United States Senate

WASHINGTON, DC 20510

February 26, 2021

The Honorable Jerome Powell
Chairman
Board of Governors of the Federal Reserve System
20th St and Constitution Avenue NW
Washington, D.C. 20551

The Honorable Randal K. Quarles
Vice Chairman for Supervision
Board of Governors of the Federal Reserve System
20th St and Constitution Avenue NW
Washington, D.C. 20551

The Honorable Blake Paulson
Acting Comptroller of the Currency
Office of the Comptroller of the Currency
400 7th St. SW
Washington, DC 20219

The Honorable Jelena McWilliams
Chairman
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Dear Chairman Powell, Vice Chair Quarles, Chairman McWilliams, and Acting Comptroller Paulson:

We write to ask that you reject the coordinated lobbying efforts of the country's largest banks to convince your respective agencies to extend a temporary rule that reduced banks' capital requirements. This temporary rule substantially weakens one of the most important regulatory requirements for large banks put in place after the 2007-2008 financial crisis. You should restore those requirements as quickly as possible.[1]

On April 1, 2020, the Federal Reserve Board of Governors (Fed) released an interim final rule (IFR) that allowed bank holding companies to exclude U.S. Treasuries and deposits held at Federal Reserve Banks from the calculation of their Supplementary Leverage Ratio (SLR) through March 31, 2021.[2] The Fed, Federal Deposit Insurance Corporation (FDIC), and Office of the Comptroller of the Currency (OCC) subsequently released a joint IFR allowing insured

[1] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, "Agencies adopt supplementary leverage ratio final rule," September 03, 2014, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20140903b.htm.

[2] Board of Governors of the Federal Reserve System, "Federal Reserve Board announces temporary change to its supplementary leverage ratio rule to ease strains in the Treasury market resulting from the coronavirus and increase banking organizations' ability to provide credit to households and businesses" April 01, 2020, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200401a.htm

depository institutions to opt-in to this capital carve out.[3] This change resulted in a $55 billion reduction of capital requirements for the largest banks.[4][5]

The stated rationale for this change was to allow banks to "expand their balance sheets as appropriate to serve as financial intermediaries and serve their customers."[6] The pandemic-induced flight to liquidity by investors and corporations resulted in increased bank deposits and bank demand for safe assets like reserves and Treasuries.[7] Regulators indicated that the increase in reserves in the banking system as a result of actions taken to support market functioning during COVID-19, and the influx of customer deposits, would put pressure on banks' balance sheets. Specifically, the IFR noted, "the resulting increase in the size of depository institutions' balance sheets may cause a sudden and significant increase in the regulatory capital needed to meet a depository institution's leverage ratio requirement."[8]

The IFR was nominally written to help banks address these – presumably temporary – restraints. But in reality, the relief went well beyond this simple accommodation, exempting *all* Reserve Bank deposits and Treasury Securities from the calculation, including those that banks held well before the crisis.[9] Moreover, it is not at all clear that the rule helped support businesses and households. Recent data suggests that big banks are committing an ever-decreasing portion of their balance sheets to business and household lending: the share of banks' assets devoted to loans is now at a 36-year low.[10]

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[3] Board of Governors of the Federal Reserve System, "Regulators temporarily change the supplementary leverage ratio to increase banking organizations' ability to support credit to households and businesses in light of the coronavirus response," May 15, 2020, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200515a.htm.

[4] Office of the Comptroller of the Currency , Board of Governors of the Federal Reserve System, and Federal Deposit Insurance Corporation, Federal Register Notice," Regulatory Capital Rule: Temporary Exclusion of U.S. Treasury Securities and Deposits at Federal Reserve Banks From the Supplementary Leverage Ratio for Depository Institutions," June 01, 2020, https://www.federalregister.gov/documents/2020/06/01/2020-10962/regulatory-capital-rule-temporary-exclusion-of-us-treasury-securities-and-deposits-at-federal.

[5] This calculation assumes that all eligible banks opt in for the relief.

[6] Board of Governors of the Federal Reserve System, "Regulators temporarily change the supplementary leverage ratio to increase banking organizations' ability to support credit to households and businesses in light of the coronavirus response," May 15, 2020, https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200515a.htm.

[7] Board of Governors of the Federal Reserve System, "Treasury Market Functioning During the COVID-19 Outbreak: Evidence from Collateral Re-use," Sebastian Infante and Zack Saravayy, December 04, 2020, https://www.federalreserve.gov/econres/notes/feds-notes/treasury-market-functioning-during-the-covid-19-outbreak-evidence-from-collateral-re-use-20201204.htm.

[8] Office of the Comptroller of the Currency , Board of Governors of the Federal Reserve System, and Federal Deposit Insurance Corporation, Federal Register Notice," Regulatory Capital Rule: Temporary Exclusion of U.S. Treasury Securities and Deposits at Federal Reserve Banks From the Supplementary Leverage Ratio for Depository Institutions," June 01, 2020, https://www.federalregister.gov/documents/2020/06/01/2020-10962/regulatory-capital-rule-temporary-exclusion-of-us-treasury-securities-and-deposits-at-federal.

[9] *Id.*

[10] Bloomberg, "Biggest U.S. Banks Keep Lending Less and Less of Their Money," Shahien Nasiripour, February 8, 2020, https://www.bloomberg.com/news/articles/2021-02-08/biggest-u-s-banks-keep-lending-less-and-less-of-their-money?sref=S5RPfkRP.

On June 19, 2020 we wrote to your agencies to express our strong opposition to the IFR. The responses we received from Vice Chair Quarles and Chairman McWilliams both confirmed that the exclusion will expire on March 31, 2021.[11] But recent reporting from the *Financial Times* indicated that "the banks and industry representatives had been in talks with the Fed to extend the exemption beyond March."[12] It is unclear whether the OCC and the FDIC are engaged in similar discussions.

Extending this exemption from capital requirements at either the bank or holding company level would be a grave error. While employment has largely recovered for the highest-paid workers, employment remains down 17 percent for the lowest-wage earners since last February,[13] and small businesses across the country are still struggling.[14] Additionally, the most recent minutes of the Federal Open Market Committee note that financial stability risks remain "notable," citing "vulnerabilities associated with household and business borrowing…reflecting increased leverage and decreased incomes and revenues in 2020."[15]

Banks' balance sheets will also likely continue to face pressure from loan defaults in the coming months. During the last three recessions, banks' loan losses did not peak until at least a year after the start of the recession.[16] Reducing banks' capital reserves needed to absorb these potential losses could result in significant risks to banks and to the stability of the financial system. Indeed, there was ample evidence before the COVID-19 shock that big bank capital, while improved since the last crisis, was still too low to support long-term sustainable economic growth.[17]

The banks' requests for an extension of this relief appear to be an attempt to use the pandemic as an excuse to weaken one of the most important post-crisis regulatory reforms. To the extent there are concerns about banks' ability to accept customer deposits and absorb reserves due to leverage requirements, regulators should suspend bank capital distributions. Banks could fund their balance sheet growth in part with the capital they are currently sending to shareholders and executives. We are also confident that the thousands of community banks that are not subject to the SLR requirements would be happy to accept deposits that large banks may reject. It is

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[11] Response from Jelena McWilliams, July 23, 2020 and Response from Randal Quarles, October 9, 2020
[12] Financial Times, "US banks push Fed for extension of Covid capital relief," James Politi, February 11, 2021, https://www.ft.com/content/91f43572-414c-48d1-af80-857b9fa2fb18.
[13] *Id*.
[14] CNBC, "53% of small business owners don't expect to return to pre-Covid levels for at least 6 months," Nadine El-Bawab, February 2, 2021, https://www.cnbc.com/2021/02/02/over-half-of-small-business-owners-dont-expect-to-recover-for-at-least-6-months.html.
[15] Federal Reserve Open Market Committee, Minutes, January 26-27, 2021, https://www.federalreserve.gov/monetarypolicy/files/fomcminutes20210127.pdf.
[16] Congressional Research Service, "COVID-19 Impact on the Banking Industry: Lag Between Recession and Bank Distress," Andrew P. Scott, David W. Perkins, September 10, 2020, https://www.crs.gov/Reports/IN11501?source=search&guid=bb5a1a698a194eb6b026c57b5a663f2f&index=0
[17] Federal Reserve Bank of St. Louis Review, " An Empirical Economic Assessment of the Costs and Benefits of Bank Capital in the United States," Simon Firestone, Amy Lorenc, and Ben Ranish, Third Quarter 2019, 101(3), pp. 203-30, https://files.stlouisfed.org/files/htdocs/publications/review/2019/07/12/an-empirical-economic-assessment-of-the-costs-and-benefits-of-bank-capital-in-the-united-states.pdf; International Monetary Fund, "Benefits and Costs of Bank Capital," Jihad Dagher, Giovanni Dell'Ariccia, Luc Laeven, Lev Ratnovski, and Hui Tong, March 2016, https://www.imf.org/external/pubs/ft/sdn/2016/sdn1604.pdf.

inexcusable to provide Wall Street with deregulatory capital exemptions while allowing them to pay out tens of billions in capital every quarter through dividends and stock buybacks.[18] Those capital distributions could instead be used to support over a trillion dollars in balance sheet growth.[19]

You and your predecessors at your independent regulatory agencies succumbed to political pressure to weaken these key reforms, creating new risks for the economy and the financial system. You now have the opportunity to rectify these errors and restore bank capital requirements, and you should do so.

Sincerely,

Elizabeth Warren
United States Senator

Sherrod Brown
United States Senator

[18] Yahoo Finance, "Here comes the return of stock buybacks," Brian Sozzi, January 26, 2021, https://finance.yahoo.com/news/here-comes-the-return-of-stock-buybacks-201519336.html.
[19] Mercatus Center, "Thomas Hoenig on Bank Capitalization and Fed Policy after COVID-19," David Beckworth, May 25, 2020, https://www.mercatus.org/bridge/podcasts/05252020/thomas-hoenig-bank-capitalization-and-fedpolicy-after-covid-19.