BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

RANDAL K. QUARLES
VICE CHAIR FOR SUPERVISION

April 22, 2020

The Honorable Mike Crapo
Chairman
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Chairman Crapo:

Thank you for your letter of April 8, asking the federal financial regulatory agencies ("the agencies") to identify steps that "strengthen the Paycheck Protection Program (PPP), right-size regulations to promote lending, and provide the Banking Committee with statutory changes and recommendations necessary to stabilize markets and expand lending during the COVID-19 crisis." As you noted, the containment measures adopted in response to the public health concerns have already demanded bold, immediate action from Congress and the agencies to protect the national economy; they will likely demand still more of us before the crisis ends. I write to offer context on the supervisory and regulatory actions that the Federal Reserve has taken thus far, and to suggest steps Congress can take to prepare for the road ahead.

I agree unreservedly that banks, credit unions, and other financial institutions have an essential role to play in our nation's response to COVID-19. The relationships of banking organizations with their customers are deep and durable, particularly those with small businesses most deeply affected by the pandemic.[1] These relationships make banking organizations a powerful and ready conduit for aid to reach those who need it most. The Federal Reserve's supervisory and regulatory actions have been geared towards putting that conduit to its full and effective use.[2] In particular, we have encouraged banks to work with borrowers affected by

[1] *See* U.S. Small Business Administration, "2019 Small Business Profile: United States"; Federal Reserve Bank of New York, "2020 Report on Employer Firms: Small Business Credit Survey," at 16 (detailing role of existing lender relationships in determining applications for financing); U.S. Small Business Administration, "Small Business Lending in the United States, 2017," January 2020, at 10 (detailing findings on U.S. banking system as "the major supplier of traditional credit to small businesses").
[2] A list of such actions is available at https://www federalreserve.gov/supervisory-regulatory-action-response-covid-19.htm.

COVID-19 and have taken steps to ensure our examination and reporting processes would not interfere that critical task.[3]

Following passage of the Coronavirus Aid, Relief, and Economic Security (CARES) Act, the agencies implemented provisions easing leverage requirements for community banks and published rules delaying the impact on regulatory capital of new loan-loss accounting standards.[4] The Federal Reserve announced the creation of a new lending facility, giving institutions that participate in the new Paycheck Protection Program (PPP) a ready source of liquidity to support further lending.[5] Together with the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency, we issued an interim final rule to clarify that a zero percent risk weight applies to PPP loans and to neutralize the regulatory capital effects of participating in the new PPP lending facility, helping preserve the flow of credit to small businesses.[6]

However, some of the most effective steps the agencies can take in this crisis concern bank capital. The U.S. banking sector entered the COVID-19 outbreak in a position of strength, having spent the last decade adapting to a new, more robust regulatory regime. This regime was designed not just to ensure the safety and soundness of individual banks, but to meet "macroprudential" goals—as former Governor Jeremy Stein put it, "to control the social costs associated with excessive balance-sheet shrinkage on the part of multiple financial institutions hit with a common shock."[7] Congress and the agencies required institutions to hold more and

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[3] *See, e.g.*, Board of Governors of the Federal Reserve System, Conference of State Bank Supervisors, Consumer Financial Protection Bureau, Federal Deposit Insurance Corporation, National Credit Union Administration, and Office of the Comptroller of the Currency, "Federal agencies encourage mortgage servicers to work with struggling homeowners affected by COVID-19," news release, April 3, 2020; Board of Governors of the Federal Reserve System, Consumer Financial Protection Bureau, Federal Deposit Insurance Corporation, National Credit Union Administration, and Office of the Comptroller of the Currency, "Agencies issue revised interagency statement on loan modifications by financial institutions working with customers affected by the coronavirus," news release, April 7, 2020; Board of Governors of the Federal Reserve System, "Federal Reserve offers regulatory reporting relief to small financial institutions affected by the coronavirus," news release, March 26, 2020; Board of Governors of the Federal Reserve System, "Federal Reserve provides additional information to financial institutions on how its supervisory approach is adjusting in light of the coronavirus," news release, March 24, 2020.

[4] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Agencies announce changes to the community bank leverage ratio," news release, April 6, 2020; Board of Governors of the Federal Reserve System, "SR 20-9: Joint Statement on Interaction of the Regulatory Capital Rule: Revised Transition of the CECL Methodology for Allowances with Section 4014 of the Coronavirus Aid, Relief, and Economic Security Act," March 31, 2020.

[5] The Federal Reserve also announced on April 9 the details of a new Main Street Lending Program; expansions of the Primary and Secondary Market Corporate Credit Facilities (PMCCF and SMCCF) and Term Asset-Backed Securities Loan Facility (TALF); and the creation of a new Municipal Liquidity Facility. The Federal Reserve, supported the Department of the Treasury, took these actions to provide up to $2.3 trillion in lending. *See* Board of Governors of the Federal Reserve System, "Federal Reserve takes additional actions to provide up to $2.3 trillion in loans to support the economy," news release, April 9, 2020.

[6] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Federal bank regulators issue interim final rule for Paycheck Protection Program Facility," news release, April 9, 2020; Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency, "Federal bank regulatory agencies issue interim final rule for Money Market Liquidity Facility," news release, March 19, 2020.

[7] *See* Samuel G. Hanson, Anil K. Kashyap, and Jeremy C. Stein, "A Macroprudential Approach to Financial Regulation," 25(1) *J. Econ. Persp.* 3, 5 (Winter 2011); *see also* Chairman Ben S. Bernanke, "Implementing a

higher-quality capital through the cycle, not just to prevent bank failures, but to prevent credit crunches. Post-crisis reforms were designed to avoid a sharp pullback in lending, precisely when access to credit becomes a matter of survival.

Now, as the nation faces a sharp economic contraction, the Federal Reserve is working to ensure banking organizations can put their capital to use. Above all, we have actively and repeatedly encouraged institutions to use their capital buffers for their primary purpose: to support safe and sound lending throughout the credit cycle.[8] Banks are already responding to the unprecedented circumstances related to COVID-19. Bank lending grew substantially last month, as banks drew on their capital buffers to expand lending to support economic activity, and large U.S. banks have suspended share repurchases.

These steps were essential to preserving credit access as the COVID-19 crisis began. Other steps will prove essential before the crisis ends. To that end, Congress should consider modifying section 171 of the Dodd-Frank Act ("the Collins Amendment") to allow regulators to provide flexibility under Tier 1 leverage requirements as banks respond to increased credit demands.[9]

Congress has amended section 171 before, recognizing the complications it presents in tailoring a capital regime to a diverse financial sector and to changing risks in the financial system over time. In the current environment, it poses an additional challenge: complicating the regulatory agencies' ability to address a severe economic stress period. Banking organizations are receiving significant inflows of customer deposits and the ability of these banking organizations to continue accepting significant deposits may become constrained due to Tier 1 leverage requirements. The regulatory agencies have taken unprecedented measures to ensure that the financial sector can meet this demand. The sector's success in this task is a matter of national urgency, and in my view, congressional action to improve regulatory flexibility to respond would only help achieve it.

I appreciate the opportunity to work with you, your office, and the Committee on identifying the best ways to support the American economy in this unprecedented time.

Sincerely,

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Macroprudential Approach to Supervision and Regulation," remarks at the 47th Annual Conference on Bank Structure and Competition, Chicago, Illinois, May 5, 2011.

[8] *See, e.g., id.*; Board of Governors of the Federal Reserve System, "Federal Reserve Actions to Support the Flow of Credit to Households and Businesses," news release, March 15, 2020.

[9] 12 U.S.C. 5371.