Americans for Financial Reform Education Fund

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Deregulation at the Powell Fed

Federal Reserve Board Chair Jerome Powell has presided over a broad deregulatory agenda since 2017 that has made our financial system less resilient, while also fortifying its role as a driver of wealth and income inequality. The Powell Fed contributed mightily to the overall assault by Trump-appointed regulators on bank regulations designed to prevent financial crises and promote a system that works for families and communities and for Main Street businesses, not Wall Street. This wave of deregulation has allowed Wall Street to increase speculation and profits but put the rest of us at risk.

The Powell Fed did more than water down Dodd-Frank reforms, the last major round of positive changes to financial regulation. It also weakened core supervisory tools that federal bank regulators have always used to monitor bank risk-taking and compliance with laws. Led by Chair Powell, the Fed has effectively turned off some of the early warning systems regulators used to detect emerging risks to the financial system.

This deregulation comes at a precarious moment. Banks and various financial markets received hundreds of billions of dollars of emergency support from the Fed in 2020, for the second time in 12 years. Even while many American households struggled with the economic effects of the pandemic, the Powell Fed provided a financial lifeline to banks *and* allowed many of them to distribute capital to their shareholders. Rather than lend more money to the real economy after receiving Fed support, banks chose to reduce critical cushions against economic shocks in order to turbocharge returns to shareholders.

Diluting core capital and liquidity rules. Chair Powell has voted and the Fed has acted to weaken various rules that require banks to maintain capital cushions against economic shocks. It watered down rules and lowered the equity capital minimums that are shock absorbers against the kind losses that have triggered bailouts of the financial system. The Fed removed its own ability to block banks from distributing capital to shareholders – thinning their cushions, so to speak – if banks demonstrated bad risk management. It also weakened liquidity rules that provide crucial defenses for banks against market disruptions and potential Depression-like bank runs.

A Republican-led Congress directed the Fed to weaken some regulations in a 2018 law, but the Powell Fed's modifications went far beyond what lawmakers sought, as Governor Lael Brainard pointed out at the time. In that episode, the Fed allowed very large banks to lower their capital cushions and liquidity, leaving them more vulnerable to shocks. These banks also now face less stringent or less frequent requirements for stress testing and planning for their own bankruptcies – two vital protections that help guard against future bailouts.

Eroding rules deterring risk-taking. Dodd-Frank introduced stress tests to assess how a bank would perform in the face of economic shocks and to work in tandem with rules improving resiliency to those shocks. The Powell Fed dumbed down the tests, and even revealed the criteria to banks beforehand, akin to giving students the exam questions in advance. This allows banks to camouflage risk-taking. Dodd-Frank also required banks to write regular living wills that would provide a roadmap for regulators to handle an insolvent bank, a vital step towards ending taxpayer bailouts. The Powell Fed degraded these requirements too.

The Volcker Rule was a pillar of Dodd-Frank that restricted the ability of banks to speculate with federally-insured money. With Chair Powell's vote, the Fed diluted both parts of the Volcker Rule: the restrictions on proprietary trading and the restrictions on bank investments in particularly risky vehicles, like private equity and hedge funds. The Fed also relaxed rules that would curtail risky derivative activities by banks. After these rule changes, bank exposures to derivatives can increase via complex and opaque transactions with their affiliates.

Promoting consolidation and limiting its own power to supervise banks. At a time when there is an increasingly widespread consensus that concentration in the American economy is a serious problem, the Powell Fed waved through mergers by large super-regional banks, increasing monopoly power and systemic risk. The Fed permitted acquisitions by very large banks of discount securities brokerage firms, further burying the now-lost but important separation between banking and securities businesses that mitigated systemic risk and conflicts of interest. Even as it fostered the creation of larger banks, the Powell Fed has decided to restrict the Fed's own ability to supervise banks for risk-taking and legal compliance.

Allowing banks to weaken their balance sheets during the COVID-19 pandemic. Even as the pandemic raged and an unprecedented economic contraction took hold, banks did well, thanks to Fed support. Even as it provided this assistance, the Powell Fed also allowed further weakened capital standards and stress tests. Those banks then distributed capital, via dividends and share repurchases that benefited shareholders, effectively subsidizing upward wealth distribution. This policy also left banks more vulnerable to future shocks.

All these actions boosted bank profitability – already at quite high levels before this deregulatory spree – at the expense of the resilience of the financial system. Public interest groups, including Americans for Financial Reform, the Center for American Progress, Better Markets, and Public Citizen, warned against many of these measures in detailed responses to the Fed, and

Governor Brainard voted against most of them, warning against the dangers they posed. But Chair Powell supported them and saw them through to completion.

Appendix
Votes by Chair Powell to Deregulate Banks
https://www.federalreserve.gov/aboutthefed/boardvotes.htm

1. Diluting core regulations -- capital and liquidity rules -- that are at the heart of preventing bank failures and lowering systemic risk.

- ***Diluting capital and capital planning rules:*** With Chair Powell's vote, the Fed has weakened different rules that require banks to maintain capital cushions against economic shocks.
    - The Federal Reserve Board replaced rules put in place to require capital set by stress testing with a "stress capital buffer." While this stress capital buffer appeared to be more comprehensive, its true net effect was to allow banks to lower capital cushions and to dilute the rigorous stress testing of banks.
        - Stress capital buffer introduced: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200304a.htm
        - Brainard dissent: https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20200304a.htm
    - The Federal Reserve also removed the "qualitative objection" that blocked banks from distributing capital to shareholders--thus lowering their cushions--if risk management was found to be inadequate.
        - Elimination of CCAR capital qualitative objection: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190306b.htm
        - Brainard dissent (not published).
- ***So-called "tailoring" rules that allowed large banks to increase leverage, lower liquidity, be subject to less frequent stress tests, and take on more risk*** *(10/10/2019):* With Chair Powell's vote, the Fed has lowered various prudential rules for very large banks--ones with between $100 and $700 billion in assets. As Governor Brainard pointed out, the Board's rule changes went beyond what Congress mandated in the 2018 Economic Growth, Regulatory Relief, and Consumer Protection Act. This change allowed very large banks to lower their capital cushions and liquidity, leaving them more vulnerable to shocks. These banks also face less onerous or less frequent requirements for providing "living wills" and stress testing.
    - Final changes: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191010a.htm

    - Brainard dissent: https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20191010.htm

    - Final rule (unanimous): https://www.federalreserve.gov/newsevents/pressreleases/bcreg20210119a.htm

    - Related Federal Reserve and other banking agency notices of rules: https://www.govinfo.gov/content/pkg/FR-2019-11-01/pdf/2019-23662.pdf https://www.occ.gov/news-issuances/federal-register/2019/84fr59230.pdf

- ***Dismantling crucial liquidity rules (including "the net stable funding ratio" and "required stable funding") and weakening the "liquidity coverage ratio":*** With Chair Powell's vote, the Fed has lowered liquidity rules that provide crucial defenses for banks against market disruptions and bank run dynamics.

    - Final rule: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201020b.htm

    - Brainard dissent: https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20201020a.htm

    - Brainard dissent on weakening of Liquidity Coverage Ratio: https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20191010.htm

2. Eroding critical rules passed under Dodd-Frank that addressed the bank risk-taking and regulatory weaknesses revealed by the financial crisis of 2007-08

- ***Weakening stress tests****:* Stress tests were one of the innovative tools introduced by the Dodd-Frank Act. They are meant to test how banks would perform in given economic shocks and to work in tandem with rules that require banks to maintain cushions against those shocks. With Chair Powell's vote, the Fed has dumbed down the rigor of those tests.

    - June 25, 2020 decision: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200625c.htm

    - Brainard dissent: https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20200625c.htm

  The Board also voted (unanimously) to increase the transparency of stress testing, which essentially gives students the test questions in advance of an exam. This can allow banks to take actions ahead of stress testing to camouflage risk-taking.

    - February 5, 2019 decision: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20190205a.htm

- ***Weakening "living wills" and resolution planning;*** In the wake of Lehman's failure, the Dodd-Frank Act required financial institutions to write regular living wills to provide a roadmap for regulators of how to tackle a future insolvency. Living wills also prompted financial institutions to simplify their complex structures. With Chair Powell's vote, the Fed has weakened these requirements.

    - Final guidance and approval of plans (12/8/20) (Brainard voted against): https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201209a.htm

    - Final rule on bank resolution planning: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191028b.htm

    - Brainard dissent: https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20191010.htm

- ***Diluting the Volcker rule, including allowing large banks to increase proprietary trading and invest in risky and opaque private funds (10/3/2019)(6/2/2020)*****:** The Volcker Rule represents a pivotal piece of the Dodd-Frank Act that restricted the ability of banks to speculate with federally-insured money. With Chair Powell's vote, the Fed diluted both parts of the Volcker Rule: the restrictions on proprietary trading and the restrictions on investments in covered funds.

    - Final changes: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191008a.htm https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200625a.htm

    - Brainard dissent: https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20191008.htm https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20200625a.htm

    - Coverage: https://www.bankingdive.com/news/federal-reserve-volcker-rule-changes-approved-final-hurdle/564664/

    - Covered funds rules weakened (1/30/2020):

https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200130b.htm

- Brainard dissent: https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20200130b.htm

Allowing banks to increase their exposure to derivatives via lowering margin requirements (swap margin rules 10/1/2019, 6/24/20) With Chair Powell's vote, the Fed relaxed rules that would curtail risky derivative activities by banks. After these rule changes, bank exposures to derivatives can increase via complex and opaque transactions with their affiliates.

- Proposed and final rule changes: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20191028a.htm https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200625b.htm

- Brainard dissent: https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20191028.htm https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20200625b.htm

3. Greenlighting acquisitions of discount brokerages and mergers of giant regional banks: With Chair Powell's vote, the Fed permitted mergers by large super-regional banks, further increasing bank concentration and increasing systemic risk profiles. With Chair Powell's vote, the Fed further permitted acquisitions by very large banks of discount securities brokerage firms. This further buried the Glass-Steagall separation between banking and securities, which was designed to mitigate systemic risk and conflicts of interest.

- Morgan Stanley acquisition of E*Trade (Brainard dissented):
  - https://www.federalreserve.gov/newsevents/pressreleases/orders20200930b.htm
- Toronto-Dominion Bank acquisition of Charles Schwab (Brainard dissented):
  - https://www.federalreserve.gov/newsevents/pressreleases/orders20200930a.htm
- PNC-BBVA merger:
  - Approval: https://www.federalreserve.gov/newsevents/pressreleases/orders20210514a.htm
  - Brainard abstained:

https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20210514.htm

4. Handcuffing the Fed's historic powers to supervise banks: With Chair Powell's vote, the Fed has decided to restrict its historic ability to exercise basic supervision of banks. This reduces the regulator's ability to monitor banks for risk-taking and legal compliance.

- Final rule: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20210331a.htm

- Proposed rule by Fed and other regulatory agencies (Nov. 5, 2020): https://www.federalregister.gov/documents/2020/11/05/2020-24484/role-of-supervisory-guidance

5. Allowing some banks to make capital distributions even during the pandemic and Fed interventions: Even as the pandemic raged and banks benefited from hundreds of billions of dollars of Federal Reserve assistance, the Federal Reserve Board, with the vote of Chair Powell, allowed many banks to meet lower capital standards, *including via weakening stress tests used to set capital*. This, in turn, allowed those banks to make capital distributions to shareholders (*e.g.* via dividends and share repurchases). This increased shareholder returns, but left banks vulnerable to future shocks.

- December 18, 2020 decision: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20201218b.htm (Brainard dissented)

- Sept. 30, 2020 decision: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200930b.htm (Brainard dissented)

- June 25, 2020 decision: https://www.federalreserve.gov/newsevents/pressreleases/bcreg20200625c.htm

- Brainard dissent: https://www.federalreserve.gov/newsevents/pressreleases/brainard-statement-20200625c.htm