United States Senate

June 23, 2020

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

The Honorable Randal K. Quarles
Vice Chair for Supervision
Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Dear Chair Powell and Vice Chair Quarles,

We write to communicate our serious concerns about how the Federal Reserve ("the Fed") plans to assess whether U.S. banks under its supervision, including the globally systemically important banks (G-SIBs), continue to pay dividends as our economy struggles to recover from the ongoing COVID-19 pandemic.

We remain concerned that the Fed is taking a "business as usual" approach to capital requirements and distributions. The Fed will soon release the results of its annual bank stress tests. This year, given the current economic crisis, the Fed is set to perform additional sensitivity analyses to determine ability of the banking system to withstand three potential coronavirus-related economic scenarios, including severely adverse double dip crisis if there is a "second wave" of the outbreak. Vice Chair Quarles recently announced that the results of the already-planned stress tests, instead of the coronavirus-based sensitivity analyses, will be the basis of bank capital requirements for the next year. This could lead to lower than appropriate capital requirements, given that the stress testing scenario published in February is far less severe than the crisis we find ourselves in now and the economic trajectory we could face going forward.

You also seem intent on relying on the automatic restrictions within the new stress capital buffer (SCB) framework to determine the allowable capital distributions of each individual bank. During positive economic times or even periods of moderate stress, that can be a reasonable approach. But those are not the times we find ourselves in. As the Fed has indicated, the economic fallout from the COVID-19 pandemic looks to be longer and more severe than any of us anticipated. We have not yet gotten the public health aspect of this crisis under control. In states that have moved to reopen their economies, thousands of new cases are being reported each day. It will likely take longer to restore economic activity and there are risks of subsequent waves of outbreaks. Above all, there is tremendous uncertainty.

The banking system will face increasing stress as the pandemic and the related economic disruption continue, and businesses and households face challenges meeting their financial obligations. Now is the time to suspend capital distributions across the board to bolster the loss-absorbing capacity of big banks. If you wait until the automatic SCB restrictions kick-in, banks may be able to pay out dividends right up until losses erode their capital levels and push them close to their regulatory minimums. By that point, banks would have let precious capital out the door over the preceding quarters and it will be far too late for a dividend suspension have a meaningful impact.

Moreover, if you decide to suspend distributions on a bank-by-bank basis later in this crisis when losses intensify, it could worsen the situation. Creditors and counterparties could run and try to limit their exposure to the bank, leading to asset fire-sales and even higher losses. An across-the-board suspension now, before heavy losses pile up, is the prudent course of action. Our economy needs a safe and sound banking system to serve as a source of strength through these difficult times. An undercapitalized banking system could seriously hinder the economic recovery if this crisis causes a wave of bank failures. You should be taking every step possible to avoid that scenario.

It is also highly disconcerting that you will not be releasing bank-by-bank results of the coronavirus-related sensitivity analyses and will only report the aggregate losses across the tested banks. Transparency surrounding the results of the tests is a bedrock principle of the stress testing framework, dating back to the Supervisory Capital Assessment Program (SCAP) that was conducted during the 2007-2008 financial crisis. In 2019, Vice Chair Quarles emphasized this point, "Stress tests each year have upheld the original principle of transparency around the capital adequacy of our largest banks... this transparency increases market discipline and it subjects the Federal Reserve to greater outside scrutiny and analysis."[i] This year's stress tests, the most critical supervisory exercise since SCAP, would lack credibility if you hide the bank-by-bank results of the three sensitivity analyses. This decision could undermine confidence in the banking system. If a bank fails any of the coronavirus-related severely adverse scenarios, it should be required to immediately raise capital to ensure it can handle potential future losses. Hiding the individual results and presenting only aggregate data will not make the possible capital shortfall go away.

We urge you to bolster the resilience of the banking system in the face of a deeply uncertain negative outlook and implement an across-the-board suspension on bank dividends and discretionary bonus payments. Former Federal Reserve Governor Jeremy Stein called the decision to suspend bank dividends, "As close as you get to a no-brainer." Janet Yellen, Dan Tarullo, Tom Hoenig, Sheila Bair, Marty Gruenberg, and other current and former regulatory officials have all called on the Fed to suspend bank capital distributions to shareholders and executives. It is not clear why the Fed has not taken this action yet. In addition, if any banks breach their regulatory minimums in the coronavirus-related sensitivity analyses, they should be directed to tap equity markets now, while they are still relatively healthy. Thank you for your consideration of this letter.

Sincerely,

Brian Schatz
U.S. Senator

Sherrod Brown
U.S. Senator

Elizabeth Warren
U.S. Senator

[i] https://www.federalreserve.gov/newsevents/speech/quarles20190709a.htm