



FedFin Client Report

Tuesday, March 7, 2023

Battle Lines Form Over Capital Rewrite

Client Report: FEDERALRESERVE72

Executive Summary

Although Chairman Powell's testimony kept exclusively to monetary policy, today's Senate Banking hearing seemed only to go through the motions set at previous hearings with regard to inflation, growth, and the Fed's long-term objectives. Real energy was reserved for regulatory-policy questions, most notably future bank capital standards. As [anticipated](#), Republicans were unified in a series of questions all focused on the extent to which Chairman Powell will allow Vice Chairman Barr's [holistic-capital](#) exercise to result in the higher capital standards Mr. Barr says are warranted for the largest banks. Mr. Powell distanced himself from the Barr inquiry without taking a stand beyond committing that the rules will be tailored – [acknowledged again](#) yesterday by Acting Comptroller Hsu – and stating as the agencies often do that U.S. law – not Basel standards – is the ultimate arbiter of their action. These exchanges are detailed below, but we do not think that they change the dynamic related either to near-term proposals regarding the end-game rules or recommendations to come from Mr. Barr beyond making it still more likely that the agencies will expect mid-sized banks where inter-agency agreement on size thresholds remains. As in the past, today's session also covered crypto and, as before, Mr. Powell urged great caution when it comes to bank activities and the need for new federal law. CRA rules remain a few months off, signaling ongoing disagreements between the agencies on matters such as public hearings, scoring, and assessment areas.

Analysis

Opening Statements

In addition to blaming corporate profiteering for inflation and urging the Fed to talk more about this issue, Chairman Brown (D-OH) raised concern over the Fifth Circuit's recent CFPB [ruling](#), claiming the court is "owned by Wall Street" and noting that the Fed's own funding would be jeopardized if SCOTUS upholds the decision. Although Ranking Member Scott (R-SC) went off-script for remarks that mainly blamed inflation on Democratic fiscal policies, he also expressed concern over Vice Chair Barr's holistic capital review as well as climate-policymaking at the Fed.

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Testimony

Mr. Powell filed the now-usual, terse statement summarizing economic prospects and monetary policy. Although acknowledging slowing growth, he reiterated his recent hawkish stand.

Q&A

- **Holistic Capital Review:** Ranking Member Scott argued that requiring banks to hold capital that is not risk-based and appropriately tailored would be economically harmful. The Ranking Member asked Mr. Powell to commit that any ongoing capital review will follow the law and that any follow-on regulatory proposal will be tailored; Mr. Powell did so. Sen. Britt (R-AL) also argued that increasing capital requirements would have a chilling effect on the economy, asking Mr. Powell if it is wise to do so during times of high inflation. Mr. Powell emphasized the importance of balancing capital standards, arguing that they make banks safer but acknowledging that it is not always clear if a perfect equilibrium between bank capital and credit availability is in place. Sens. Haggerty (R-TN) and Tillis (R-NC) echoed the Ranking Member in asking for Mr. Powell's views on capital adequacy as well as the retention of tailoring requirements in the capital rewrite; Mr. Powell did not opine directly, only saying that it is appropriate for the Vice Chair to conduct a review. He also strongly asserted that tailoring would continue.
- **CRA:** Chairman Brown asked Mr. Powell if the Fed remains committed to working with the FDIC and OCC to finalize CRA revisions, asking also when they would be finalized. Mr. Powell affirmed the Fed's commitment to interagency work on CRA finalization, stating that he believes the Fed is in broad agreement with the other agencies but noting it will be some months before it is finalized. Asked by Sen. Smith (D-MN) about who would be spearheading the Fed's CRA effort, Mr. Powell said that Vice Chair Barr would be pushing it forward. Sen. Smith also asked Mr. Powell for his views on whether CRA credit for disaster resiliency fits with the CRA's overarching objectives; Mr. Powell said that it does.
- **Crypto:** Chairman Brown asked Mr. Powell how the Fed is evaluating the risk of crypto activities among supervised institutions. Mr. Powell emphasized the importance of innovation but maintained that the Fed is monitoring multiple risks and making sure that financial institutions are taking great care in their exposures to cryptoassets. Alluding to a recent [interagency statement](#) on cryptoassets and liquidity risks for banking organizations, Sen. Sinema (D-AZ) asked Mr. Powell if he believes liquidity risks are inherent to crypto assets or if some derives from the current regulatory environment. Mr. Powell only reiterated that regulated financial institutions should be cautious in the crypto space. Asked by Sen. Lummis (R-WY) if the U.S. is in danger of being a digital asset rule-taker rather than rule-maker, Mr. Powell once again emphasized the importance of legislation and urged Congress to act.

- **Stablecoins:** Referencing a January [interagency statement](#) raising safety and soundness concerns with bank stablecoin issuance on an open public decentralized network, Sen. Lummis (R-WY) asked Mr. Powell if the Fed believes stablecoins have no place in banks; Mr. Powell affirmed concerns with permissionless public blockchains, but did not comment further. Sen. Lummis also asked whether the Chairman believes properly-regulated stablecoins have a place in banks; Mr. Powell again said yes.
- **Climate Finance/ESG:** Ranking Member Scott asked the Chairman if he agreed that the Fed lacks the authority to weigh into ESG and other climate policies; Chairman Powell agreed. Sens. Britt, Cramer (R-ND), and Tillis also took issue with what they characterized as ESG and climate-related mission creep at the Fed, asking Mr. Powell to stand by [earlier comments](#) on this issue. Mr. Powell reiterated that safety and soundness is the only goal of the Fed's climate pilots and that the Fed is not looking to make climate policy or stray from its dual mandate.
- **NBFI:** Sen. Warner (D-VA) raised concern over the "vast" amount of financial activity taking place outside of the regulatory perimeter, asking Mr. Powell if he agreed with the same risk, same regulation construct. Mr. Powell affirmed that he shares this regulatory principle, noting that digital assets and stablecoins in particular are in need of attention and that nonbank financial intermediation is an area in need of monitoring.
- **CRE/Corporate Debt:** Sen. Warner also raised concern with commercial debt levels and risks stemming from commercial real estate vacancies and asked Mr. Powell how the Fed is looking into this issue; Mr. Powell acknowledged there are pockets of concern with corporate debt and that the Fed is monitoring them carefully. He also noted that CRE vacancy rates have been remarkably high and that the Fed is monitoring the financial stability risks to banks due to interconnection with this sector.
- **Fifth Circuit CFPB Decision:** Echoing Chairman Brown's opening statements in noting that both the Fed and CFPB rely on the same source of funding, Sen. Reed (D-RI) asked Mr. Powell what effect SCOTUS upholding the Fifth Circuit Court's decision would have on monetary policy. Mr. Powell said the effect would be significant but was reluctant to comment further, also stating that the Fed's funding structure is a key factor of its independence.
- **Fed Board Diversity:** Chairman Brown was joined by Sens. Cortez-Masto (D-NV) and Warnock (D-GA) in noting Vice Chair Brainard's departure as an opportunity to advance recent calls by Sens. Menendez (D-NJ) and Reed for Fed Board diversity. Sen. Menendez also sharply criticized the Fed for its lack of board diversity, particularly for its lack of Latino representation.