MAXINE WATERS, CA
CHAIRWOMAN

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

PATRICK MCHENRY, NC
RANKING MEMBER

March 9, 2021

The Honorable Jerome H. Powell
Chair
Board of Governors of
the Federal Reserve System
20th Street & Constitution Avenue, NW
Washington, D.C. 20551

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

The Honorable Randal Quarles
Vice Chair for Supervision
Board of Governors of
the Federal Reserve System
20th Street & Constitution Avenue, NW
Washington, D.C. 20551

Mr. Blake Paulson
Acting Comptroller of the Currency
Office of the Comptroller of the Currency
400 7th Street, SW
Washington, D.C. 20219

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

As we approach the one-year anniversary of the onset of the COVID-19 pandemic, financial stability risks are more pronounced than they were prior to the pandemic, raising significant concerns about any effort to reduce bank capital requirements. This would include extending the temporary exclusion of U.S. Treasury securities and deposits at Federal Reserve Banks from the supplementary leverage ratio (SLR) that reduced tier 1 capital requirements for the largest banks by approximately $72 billion,[1] among other proposals. For the reasons detailed below, I urge the Board of Governors of the Federal Reserve System (Fed), Federal Deposit Insurance Corporation (FDIC), and Office of the Comptroller of the Currency (OCC) to not extend temporary exemptions or make any other reforms to weaken big bank capital and leverage requirements.

Prior to the COVID-19 pandemic, I led 18 of my colleagues in urging the Fed against weakening capital requirements for global systemically important banks (G-SIBs).[2] In our letter, my colleagues and I cited numerous regulatory experts across the political spectrum speaking to the importance of G-SIB capital requirements in protecting the safety and soundness of our financial system, and pointed out that there was no evidence that the requirements prevented the G-SIBs from being profitable. By causing enormous uncertainty and amplifying systemic risks, the economic recession caused by COVID-19 has reminded us again of the importance of robust capital protections.

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[1] The temporary SLR exemptions lowered tier 1 capital requirements by roughly $55 billion for insured depository institutions and $17 billion for bank holding companies. These exemptions expire on March 31, 2021. See Fed, *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* (Apr. 1, 2020); and Fed, FDIC, OCC, *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).

[2] House Financial Services Committee, *Waters, Perlmutter and 17 other Democrats Call on Fed to Maintain Capital Requirement for Megabanks*, (Sep. 21, 2018).

At the onset of the pandemic a year ago, I and other Members also warned former Treasury Secretary Steven Mnuchin that, "Deregulation is not the solution to the coronavirus."[3] I reemphasized the point during Chair Powell's most recent testimony before the Committee, urging the Fed to stop deregulating banks.[4] Relatedly, bank capital requirements should not be diminished at this time given that, according to a banking expert, "Research shows that an increase in capital is associated with an increase in loan growth and that better capitalized banks expand lending more quickly coming out of a financial crisis. Well-capitalized banks can serve as a source of strength for the economy in good times and bad."[5] If capital requirements were of concern, then it is unclear why your agencies would allow banks to continue making capital distributions through dividend payments and discretionary executive bonus payments. According to one estimate, suspending bank dividend payments could preserve roughly $40 billion of capital per year.[6]

Yet, it has been disappointing to observe your agencies permitting big banks to make capital distributions while advancing proposals that directly or indirectly weaken large bank capital requirements, including through a weaker stress testing regime.[7] This is particularly true given there's a vast body of research from the Federal Reserve and other experts demonstrating that capital requirements should have been increased beyond where capital levels stood in 2017.[8] Yet, your agencies gave Wall Street a $40 billion gift by eliminating initial margin requirements for inter-affiliate swaps during the pandemic.[9] Furthermore, the Fed and OCC has yet to rescind a harmful proposal to substantially weaken the enhanced supplementary leverage ratio (eSLR) and reduce capital by more than $120 billion for the G-SIBs.[10] Additionally, the temporary exclusion to the SLR is a mistake that should not be perpetuated after it expires at the end of this month. These are all regulatory matters I highlighted for President Biden and urged his appointees to rescind or otherwise reverse as soon as possible.[11] As FDIC Board Member Gruenberg explained at the time the SLR exclusions were granted last year, "[N]ow is not the time to reduce significantly

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[3] House Financial Services Committee, *Waters Leads Letters Calling on Regulators and Financial Institutions to Protect Americans and the Financial System from Impact of Coronavirus* (Mar. 11, 2020).
[4] House Financial Services Committee, *Waters to Powell: The Fed Must Use All of its Tools at its Disposal to Ensure an Equitable and Swift Recovery*, (February 24, 2021).
[5] Gregg Gelzinis, *Bank Capital and the Coronavirus Crisis*, Center for American Progress (May 12, 2020).
[6] *Id*.
[7] *Id*. Also see Stephen G. Cecchetti and Kermit L. Schoenholtz, *An Open Letter to Randal K. Quarles, Federal Reserve Vice Chair for Supervision* , Money and Banking (June 21, 2020); and Daniel K. Tarullo, former Fed Governor, *Taking the Stress Out of Stress Testing* (May 21, 2019).
[8] See, e.g., Daniel K. Tarullo, former Fed Governor, Speech at the Woodrow Wilson School, Princeton University: *Departing Thoughts* (Apr. 4, 2017); Simon Firestone, Amy Lorenc and Ben Ranish, *An Empirical Economic Assessment of the Costs and Benefits of Bank Capital in the U.S.*, Fed's Finance and Economic Discussion Series 2017-034; Federal Reserve Bank of Minneapolis, *The Minneapolis Plan to End Too Big To Fail* (Dec. 2017); Jihah Dagher, Giovanni Dell'Ariccia, Luc Laeven, Lev Ratnovski, and Hui Tong, *Benefits and Costs of Bank Capital*, IMF Staff Discussion Note (2016); Bank for International Settlements (BIS), *Assessing the Economic Costs and Benefits of TLAC Implementation* (Nov. 2015); Basel Committee on Banking Supervision (BCBS), *An Assessment of the Long-Term Economic Impact of Stronger Capital and Liquidity Requirements* (Aug. 2010); Macroeconomic Assessment Group (MAG), *Final Report: Assessing the Macroeconomic Impact of the Transition to Stronger Capital and Liquidity Requirements* (Dec. 2010); Financial Stability Board (FSB), *Summary of Findings from the TLAC Impact Assessment Studies* (2015).
[9] House Financial Services Committee, *Waters Statement on FDIC Proposal to Eliminate Inter-Affiliate Swaps Initial Margin* (Sep. 17, 2019); Fed, *Agencies finalize amendments to swap margin rule* (June 25, 2020).
[10] See, e.g., FDIC, *Statement of Martin J. Gruenberg, Chairman, Federal Deposit Insurance Corporation (FDIC), Notice of Proposed Rulemaking on Supplementary Leverage Ratio Issued by the Federal Reserve and OCC* (Apr. 11, 2018), and FDIC, Remarks of Martin J. Gruenberg before the Peterson Institute for International Economics, *An Essential Post-Crisis Reform Should Not Be Weakened: The Enhanced Supplementary Leverage Capital Ratio* (Sep. 6, 2018).
[11] House Financial Services Committee, *Waters Provides Recommendations to President-Elect Biden on Trump Actions to Reverse* (Dec. 4, 2020).

the capital of the most systemically important U.S. banks in order to facilitate financial market liquidity. Both are essential to the stability of the financial system and the functioning of the economy. We learned the hard way during the 2008 financial crisis the importance of preserving loss absorbing leverage capital at systemically important banks."[12]

Following the onset of the COVID-19 pandemic, the passage of the CARES Act and swift action by the Fed helped to stabilize financial markets, temporarily reducing the risk of the pandemic simultaneously causing mass unemployment and a financial crisis. Then, at the end of 2020, former Treasury Secretary Steve Mnuchin abruptly eliminated the emergency lending facilities that had served as a crucial backstop for several segments of the market. Without the backstop from the Fed that existed for most of last year, elevated risks in the commercial real estate and corporate bond sectors pose a greater threat of spilling over to the broader financial system – a point underscored at the January meeting of the Federal Open Market Committee (FOMC) [13] – and signs of long-term distress among small businesses, state, local, and territorial governments are cause for even greater concern. A recent survey of institutional investors found that a significant number see signs of numerous asset bubbles on the horizon.[14]

With the path of the economy highly uncertain in the months ahead, it is crucial that regulators remain vigilant, requiring the largest banks to maintain loss-absorbing capital to guard against risks. Indeed, the results from December's stress tests show that under certain adverse scenarios, some large banks would reach their regulatory minimums for capital. This point was underscored in a recent speech by Fed Governor Lael Brainard, who observed that "According to past experience, banks that approach their regulatory capital minimums are much less likely to meet the needs of creditworthy borrowers. It is important for banks to remain strongly capitalized in order to guard against a tightening of credit conditions that could impair the recovery."[15]

Moreover, if your agencies were to consider extending or otherwise modifying capital, leverage, or other prudential requirements for the largest banks, I would like to know if you plan to consult with the Secretary of the Treasury, Janet Yellen, in her role as the Chair of Financial Stability Oversight Council (FSOC), prior to making those decisions. After all, Congress gave FSOC a role in overseeing the implementation of prudential requirements for the largest bank holding companies. For example, under Section 115 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, FSOC can make recommendations regarding the establishment and refinement of prudential standards applicable to large bank holding companies to mitigate potential systemic risks. While FSOC should consider deploying this unutilized tool already based on the extensive deregulatory actions taken by your agencies the last few years, it would be imprudent to compound the matter by further weakening big bank capital and leverage requirements.

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[12] FDIC, *Statement by Martin J. Gruenberg, Member, FDIC Board of Directors; on the Interim Final Rule: Temporary Exclusion of U.S. Treasury Securities and Deposits at Federal Reserve Banks from the Supplementary Leverage Ratio* (May 15, 2020).
[13] Minutes indicate that Fed staff have "characterized the financial vulnerabilities of the U.S. financial system as notable," citing "elevated" asset valuation prices, spreads in the corporate bond markets, risks in the commercial real estate sector, and ongoing challenges with leverage among households and businesses hit hard by the pandemic's continued economic fallout. See FOMC, *Minutes of the Federal Open Market Committee,* (Jan. 26-27, 2021)
[14] Politico, *Biden's Bubble Risk,* (March 1, 2021).
[15] Governor Lael Brainard, *Some Preliminary Financial Stability Lessons from the COVID-19 Shocks,* (March 1, 2021).

In conclusion, it is past time that your agencies stop prioritizing the wishes of Wall Street over the public good. I urge your agencies to stop weakening bank requirements, including by allowing the temporary SLR relief to expire, to help ensure the resilience of our financial system through the remainder of this pandemic and economic recovery.

Sincerely,

Maxine Waters

MAXINE WATERS
Chairwoman

cc: The Honorable Janet Yellen, Secretary, U.S. Department of the Treasury
The Honorable Patrick McHenry, Ranking Member, Committee on Financial Services