



FedFin Client Report

Tuesday, January 11, 2022

FedFin Assessment: Powell Sidesteps Many Challenges, Promises Much

Client Report: FEDERALRESERVE67

Executive Summary

As promised yesterday ([see Client Report FEDERALRESERVE66](#)), we listened closely today to gauge the extent to which Chairman Powell faces a serious challenge to reconfirmation. At least as far as Senate Banking Members are concerned, he doesn't. Although Sen. Warren (D-MA) and other Democrats lambasted Mr. Powell over insider-trading allegations and what they called the Fed's unresponsiveness, all still were cordial and seemed generally to blame the problem on institutional failures, not the chairman. Sen. Menendez (D-NJ) called the Fed's diversity policy "outrageous," but also does not seem inclined to block confirmation based solely on this issue. As anticipated, most senators focused on inflation and the economy; Mr. Powell often reflected this by affirming that the Fed will soon cease to be quite as accommodative. Senate Banking Chairman Brown (D-OH) urged Mr. Powell not to let up on economic stimulus, also complaining about big-bank consolidation, capital distribution, bank profits, and the need for more lending to "Main Street." As detailed below, Mr. Powell was noncommittal when asked about allowing special-purpose crypto charters access to the payment system, saying again that the CBDC discussion paper will be out soon when pressed by Sens. Crapo (R-ID) and Daines (R-MT). The session also focused on climate risk, with Republicans again asserting action here is outside the Fed's mandate and Democrats demanding still quicker action; Mr. Powell stressed the extent to which climate risk may be a systemic risk and reiterated that scenario analyses are coming without providing a timeline. Mr. Powell denied that the FRB has any new policy against large bank mergers and again indicated at least interest in revising the SLR to address deposit inflows. Mr. Powell has until January 19 to answer the many questions filed for the record; it is unclear if his floor vote can be scheduled quickly enough before the end of this term this month, but there will be no disruption in Fed leadership should this occur.

Analysis

Opening Statements

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Chairman Brown praised the Fed's pandemic-recovery efforts, urging Mr. Powell to not alter course before working Americans have fully recovered. He said the Fed needs to take seriously systemic risks such as cryptocurrencies, stablecoins, and climate change, arguing also for the interagency update to CRA. Sen. Brown also said it is Chair Powell's responsibility to restore trust in the Fed following its ethics scandal.

Ranking Member Toomey (R-PA) applauded Fed regulatory relief implemented under Chair Powell as well as pandemic relief. He urged the Fed to act with increased urgency regarding inflation and to normalize monetary policy, also arguing it should stay out of climate change and racial justice policy.

Testimony

Mr. Powell's formal testimony was brief, praising the Fed's actions under his watch, providing no insight to pending rules, and committing to efforts to ensure that rising inflation is indeed short-lived.

Q&A

Capital Requirements: Sen. Rounds (R-SD) asked that the Fed consider adjustments to the SLR; Mr. Powell said it will consider the issue, arguing the Fed wants risk-based capital, not the leverage ratio to be the binding requirement. Potential adjustments would not reduce the "overall bindingness" of capital requirements but instead handle deposit inflows. Sen. Brown (D-OH) pushed for stricter large-bank capital requirements.

Climate Risk: Democrats including Sens. Brown, Reed (D-RI), and Van Hollen (D-MD), asked Mr. Powell to make this a top priority; Chair Powell said it is within the Fed's limited role, noting climate change poses transitional risks. Republicans such as Sens. Cramer (R-ND) and Daines (R-MT) argued that climate change falls outside of the Fed's dual mandate, noting also that blackouts from forced closures of energy sources such as coal also pose financial stability risk.

Mergers and Acquisitions: Sen. Tillis (R-NC) said bank mergers are already highly regulated transactions and worries about increased difficulties for regional bank consolidation, saying there is bias in the system and asking Mr. Powell for confirmation that super regional banks will be able to consolidate. Chair Powell said only law and thus Fed policy have not changed. Sen. Smith (D-MN) said the number of banks has significantly decreased, asking how bank concentration affects underserved regions. Chair Powell said consolidation of banks was due to outside sources, such as demographic shifts away from rural areas and higher fixed technological and regulatory costs.

CBDC: As noted, Sens. Crapo and Daines expressed disappointment in the Fed delaying releasing its report on digital currency and asked when the report will come out, with Sen.

Crapo asking if there was a reason Mr. Powell might not want Congress and the American public to see the report. Mr. Powell once again stated that the report will be released within the coming weeks, saying it will explore a “series of questions” while only taking some positions. Sen. Toomey argued against mandating retail accounts at the Fed, asking if Congressional authorization of CBDC would preclude coexistence with well-regulated privately owned stablecoins; Mr. Powell agreed with Sen. Toomey that the Fed is not a retail bank, and said well-regulated stablecoins could coexist with a CBDC.

Special Purpose Depository Institutions (SPDIs): Sen. Lummis (R-WY) said that Wyoming’s SPDIs are banks per Federal Reserve Act, FDIC, and federal courts, and the Fed thus should not have discretion to deny them master accounts. Chair Powell said the Fed wants to be very careful when setting precedent, noting there are good arguments for viewing these charters as depository institutions but it has to first think through safety and soundness implications.

Independence: Republicans called for Chair Powell to ensure that the Fed remains independent and apolitical, urging that it refrain from engaging on climate-change and racial-justice issues.