



FedFin Client Report

Wednesday, June 21, 2023

Powell Tries to Deflect GOP Capital Assault

Client Report: FEDERALRESERVE74

Executive Summary

Chairman Powell's HFSC appearance today led to unusually substantive discussion of pending financial-policy actions. As detailed in this report, Republicans renewed their vigorous campaign against new capital rules, refusing to be put off by Mr. Powell's assurances that they would apply only to the largest banks, would be phased in, and will have less impact on growth than interest rates. Even though Mr. Powell also said he recognized capital trade-offs and had taken no position on new rules, Chairman McHenry (R-NC) is so opposed to these and other recent proposals from Vice Chairman Barr that his opening [statement](#) includes the suggestion of legislation to separate monetary from regulatory policy, presumably moving regulation to another agency perhaps in the manner recently proposed by Sen. J.D. Vance (R-OH). However, neither Mr. McHenry nor other Republicans raised this idea in their questioning, suggesting it is not a near-term legislative-agenda item. What is near-term are mark-ups announced today for the HFSC/Ag bill on crypto jurisdiction strongly [opposed](#) by Democrats and the stablecoin bill to which they are considerably more amenable. Mr. Powell was more forthcoming on CBDC, making clear that the Fed will only support a bank-intermediated product if it ever approves a CBDC. Although he did not commit to specific liquidity standards, the Fed chairman was emphatic that recent social-media runs have demonstrated the need to update both regulation and supervision in this arena. He was steadfast in his ONRRP support, saying also that a systemic-risk designation was deployed in March rather than OLA because the emergency was a surprise.

Analysis

Opening Statements

In addition to lambasting Democratic fiscal policy and warning of economic headwinds, Chairman McHenry (R-NC) took issue with what he described as a potentially "massive" increase in capital standards for medium and large institutions on grounds that a well-capitalized banking system needs regulatory and supervisory certainty. Ranking Member Waters (D-CA) highlighted the Senate's clawback legislation and urged Chair McHenry to advance "sensible" reforms to strengthen the nation's banking system and hold executives

Federal Financial Analytics, Inc.
2101 L Street, NW – Suite 300, Washington, D.C. 20037
Phone (202) 589-0880
E-mail: info@fedfin.com www.fedfin.com

© 2023. Federal Financial Analytics, Inc. All rights reserved.

accountable. Subcommittee on Financial Institutions Chairman Barr (R-KY) also raised serious concerns with the Fed's pending capital review, arguing that banks are well-capitalized and that higher capital requirements would hinder regional banks already under stress. In addition to arguing that the law does not give the Vice Chair unilateral ability to write regulation, he requested that Chair Powell commit to providing analysis done by the Fed on the Vice Chair's proposal. Subcommittee on Financial Institutions Ranking Member Foster (D-IL) applauded the Fed's recent actions and criticized banks for ignoring signs of interest rate increases.

Testimony

Chairman Powell's [testimony](#) was the usual stout defense of recent Fed monetary policy, acknowledging the harmful effects of high inflation across the nation and reiterating that the FOMC is mindful of potential adverse effects. The FOMC's recent decision to pause [rates](#) is based on "compelling" evidence that will be reconsidered as data warrant. The statement makes no mention of financial policy.

Q&A

- **Regulatory Capital:** Several Republican members sharply criticized pending bank capital requirements, underscoring Chairman Powell and Vice Chair Barr's statements that banks are already well-capitalized. Chairman McHenry raised concerns that new capital requirements will be procyclical and restrict lending; Chair Powell said that regulation should be transparent and consistent, underscoring that banks should be resilient to shocks and that GSIBs must have very high levels of capital and liquidity. He agreed that capital is strong and promised to look at what increases are justified, noting that this will be a matter of weighing costs. He also emphasized the economic benefits of banks of all shapes and sizes and said that he does not want to regulate the smallest banks beyond their business model. Rep. Hill (R-AR) asked if U.S. GSIBs are better capitalized than global peers in Europe and Asia; Mr. Powell said they are "at the top of the league," a point underscored in a Kansas City Fed report [yesterday](#). Asked by Rep. Garbarino (R-NY) if he thinks increasing capital standards is necessary at this time, Chair Powell said only that he would react to the proposal this summer. Rep. Lawler (R-NY) asked if excessive capital levels can constrain bank lending with immediate negative spillover effects; Chair Powell emphasized that a tradeoff between safety and soundness and capital exists. Rep. Sherman (D-CA) asked if banks can be considered well-capitalized if their assets are valued at the current market value and loan portfolios are priced at today's interest rates; Chair Powell only said that a rising rate environment has increased the value of deposit franchise.
- **Regulatory Transparency:** Several Republican members echoed Chairman McHenry and Rep. Barr in demanding that the Fed deliver a quantitative economic analysis of any forthcoming proposal to the Committee before it is presented to the Board. Chairman Powell would not promise to do so, only saying that the Board will vote at a closed-door meeting on the proposal this summer, with proposals out for a ninety-day comment

period. Rep. Barr took serious issue that the meeting might be virtual and also raised concerns that Vice Chair Barr is acting unilaterally; Chairman Powell highlighted that the Board is working around individual calendars with briefings from the Vice Chair.

- **Tailoring:** Rep. Barr called on Chair Powell to commit to proposing appropriately-tailored regulatory requirements based on complexity and size; Mr. Powell committed to tailoring without committing to any specific proposals.
- **Electronic Runs:** Rep. Foster asked if the threat of electronic bank runs should inform capital and liquidity requirements and whether lenders other than the Fed can provide emergency assistance; Chair Powell emphasized that the Fed is the lender of last resort, but noted that changes to regulation and supervision are needed to prevent mismatch of runnable liabilities and available cash.
- **Stablecoin Legislation:** Ranking Member Waters raised concerns about state preemption in draft stablecoin legislation set for a Committee mark-up next month, arguing that a federal floor and greater state oversight similar to the dual banking system; Mr. Powell said the Fed sees stablecoins as a source of money and endorsed a robust federal role. Rep. Davidson (R-OH) asked Chairman Powell if he agreed that crypto has staying power as an asset class; Mr. Powell said yes but noted declining market capitalization.
- **CBDC:** Rep. Nunn (R-IA) raised concerns that Fed-intermediated CBDC accounts would cause serious privacy issues; Mr. Powell agreed, noting that the Fed would not support individual accounts at the Fed, indicating that – if the Fed comes to support a CBDC – it will be bank-intermediated.
- **DEI:** Ranking Member Waters discussed her racial-mandate bill ([see FSM Report FEDERALRESERVE58](#)), asking what steps the Fed will take to address racial and economic inequality; Mr. Powell replied that the Fed considers inequality but its ability to address it is limited. Rep. Beatty (D-OH) said that the previous Chairman’s “deregulation” enabled fair lending discrimination and asked what Chair Powell is doing to combat inequality; Mr. Powell responded that, while the maximum employment rate is an inclusive goal, the federal funds rate is not a distributional tool.
- **ONRRP:** Rep. Davidson asked Chair Powell for his views on the implications of the overnight reverse repo facility on the economy; Mr. Powell said “not much,” likening it to a mutual fund and noting that the facility has been declining in conjunction with Treasury bill issuance. Rep. Davidson also asked if a conflict exists between higher reserve requirements and market lending and liquidity; Mr. Powell said he didn’t think so, noting that, as rates normalize, he expects the facility to decline significantly. Rep. Davidson then raised the Fed’s intervention in the repo market in 2019 and asked if it was an aberration; Mr. Powell emphasized reserve scarcity and demand volatility, reiterating that he believes the facility will shrink.
- **Fed Supervisory Culture:** Rep. Velazquez (D-NY) asked Chair Powell if he was aware of the “cultural shift” attributed to Fed supervision under former Vice Chair Quarles in the

Fed's SVB post-mortem; Mr. Powell emphasized that he had no role in preparing the report and said he could not characterize it as a "cultural shift," also noting that the Fed needs stronger supervision and regulation of banks of SVB's size. He also said that the Fed needs to update its thinking around liquidity regulation, which he said was based on an outdated concept of bank run speed.

- **Systemic Risk Exemption:** Rep. Huizenga (R-MI) asked why the Federal Reserve invoked the systemic risk exemption when it could have used OLA; Chair Powell did not directly answer, saying that he hopes the situation won't arise again and that the Fed responded with no warning and limited time to act.
- **CRE Risk:** Reps. Kim (R-CA) and Gottheimer (D-NJ) raised concerns over CRE portfolio risk at small banks and asked Chair Powell if the Fed is considering policies that provide time for CRE loans to be refinanced; Chair Powell acknowledged CRE risk as a problem for small banks and said that supervisors are working with affected banks to preserve capital.
- **Climate-Related Financial Risk:** Rep. Gonzalez (D-TX) asked Chair Powell if he agreed that policy addressing climate-related financial risk should be addressed by Congress and not the Fed; Mr. Powell strongly agreed, stating that the Fed has a narrow role in climate change and that these decisions should be made by elected officials.
- **Dollar Dominance:** Several Democrats raised concerns about the dollar's status as the global reserve currency; Chair Powell emphasized that USD dominance is an effect of America's global economic power and that the USD will retain its reserve currency status as long as the U.S. maintains liquid capital markets, strong democratic institutions, rule of law and price stability.
- **FedNow:** Rep. Loudermilk (R-GA), referencing FedNow, raised concerns over the Fed's potential advantage over the private sector in the payments space and asked Chair Powell why the service is being created rather than improving existing payment services; Mr. Powell said that small banks overwhelmingly wanted FedNow as an alternative to RTP, but emphasized that work is still need on the efficiency of other payment services.
- **Financial Stability Mandate:** Rep. Torres (D-NY) asked Mr. Powell about the extent to which he factors safety and soundness and financial stability in FOMC decisions; Mr. Powell said that the Fed tries to separate monetary policy and financial stability tools but acknowledged that they affect each other and separation is not perfect. Rep. Torres then asked if Mr. Powell thinks that SVB's failure revealed a tension between the Fed's financial stability mandate as a bank regulator and administrator of monetary policy; Mr. Powell said no, arguing that interest rate risk is a basic risk for which the Fed supervises and blaming recent banks failures on bank mismanagement.
- **Asset Manager Compliance:** Reviving Senate GOP [concerns](#) about asset manager ownership structure, Rep. Huizenga (R-MI) asked Chair Powell if the Fed is taking any steps to ensure that the largest asset managers are complying with statutory

requirements; Mr. Powell said the Fed is broadly monitoring the situation but did not know about an asset manager focus, also noting he does not have a reason to believe they are not in compliance. Rep. Huizenga promised to follow up with a letter on this topic.

- **Nonbank Risk:** Rep. Gottheimer asked Chair Powell if he is concerned about nonbanks in the face of a potential credit crunch; Mr. Powell said yes, noting that the Fed is watching them but does not supervise them. Rep. Gottheimer then asked if Mr. Powell had any recommendations for how Congress should look at nonbanks; Mr. Powell emphasized a same activity, same regulation approach.
- **Receivership:** Rep. Gottheimer raised concern that large banks were favored during the bidding process for FRC and that regional banks were unable to bid due to a time-consuming process that put them at a disadvantage; Mr. Powell emphasized that this is the FDIC's jurisdiction.
- **Fed Master Accounts:** Rep. Davidson asked Chairman Powell if he knew if any non-FDIC-insured institutions have master accounts; Mr. Powell said he didn't and promised a written answer.