends at the onset of the unprecedented pandemic-induced economic shutdown and extreme financial stress last year. That is exactly what they did in 2008, ejecting capital even after the collapse of Lehman Brothers and the receipt by some of TARP bailout money.⁷⁶ This makes banks more likely to fail and makes it more likely that banks will receive taxpayer bailouts to avoid contagion and catastrophe in a crisis. This is the exact opposite of what a responsible Fed that prioritizes the public interest should do.

On the supervisory front the Powell Fed also has moved in the wrong direction and undermined successful practices that were implemented after the 2008 Crash, practices that had finally gotten the attention of the largest banks and forced them to take seriously the need for strong risk management. The Fed eliminated the highly effective CCAR “qualitative objection,” which had given the Fed the option to restrict banks’ dividends and share buybacks if Fed supervisors found material problems in large banks’ practices for identifying and managing risks. This very powerful tool provided the Fed with a direct link between supervisors’ qualitative assessments of key bank practices and meaningful consequences for banks with dangerously bad practices. Bank supervisors could ensure that banks prioritized risk management and had effective systems in place to manage their risks.

“On the supervisory front the Powell Fed also has moved in the wrong direction and undermined successful practices that were implemented after the 2008 Crash, practices that had finally gotten the largest banks attention and forced them to take seriously the need for strong risk management.”

Because the banks highly value their ability to distribute capital via dividends and share buybacks, this potential objection by the Fed and its restrictions on that ability forced bank boards of directors and senior management to allocate time and resources to ensuring adequate risk management, making the banks and the system safer. Removal of the qualitative objection by Powell’s Fed significantly damaged the ability of Fed banking supervisors to hold banks accountable for dangerously bad practices and created a strong incentive for banks to de-prioritize efforts to improve capital planning and risk management practices. As important, this unilateral disarmament by the Fed sent a message throughout the Fed supervisory system that the Fed leadership—including importantly Chair Powell himself—were downplaying the importance of ensuring that banks were prioritizing robust and effective risk management and capital planning.

It is also worth noting that the risks highlighted by the recent collapse of the Archegos hedge fund provide clear evidence that the Fed’s confidence in large banks’ post-crisis improvements in risk management—which was the stated basis for eliminating the CCAR qualitative objection—was misplaced. Clearly, some of the largest and supposedly most sophisticated global US banks, including Goldman Sachs and Morgan Stanley, misidentified and/or mismanaged the risks of their prime brokerage activities.⁷⁷ Chair Powell has admitted as much in his post-FOMC press conference in April of this year—“It seems

⁷⁶ See Dennis M. Kelleher and Jack Reidhill (n 56).

⁷⁷ Of course, Archegos isn’t the only example. The recent criminal cases (in addition to the innumerable civil actions) against both JPMorgan Chase and Goldman Sachs provide powerful evidence of the inadequacies of their risk management, compliance, legal and audit operations. See Better Markets blog *Better Markets Fights to Stop the Wall Street Crime Spree, Releases Two Reports on JPMorgan Chase’s and Goldman Sachs’ 20 Years of Criminal and Illegal Activity* (September 30, 2020), <https://bettermarkets.com/newsroom/better-markets-fights-stop-wall-street-crime-spree-releases-two-reports-jpmorgan-chase-s>.



“This type of unrealized losses was an important feature of the rampant uncertainty about banks’ financial soundness that contributed to panic and crash during the 2008 Crisis. Obscuring the banks’ true financial condition by allowing this ‘opt out’ is dangerous.”

as though there were risk-management breakdowns at some of the firms”—but also stated that these breakdowns were “not an indictment on [the Fed’s] supervision.”⁷⁸ Even if this were not an indictment on the Fed’s supervision, which is a curious statement, it demonstrates that firms will tend to deprioritize their risk management practices when there is money to be made and that they must be pushed hard by their supervisors, including through facing meaningful supervisory consequences when their practices are bad. The Fed’s explicit weakening of supervisory consequences of poor risk management through elimination of the CCAR qualitative objection was a huge mistake.

Deregulation was Greatest for Banks between \$100 and \$700 Billion of Assets, Despite not Being Required by EGRRCPA

As noted above, Powell’s Fed went even further in weakening regulations for those large banks with assets between \$100 billion and \$700 billion as part of what the Fed calls “tailoring”⁷⁹ of regulatory requirements to banks of different sizes. Banks in this range represent a significant share of the U.S. banking system, and severe problems at such banks could without question represent a threat to the system in a downturn. Congress did not require the Fed to ease standards for these large banks, but, with Chair Powell in charge and Vice Chair Quarles pursuing Trump’s deregulatory agenda, it nonetheless exercised its discretion to do so.

The weakening in capital requirements affected this group of banks significantly—the Fed’s final rule estimated a \$35 billion reduction in capital requirements for these banks and Governor Brainard’s dissent estimated the reduction to be \$65 billion.⁸⁰ In addition to the weakening in capital requirements described above, these banks are now also allowed to “opt out” of including unrealized losses on securities in their stress test results and SCB capital requirement. Unrealized losses were an important feature of the rampant uncertainty about banks’ financial soundness that contributed to panic and crash during the 2008 Crisis. Obscuring the banks’ true financial condition by allowing this “opt out” is dangerous.

Liquidity requirements were weakened for these firms by lowering requirements for how much liquidity under stress they needed to be prepared for under the Liquidity Coverage Ratio (LCR). Although not required by EGRRCPA, Powell’s Fed also reduced the LCR requirement for banks in the \$250 to \$700 billion size range and completely eliminated it for banks in the \$100 to \$250 billion range. Similarly, the

⁷⁸ While some of the facts were unique to Credit Suisse, the recent investigation and report into that bank’s involvement with Archegos, including multiple material deficiencies in risk management, likely provide some insight to what happened at the US based banks as well. See Credit Suisse announcement and full report available at <https://www.credit-suisse.com/about-us-news/en/articles/media-releases/archegos-202107.html>.

⁷⁹ The deregulatory agenda enacted under Chair Powell was justified by euphemisms like “tailoring,” “right-sizing,” and “calibrating.” However, such changes were always deregulatory in nature and always benefited the banks. If in fact such changes were truly based on tailoring, then the final result would cause some to benefit the banks and some not to. The fact that they were all one-sided in favor of the banks reveals the truth behind the euphemisms.

⁸⁰ See Governor Lael Brainard (n 72).

requirement for living will submissions was reduced in frequency to only once every six years for banks between \$250 billion to \$700 billion and eliminated altogether for banks between \$100 to \$250 billion.

It is important to remember that in March 2008 Bear Stearns was only \$395 billion in assets but received a Fed-brokered fire sale after the Fed guaranteed \$30 billion of its most toxic assets. Lehman Brothers had total assets of \$639 billion at the time it collapsed and ignited the contagion that engulfed the US and global financial system and became the 2008 Crash. While those figures are not present values, it is informative to see how utterly useless a living will for any one of them would be if it was six years old as is provided for under the Fed’s current rules for banks between \$250 billion to \$700 billion.

These dangerous actions by Powell’s Fed are highlighted by a quick glance at the size of US banks today:

Table 1: Total Assets of Top 15 Bank Holding Companies as-of March 2021

RANK	BANK HOLDING COMPANY	TOTAL ASSETS (\$B)
1	JP Morgan Chase & Co.	3,689
2	Bank of America	2,970
3	Citigroup	2,314
4	Wells Fargo & Co.	1,960
5	Goldman Sachs	1,302
6	Morgan Stanley	1,159
7	Charles Schwab	563
8	US Bancorp	553
9	TD Group	518
10	Truist Financial	518
11	PNC Financial	475
12	Bank of New York Mellon	465
13	Capital One	425
14	TIAA	329
15	State Street	317

Source: Federal Reserve FR Y-9C data collection

Under the new rules Powell voted for, the eight largest, most complex banks⁸¹ have to file so-called full living wills only every four years, with other banks filing full plans every six years. That is senselessly gutting the value of living wills and reversing momentum that, while far from making these banks resolvable, was at least forcing large banks to prepare better for their own demise. This change has made the too-big-to-fail problem worse and taxpayer bailouts more likely. For example, if these rules applied before the 2008 Crash and if Lehman Brothers had filed its living will in 2002 or even 2004, it would have been virtually useless when it failed in 2008 because its operations, activities, leverage, derivatives, structured products, and other actions bore little relationship to what they were four to six years earlier.

Taken together, these broad-based deregulatory efforts have materially eroded valuable and successful post-crisis reforms and undermined the safety and soundness of the banking system, materially increasing risks to the system. However, Chair Powell remains comfortable with this deregulation, as was made apparent during his recent testimony to both the House and Senate in mid-July of this

⁸¹ These banks are designated as Global Systemically Important Banks (GSIBs): Bank of America, The Bank of New York Mellon, Citigroup, Goldman Sachs, JP Morgan Chase, Morgan Stanley, State Street, and Wells Fargo.

year. Not only does he feel that the pandemic demonstrated that “the level of loss absorbing capital in the system is about right,” he asserted that the Fed under his leadership has “done a lot of things to strengthen regulation and capital.”⁸² Such statements strongly indicate that Powell has no intention of examining the effects of the significant weakening under his leadership of important regulations and supervisory processes that took years to build, considering strengthening those regulations from their currently weakened state or taking even further steps that would make the banking system more resilient. Indeed, such actions would require Chair Powell to repudiate his past support and votes for the deregulation discussed above.

In response to the financial system’s vulnerabilities being made apparent yet again during the pandemic, the Fed should be leading in “re-regulating” the banking system, not simply by putting key post-2008 Crash reforms back in place but by fundamentally re-assessing where the regulatory landscape needs to be strengthened to reduce vulnerabilities and by pushing for reforms.⁸³ After all, the pandemic-caused economic shut down and financial crash was a live stress test of the post-Dodd-Frank financial regulatory system. The regulatory agencies should be closely analyzing what happened (and importantly what could have happened without regulatory relief and trillions in Fed support), what worked, what didn’t, and why. It is astonishing that isn’t happening and that the Fed isn’t in the lead given that it once again had to bail out the bank and nonbank financial system.

“In response to the financial system’s vulnerabilities being made apparent yet again during the pandemic, the Fed should be leading in ‘re-regulating’ the banking system...”

Additionally, as long as the Fed has a significant presence in the economy and private markets, there must be more and stricter regulation of the bank and nonbank sectors. As Simon Johnson of MIT recently stated, the Fed needs “strong financial regulation to cope with asset bubbles that only become more likely during prolonged periods of easy money,”⁸⁴ as is the situation today. Financial stability isn’t simply about ensuring there is “smooth functioning” financial markets. It is also critically about proper risk management not only by banks and other financial institutions but also by the Fed itself, and regulation of the banking system is perhaps the most significant part of that. After all, in our capitalism-based market structure, the banking system is supposed to be serving the function as the market intermediary even in times of stress, and the Fed is only supposed to be the “lender of last resort.” However, the “last resort” is becoming more frequent. And this situation is all the more likely when the financial markets are pumped full of liquidity and investors are taking any avenue to invest it. Proper regulation and accompanying strong supervision will help to prevent bubbles and pressures from forming in the markets and ensure that the financial system is better prepared and able to absorb them when they do.

⁸² These quotes are portions of Chair Powell’s responses to questions by Senators Sherrod Brown and Elizabeth Warren during the hearing on July 15, 2021 with the Senate Committee on Banking, Housing, and Urban Affairs “The Semiannual Monetary Policy Report to the Congress.”

⁸³ See Better Markets report on deregulation (n 7) and needed reforms (n 69).

⁸⁴ Simon Johnson in Politico’s July 16, 2021 Morning Money regarding the illogic of re-appointing Chair Powell and appointing a “strong” Vice Chair for Supervision to replace Randal Quarles. See also Revolving Door Project’s “one pager”, *No, Biden Can’t Just “Appoint A Strong Vice Chair Of Supervision* (August 2021), <https://therevolvingdoorproject.org/wp-content/uploads/2021/08/No-Biden-Cant-Just-Appoint-a-Strong-Vice-Chair-of-Supervision-3.pdf>.



Photographer: Michael Nagle/Bloomberg via Getty Images.

The Fed’s Monetary Policy Dual Mandate

Over the last year in the midst of the ongoing turmoil from the pandemic, Chair Powell and the Fed unveiled and implemented a new monetary policy approach with unanimous support from the members of the FOMC. This new monetary policy approach, outlined by Powell in his Jackson Hole speech in August 2020,⁸⁵ puts a greater emphasis on the appropriate goal of achieving maximum employment through three key modifications:

- 1) defining the concept of maximum employment to be a “broad and inclusive” goal, which includes consideration of employment levels along different lines, including race;
- 2) changing the focus from deviations in employment from the maximum level (which at best can only be estimated anyway) to shortfalls of employment from possible maximum levels; and
- 3) taking a longer-term perspective about the inflation target by seeking to maintain an average level of 2 percent over time rather than holding to that absolute target. In other words, some periods of inflation above 2 percent will be tolerated in pursuit of maximum employment goals.

These changes will result in the Fed maintaining an expansionary position for monetary policy to promote maximum employment until there are persistent inflationary pressures that seem to be bringing up long-term average inflation. Chair Powell and his colleagues therefore want to hold interest rates at lower levels for an extended period, longer than the prior policy would have suggested. This theoretically will boost employment across struggling segments of the population and could ultimately be beneficial to lower income and minority populations in closing the employment and income gaps. Governor Lael Brainard has noted that had that policy been in place previously, the rate hikes that began in 2015 would have occurred later, allowing for greater labor market gains.⁸⁶

To date, the approach has been applauded by many for its greater focus on maximum employment levels, changes to strict inflation targeting, and a broader conception of maximum employment. Others have found it to be too little to make a meaningful difference in achieving greater equity in labor markets while exacerbating the wealth gap or, alternatively, too focused on employment to catch runaway inflation early on, increasing the risk of high inflation. But more equitable and tighter labor markets could help to

⁸⁵ See speech by Chair Jerome Powell (n 14).

⁸⁶ Speech by Federal Reserve Governor Lael Brainard Bringing the Statement on Longer-Run Goals and Monetary Policy Strategy into Alignment with Longer-Run Changes in the Economy at the event “How the Fed Will Respond to the COVID-19 Recession in an Era of Low Rates and Low Inflation” hosted by the Hutchins Center on Fiscal and Monetary Policy at the Brookings Institution, Washington, D.C. on September 1, 2020, <https://www.federalreserve.gov/newsevents/speech/brainard20200901a.htm>.

close the income gap by creating better distributed and higher earnings which, combined with greater access to credit, would be a foundational step to closing the wealth gap.

The concerns of critics are not baseless. The wealth gap has increased materially in a short period of time over the course of the pandemic as asset prices have increased as a consequence of the zero-interest-rate policy and additional boost from increased liquidity in the markets; financial assets are mostly owned by the wealthy.⁸⁷ And asset valuations are high by historical standards, including for the riskiest of assets, which risks turning into large asset price bubbles that could lead to financial crises when those bubbles burst. These crises hurt the poor the most. Furthermore, this policy was conceived and effectively given a trial run in 2019 prior to the pandemic, so it is difficult to say how it will affect markets and the economy during such an unprecedented time and with a Fed balance sheet size of over \$8 trillion.

Additionally, inflation recently has been coming in at higher-than-expected levels. Critics fear this could result in a situation of “too much too late” when the Fed has to over-react (“slam the breaks”) if inflation gets out of control because the new policy allows inflation to rise above the target for an indeterminate amount of time. The concern is that, if the Fed acts too late and therefore raises rates too much too quickly, the result would be high inflation with the inflation fighting actions potentially creating a weak economy if not causing a recession. This is a concern as old as central banking, and historically it has outweighed concerns about improving the labor market, to the detriment of workers.

However, prior to the recent and quite possibly short-term inflationary pressures, inflation has generally remained at or below the 2 percent target since the 2008 Crash. Indeed, despite those critics that are fearing the worst is yet to come, indications are that inflation expectations are anchored around the 2 percent target in the longer term and that the current higher inflation will abate and revert to those long-run expectations.⁸⁸ Additionally, many categories that have been leading to the uptick in inflation have resulted from pandemic-related supply-side constraints and pent-up demand from 2020.⁸⁹

Importantly, real unemployment remains decidedly below maximum employment, and it is necessary to reverse the income and wealth gaps that have been growing for decades. Closing the employment and income gaps are important steps to reducing the wealth gap in the long run, and the new policy framework can help reduce the employment and income gaps by prioritizing the labor market. If a broader set of people have higher and more stable income as well as better access to credit, they can purchase assets such as homes to increase wealth over time. The Powell Fed is right to be pursuing this approach, though only time will tell if it will succeed.

⁸⁷ About this new monetary policy framework, former FDIC Sheila Bair posted the following on her Twitter account on August 28, 2020 – “[Though] well-intentioned, the Fed’s new policy will just give it more reason to keep rates near zero for a very long time, pumping more cheap debt into the system, making the big bigger, the rich richer, and dragging down economic innovation and growth.”

⁸⁸ The second quarter 2021 results of the Survey of Professional Forecasters from the Federal Reserve Bank of Philadelphia shows that the median forecast of headline Personal Consumption Expenditure (PCE) of those surveyed is 2.2 percent for both 2022 and 2023. The June 2021 results of the Surveys of Consumers from the University of Michigan show that while year-ahead inflation expectations are 4.2 percent, longer term expectations are 2.8 percent with nearly 40 percent of respondents expecting inflation of 2 percent or less. The July 2021 preliminary results showed similar longer term expectations of 2.9 percent. Additionally, as of mid-August 2021, inflation implied from Treasury Inflation Protected Securities (TIPS) is around 2.3 percent for both the 10-year breakeven inflation rate and inflation expectations for a five-year period that begins five years from the present.

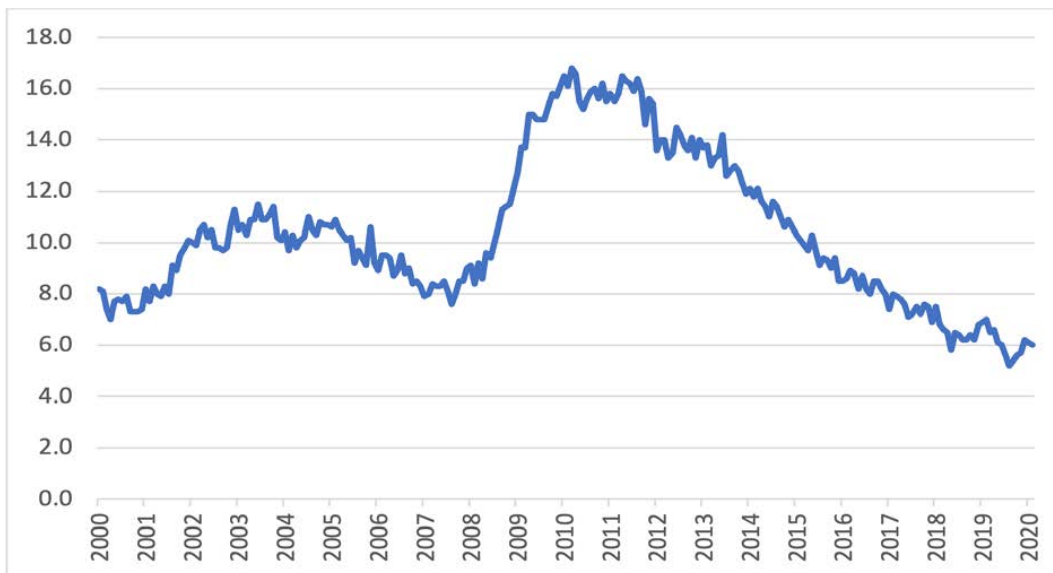
⁸⁹ See Colby Smith, *Sticker shock: what is driving US inflation higher?*, Financial Times (July 13, 2021), <https://www.ft.com/content/aadaa577-b286-443f-b173-256dfc4af6a5>.



The Fed’s Role in Racial Justice

In his June 2020 press conference Powell stated “everyone deserves the opportunity to participate fully in our society and our economy,” subsequently making a number of statements about the need to address growing inequality. He has noted that the lowest-ever Black unemployment rate was achieved in 2019 without a negative impact to inflation, a case-in-point precursor to the new monetary policy framework.

Figure 9: Black unemployment rate



Source: U.S. Bureau of Labor Statistics, Employment Situation Release

As discussed above, this new framework prioritizes the strength of the labor market and makes the Fed’s goal on maximum employment more inclusive. However, Chair Powell has stopped short of providing more details on what inclusivity will mean in practice and has not directly discussed the issue of how easy monetary policy and other pandemic-related actions have dramatically increased the wealth gap by pushing up asset prices. More communication on these issues is needed.

As a first step, the Fed should greatly increase its communication around issues of racial justice and their relationship to the economy and financial system. The Fed has started to shed some light on the inclusivity picture by providing employment rate metrics broken out by race in its Monetary Policy Report and in public venues, but it should be communicating more detailed metrics more regularly and openly

discussing the issues, importantly including the causes and the range of possible solutions. One good source of information is the Survey of Consumer Finances, which provides a view of income and wealth by race, but it is conducted only every three years. Including in-depth discussions on the employment, income, and wealth gaps and their place in monetary policy decisions in the Monetary Policy Report would be a good start. Similarly, analysis on the erosion of net real (after inflation) purchasing power over time for low-income households and the economic benefits of reversing these trends should be included.

Additionally, more needs to be said and done with respect to the financial industry's role in promoting racial equity. Bank lending and credit availability to communities of color is a key component to enhancing economic well-being. The Fed and the other bank regulatory agencies (the FDIC and the OCC) have the ability and authority to enhance credit availability through the enforcement of the Community Reinvestment Act (CRA), which provides a strong incentive for banks to meet the credit needs of the low to moderate income communities in which they have a presence.

The current inter-agency (the Fed, FDIC, and OCC) CRA-related regulation has not been meaningfully updated in many years despite, among other things, its insufficient "testing" criteria, and failure to keep up with the changing banking landscape, particularly online banking which has allowed banks to effectively bypass the regulation. The Fed initiated its efforts to revamp the regulation by issuing a draft revision last September.⁹⁰ On a positive note it issued this draft revision separately from the truly awful OCC-only rule that was finalized last year, and which the Powell Fed quite publicly refused to go along with⁹¹. Since then the other regulatory agencies have committed to working with the Fed on developing a comprehensive, effective inter-agency regulation, with the OCC recently announcing it will rescind its Trump-era rule.⁹²

It is critically important to ensure the provisions of the revised regulation meaningfully increase access to credit in communities of color. Although the Fed's draft revision and request for public feedback had some positive reception, no details have been shared by any of the agencies on their progress nearly a year on from the Fed's draft rule. The Fed must continue to lead here. That means ensuring maximizing public and advocacy input, not just industry input. With that, the Fed needs to push the agencies to finalize a rule as soon as possible so that any success from the new monetary policy on employment and wages for communities of color can be amplified by increased access to credit.

More transparency with respect to the CRA is necessary as well. Within its semi-annual report on the health of the banking sector and its level of support for the economy, the Fed should include assessments of bank credit supply and consumer and business loan demand within low- and moderate- income communities that are intended to be serviced through the provisions of the CRA. Greater transparency is also necessary for other aspects of retail banking that affect communities of color. For example, overdraft fees disproportionately affect low-income communities and communities of color—there were \$31 billion in total overdraft fees across big and small banks in 2020.⁹³ The Fed should require more reporting and disclosure of how bank business activities impact communities of color.

⁹⁰ 85 FR 66410 press release at <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200921a.htm>.

⁹¹ 85 FR 34734 press release at <https://www.occ.gov/news-issuances/news-releases/2020/nr-occ-2020-63.html>; for more information see the National Community Reinvestment Coalition (June 15, 2020), Analysis Of The OCC's Final CRA Rule <https://ncrc.org/analysis-of-the-occs-final-cra-rule/>.

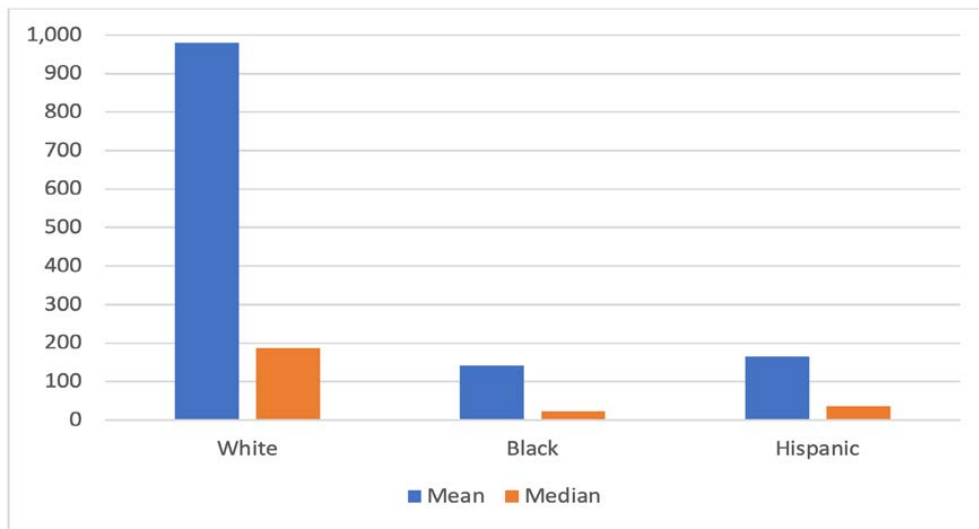
⁹² See the Office of the Comptroller of the Currency, *OCC Statement on Rescinding its 2020 Community Reinvestment Act Rule* (July 20, 2021), <https://occ.gov/news-issuances/news-releases/2021/nr-occ-2021-76.html>.

⁹³ See Tara Siegel Bernard, *Banks Slowly Offer Alternatives to Overdraft Fees, a Bane of Struggling Spenders*, THE NEW YORK TIMES (June 22, 2021), <https://www.nytimes.com/2021/06/22/your-money/overdraft-fees-banks.html>.

The Fed should also provide an assessment of the extent to which the financial needs of communities of color are not being serviced by the banking industry. Black and Hispanic Americans are significantly more likely to be unbanked or underbanked compared to White Americans, which leads to a heavier reliance on nonbank alternative financial services such as check cashing and payday loans. For example, in 2019 the FDIC reported that Black and Hispanic households utilized nonbank credit at more than twice the rate of White households and used money orders and check cashing services about three to six times more frequently.⁹⁴ These services are often predatory and come at punitive costs that perpetuate the inability to accumulate wealth, open a bank account or to develop a credit history sufficient to utilize mainstream bank credit products.

As noted above, one natural consequence of the Fed’s extremely accommodative policy that has been exercised throughout the pandemic is an increase in asset prices that has exacerbated the already stunning wealth gap that has long been a problem. Black and Hispanic households have fewer assets and therefore have seen significantly less benefits from the huge runup in asset prices. Indeed, the most recent Fed Survey of Consumer Finances from 2019 shows that the average Black family had less than 15 percent of the wealth of the average White family heading into the pandemic, a gap that has been growing for decades.⁹⁵

Figure 10: Average Household Net Worth by Race in 2019 (\$ thousands)



Source: 2019 Federal Reserve Survey of Consumer Finances

Of course, as discussed above, the Fed’s monetary policy shift in focus to the labor market is important to the goal of realizing a more equitable and inclusive level of employment that may start to reduce the income gap between White households and Black and Hispanic households. Closing the employment and income gaps is an important step to closing the wealth gap in the long run. Combined with increased access to credit, more equitable income will allow for communities of color to purchase wealth-creating assets such as homes. Since the wealth gap is so inter-related to the employment and income gaps, the Fed should be discussing the wealth gap issue along with employment, income, and credit availability and should more clearly define the long-term goals and benefits to the economy from achieving more “broad and inclusive” employment.⁹⁶

⁹⁴ See FDIC, *How America Banks: Household Use of Banking and Financial Services* (Oct. 19, 2020), <https://www.fdic.gov/analysis/household-survey/2019report.pdf>.

⁹⁵ See Federal Reserve, *2019 Survey of Consumer Finances*, <https://www.federalreserve.gov/econres/scfindex.htm>.

⁹⁶ It is important to note that there are many policy actions that could and should be taken to address these many longstanding problems that are completely outside of the Fed’s scope of authorities. For example, raising the minimum wage could be a major factor in this regard.



The Fed’s Role in Climate Change

To date the Fed Board under Chair Powell has been inexplicably slow in taking any concrete steps to address the climate crisis, lagging well behind other developed economies in action, communication and effort. So far, they have simply acknowledged that climate change poses substantial risks to the economy and financial stability, including through its direct impact on the risks faced by banks and the potential for significant repricing of financial assets related to the effects of climate change and government policies that may be used to address it.

The Fed has, however, stopped short of actively moving to incorporate climate change analyses into its monetary policy decisions or its formal banking supervision and regulation practices. Chair Powell recently stated that the Fed does not see itself as a climate policy maker, but rather that it will focus on the issue within its mandates for financial stability and banking oversight.⁹⁷ Regardless of one’s view on whether that is appropriate or sufficient, the Fed has still not gone further than being in “beginning stages” of a program to engage with financial institutions on risk identification.⁹⁸ Chair Powell has made clear that he feels more analysis is warranted before considering making any concrete, meaningful changes. Meanwhile, the clock is ticking and there is no time to waste.

The Fed has set up two internal groups to study and consider strategies for addressing climate change within its mandates, one in the context of financial stability and the other in banking supervision. Additionally, it recently became a permanent member of the Network of Central Banks and Supervisors for Greening the Financial System (NGFS), becoming the last central bank from a major country to join this global group focused on how to address the impact of climate change on the economy and financial system. The Fed did not join this group until December 15, 2020.

At a recent climate change conference Powell clarified that he does not feel direct climate change effects are currently material enough to be a consideration in monetary policy and that at this time it is sufficient for the banking system to have general resiliency for “low probability events.” As a result of this view, the Fed’s supervisory stress testing program, for example, does not yet include analyses of

⁹⁷ Chair Jerome Powell at 2021 Green Swan Conference (n 15).

⁹⁸ Chair Jerome Powell to the House Financial Services Committee (n 15).



“The Fed should be doing more right now in its role as the key supervisor of the banking system and Chair Powell could be and should be a leader in this effort.”

any specific potential climate change effects. While the Fed may view it as premature to incorporate the potential effects of climate change directly into capital requirements,⁹⁹ it should at least be using stress testing capabilities to assess vulnerabilities across large banks to climate related issues.

It is understandable that Chair Powell and the Fed more broadly would want to tread carefully in what are very fraught political waters. Congressional Republicans have already publicly chastised the Fed for even the minimalist statements Powell has made to date and strongly urged him to not join the NGFS. Nonetheless, the science proving the climate crisis is beyond dispute, as is the threat to the economic and financial systems of the United States, even if reasonable people can disagree about its particular manifestations and timelines. Actions must be taken now to address climate change.

The Fed should be doing more right now in its role as the key supervisor of the banking system and Chair Powell could be and should be a leader in this effort. The Fed has stated that it expects banks “to have systems in place that appropriately identify, measure, control, and monitor all of their material risks, which for many banks are likely to extend to climate risks.”¹⁰⁰ But it has not articulated to banks, at least publicly, that this expectation will become a part of its supervisory assessments nor that it will include assessments of banks’ climate change-related practices into its supervisory ratings. This could and should be done immediately to ensure banks understand that failing to effectively address climate-related risks will have meaningful consequences for their supervisory ratings and by extension could lead to restrictions on their operations. This will only happen if the Chairman of the Fed leads.

⁹⁹ The European Banking Authority initiated its consideration of climate-related capital requirements; See European Banking Authority, *EBA Action Plan on Sustainable Finance* (December 6, 2019), https://www.eba.europa.eu/sites/default/documents/files/document_library/EBA%20Action%20plan%20on%20sustainable%20finance.pdf.

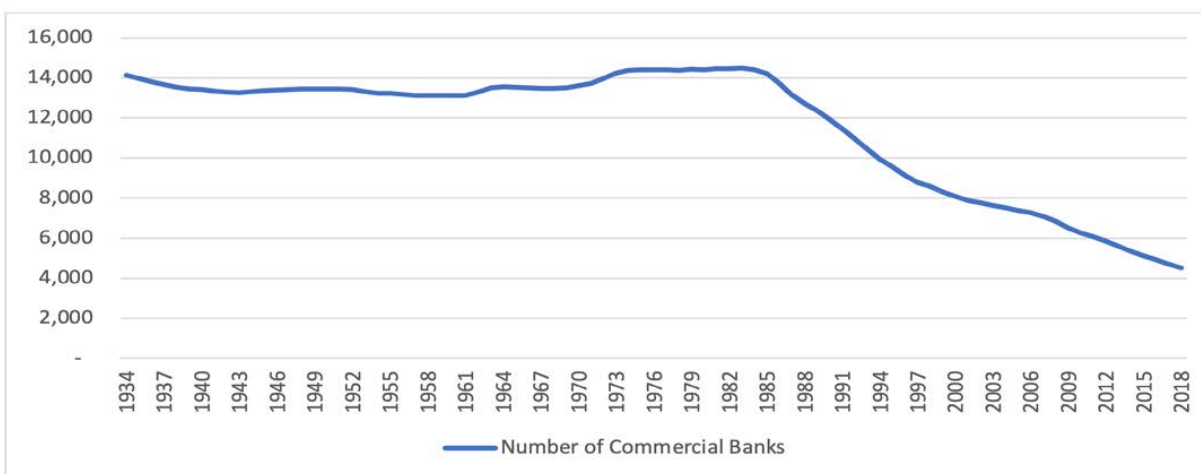
¹⁰⁰ See Board of Governors of the Federal Reserve System, *Financial Stability Report* (November 2020), <https://www.federalreserve.gov/publications/files/financial-stability-report-20201109.pdf>.



The Fed’s Role in Consolidations, Mergers and Acquisitions

The Fed’s (and the other banking regulatory agencies’) insufficient merger review process, combined with other factors such as changes in laws and economic events, has led to massive consolidation in the banking industry over the last three and a half decades. Since the mid-1980s, the number of commercial banks has declined nearly 70 percent from around 14,500 to 4,500 at the end of 2019. Banks could not operate across state lines prior to the late 1970s, and so the number of banks was relatively stable for many years. However, states began to allow out-of-state banks to acquire banks within their state—33 states by 1991,¹⁰¹—and in 1994 Congress passed a law that codified the right to interstate banking at a national level.¹⁰² Additionally, the 2008 Crash resulted in government-brokered takeovers of large, failing Wall Street banks by already too-big-to-fail banks.¹⁰³

Figure 11: Number of commercial banks in the U.S.



Source: FDIC historical BankFind Suite data

There has also been a consolidation of banking and other financial activities. In 1999 the Gramm–Leach–Bliley Act repealed the portion of the Glass-Steagall Act of 1933 that required the separation of commercial banking, investment banking and insurance, setting off mega-mergers between these three types of companies and greatly exacerbating the too-big-to-fail problem and creating a too-big and too-

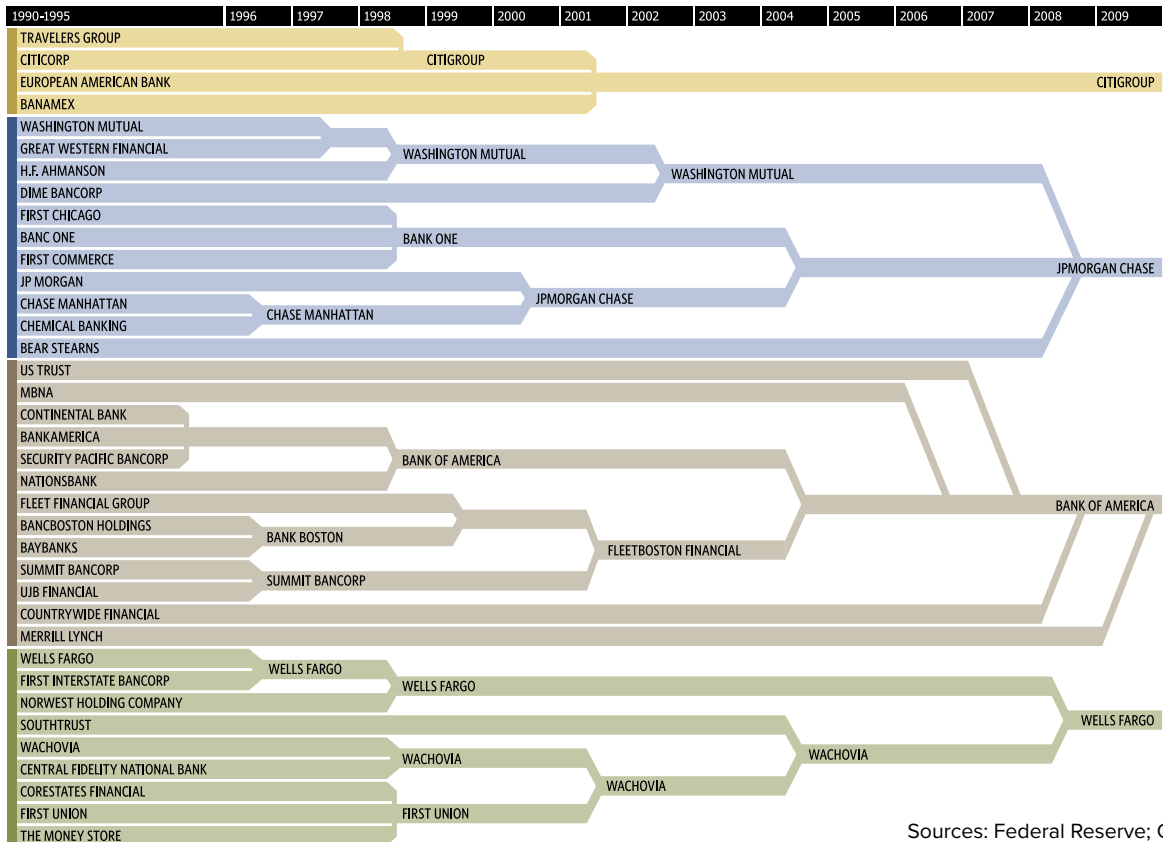
¹⁰¹ See Art Wilmarth, *Taming the Megabanks: Why We Need a New Glass-Steagall Act*, OXFORD UNIVERSITY PRESS, 2020.

¹⁰² The Riegle-Neal Interstate Banking and Branching Efficiency Act, 12 USC 1811.

¹⁰³ Bank of America acquired Merrill Lynch and Countrywide Financial; JPMorgan Chase acquired Bear Stearns and Washington Mutual; Wells Fargo acquired Wachovia.

diversified-to-manage problem.¹⁰⁴ For example, about 30 banks at the time consolidated into just four gigantic, too-big-to-fail banks by the time of the 2008 Crash:

Figure 12: Illustration of bank consolidation after the Gramm-Leach-Bliley Act



The consolidation both in number of banks and in products and services has completely changed the landscape of the banking industry, reducing competition, and concentrating risks into systemic concerns. Currently, the very largest banks virtually control the U.S. banking system:

- The top four banks hold about half of all assets in the banking system
- The top ten banks hold almost half of all deposits and loans
- JPMorgan Chase, Goldman Sachs, Bank of America, and Citigroup hold 89% of the total notional amount of all derivatives contracts held at U.S. banks.

The three banking regulatory agencies—the Fed, OCC and FDIC—are required by law to review merger applications in consideration of four main factors:

1. anticompetitive effects,
2. financial stability risks,
3. effect on the public interest/ convenience and needs of communities served, and
4. the financial condition and management effectiveness at the merging companies.¹⁰⁵

¹⁰⁴ See Better Markets Fact Sheet, *Glass-Steagall Financial Reform Law and Efforts to Reinstate It*, https://bettermarkets.com/sites/default/files/Better%20Markets%20Fact%20Sheet%20on%20Glass-Steagall%20_0.pdf.

¹⁰⁵ 12 USC 1828(C)

Yet none of these factors seem to truly matter in the final decisions. The bank regulatory agencies have not formally denied a merger application in over 15 years.¹⁰⁶

This includes Powell's term as Chair, which has seen the two largest bank mergers since the 2008 Crash. The resulting banks fall into the \$250 to \$700 billion range, one of the groups of banks that the deregulatory agenda under Powell has affected the most. BB&T and SunTrust banks (renamed Truist Financial) merged in 2019 to become the tenth largest bank holding company at over \$500 billion in assets. PNC Bank acquired the US operations of BBVA to become the eleventh largest bank holding company with around \$560 billion in assets.

That isn't to say the approvals process under Chair Powell has been materially different from prior Chairs. As noted, the two previous chairs approved all applications received. Nonetheless, the Powell Fed has a duty to assess the financial stability risks resulting from the mergers the Fed reviews and decides on. These risks are particularly significant given the severely weakened regulatory framework implemented under his leadership and the fact that the two largest mergers since the 2008 Crash happened on his watch. Despite this there has been no effort to strengthen the merger review process.

Governor Brainard recognized this issue in a statement made after abstaining from voting on the PNC acquisition:

“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.”¹⁰⁷

The Fed's current merger review process ostensibly prioritizes the factor of anticompetitive effects, seemingly in-line with the implied prioritization with the applicable laws: the Bank Holding Company Act and the Bank Merger Act. These laws are specific that a merger should not be approved if it could lead to a monopoly or if it would substantially lessen competition. However, the laws grant the agencies' substantial discretion as to how to include the non-competition factors (financial stability, community needs, and financial and managerial resources), only directing the banking agencies to “consider” them in the review process. This discretion allows the Fed to elevate the non-competition factors to their appropriate role in the merger review process, particularly in light of evolving and current circumstances.

The merger review assessments published by the Fed nonetheless indicate approvals are based on whether a merger has a significant negative impact on all four major assessment factors listed above. This includes a quantitative measure for anticompetitive effects¹⁰⁸ but only subjective assessments for the other factors. Among other things, the Fed should start including some thresholds, such as minimum ratings on CRA exams, or more quantitative-based metrics, such as metrics around potential financial

¹⁰⁶ See Jeremy C. Kress, *Modernizing Bank Merger Review*, *Yale Journal on Regulation*. Vol. 37:435 (2020).

¹⁰⁷ See Governor Lael Brainard, *Statement on PNC/BBVA Application* by Governor Lael Brainard, Board of Governors of the Federal Reserve System (May 14, 2021), <https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20210514.htm>.

¹⁰⁸ The Federal Reserve uses the Department of Justice's Bank Merger Guidelines to assess competition. Concentration levels are measured by the Herfindahl-Hirschman Index (HHI). A market is considered unconcentrated if the post-merger HHI is under 1000, moderately concentrated if the post-merger HHI is between 1000 and 1800, and highly concentrated if the post-merger HHI exceeds 1800. According to Federal Reserve documentation, the Department of Justice has informed the Federal Reserve that a bank merger or acquisition generally would not be challenged (in the absence of other factors indicating anticompetitive effects) unless the post-merger HHI is at least 1800 and the merger increases the HHI by more than 200 points.

stability effects, for the non-competitive factors.¹⁰⁹ After all, despite the Fed’s apparent prioritization of the anticompetitive factor, the law requires consideration of all the factors, which are all critically important to ensuring a banking system that works for all Americans.

For example, large mergers not only increase financial stability risks, but they can also harm hardworking Americans and small businesses. They can lead to a reduction in consumer banking services or increase the cost associated with them¹¹⁰ or even to a lack of access altogether when branches are closed, especially in low-income communities. With insufficient access to banking services, there is increased use of alternative financial services such as check cashing or payday loans. Additionally, the size of¹¹¹ and access to¹¹² small business loans decline with larger banks, making it more difficult to open or sustain a successful small business. Combined with nonfinancial corporate consolidation and the employment and income gaps, this can have strongly negative long-term impacts on employment and wealth within low-income communities.

President Biden’s recent Executive Order¹¹³ has highlighted the many detrimental impacts of consolidation throughout the economy, including in banking and the financial industry. That Order encouraged the Attorney General to engage with the banking regulatory agencies to review guidelines around bank mergers for the “revitalization” of the merger oversight process. The Fed should be embracing the opportunity to engage with the Attorney General, OCC, and FDIC to enhance the merger review processes, particularly along the dimensions of financial stability, taking into account the effects of the deregulations, and the public interest. Given the law already requires the Fed to do this and already grants it broad authority, that is the least the Fed should do.

“...Large mergers not only increase financial stability risks, but they can also harm hardworking Americans and small businesses..”

After nearly forty years, the ever-increasing consolidation of the banking industry must be put on hold, the Fed must actually consider all four factors described above and exercise its discretion to achieve all the objectives of the law. The merger process should be rationalized to ensure that future mergers only enhance the public interest while reducing, or at least not increasing, the level of risk in the system.

¹⁰⁹ These and other solutions are being proposed by advocates for reform to the bank merger process. See Jeremy Kress (August 21, 2019), *Modernizing Bank Merger Review*. 37 *Yale Journal on Regulation* 435 (2020) <https://ssrn.com/abstract=3440914>; See also Rohit Chopra, Comment of Commissioner Chopra and Professor Jeremy Kress on the U.S. Department of Justice’s Bank Merger Competitive Review Guidelines, Letter to Attorney General William Barr (October 16, 2020), https://www.ftc.gov/system/files/documents/public_statements/1581730/chopra_-_comment_doj_banking_merger_guidelines.pdf.

¹¹⁰ Vitaly M. Bord. Working Paper. “Bank Consolidation and Financial Inclusion: The Adverse Effects of Bank Mergers on Depositors [Job Market Paper]”.

¹¹¹ According to national data from the Federal Financial Institutions Examination Council on assessments related to the Community Reinvestment Act, the average small business loan size decreases significantly across bank groupings of increasing size.

¹¹² Vitaly M. Bord, Victoria Ivashina, Ryan D. Taliaferro, *Large Banks and Small Firm Lending*, *National Bureau of Economic Research*, Working paper 25184 (2018); See also Achraf Mkhiaiber and Richard A. Werner, *The relationship between bank size and the propensity to lend to small firms: New empirical evidence from a large sample*, *Journal of International Money and Finance*, Vol. 110:102281 (2021).

¹¹³ President Joseph Biden, *Executive Order on Promoting Competition in the American Economy*, Presidential Actions (July 9, 2021), <https://www.whitehouse.gov/briefing-room/presidential-actions/2021/07/09/executive-order-on-promoting-competition-in-the-american-economy/>.



The Fed’s Communications and Transparency Policies and Actions

Communication from the Federal Reserve has gradually increased over the past 10 years and continued to improve under Chair Powell, but further improvement is sorely needed in some key areas. The Fed should substantially expand public disclosure of supervisory issues, provide a clearer picture to the public of the considerations that go into its decision making, and increase its public engagement on racial justice- and climate change-related issues. The Fed should also provide more robust public assessments of the effectiveness of its actions, including both successes and failures.

Chair Powell has expanded on the efforts begun under the Bernanke and Yellen regimes by stepping up the frequency of post-FOMC press conferences, which now occur after every FOMC meeting. Powell has also been quite visible in other forums, appearing regularly at conferences and spearheading the Fed Listens event series¹¹⁴ to engage with members of the public on everything from simple “listening sessions” to outlining the Fed’s strategy for COVID-19 and its monetary policy approach going forward. These efforts have made monetary policy more accessible to the public. Nonetheless, the Fed could still significantly improve on these communications, particularly around the Fed’s new monetary policy approach, racial inequality, and climate change, as highlighted above.

Under Powell and Vice Chair for Supervision Quarles, the Fed began the publication of the semiannual banking supervision and regulation report (the “S&R Report”) and increased regular testimony to Congress about its oversight of the banking system, a requirement that was enacted as part of the Dodd-Frank Act in 2010. The S&R Report does provide some useful information, but it falls short of being as useful to the public as it should be. For example, while the report includes high-level metrics on lending, there is no analysis of the lending specifically provided to low- and moderate-income communities. There is also no meaningful assessment of how the banking system is supporting the real economy even in the aggregate. Such an assessment is particularly important as the Fed has increased its role in private markets, including over the pandemic period as it stood up emergency programs, and provided regulatory relief based on the publicly-stated purpose of promoting banks capacity to support the economy. The S&R report should include a granular analysis of how bank activities are or are not meeting the needs of various aspects of the economy, including by client type from consumers to business of all sizes and by product from bank accounts and types of lending to bond underwriting.

¹¹⁴ See Board of Governors of the Federal Reserve System, *Review of Monetary Policy Strategy, Tools, and Communications*, Fed Listens Series <https://www.federalreserve.gov/monetarypolicy/review-of-monetary-policy-strategy-tools-and-communications-fed-listens-events.htm>.



“The public also has a right to know more about what the Fed is doing to address the large banks’ clear problems with respect to complying with laws and regulations that apply to them, and to know if what the Fed is doing is working.”

Similarly, the aggregate statistics provided on bank ratings in the Fed S&R Report are not without value but fall short of the type of firm-specific commentary that was in the past disclosed with results of the CCAR exercise. Given their systemic importance and potential threat to the economy, the public has a right to understand the Fed’s assessments of the largest banks and to know what the Fed is doing to promote their resilience and prevent another taxpayer bailout. The public also has a right to know more about what the Fed is doing to address the large banks’ clear problems with respect to complying with laws and regulations that apply to them, and to know if what the Fed is doing is working.

Additionally, throughout all their Trump-era deregulatory efforts, the Fed failed to provide compelling justification for the changes they made, as noted in a number of Better Markets comment letters.¹¹⁵ The public has not been provided with adequate information to understand how the Fed reached the decisions that these deregulatory changes were in the public interest, not just those of the large banks.

Enhancing communication and transparency related to supervision and the rulemaking process will not only increase the credibility and public accountability of the Fed, but it will also likely provide it with valuable information in the form of feedback from the public. For example, providing more public information will likely engender academic and expert analyses which could supplement and inform the Fed’s views and broaden a too-small circle of bank and other market participants that have frequent opportunities to provide input to Fed thinking.

¹¹⁵ For example, see the comment letter filed by Better Markets regarding the proposed changes to applicability thresholds for regulatory capital and liquidity requirements (January 22, 2019), <https://bettermarkets.com/sites/default/files/Better%20Markets%20Comment%20Letter%20Capital%20and%20Liquidity%20Proposal.pdf>.




Photo by Toni L. Sandys-Pool/Getty Images

Conclusion

As is clear, the Fed's role in the financial system and economy is as large and consequential as it has ever been, if not more so. Its many actions, cumulatively from the 2008 and 2020 crashes through today, are impacting the lives, livelihoods, economic opportunities, standard of living, and quality of life of virtually every American.

The Fed is now faced with the daunting challenge of not only protecting but broadening the current economic recovery while unwinding its unprecedented programs in the middle of an ongoing pandemic with a less regulated, more fragile financial system. Compounding that challenge is the market's increasingly pervasive view that the Fed is going to step in to stop any disruptions (which seem to be defined as any significant investor or creditor losses) by bailing out financial market participants. This "Fed put" has incentivized dangerous risk taking and increased moral hazard throughout the financial industry.

That makes comprehensively investigating the non-pandemic related causes and consequences of the 2020 financial crash even more imperative. This was the first time the post-Dodd Frank financial reform architecture was stress tested and it confirmed once again that the financial system is still deeply riddled with unregulated weaknesses that are as unacceptable as they are unsustainable.

Thus, the importance of President Biden's choice for the next Chair of the Fed cannot be overstated. That means the candidate review process must be searching, all-inclusive and thorough. In addition to monetary policy and the so-called "dual mandate" of maximum employment and stable prices, anyone being considered for Fed Chair must also be evaluated on their actions and views regarding financial regulation, the climate change crisis, racial justice issues, bank merger and acquisition approvals, transparency and accountability, and the pandemic-caused 2020 financial crash.

That review must be responsive to the American public, which will be looking to the Fed to follow through on its promise of making the economic recovery and future economic cycles more inclusive. The broader public deserves a Fed that is more open in its communications and forceful in its actions related to diversity, equity, and inclusion. The Fed also needs to fulfill its appropriate role addressing the climate crisis and start taking actions similar to central banks in other developed countries, eventually taking its place as a world leader. And all this must be done while managing inflation fears and the unwind of trillions of dollars of pandemic-related support that the Fed continues to funnel into the markets.

If Jay Powell is to be renominated and approved, he will be well-positioned to continue the pursuit of a more inclusive economy through the updated monetary policy framework and the momentum on expanded communication (all other things being equal). But he may be poorly positioned to fix or even address issues that were created or occurred during his term so far as Chair. For example, the broad-based and dangerous deregulatory agenda of the Trump administration that he uniformly supported and voted for was unwarranted and has made the financial system weaker at the worst possible time. Admittedly, the deregulation could have been more extreme, and Powell's influence may have prevented that from happening, but what was done was not in the public interest and he has made it clear recently he does not see that problem. Based on his Congressional testimony, he does not appear to feel any additional regulation of the industry is necessary and, therefore, is unlikely to support any "re-regulation." Those blind spots have prevented him from even acknowledging that the resiliency of the banking sector during the pandemic was in large part due to the massive market support from the Fed and taxpayer support through the CARES Act.

Similarly, while the market support during the pandemic was warranted and necessary, he has not provided the public with a complete picture of the fundamental issues that preexisted in the markets, the extent to which they amplified the market stress caused by the pandemic, and the range of possible solutions. Although he and Vice Chair Quarles have noted the major issues and discussed some of the Fed's views on possible modifications to banks' leverage requirements (SLR), the range of options being considered and their pros and cons have not been disclosed to the public, and instead have only been discussed in closed-door meetings. That is unacceptable.

"The next Fed Chair, Powell or another nominee, must work to address the issues and gaps that have been left open during Powell's chairmanship."

Additionally, his record on social and environmental issues has been mixed. The new monetary policy framework appropriately prioritizes the development of a more inclusive economy, and he has made it clear that he considers race to be a key component of inclusivity. On the other hand, the conversations around this have fallen short by not more clearly defining inclusivity, side-stepping the wealth gap, and excluding discussions of improving access to credit and capital in the overall picture.

With regard to climate change, his Fed has lagged behind every other developed country, with Powell making it clear recently that he does not feel the climate issue is currently important enough to include in monetary policy considerations and concrete action incorporating climate change in banking supervision has yet to be taken.

The next Fed Chair, Powell or another nominee, must work to address the issues and gaps that have been left open during Powell's chairmanship. The issues experienced during the pandemic and the unprecedented support required by the Fed should be the catalyst to re-strengthen the supervision and regulation of the banking industry as well as to work to close the gaps exposed in the Nonbank sector and address the impact of its increasingly important linkages to the banking sector.

The post-2008 Crash reforms had significantly improved the safety and soundness of our financial system, but the experience during the pandemic clearly showed these reforms were not enough and that the significant rollbacks on banking supervision and regulation under Powell's chairmanship were unwarranted and dangerous. These deficiencies in securing the safety and soundness of our financial system must not be brushed aside as only being related to extreme tail events. These events result in huge taxpayer-backed support and bailouts, dramatic and deep Fed involvement in the markets



“There will be no perfect candidate, but such a process—done right—should result in the nomination of the best possible person. Given this decision will affect the lives of Americans for many years to come, the American people deserve no less.”

contrary to the principles of capitalism, damage to the economy and the livelihoods of hardworking Americans, and ever-growing financial industry moral hazard incentivized by the Fed support needed to calm dysfunctional markets in stressful periods.

With so much at stake, it is obvious that the selection of the next Fed Chair should not be made with an automatic or status quo bias towards the incumbent. Nor should that decision be made based on short term political considerations like a bipartisan vote or temporary market sentiment. The next leader of the Fed, be it Powell or some other candidate, must be selected only after all the critical issues and policies are rigorously examined. There will be no perfect candidate, but such a process—done right—should result in the nomination of the best possible person. Given this decision will affect the lives of Americans for many years to come, the American people deserve no less.

APPENDIX 1

Facilities enacted by the Federal Reserve in response to the COVID-19 pandemic

Federal Reserve Facility or Program	Max Allocation (\$B)	Peak Deployment (\$B)	Purpose
Municipal Liquidity Facility	500	6.4	Help state and local governments better manage cash flow pressures in order to continue to serve households and businesses in their communities by purchasing their short-term debt.
Main Street Lending Program	600	16.5	Support lending to small and medium-sized businesses and nonprofit organizations by purchasing participations in loans originated by eligible lenders.
Commercial Paper Funding Facility (CPFF)	10	4.3	Support the flow of credit to households and businesses by ensuring the smooth functioning of the commercial paper market.
Primary Dealer Credit Facility (PDCF)	NA	33.4	Support the credit needs of American households and businesses by allowing primary dealers to support smooth market functioning and facilitate the availability of credit to businesses and households.
Money Market Mutual Fund Liquidity Facility (MMLF)	NA	53.2	Broaden its program of support for the flow of credit to households and businesses by assisting MMFs in meeting redemptions through loans to financial institutions secured by high-quality assets purchased from MMFs.
Primary Market Corporate Credit Facility (PMCCF)	500	–	Support credit to employers through bond and loan issuances through direct purchases.
Secondary Market Corporate Credit Facility (SMCCF)	250	14.3	Support credit to employers by providing liquidity to the market for outstanding corporate bonds through direct purchases.
Term Asset-Backed Securities Loan Facility (TALF)	100	3.7	Support the flow of credit to consumers and businesses by lending on a non-recourse basis to holders of certain AAA-rated ABS backed by newly and recently originated consumer and small business loans.
Paycheck Protection Program Liquidity Facility (PPPLF)	NA	76.5	Bolster the effectiveness of the Small Business Administration’s Paycheck Protection Program (PPP) by supplying liquidity to participating financial institutions through term financing backed by PPP loans.
Central Bank Liquidity Swaps*	NA	448.9	Enhance the provision of liquidity via the standing U.S. dollar liquidity swap line arrangements and temporary dollar liquidity swap lines with nine additional foreign central banks.
Temporary Foreign and International Monetary Authorities (FIMA) Repo Facility	NA	1.4	To help support the smooth functioning of financial markets, including the U.S. Treasury market, and thus maintain the supply of credit to U.S. households and businesses.
Total Deployment 658.4			

*Since the Federal Reserve regularly conducts liquidity swaps with other central banks, the “peak deployment” amount for the Central Bank Liquidity Swaps is based on the change from a chosen “pre-stress” date (February 7, 2020) to the maximum level over 2020.



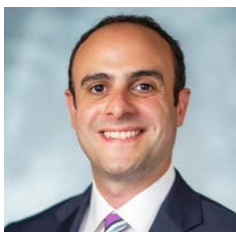
DENNIS M. KELLEHER
Co-Founder, President
& CEO of Better Markets

Dennis Kelleher co-founded Better Markets in October 2010, where he is the President and Chief Executive Officer. He is an internationally sought expert on financial reform, financial markets, economics, regulation, legal issues, and their intersection with political matters. In addition to testifying in the U.S. Senate and House of Representatives, he also speaks frequently in the U.S. and Europe on these matters at conferences, seminars and symposiums as well as on all media platforms. Mr. Kelleher recently served as a member of the Biden-Harris Transition team on the Federal Reserve, Banking and Securities Agency Review Team. Prior to Better Markets, Mr. Kelleher worked for almost eight years in senior staff positions in the United States Senate, including as General Counsel and Deputy Staff Director on the Labor and Human Resources Committee (now known as the HELP Committee) and as Chief Counsel and Senior Leadership Advisor to the Chairman of the Senate Democratic Policy Committee, a member of Senate leadership. Earlier in his career, Mr. Kelleher was a partner with the international law firm Skadden, Arps, Slate, Meagher & Flom, where he specialized in crisis management, financial markets, securities, and complex corporate matters.



TIM P. CLARK
Distinguished Senior
Banking Advisor

Tim Clark is the Distinguished Senior Banking Advisor for Better Markets. Prior to joining Better Markets, Mr. Clark was Deputy Director of the Division of Supervision and Regulation for the Federal Reserve Board until he retired in late 2017. He joined the Federal Reserve in 1995 as a bank examiner in New York and moved up the ranks there until 2008 when he was recruited to join the staff of the Board of Governors in Washington. He was the chief architect of the Federal Reserves' capital stress tests and liquidity stress tests. Mr. Clark also was Chairman of the Operating Committee of the Federal Reserves' Large Institution Supervision Coordinating Committee (LISCC), which was created after the crash to coordinate oversight of the biggest, riskiest banks. As such, he was a crucial voice on virtually all decisions regarding bank oversight, particularly regarding the to-big-to-fail banks and global systemically important banks. Mr. Clark was also the Federal Reserves' key contact with the senior executives at the largest banks.



PHILLIP BASIL
Director of Banking
Policy

Phillip Basil is Director of Banking Policy for Better Markets where he covers all aspects of the banking sector. Specifically, he works on economic and financial matters that are crucial to Main Street families, workers, investors, consumers and community banks, and that support financial and banking reforms to prevent crashes and bailouts. Mr. Basil has more than 15 years of experience in both the public and private financial sectors, primarily focused on the trading and investment portfolios of large and complex banks. Most of his career has been with the Federal Reserve Board, starting in the Division of Research and statistics (R&S) and moving to the Division of Supervision and Regulation (S&R). During his time in S&R, he was responsible for developing and executing aspects of the supervisory stress test as well as portfolio-specific risk analytics and reports for the largest, most complex banking institutions. His time in R&S primarily involved working to develop a framework to assess the systemic impact and risks of mergers and acquisitions within the banking industry.

Support and Follow Us



Donations:
Visit our website
www.bettermarkets.com



Stay Informed with our
Financial Reform Newsletter:
sign up on our website



Follow the Fight:
@BetterMarkets



Current News:
/BetterMarkets



Watch:
/BetterMarkets



Connect:
/BetterMarkets





BETTER MARKETS

Better Banks

Better Businesses

Better Jobs

Better Economic Growth

Better Lives

Better Communities

Better Markets is a non-profit, non-partisan, and independent organization founded in the wake of the 2008 financial crisis to promote the public interest in the financial markets, support the financial reform of Wall Street and make our financial system work for all Americans again. Better Markets works to restore layers of protection between hardworking Americans on Main Street and Wall Street's riskiest activities. We work with allies – including many in finance – to promote pro-market, pro-business and pro-growth policies that help build a stronger, safer financial system that protects and promotes Americans' jobs, savings, retirements and more.