Financial Services Management

Federal Reserve Mandate

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H.R. 7946/S. ____, Federal Reserve Racial and Economic Equity Act

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Websites:
https://financialservices.house.gov/uploadedfiles/fed_fet_01_xml.pdf

Impact Assessment

- The FRB and FOMC would be expressly ordered to consider racial and ethnic factors across the Fed's full range of duties and functions.
- The manner in which the Fed does so – i.e., substantive policy change versus additional reports – will determine the extent to which financial policy becomes more racially and ethnically equitable, discriminatory, or unchanged.
- Drafting suggests some additional focus also on economic equality by gender, educational attainment, and perhaps other factors, but the new mandate is expressly targeted to racial and ethnic equity. Policy distortions due to lack of consideration of other under-served groups (e.g., low-income Whites, the disabled, minority sexual orientation) may ensue.
- The equity-focused monetary policy could reduce or even abandon market stabilization/correction in favor of capital investment, other market priorities.
- The new payment-system mandate could accelerate FedNow introduction, hastening faster U.S. payments but challenging private-sector real-time payment options.
- A U.S. CBDC could also be more quickly implemented with significant financial-system structure impact based on the Fed's chosen CBDC approach.

Overview

Senior Democrats in both the House and Senate have introduced legislation that turns a general call for a "racial-equity mandate" in campaign statements by Vice President Biden into an express directive to conduct monetary, regulatory, payment system, and other policy to reduce racial and ethnic economic disparities. This could create a new monetary-policy mandate that could significantly alter the Fed's focus, especially if the mandate forced attention on heterogeneous, distributional data instead of the representative-agent (i.e., average and aggregate) data on which policy is now largely premised. However, heterogeneous data focused only on racial and ethnic groups may overlook significant economic-equality challenges that undermine economic growth and/or financial stability. The FRB has never before had a policy mandate beyond general instructions to ensure financial stability with regard to its regulatory and supervisory activities and its mandate related to the payment system is focused on "integrity and efficiency." These activities as well as others outside monetary policy could thus change dramatically if a new racial-equity mandate were required. However, policy objectives at the Fed independent of racial equity and the extent to which Congress holds the Fed accountable to its interpretation of this mandate will determine the extent to which it results in more than a set of extensive new Fed reports to Congress.

Impact

The Federal Reserve's mandate has been set by laws enacted from 1913 at its founding to the Humphrey-Hawkins Act of 1978. Although often said to be a dual mandate covering only maximum employment and price stability, the mandate also includes a requirement for "moderate" interest rates. However, the FRB historically focused only on price stability, referencing employment in its FOMC statements beginning only in 2010 when unemployment became a significant concern. The moderate interest-rate mandate has long been subsumed within the "dual" one focused on employment and inflation because the Fed believes that these goals cannot be achieved without moderate rates.

It is thus clear that the Fed has long used discretion to interpret its mandate and, even with a new one, could continue to do so. However, the thrust of this legislation is so explicit with regard to racial and ethnic economic equality and prescriptive regarding reporting that it may be hard for the Fed to continue business as usual. At the very least, it would need to add new data points to the "dot plots" on which FOMC policy is premised, data points that might refocus the Fed to new policies.

If, for example, data now demonstrate that ultra-accommodative policy in fact adversely affects racial and ethnic wealth even if employment is heightened, the Fed could increase rates more than might be expected under the current construct. A more detailed understanding of real wages could also move the FOMC to seek ways to boost capital investment instead of or in addition to consumption. The "Greenspan Put" now often called the "Powell Put" emphasizing financial-market stability or even increases over other measures of prosperity could also be taken back or modified, resulting in significant volatility if not carefully introduced. Some of these equity-focused policies may remain the province of fiscal – not monetary – policy, but new data under a new mandate could well lead the Fed on its own or at the direction of Congress to revamp its current approach.

It is even less clear how the Fed would respond to this racial/ethnic equity mandate in its other functions. If the Fed were to take this new mandate to heart, regulatory policy changes could for example include greater recognition that high risk-based capital ratios on certain types of credit exposures force pricing increases that violate the bill's provisions related to affordable credit or drive activities outside regulated banks to institutions that may pose risk to racial and ethnic groups. The bill also requires a racial/ethnic mandate with regard to Fed policies on the Community Reinvestment Act (CRA) and community development. All of these functions are already required by law to improve racial and ethnic economic well-being to the extent that racial and ethnic groups are significant portions of the low-and-moderate income communities expressly mandated in law. A greater focus on racial and ethnic groups might reduce focus on other LMI communities depending on the manner in which the mandate is met or interpreted. Fair lending is already a mandate with a direct focus on racial and ethnic equity. As a result, it is unclear how reiterating it by law would affect policy, but it could lead to a more affirmative role by the Fed in this sector despite the express authority of the Consumer Financial Protection Board over the Equal Credit Opportunity act.[1]

The racial/ethnic mandate could also have significant financial-industry structural implications. As a major participant in the Financial Stability Oversight Council, the Fed has long been subject to a Dodd-Frank mandate to consider systemic risk not just in financial-market terms, but also with regard to lower-income and minority communities.[2] However, FSOC has yet to do so beyond reiterated mention of this equality-focused mandate within the Council's latest policy on nonbank systemic-institution designations.[3]

Indeed, one reading of the new mandate might be to force the Fed to take a tougher role with FSOC and in other forums to address "shadow banking" deemed to adversely affect vulnerable communities. Like other bank regulators, the Fed has long prioritized bank safety and soundness; with a new mandate, it might wish or feel compelled also to consider the construct of U.S. retail finance with an eye to economic opportunity.

As noted, the Fed's payment-system mandate has never addressed equality. Under this bill, it would, perhaps force the Fed to accelerate implementation of its FedNow faster-payment system.[4] Democrats have in fact demanded this,[5] on grounds that faster payments reduce the risk that lower-income households will be forced to rely on costly payday lenders.

Challenges delivering COVID stimulus payments have only heightened this concern, leading Democrats also to press for rapid action on central-bank digital currency (CBDC).[6] Again, with a new mandate, the Fed might wish or be forced to accelerate action on these payment-system projects. Doing so would have far-reaching implications for the structure not just of U.S. finance, but also monetary policy and the role of regulated financial institutions versus that of the Post Office, technology firms, and nonbank financial companies.

What's Next

H.R. 7946 was introduced on August 5 by HFSC Chairwoman Waters and 12 Democratic cosponsors including most of the chairs of the Financial Services

[1] See **FAIRLEND7**, *Financial Services Management*, July 31, 2020.
[2] See **SYSTEMIC29**, *Financial Services Management*, July 13, 2010.
[3] See **SIFI35**, *Financial Services Management*, December 18, 2019.
[4] See **PAYMENT17**, *Financial Services Management,* August 19, 2019.
[5] See *Client Report* **PAYMENT18**, September 25, 2019.
[6] See *Client Report* **CBDC2**, June 11, 2020.

Committee's subcommittees. Introduction of a Senate companion bill announced by Sens. Warren (D-MA) and Gillibrand (D-NY) along with Sen. Bernie Sanders (I-VT) and 6 Democrats, including Senate Banking Ranking Member Brown (D-OH).

Analysis

A. Mandate

The FRB and FOMC are instructed to "exercise all duties and functions" to eliminate disparities across ethnic and racial groups related to employment, income, wealth, and affordable-credit access. This mandate covers:

- monetary policy;
- all regulation and supervision;
- the payment system;
- CRA implementation;
- fair-lending enforcement; and
- community development.

B. Congress

The Fed's semi-annual report to Congress as well as the Chairman's semi-annual testimony would also cover economic development with regard to racial and ethnic economic disparities and "other specific segments of the population" that are unnamed in the legislation. These statements must also detail the Fed's plans to counter racial disparities, but apparently not ethnic ones or those related to other groups. However, the FRB's report to Congress must detail recent trends regarding employment, labor participation, household income, changes to "real earnings," and other matters by demographic groups, as well as by race, ethnicity, gender, and educational attainment.