United States Senate
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
WASHINGTON, DC 20510–6075

March 3, 2023

The Honorable Jerome Powell
Chair
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Dear Chair Powell:

We write to express our concerns regarding the Board of Governors of the Federal Reserve System's ("Federal Reserve") ongoing, "holistic" review of capital requirements. In one of his first speeches as Vice Chair for Supervision of the Federal Reserve, Michael Barr stated that the Federal Reserve would take a holistic review of capital standards, without providing additional context as to what this review may entail.[1] We write to remind you that any such review must follow the law, and be "tailored in application…taking into consideration their capital structure, riskiness, complexity, financial activities (including the financial activities of their subsidiaries), size, and any other *risk-related* factors that the Board of Governors deems appropriate."[2] (*emphasis added*).

As you are aware, the goal of regulatory capital is to support bank operations and to absorb unanticipated losses and declines in asset values. Therefore, bank capital and its quality must continually be evaluated and scrutinized to ensure it is tailored to the risks facing our financial institutions and their activities, thereby protecting the safety and soundness of our banking system. Otherwise, such reviews may unjustly increase capital requirements and have a chilling effect on market making activities and availability of financial services.

In his recent remarks, Mr. Barr has suggested a need to increase capital requirements, which appears unfounded as banks subject to the current regulatory capital regime seem to have weathered the real-life stress test of the COVID-19 pandemic well. Moreover, increasing capital requirements during an inflationary cycle may have serious consequences for lending, market liquidity, and the broader economy. For instance, there is a significant body of economic research finding that a 1 to 2.5 percentage point increase in capital requirements has the potential

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[1] Michael Barr, Vice Chair for Supervision, Bd. of Governors of the Fed. Reserve System, Speech at the Brookings Institution: Making the Financial System Safer and Fairer (Sept. 7, 2022), https://www.federalreserve.gov/newsevents/speech/barr20220907a.htm.

[2] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub.L. 111-203, Title I, § 165, 124 Stat. 1423 (2010) (codified as amended at 12 U.S.C. § 5365).

to sacrifice over a $100 billion in GDP annually.[3] Importantly, there can be negative impacts for consumers by increasing capital requirements and requiring banks to sequester funds they could otherwise use to provide financial services offerings. Increased capital does not necessarily provide an increased benefit and may likely lead to higher borrowing costs for businesses and families, less investment and growth across the entire economy, and a deterioration in competitiveness of the U.S. capital markets—ultimately harming Main Street and American economic opportunity.

In 2018, the bipartisan *Economic Growth, Regulatory Relief, and Consumer Protection Act* (S.2155)[4] was enacted to address the overly broad and overly prescriptive implementation of the *Dodd-Frank Wall Street Reform and Consumer Protection Act*, also known as Dodd-Frank.[5] As the Vice Chair of Supervision, Mr. Barr should adhere to the letter and spirit of the tailoring provisions as enacted by Congress. Reports of regulators' efforts to unwind those tailoring reforms are concerning and do not comply with the law.

Should the Vice Chair of Supervision move forward with this "holistic" review, the analysis should follow the letter of the law, fully assessing the impact on economic growth, cost of credit, and the availability of critical banking products and services. As the Federal Reserve conducts its review, it must be fully transparent with Congress and the public throughout the process. Members of this Committee must be fully informed and provided robust analysis. Furthermore, in your role as Chair of the Federal Reserve, it is incumbent on you to oversee any such review to ensure that the Federal Reserve's work is consistent with the law, the risks, and the commonsense principles that support tailored capital requirements and the continued availability of a broad swath of financial services for everyday Americans.

Thank you for your attention to this matter.

Sincerely,

Tim Scott
Ranking Member

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[3] *See, e.g.*, Pablo D'Erasmo, "Are Higher Capital Requirements Worth It?," Federal Reserve Bank of Philadelphia *Economic Insights* (Second Quarter 2018), https://www.philadelphiafed.org/the-economy/banking-and-financial-markets/are-higher-capital-requirements-worth-it; Brooke Martin, Oliver Bush, Robert Edwards, Jas Ellis, Bill Francis, Rashmi Harimohan, Katharine Neiss, and Caspar Siegert, "Measuring the Macroeconomic Costs and Benefits of Higher UK Bank Capital Requirements," Bank of England Financial Stability Paper 35 (2015), https://www.bankofengland.co.uk/financial-stability-paper/2015/measuring-the-macroeconomic-costs-and-benefits-of-higher-uk-bank-capital-requirements; Patrick Slovik and Boris Cournede, "Macroeconomic Impact of Basel III," OECD Economics Department Working Papers, No. 844 (2011); Bank for International Settlements, "Assessing the Macroeconomic Impact of the Transition to Stronger Capital and Liquidity Requirements," Macroeconomic Assessment Group Final Report (December 2010), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2650033.

[4] Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub.L. 115-174, Title IV, § 401(a), 132 Stat. 1356 (2018) (codified at 12 USC § 5365).

[5] *See* 164 Cong. Rec. S1423-S1424 (daily ed. Mar. 7, 2018) (statement of Sen. Mike Crapo).

Mike Crapo
U.S. Senator

Mike Rounds
U.S. Senator

Thom Tillis
U.S. Senator

John Kennedy
U.S. Senator

Bill Hagerty
U.S. Senator

Cynthia Lummis
U.S. Senator

Katie Boyd Britt
U.S. Senator

Kevin Cramer
U.S. Senator

Steve Daines
U.S. Senator

cc: Federal Reserve Vice Chairman of Supervision Michael Barr
Federal Deposit Insurance Corporation Chairman Martin Gruenberg
Office of the Comptroller of the Currency Acting Comptroller Michael Hsu