March 6, 2023

Via Email

The Honorable Jerome H. Powell
Chair
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Capital, the Vice Chair for Supervision, and the March 3, 2023, Letter from Ten Republicans on the Senate Banking Committee

Dear Chair Powell,

I write in response to a letter dated March 3, 2023, sent to you from Sen. Tim Scott and nine other Republican members of the Senate Banking Committee. They wrote to express their "concerns" about Vice Chair for Supervision Michael Barr's ongoing holistic review of capital and the possibility that it might lead to higher capital requirements.

As you know, the quantity and quality of capital that too-big-to-fail banks have is critically important to every American because a bank's capital cushion is all that stands between a failing bank and taxpayer bailouts. Either banks' capital absorbs banks' losses and prevents failures, contagion, and crashes, or those losses get shifted to the American people as happened in the catastrophic financial crash of 2008. That's why it is imperative that the Fed and other regulators regularly review and revise capital adequacy to ensure it is sufficient to protect the American people, the financial system, and our economy.

This preemptive strike prejudging possible Fed actions and suggesting any increase in capital is a priori unnecessary irrespective of the merits and risk analysis is premature, unwarranted, unnecessary, and unfair. As you know, the Fed under the leadership of the Vice Chair is undertaking a rigorous, comprehensive, thorough, data-driven, risk-based, holistic analysis of capital, focusing on the safety and soundness of banks and the banking system. That's exactly what the Fed is required to do and should be doing, particularly given the ongoing unprecedented monetary policy actions and the numerous macroeconomic and geopolitical events pummeling the country and the globe. It cannot be denied that the financial

system remains fragile and the world decidedly uncertain, making robust financial protection measures even more essential.

It is not accurate to claim that the banks and the financial system performed well during the "real-life stress test of the COVID-19 pandemic" and that, therefore, their capital is by definition adequate. Indeed, not only did the Fed lower interest rates to zero and exponentially increase asset purchases ($3 trillion in just 90 days), but it also revived and expanded all of the then-unprecedented emergency rescue facilities and programs employed to prevent a collapse of the financial system during the 2008 crash. While nonbanks were most often the immediate beneficiaries of those actions, without them the deeply interconnected, systemically significant banks would have collapsed shortly after the nonbanks without such emergency rescue facilities and programs. The collapse caused by the COVID-19 pandemic was a stark reminder of the need for banks to be adequately capitalized and resilient to withstand any number and type of unforeseen and unforeseeable shocks.

Those facts – and numerous other data – demonstrate that both the quality and quantity of capital at the too-big-to-fail banks needs to be materially higher, as Better Markets has repeatedly detailed, including most recently in this report: "Protecting Our Economy by Strengthening the U.S. Banking System Through Higher Capital Requirements." We are, of course, mindful of the implications of capital requirements on economic activity, lending, market liquidity, consumers, and related issues, but capital is just a source of bank funding (i.e., there is no "sequester" or "sidelining" of funds) and the impact of higher capital on those issues is not just manageable, but likely quite minimal. Indeed, banks should be able to increase their lending with higher capital requirements because their likelihood of failure decreases across the spectrum of scenarios, making their cost of capital lower.

It should also be noted that banks have always objected to capital requirements because they limit the amount of leverage they can use. That limits the banks' ability to take greater risks seeking larger returns on their positions and it lowers the metrics upon which their executives are paid. Of course, the banks never mention any of that when they object to capital requirements. Instead, they always claim that raising capital requirements will harm the economy and Main Street families. However, it is objectively true that these repeated claims of harm have not materialized when capital requirements have been raised over the years, including very significantly (even if not adequately) since the 2008 crash.

Unfortunately, S.2155 has been used and abused frequently, often by mischaracterizing what it does and does not require. Indeed, over the years it has become an all-purpose club deployed to try to beat and defeat even the most modest, sensible, and necessary financial reform actions. As enacted by Congress, S.2155 legislated certain, limited regulatory tailoring for large but not the largest banks based on an individualized, multifactor analysis that includes size, activities, complexity, interconnectedness, leverage, and other factors to provide a comprehensive risk picture. Ironically, the Fed was already doing that long before the law was passed, as Better Markets detailed in this Fact Sheet: "Everything You Need to Know About the

$50 Billion Threshold." Contrary to the claimed interpretation by some, the actual statutory language is decidedly limited, as Better Markets spelled out here in a "Correcting the Record" Fact Sheet. Living up to the letter and spirit of S.2155 will undoubtedly not be a problem for anyone involved in the holistic review.

Finally, I write to remind you that you repeatedly promised in testimony and elsewhere -- publicly and privately -- not to interfere with the duties and responsibilities of the Vice Chair for Supervision. In fact, you testified that "the law gives the Vice Chair for Supervision the authority to set the regulatory and supervisory agenda" and that he or she "was entitled to "deference," subject (of course) to having to "convince the members of the Board to vote for whatever that person is proposing." You pointedly stated that this was your position not only when Governor Quarles was Vice Chair for Supervision, but also notably when Governor Tarullo had the job. Therefore, given that the holistic review is ongoing and that the Vice Chair is leading it, it would be reasonable to expect that you would defer any questions about it to him and until after the review was completed, other than agreeing that periodic reviews of capital are appropriate, that ensuring capital is adequate is important, and that you are highly confident that the review will be rigorous, comprehensive, and thorough.

The bottom line is everyone should let the Vice Chair and the Fed's staff do their work and complete the holistic review. While we believe that the facts and data compel the conclusion that capital should be materially higher, we will reserve judgment until the review is completed and publicly disclosed. We would urge others to do the same.

Thank you for your attention to this matter.

Sincerely,

Dennis M. Kelleher
President and CEO

CC: Members of the Board of Governors
Ms. Ann E. Misback, Secretary, Board of Governors
Members of the Senate Banking Committee
Members of the House Financial Services Committee