



FedFin Client Report

Tuesday, May 25, 2021

Senate Banking Democrats Take Quarles to Task

Client Report: REFORM206

Executive Summary

In the one-two punch [we anticipated](#), Senate Banking Chairman Brown (D-OH) convened today's hearing with FRB Vice Chairman Quarles not only to lambast supervision and regulation under Mr. Quarles' watch, but also to reiterate the malign role [he believes](#) big banks play in the U.S. economy ahead of tomorrow's hearing with GSIB CEOs. Sen. Brown also argued that banks engage in systemic racism in part due to Fed tolerance of discriminatory behavior. In sharp contrast, Ranking Member Toomey (R-PA) suggested that the type of focus Sen. Brown espouses on racial equity and worker equality is beyond the Fed's mandate, reiterating criticism of "woke" [Reserve Banks](#) and saying this "mission creep" threatens Fed independence. Banking Committee Members were similarly divided, with Sen. Warren (D-MA) taking particularly strong exception to Mr. Quarles' actions as vice chairman and strongly opposing his reappointment (which we have long thought unlikely). Although Acting Comptroller Hsu announced his interest in an inter-agency approach to crypto-assets just last week ([see Client Report REFORM205](#)), Mr. Quarles today indicated that the agencies are now in a "sprint" to craft one. Mr. Quarles also stated that even a pilot U.S. CBDC program would likely require statutory change, heightening concern about the ability of the Fed quickly to proceed to ensure a digital form of [legal tender](#) any time soon.

Analysis

Opening Statements

Chairman Brown criticized Mr. Quarles for failing to check Wall Street's power, calling on him to stand up for the American people and ensure that banks take climate and cryptocurrency risks into account. He also noted the need to close the racial wealth gap.

Following letters sent to the heads of three regional Fed Banks [yesterday](#), Ranking Member Toomey criticized the Fed for its work on climate change and urged the Fed to issue permanent SLR relief.

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Testimony

Vice Chair Quarles reiterated his testimony from last week's HFSC hearing ([see Client Report REFORM205](#)).

Q&A

- Archegos: Sen. Warren criticized Mr. Quarles for his decision to pull Credit Suisse out of the LISCC supervisory process, asking if he was right to weaken supervision; Mr. Quarles does not believe this decision weakened supervision, emphasizing that the bulk of the bank's losses occurred outside the United States and would not have been caught under the LISCC process. Urging President Biden to pick a better Vice Chair, Sen. Warren argued that the financial system will be safer when Mr. Quarles is gone.
- Incentive Compensation: Sen. Menendez (D-NJ) pressed the Fed to finalize the incentive-based compensation rulemaking, saying this would have helped prevent risks such as those revealed by Archegos.
- Climate Change: Sens. Toomey and Hagerty (R-TN) worried about the Fed's "mission creep" into environmental policy, arguing that climate change poses no threat to the stability of the financial system; Mr. Quarles maintained that the Fed's mandate allows it to examine climate risk. Sen. Van Hollen (D-MD) announced his plans to reintroduce the Climate Change Financial Risk Act, which would direct the Fed to develop financial risk analyses related to climate change. He also asked if the standardization of climate risk data is important from a supervisory perspective; Mr. Quarles said it is.
- CBDC: Sen. Van Hollen worried about the U.S. falling behind on CBDC, asking if the Fed needs congressional authority to launch a pilot program; Mr. Quarles believes even a pilot would likely require approval authority.
- Crypto: Sen. Warner (D-VA) noted that digital ledger technology has promise, but is concerned about the illicit use of crypto currencies. Sen. Lummis (R-WY) asked for an update on the Fed's work on digital assets; Mr. Quarles noted that the Fed, FDIC, and OCC are engaged in a "sprint" to create a common regulatory framework.
- NBFIs: Sens. Tester (D-MT) and Ossoff (D-GA) asked which risks Mr. Quarles considers most pressing; Mr. Quarles noted his focus on improving the resiliency of non-banks' regulatory framework. Sen. Ossoff asked if there are any corners of capital markets where regulators lack visibility; Mr. Quarles noted some data

gaps in information from nonbanks. Sen. Cortez Masto (D-NV) asked about the Fed's review of financial services trends; Mr. Quarles noted questions about the supervision of fintechs operating without banking partners, large tech firms providing services to the banking industry, and bank-fintech partnerships.

- Systemic Racism: Chairman Brown criticized the Fed for rules he believes allow banks to take risky bets instead of investing in communities as well as its failure to take action against banks for lending discrimination, arguing that these actions have contributed to systemic racism; Mr. Quarles believes that the Fed has been aggressive in pursuing fair lending violations and discrimination. Sen. Toomey argued that the Fed is engaging in advocacy related to systemic racism, harming its reputation; Mr. Quarles agreed that the Fed should not engage in advocacy, but noted its important role in research and analysis.
- Bank Mergers: Chairman Brown asked if the Fed, through bank mergers and consolidations, has contributed to the loss of banks in rural areas; Mr. Quarles disagreed.
- MMF Reform: Sen. Toomey suggested that the presence of the 30 percent liquid asset threshold exacerbated MMF issues last year; Mr. Quarles pointed to the Fed's broad, ongoing review of MMFs.
- NSFR: Sen. Lummis asked if the net stable funding ratio ([see FSM Report LIQUIDITY32](#)) might cause changes for certain commodity markets in the U.S.; Mr. Quarles has seen no evidence of this.
- SLR: Sen. Toomey asked if the Fed anticipates permanent changes to the SLR; Mr. Quarles mentioned the Fed's current review of the SLR, noting its examination of all methods to address capital pressure on banks.
- CRA: Sens. Menendez and Warnock (D-GA) pressed for an interagency CRA rule; Mr. Quarles believes that there will likely be one.
- Supervisory Process: Sen. Tillis (R-NC) worried that the confidential nature of MRAs and MRIs impairs due process; Mr. Quarles noted that although the Fed has historically been cautious about the release of information, greater transparency is important.