Federal Financial Analytics, Inc.

MEMORANDUM

TO: Federal Financial Analytics Clients

FROM: Karen Petrou

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Friday's *American Banker* included a Kyle Campbell article quoting me reiterating some points in my recent testimony about the need for cumulative-impact analyses of the raft of pending rules. This led others to suggest ulterior motives, arguing that calls for cumulative-impact analyses are fig-leaves dangling over efforts to gut the rules. While advocates do not often argue for analytical purity when obscurity suits them, the absence of analytical rigor is nonetheless an abrogation of the public good by public officials. Setting rules based on airy assertions that it will all come right in the end since there most likely won't be financial crises or at least new financial crises like the old financial crises ensures that this regulatory round will have at least as much wreckage as those that came before.

The public good when it comes to financial policy is best measured by careful consideration of something wholly absent in all of the agencies' thinking: economic equality. In its absence, the nation will suffer from still-worse political acrimony, an even worse public-health crisis, growing populations of Americans without fundamental financial security, and even higher odds for still more devastating financial crises. How do I know this? Look at American financial policy since at least 2000 and see what happened.

The Fed is particularly high-handed when it comes to public-good rationales not just for its rules, but also for its still more vital monetary-policy responsibilities. The Fed cloaks itself with the "dual" mandate of "maximum employment" and "price stability" even though, as noted, its mandate actually requires attention not only to "moderate long-term interest rates" as stipulated in one part of its governing law, but also to the "general welfare." Instead, as my book details, the Fed's focus is far more on financial-market returns than on shared prosperity. Income inequality may be mostly a function of fiscal policy, but wealth inequality is the result of massive changes in financial-market returns over decades of ultra-low rates and hyper moral hazard.

And, where's the public good in a financial system increasingly outside the reach of safety-and-soundness or consumer-protection standards? As I've noted elsewhere (here and here), the agencies' impact analyses are singularly insouciant about the risk that critical financial services and infrastructure could move into the nether sphere of high-risk, high-return providers. The transformation of corporate finance from a core regulated-bank function to a galloping, high-risk private-credit market is clear evidence yet again that money moves where return is to be quickly had, not where regulators wish it would remain.

And then there's just plain unwillingness to think hard about public-good complexities. The Fed's new proposal to cut debit-card interchange fees is a particularly problematic case in point. As our in-depth analysis noted, the Fed's impact analysis acknowledges as data say it must that the 2011 fee cut led to sharp curtailment in essential transaction-account services for low-balance depositors

2101 L Street, N.W. – Suite 300
Washington, DC 20037
Phone: 202.589.0880

E-mail: info@fedfin.com
Website: www.fedfin.com

who need them the most. The analysis goes breezily on to say that it doesn't think this will happen again because deposit-account pricing is already so inequitable -- my words, not the Fed's – that it can't change for the still worse. Really? How does the Fed know this?

Congress told the Fed to cut debit-card fees even if it hurts bank profitability, so the public good as Congress gave the Fed to know it with regard to this rule is not to ensure that banks of any size can continue to offer debit card services at a healthy profit. But the law comes with a particularly explicit requirement for the Fed to ensure also that lower fees don't just benefit merchants. The new proposal also breezily says it's sure that won't happen this time because – while it might have happened before – merchants this time will really cut prices and improve customer service. Maybe this time merchants will be altruistic, but even if they are, that will still be regressive. What matters most to wealth equality is return on savings, not cost reductions other than when it comes to household essentials or housing. For these prices, let's return to the discussion of Fed monetary policy and the damage it does to those who can afford it the least.

Advancing the public good always pick winners and losers. It's not too much to ask that the banking agencies say which ones they've picked and why.