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Federal Reserve Vice Chair's priorities for the regulatory and supervisory agenda

Federal Reserve Vice Chair for Supervision Michael S. Barr's speech at the Brookings Institution

September 7, 2022

Federal Reserve Vice Chair's priorities for the regulatory and supervisory agenda

In his first speech as Federal Reserve Vice Chair for Supervision, Michael Barr laid out his priorities for the regulatory and supervisory agenda.[1] The Federal Reserve Board (FRB) increasingly sets its regulatory and supervisory priorities, including exam focus areas, to correspond with the views and perspectives of its top officials. Key items of note:

- The Federal Reserve Board (FRB) plans to launch in 2023 a pilot micro-prudential scenario analysis exercise to better assess the long-term, climate-related financial risks facing the largest institutions.
- FRB is committed to updating the capital framework and implementing Basel III, with public comment this fall.

Also highlighted in his speech: his approach to supervision, capital requirements, examining ways to reduce costs of a potential failure of a large regional bank; reviewing bank merger policy; addressing risks of stablecoins, an area where he called for Congress to pass legislation; consumer protection; faster payments and the Community Reinvestment Act. These are further discussed in the summary below.

Approach to supervision

Mr. Barr believes that the FRB must stay ahead of changes in the financial system, evaluating how banks are managing risks, and making the system safer and fairer for households and businesses. In his view, FRB improves safety through an active and never-ending effort to analyze risks and make necessary adjustments. Further, the FRB improves the fairness of the system through regulation, supervision, and enforcement so that businesses and households have access to services, necessary information, and protection from unfair treatment.

Capital

Mr. Barr is supportive of a capital framework that evolves through changes in macroeconomic conditions, market structure, and financial activities. The framework must be risk focused. Different activities pose different potential for loss, and the capital regime should calibrate requirements to account for the risks of specific activities. Non-risk-based approaches can serve as important backstops (i.e. leverage ratios). Requirements on institutions should be tired, with more stringent requirements as complexity, size and interconnectedness.

The FRB is looking at calibrating capital tools (i.e., supplementary leverage ratio, countercyclical capital buffer, and stress testing) and is committed to implementing enhanced regulatory capital requirements of Basel III. Public input is expected to begin this fall. At this time, Mr. Barr is unsure if the FRB will take a package or sequential approach to the capital framework rules.

Resolution

Financial regulators need to continue to analyze whether firms are taking all appropriate steps to limit the costs to society of their potential failure. The FRB will continue to work with the Federal Deposit Insurance Commission (FDIC) to rigorously review firms' plans, making clear when firms do not meet our expectations and when remediation is necessary. In the coming months, the FRB will be looking at the resolvability of some of the other largest banks as they grow and as their significance in the financial system increases.

Bank mergers

Mr. Barr's priority is to evaluate the FRB's approach to reviewing banks' proposed acquisitions. Mergers have potential to reduce competition and access to services in a geographic area by raising prices and narrowing services, thereby reducing the supply of small business or community development loans that rely on local knowledge.

Stablecoins

Stablecoins, like other unregulated private money, could pose financial stability risks. Mr. Barr believes Congress should work expeditiously to pass much-needed legislation to bring stablecoins, particularly those designed to serve as a means of payment, inside the prudential regulatory perimeter. There are already regulatory authorities that can be used within the perimeter.

Mr. Barr believes there is no urgent need for the FRB to move forward with a Central Bank Digital Currency (CBDC) right now. However, it is a good idea for the FRB to explore a CBDC by thinking about use cases. Mr. Barr is all for doing the work, but not "in crisis mode" about CBDCs.

Financial risks from climate change

The FRB, FDIC, and Office of the Comptroller of the Currency (OCC) are working to provide guidance to large banks on how we expect them to identify, measure, monitor, and manage the financial risks of climate change. In addition, the primary banking regulators are considering how to develop and implement climate risk scenario analyses.

In 2023, the FRB plans to launch a pilot micro-prudential scenario analysis exercise to better assess the long-term, climate-related financial risks facing the largest institutions. The scenario analysis will take place at a handful of the largest banks. No direct capital or supervisory implications are expected as a result of the analysis. This is considered a "learning exercise."

Innovation, Access, and Consumer Protection

In Mr. Barr's opinion, the three essential elements of fairness are:

Financial capability: Basing policy on a deeper understanding of human decision-making, and the contexts in which households and businesses make those choices.

Financial access: Promoting access to low-cost and safe banking services for low- and moderate-income (LMI) consumers, such as through local Bank On initiatives

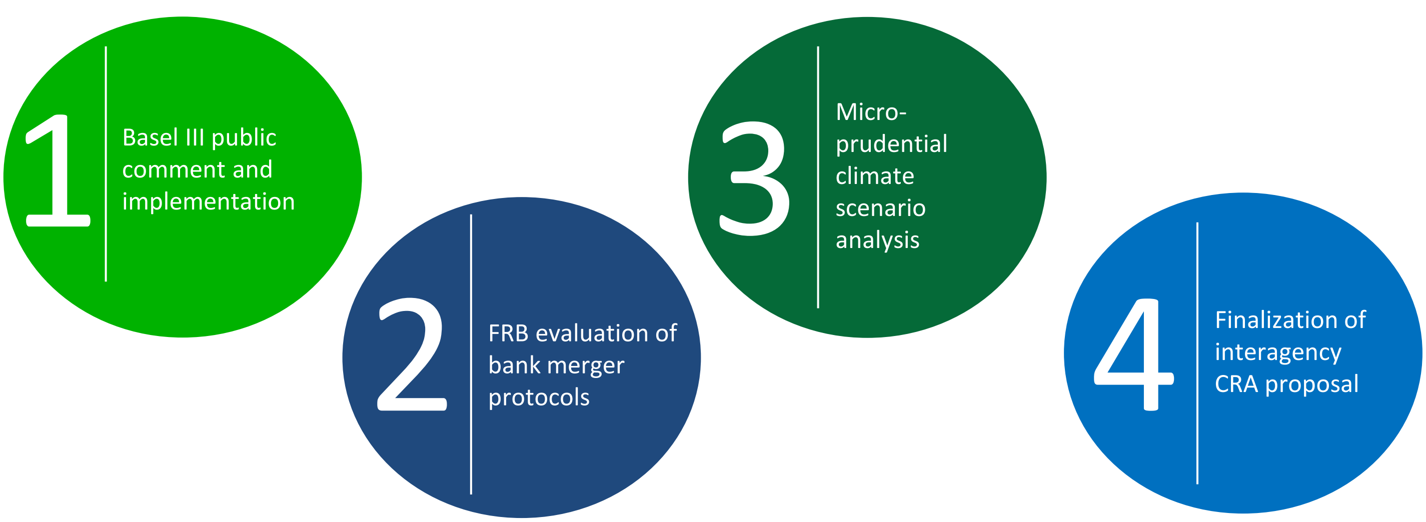
Consumer protection: Using supervision and regulation to fully implement laws to promote fair lending, consumer protection, and transparency in the consumer financial services marketplace.

The FRB plans to work with other bank regulatory agencies to ensure that crypto activity inside banks is well regulated, based on the principle of same risk, same activity, same regulation, regardless of the technology used for the activity. The FRB is evaluating that the crypto activity of supervised banks is subject to the necessary safeguards that protect the safety of the banking system as well as bank customers. Banks engaged in crypto-related activities need to have appropriate measures in place to manage novel risks associated with those activities and to ensure compliance with all relevant laws, including those related to money laundering.

There are some methods in place that are good for monitoring non-banks and there are others where there is insufficient data. The sufficiency of macroprudential tools depends on where a particular entity falls in the system or with respect to the regulatory perimeter. Mr. Barr believes that the Financial Stability Oversight Council's (FSOC) designation authority would be good for non-banks and for payments, settlement, clearing activities more broadly from a supervisory perspective. It is important for the process to be used and for the FSOC to maintain this authority in its toolkit.

Further, Mr. Barr is supportive of access to fast, efficient digital payments (FedNow) and the interagency Community Reinvestment Act (CRA) proposal.

Near-term regulatory expectations



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Notes

1 Board of Governors of the Federal Reserve System, "Making the Financial System Safer and Fairer" prepared remarks by Vice Chair for Supervision Michael S. Barr at the Brookings Institution, September 7, 2022.

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