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United States Senate

COMMITTEE ON BANKING, HOUSING, AND
URBAN AFFAIRS

WASHINGTON, DC 20510-6075

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April 9, 2020

The Honorable Jerome H. Powell
Chairman of the Board of Governors
Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Dear Chairman Powell:

After the 2008 financial crisis, Congress expanded the Federal Reserve's responsibility for assuring the safety and soundness of the banking system. In fact, you aptly described this new mandate, and your job as Chairman, as "us[ing] our tools to achieve maximum employment and stable prices, and to supervise and regulate banks...so that they're strong, well-capitalized and can perform their critical function in good times and in bad."¹

While the Fed's monetary policy actions in response to the coronavirus outbreak are commendable, we are deeply concerned that the Fed is not ensuring banks remain healthy enough to continue lending into what may be a prolonged recession. To prepare banks for the challenges that lie ahead, the Fed should immediately prohibit banks with more than \$50 billion in assets from making any further capital distributions like stock buybacks and dividends.

Despite the biggest banks' claims to the contrary, higher capital requirements support increased lending activity, as capital is the critical funding mechanism for all banking activity. As you know, every dollar in equity capital at a bank supports around ten dollars in lending. The evidence is clear: banks with greater amounts of loss-absorbing capital lend more, in good times and in bad, and well-capitalized banks are far more likely to survive in a stressed environment without requiring a government bailout.

Given the many benefits of a well-capitalized financial system, it is hard to understand the Board of Governors' recent policy actions and failures to take action, which will result in reduced capital, reduced lending ability, and increased financial fragility at precisely the time we cannot afford it. These missteps include rolling back capital requirements at the largest banks lengthy delays for the implementation of important reforms, and the Fed's failure to rein in capital-draining activities like stock buybacks, dividends, and executive bonuses.

For example, as recently as March, in the midst of the pandemic, the Board took steps to reduce capital standards when it proposed eliminating the requirement that that banks pre-fund buybacks

¹ Interview with CBS News, March 10, 2019. Transcript available at: <https://www.cbsnews.com/news/full-transcript-60-minutes-interview-with-fed-chair-jerome-powell/>

and dividends.² At the time, Fed Governor Lael Brainard pointed out that “It is imprudent to reduce the loss absorbing capital at the core of the system at this point in the cycle...”³ We strongly agree.

The Board has also given large banks far too long to adopt reforms for recognizing expected losses under CECL.⁴ Though Congress provided some flexibility on CECL through the end of the year, the Board’s actions will allow banks to delay meeting this requirement for up to five years, effectively reducing their capital levels well into the future.

Perhaps most concerning, the Board has rolled back one of the most important capital standards for the biggest, riskiest banks in the country.⁵ The supplementary leverage ratio is a simple rule based on direct experience from the financial crisis – more equity capital means safer banks and a more stable financial system. The Board’s decision to reduce this capital requirement by two thirds at banks with more than \$250 billion in assets further harms our financial system.

Some at the Board have argued that these steps to reduce capital will increase lending. But it is a myth that well-capitalized banks are less likely to lend – in fact, the opposite is true. After the crisis, well-capitalized community banks continued lending into the recession and deployed a much higher proportion of their capital to small business lending compared to highly-leveraged megabanks.⁶ Recent experience shows us that when we reduce capital requirements at the largest banks, they shower money on executives and stockholders through stock buybacks, dividends, and bonuses.⁷ Every dollar spent on these capital distributions could instead be supporting multiples of that in loans to small businesses and hardworking families in need.

The Board must take immediate steps to stop buybacks, dividends, and other bank activities that increase risk to the financial system but do not help the recovery of our economy. While some of the largest banks have volunteered not to engage in further buybacks⁸, they are still paying dividends and lining their CEOs’ pockets. In fact, just this week those large banks told regulators⁹ in their proposed capital plans exactly what they will continue doing instead of lending into communities that need access to capital – more dividends, more executive pay. The

² Federal Reserve Board of Governors Release regarding changes to the Stress Capital Buffer rule, March 4, 2020. Available at: <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200304a.htm>

³ Statement by Federal Reserve Board Governor Lael Brainard, March 4, 2020. Available at: <https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20200304a.htm>

⁴ Joint Statement of Federal Banking regulators regarding Interim Final Rule on Current Expected Credit Losses (CECL), March 27, 2020. Available at: <https://www.occ.treas.gov/news-issuances/federal-register/2020/nr-ia-2020-42b-federal-register.pdf>

⁵ Federal Reserve Board of Governors Statement regarding the Supplementary Leverage Ratio, April 1, 2020. Available at: <https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200401a.htm>

⁶ Federal Reserve Bank of Chicago, Economic Perspectives, 3Q 2016. “As of March 2015, these banks accounted for 16.5 percent of all banking assets but funded 43 percent of SBL originated by all banks.” Available at: <https://www.chicagofed.org/publications/economic-perspectives/2016/3-jagtiani-lemieux>

⁷ “Banks Announce Billions in Share Buybacks after Fed Approval,” Associated Press, June 27, 2019. Available at: <https://www.usnews.com/news/business/articles/2019-06-27/fed-approves-buyback-dividend-plans-for-all-largest-banks>

⁸ Statement of the Financial Services Forum on Share Buybacks, March 15, 2020. Available at: <https://www.fsforum.com/types/press/releases/financial-services-forum-statement-on-share-buybacks/>

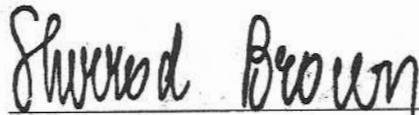
⁹ “U.S. Banks to Defend Dividend Payments in Stress Tests: FT,” Reuters, April 5, 2020. Available at: <https://www.reuters.com/article/us-usa-banks-stress-tests/u-s-banks-to-defend-dividend-payments-in-stress-tests-ft-idUSKBN21N0QS>

Board must reverse course, and it can start by barring any further capital distributions at banks with more than \$50 billion in assets.

Ending capital distributions now will refocus these banks on their core mission: lending into their communities, a critical goal during these difficult economic times. The Board should also adopt rigorous supervision and stress testing, and commit to aggressively increasing capital requirements once banks have the organizational capacity to focus their efforts beyond the response to the pandemic. This is not an easy undertaking, but it is critical to ensure a sound economy.

As you said yourself, Congress conferred on you a duty to ensure banks are strong and well-capitalized so that they can perform their critical function – lending – in good times and in bad. Suspending stock buybacks and dividends at Wall Street banks would be a critical step in the right direction.

Sincerely,



Sherrod Brown
U.S. Senator



Brian Schatz
U.S. Senator



Elizabeth Warren
U.S. Senator