Fact Sheet: Six Key Questions for Federal Reserve Chair Jay Powell at the House and Senate Congressional Hearings the Week of June 19, 2023

June 20, 2023

Federal Reserve Board of Governors Chair Jay Powell will have two chances[1] to answer key questions on critical banking issues this week. After a tumultuous spring, punctuated by three of the four largest bank failures in U.S. history and the ongoing tremors reverberating throughout the banking system, the American people deserve clear, complete, and straight answers.

The Fed's recent June 2023 Monetary Policy Report addresses expected albeit very important topics, including the persistently high level of inflation, continued tightness in the labor market, and the Fed's interest rate and balance sheet policies. It also addresses special topics, notably "Developments Related to Financial Stability." While it predictably still characterizes the banking system as "sound and resilient," there are serious concerns arising from the three banks that failed, significant weakness among other institutions, and the sizable extraordinary government interventions to support the banking system this year.

Leaving the expected topics to others, Better Markets believes that the American people deserve clear and specific answers from Chair Powell to the following questions and topics:

1. **Why is the Fed not acting as decisively to prevent the next banking crisis as it does when reacting to a crisis after it happens? To prevent that next crisis, shouldn't the Fed and fellow banking regulators enact immediately effective Interim Final Rules (IFRs) ASAP to address well-known, well-documented, and objectively proven regulatory weakness?**
   - The Fed stated in the June 2023 Monetary Policy Report that regulators, "to prevent broader spillovers in the banking system, took decisive actions to protect bank depositors and support the continued flow of credit…." The Fed's May Financial Stability Report also repeatedly emphasized how "decisively" regulators acted once the crisis happened.
   - That is in stark contrast to regulators conduct in the months and years before the crisis (as detailed by the Fed in its report on Silicon Valley Bank and the FDIC's report on Signature Bank) ***and*** in stark contrast to regulators plans to now engage in a multi-year rulemaking process where the very industry that caused those bank failures will fight every rule for years.
   - Those reports detail and document egregious regulatory and supervisory weaknesses that caused or contributed to the banking failures and crisis. The dissents of then-Governor Brainard, then-FDIC Director Gruenberg and others provide additional ample documentation of actions that need to be taken to prevent the next crash. And the failure of those banks provided objective proof as well.
   - That is an ample basis for enacting interim final rules (IFRs), which only require a finding of "good cause" and become effective immediately. Obviously, if merited, regulators can modify the rule after receiving public comment.[2]

[1] As part of the Federal Reserve's semiannual Monetary Report to Congress, required by the Humphrey–Hawkins Full Employment Act of 1978, Chairman Powell will testify before the U.S. House Financial Services Committee and on Wednesday, June 21, 2023, and the U.S. Senate Committee on Banking, Housing, and Urban Affairs on Thursday, June 22, 2023.

[2] The Office of the Federal Register describes the use of Interim Final Rule (IFR) flexibility at: https://www.federalregister.gov/uploads/2011/01/the_rulemaking_process.pdf.

- Shouldn't the Fed and other regulators enact IFRs to address the most egregious, obvious, and longstanding weaknesses in the banking system?
- That would be regulators acting as decisively to prevent the next crash as they do when trying to stop an ongoing crash.
    - Isn't preventing a banking crisis better than expensive clean up afterwards with extraordinary actions and taxpayer money?

2. **Why have regulators failed to ensure that systemically significant banks have resolution plans (aka "living wills") that enable them to be unwound without contagion or bailouts as required by law? Three of the four largest bank failures in U.S. history just happened and none had effective resolution plans. All three required bailouts due to threatened contagion and spillover effects, exactly what resolution plans are supposed to prevent. Why did the bank resolution process fail and what are you going to do to make sure that never happens again?**
    - The process followed by regulators in connection with the three recent failures was a failure. All three required extraordinary government support. This is inexcusable and regulators should have been much better prepared, especially given that bank failures are common. Moreover, although large, these were not domestic, not GSIB banks and had straightforward operations almost entirely within the U.S.
    - Yet none of the recent failed banks had workable living wills and the regulators clearly failed to preplan, which could have – and should have - avoided panic and cost to the FDIC's Deposit Insurance Fund.
    - Why did you and other regulators fail to
        - (1) regularly "war game" bank failures of different sizes, types, and amounts?
        - (2) identify financial institutions or consortiums that are not already too-big-to-fail banks so that they could meaningfully participate in the auction process that typically happen when there are bank failures?
        - (3) establish guidelines that are publicly disclosed for exactly how you are going to conduct such auctions in the future for banks of all sizes, which would likely enable bidders other than already too-big-to-fail banks to participate?
    - Isn't the current ad hoc process of auctioning banks over a weekend behind closed doors
        - (a) unfairly biased to advantage already too-big-to-fail banks?
        - (b) undermining the trust and confidence of the American people in regulators?
    - Given how consequential if not catastrophic bank failures are, don't you agree that there simply must be much more planning, as well as more transparency and accountability, regarding the resolution and auction processes?
    - Would you agree that resolution plans are excellent candidates for an IFR, which would show the American people that you not only know what you did wrong in the past, but that that you have also taken action to correct those errors and failures?

3. **Given the recent bank failures and crisis were due in part to insufficient capital, isn't it obvious that higher capital requirements are necessary for banks with $100 billion or more in assets to avoid bailouts that are paid for by the American people?**
    - While some have claimed the recent bank failures were due to liquidity problems, weren't they in fact primarily due to inadequate capital? Put differently, if those banks had adequate capital, they would not have failed, right?

- Isn't that why the FDIC had to inject capital into those banks and why those capital bailouts are going to cost at least $31.5 billion in capital? [3]
    - That's because adequate capital provides protection to a bank that is facing potential failure. Capital also prevents depositors, taxpayers, the banking system, and the economy from shouldering the cost of a bailout in the event of a potential failure.
- You agree, of course, that banks should have enough of their own capital pre-failure so that taxpayers don't have to subsidize their failure?
    - You also agree that the ten Republican Senators on the Senate Banking Committee that sent you a letter dated March 6, 2023 (just days before the collapse of Silicon Valley Bank on March 10, 2023) urging you to prevent Vice Chair for Supervision Michael Barr for conducting his holistic capital review were wrong?
- Doesn't all this mean that the Fed should reverse the recent needless and baseless weakening of capital and other regulatory requirements for banks with more than $100 billion in assets?
- Would you agree that reversing these rules are also excellent candidates for an IFR, which would show the American people that you not only know what you did wrong in the past, but that that you have also taken action to correct those errors and failures?

4. **Why were the Fed and other banking regulators "surprised" when known and obvious financial risks like interest rates and commercial real estate materialized? What are you doing now to perform better risk assessment so that you can identify and respond to risks with timely action, rather than being surprised after the fact?**
    - The Fed's 2022 stress test missed the risk and implications of a rapid rise in interest rates due to the Fed's own actions, despite many market participants and other banking regulators (OCC and FDIC) recognizing the possibility of a rapid and sharp increase in rates, and the negative implications for banks, particularly related to the value of the securities portfolios.
    - Banking regulatory officials (including you at the FOMC press conference on June 14, 2023) continue to mention commercial real estate ("CRE") concerns, often including factors such as high concentrations of CRE loans on banks books, price declines in CRE properties, rising interest rates, and a fundamental change in how Americans live, work, and shop after the pandemic. But the only solution mentioned is often no more than continued "careful monitoring."
        - Do you think that is an appropriate response given the size and potential consequences of a CRE loan crash?
    - Cybersecurity, fintech, and climate-related financial risks have also been mentioned, but again it is not clear whether they represent the next meaningful risk to bank safety, soundness, and financial stability.
    - What concrete and specific actions are you and the Fed taking to improve risk identification and actionable mitigation?

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[3] According to FDIC Chairman Gruenberg's testimony in May 2023, recent failures are estimated to cost the FDIC's Deposit Insurance Fund $31.5 billion: $16.1 billion for Silicon Valley Bank, $13 billion for First Republic Bank, and $2.4 billion for Signature Bank. While the FDIC's proposed Special Assessment rulemaking suggests that the costs for Silicon Valley Bank and Signature Bank should be borne primarily by remaining large banks, the regulators' subsidized JPMorgan's acquisition of First Republic Bank in such a way that the $13 billion bailout is going to be paid by all banks. Of course, while these fees are assessed on banks, it is reasonable to assume that some likely significant portion of these costs will be passed along to bank customers through higher fees on bank products and services.

5. **Given that the Fed supported the recent FSOC proposals to reinstate the process to identify, regulate, and supervise systemically important nonbanks, you obviously agree with that, right? Are you surprised that today there is not one nonbank in the U.S. designated as systemically significant? Do you think that there is not one systemically significant nonbank in the U.S.?**
    - Following the 2008 Crisis, the Dodd-Frank Act created the Financial Stability Oversight Council ("FSOC") to focus on threats from nonbank financial firms.
    - However, FSOC has never lived up to its mission and it was effectively neutered starting in 2017.
        - Although nonbanks offer comparable products and services to regulated banks and present many of the same, or worse, risks, they often get less attention and no oversight.
    - With the vast array of protective backstops that the Fed put place during the pandemic to support nonbanks, don't you agree that it is not credible that there currently is not a single nonbank financial firm designated as systemically important by the FSOC.
        - Don't you think that the American people deserve better protection and more transparency regarding nonbanks?
    - Don't you think that the recently proposed actions to revive and revitalize FSOC so that the risks in the nonbank arena - which are deeply interconnected to the banking system – are finally addressed should be finalized as quickly as possible?

6. **You have stated that "the trust of the American people is essential for the Fed to effectively carry out its important mission," right? You agree that the trading by senior Fed officials during the pandemic in their personal accounts was an egregious violation of that trust, right?**
    - As you know, in 2020, as hundreds of thousands of Americans were dying and tens of millions were being thrown out of work due to a catastrophic pandemic that gripped the country with fear, some of the most senior officials at the Fed were making dozens of multimillion-dollar trades, seeking to profit during the disaster.
        - It appears that at least some of those trades happened at the same time those officials were in possession of a wide range of material, nonpublic information relating to virtually all financial markets for much or all of 2020, which would have conferred enormous advantages on anyone trading with that information.
        - That happened even though the Fed's ethics officer on March 23, 2020 warned Fed officials in an email not to trade, right?
        - Yet only two officials resigned for that breach of trust.
        - And, one, former Vice Chair Clarida, resigned when it was belatedly revealed the claims about his trading during the height of the pandemic were not consistent with the facts or the Fed's prior statements.
            - Do you think that allowing senior officials - who violate such key and obvious policies as well as the public trust - to merely resign is sufficient in light of the violations?
                - I AM NOT ASKING YOU TO COMMENT ON ANY PENDING INVESTIGATION
                    - I'm asking if you think merely resigning under such circumstances is sufficient.
    - **You also agree that no one at the Fed should engage in any conduct that could even create an appearance of a conflict of interest or a violation of the public trust, right? You of course also agree that everyone working at the Fed should strictly adhere to the letter and spirit of the Fed's**

policies and procedures regarding actual or apparent conflicts of interests, right?

- You agree that the Fed has many policies in addition to those referred to as the "blackout" periods in connection with FOMC meetings, right?
    - Those policies include the "Voluntary Guide to Conduct for Senior Officials," "Policies Governing Directors," FOMC "Rules and Authorizations," and the "Directors Guide to Conduct for Directors of the Fed and Branches" (herein "Policies"), right?
        - But no one has ever evaluated the pandemic trading in light of those Policies, have they?
            - To this day, there has been no accountability by anyone at the Fed for violating those Policies, right?
                - AGAIN, I AM NOT ASKING YOU TO COMMENT ON ANY PENDING INVESTIGATION
- In fact, the Fed has never even publicly disclosed a complete list of all Fed personnel who traded in their personal accounts during the pandemic, right?
    - The Fed has only identified a few senior personnel, right?
- The Fed IG is not independent, right? He reports to you, right? You are his boss, right? Yet you charged him with investigating the personal trading during the pandemic, including your trading, right?
    - And you did that after you had already made numerous public statements that no Fed policies were violated, right?
    - In fact, you pre-judged his entire investigation and exonerated everyone who had traded before his so-called investigation even began, right?
        - That means that, if he found you or others had violated Fed policies when he did begin his investigation, that he would have had to contradict his boss, you, isn't that right?
            - And, of course, he did not contradict you.
                - Unsurprisingly, he found that you had not violated any policies regarding the trades and policies he looked at, right?
        - However, the IG didn't review all your trading, did he? And he didn't review all the applicable policies, did he?
            - For example, the IG did not review any trading for compliance with the Policies identified above, did he?
                - AGAIN, I AM NOT ASKING YOU TO COMMENT ON ANY PENDING INVESTIGATION
                    - This part of his investigation is complete and he has publicly released his conclusions.
        - So, even now, no one has reviewed all the trading by Fed officials during the pandemic or all the potential policy violations, right?
- As a result, the Fed IG, your subordinate and direct report, only conducted a very narrow review and even that omitted key information, right?
    - Isn't that a violation of **"the trust of the American people" that you say is so "essential for the Fed to effectively carry out its important mission"?**

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Better Markets fights for the economic security, opportunity, and prosperity of the American people by working to enact financial reform, to prevent another financial crash and the diversion of trillions of taxpayer dollars to bailing out the financial system.

By being a counterweight to Wall Street's biggest financial firms through the policymaking and rulemaking process, Better Markets is supporting pragmatic rules and a strong banking and financial system that enables stability, growth, and broad-based prosperity. Better Markets also fights to refocus finance on the real economy, empower the buyside and protect investors and consumers.

For press inquiries, please contact us at press@bettermarkets.com or (202) 618-6430.

2000 Pennsylvania Ave NW | Suite 4008 | Washington, DC 20006 | 202-618-6464 | www.bettermarkets.org