GERALD R. FORD SCHOOL OF PUBLIC POLICY
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Michael S. Barr • Joan and Sanford Weill Dean of Public Policy

The Honorable Elizabeth Warren
United States Senate
Washington, DC 20510

February 23, 2022

Dear Senator Warren,

You have asked me to respond to four questions related to the Senate Banking Committee's consideration of the nomination of Sarah Bloom Raskin for the position of Vice Chair for Supervision on the Board of Governors of the Federal Reserve System. Let me state at the outset that I have the highest respect for Raskin and strongly support her confirmation. She would make an outstanding Vice Chair for Supervision. She brings to the position deep experience, sound judgment, and utmost integrity.

By way of background for the Committee, I am the dean of the Gerald R. Ford School of Public Policy at the University of Michigan and an expert on financial regulation. I am the co-author of a leading textbook on financial regulation, and previously served as Assistant Secretary of the Treasury for Financial Institutions, where I helped to lead the Administration's initiative to enact the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.

Given the brevity of time, I will respond only briefly to your questions.

1. Vulnerabilities facing the financial system and the economy

Current conditions in the United States and globally warrant attention to a broad range of risks facing the financial system and the economy, as well as difficult questions regarding Federal Reserve supervision of emerging risks. While capital and liquidity levels in the banking sector are strong, emergent risks need to be closely monitored. By way of examples: The global pandemic presents ongoing risks to the economy, and bank balance sheets, particularly with respect to commercial real estate loans. Inflation has become a central concern for monetary policy, and it is also influencing asset prices in ways that merit close attention. Russia's invasion of Ukraine is likely to cause increases in energy prices and instability in global financial markets. Underlying fragilities that caused severe disruption in the Treasury markets in March 2020 still largely persist. Emerging risks in the cryptocurrency sector and more broadly in fintech require oversight and regulation. Climate change poses severe long-term risks to the economy and financial stability that must be urgently addressed today if we are to have a meaningful impact.

2. The role of the Vice Chair for Supervision

The Dodd-Frank Act created the role of Vice Chair for Supervision to focus the Federal Reserve's attention and resources on supervision of the financial sector. The Vice Chair plays a key role in organizing the Federal Reserve's responses to financial stability risks, and in surveilling the financial system for potential or emerging risks. By law, the Vice Chair for Supervision "shall develop policy recommendations for the Board regarding supervision and regulation" of financial companies and "shall oversee the supervision and regulation of such firms." Without a Vice Chair for Supervision in place, it is difficult for the Federal Reserve to act. For example, while it is Federal Reserve policy to hold a regular vote on whether to impose a countercyclical capital buffer, no such vote has been called since 2020, despite escalating financial stability risks. The Vice Chair for Supervision testifies twice annually on the Board's Report on Supervision and Regulation. No report or testimony has occurred since November 2021. Without a Vice Chair for Supervision, the Banking Committee's ability to provide effective oversight of the Federal Reserve's supervisory responsibilities is severely diminished. Moreover, in the absence of a Vice Chair for Supervision, steps to improve regulation have slowed or stalled, including important pending rules on capital requirements.

3. Steps the Vice Chair could take

The Vice Chair for Supervision can take several steps to monitor and assess risks to the financial system and to address such risks. For example, the Vice Chair could direct staff resources to monitor emerging risks. The Vice Chair could recommend that the Board impose a countercyclical capital buffer, consistent with the Federal Reserve's mandate to make capital requirements countercyclical. The Vice Chair can shape the content of stress tests to include potential or emergent risks, thus strengthening bank holding company's resilience to economic shocks. The Vice Chair can move forward on regulatory initiatives to reduce risks to the financial system, such as through finalizing the "Basel III endgame" capital framework. The Vice Chair can also deploy tools to address emerging risks arising from nonbank financial institutions, including fintech companies, and prevent those risks from impairing financial stability.

4. Whether it would be appropriate to delay confirmation

In my judgment it would not be appropriate to delay confirmation of the Vice Chair for Supervision, or to delay the confirmation of any of the pending nominees to serve on the Board of Governors. All of the nominees are highly qualified to serve. It greatly weakens the ability of the Board to conduct monetary policy and supervise the financial system to have these nominees' confirmations delayed. I urge all of the Committee's members to move forward promptly with the confirmation process and to vote to confirm the nominees.

Sincerely,

Michael S. Barr

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February 24, 2022

Senator Elizabeth Warren
U.S. Senate

Dear Senator Warren:

I am writing in response to your letter of February 22, 2022, which posed four questions about financial stability and the role of the Vice Chair for Supervision at the Board of Governors of the Federal Reserve System.

I follow global financial systemic risk issues closely in my current position as a professor at MIT's Sloan School of Management, where I have headed of the Global Economics and Management group for over a decade. I was chief economist of the International Monetary Fund in 2007-08; a member of the Congressional Budget Office's Panel of Economic Advisers in 2009-15, a member of the Federal Deposit Insurance Corporation's Systemic Resolution Advisory Committee in 2011-16; and, in 2014-17, a member of the Financial Research Advisory Committee of the U.S. Treasury's Office of Financial Research (OFR), within which I chaired the Global Vulnerabilities Working Group. I have been a member of the CFA Institute Systemic Risk Council (SRC) since it was founded by Sheila Bair in 2012; in September 2021, I became co-chair of the SRC, alongside Erkki Liikanen.

Below I answer each of your questions in turn, and then provide an overall assessment.

"1. In your view, do current economic conditions – including elevated inflation, potential interest rate increases, the threat of additional COVID-19 variants, and geopolitical instability – present heightened risks to financial stability today? Please describe your assessment of the vulnerabilities currently facing the financial system and economy."

As the world continues to exit (we hope) from the COVID pandemic, the U.S. faces a complex and rapidly set of issues, which include all the concerns listed in your question. The usual way in which large financial stability risks materialize is through a version of the following combination: (a) entities outside the regulated perimeter take on a lot of risk, and this is detected late or only partially by the authorities; (b) there is a large adjustment or anticipated adjustment in asset prices, due to a shock of some kind; and (c) the executives in charge of large global banks find that they have much more exposure to high risk entities and activities than they previously supposed.

Today, all the conditions necessary for an elevated financial risk scenario are already in place, although it is not possible to predict the precise timing or direction of what will emerge. The low interest rates of the past decade, including during the pandemic, have encouraged the build-up of leverage in some parts of the economy, including hedge funds, private equity, and other leveraged investment vehicles. We should expect – and we are seeing – large movements in asset prices as interest rates rise and as the rise of global conflict impacts energy markets and the likely value of a wide range of other assets. The perceived risk of inflation likely intensifies the precariousness of some financial markets. Russia's invasion of Ukraine increases risks across a wide range of transactions, markets, and assets.

I would also emphasize that from 2016 to 2020, financial regulation and supervision was relatively weak. The stress tests required from banks were not onerous. Regulators explicitly and implicitly encouraged various kinds of wild cryptocurrency ventures and promises. The Financial Stability Oversight Council (FSOC) was not attentive to the build-up of potential systemic risks. There was insufficient attention paid to potential military events that could disrupt U.S. financial markets.

In addition, events in March 2020 exposed some serious weaknesses in and around the global market for U.S. Treasury debt. While we usually expect U.S. government obligations to function as a haven in a time of crisis, at that moment the price of treasuries fell (rather than increased). This may have been due to some technical issues or, more likely, the interplay of leverage, margin calls, and the need for cash across borders among both official and private sector participants. In any case, neither the Treasury Department nor the Federal Reserve have yet got to grips with what really happened – or how to prevent any kind of recurrence.

All this recent history, as well as the current geopolitical situation, suggests that potential serious financial vulnerabilities need scrutiny and potential action as soon as possible.

"2. Given current economic conditions, why would it be helpful to have a Vice Chair for Supervision in place?"

While the contours of our general financial vulnerabilities are clear enough from publicly available information, there is a great deal of confidential supervisory information that is only available to responsible officials within the Federal Reserve System. As you point out in your letter, the position of Vice Chair for Supervision was created to ensure that – as much as possible – one person has overarching access to data and all relevant information.

This is an incredibly important job which cannot be effectively covered by others on a part-time basis. In addition, this Vice Chair has statutory authorities that are currently, with no Vice Chair for Supervision in place, much harder to use.

“3. What steps could a Vice Chair for Supervision take to help mitigate heightened macroeconomic and financial stability risks today?”

I do not have access to the privileged information available to the Vice Chair for Supervision, so I would not presume to know the full range of known risks or the current views of Federal Reserve System staff. From an outside perspective, it seems obvious that the global risks to big banks’ balance sheets require much great attention, from various angles.

As co-chairs of the CFA Institute Systemic Risk Council, last week Erkki and Liikanen and I sent a letter to the FSOC, recommending action be taken to prevent cryptocurrency “stablecoins” from becoming a serious systemic risk. In my view, there is time to act on this front, but continued inaction is dangerous. To be clear, the Vice Chair for Supervision would not be expected to act alone on issues such as this – there needs to be a process of consensus building within official circles. Because this process takes time, it is important to start soon and to push from multiple directions.

“4. Do you believe it is appropriate for Congress to delay the confirmation of a Vice Chair for Supervision?”

Delaying the confirmation of the Vice Chair for Supervision is not appropriate. No one wants another financial crisis with all the damage this does to people, as seen in 2008 and after. The Vice for Supervision is uniquely positioned to anticipate and help forestall major systemic financial risks. Without this person in place, the risks of a major – and avoidable – disaster grow ever larger.

To sum up, my overall assessment is that Congress was right to create the position of Vice Chair for Supervision. This is a critical leadership role within the Federal Reserve and more broadly. Leaving this position unfulfilled at the current time is not appropriate, with potentially serious and long-lasting negative consequences.

Yours sincerely,

Simon Johnson

PIIE PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS

February 24, 2022

Senator Elizabeth Warren
United States Senate
Washington, DC 20510-2105

Dear Senator Warren:

Thank you for your leadership in getting the Federal Reserve Board filled with qualified public servants of integrity. I support your standing up for the current slate of Board nominees under consideration by the Committee on Banking, Housing and Urban Affairs and soon I hope by the full Senate. In particular, I wish to add my voice to yours and others arguing that leaving the post of Vice Chair for Supervision unoccupied presents real and present risks to financial stability and therefore the economic well-being of all Americans.

To that effort, please allow me to respond to the questions posed in your letter of February 22nd:

1. The U.S. economy is at rising financial stability risk right now due to the combination of Russian aggression in Ukraine and the coming increases in interest rates to counter high inflation.
    a. These feedback on each other. The Russian invasion and related geopolitical tensions are causing large jumps in energy and commodity prices, feeding inflation and thus the need for interest rate increases; sanctions on Russian financial institutions and individuals, and a potential exclusion of Russia from SWIFT and the Western financial system, increase risks of criminality and cyberattack, as well as the burdens on bank supervision.
    b. Sharply rising interest rates after years of low for long rates expected force adjustment on lenders and borrowers, and potential financial crises in foreign economies where U.S. savings and companies are exposed.
    c. The extreme volatility of crypto assets which are directly or indirectly tied to activities in Russia and Eastern Europe also are likely to undermine confidence among a subset of small investors, and may provoke cyberattacks on the U.S. financial system.
    d. Flight to safety and quality may put at risk leveraged businesses and investments in the non-bank financial intermediary space (aka shadow-banking) which is rightly not in the same safety net.
    e. While the capitalization of the core U.S. banking system is sound and the balance sheets of the vast majority of U.S. households are in good condition, the risks around these bulwarks are rising, and spillovers onto them are more likely.

2. In the face of these risks, it would be helpful to have a Vice Chair for Supervision in place for three significant reasons.

    a. First, there are no simple automatic rules which can be applied to assess let alone manage these risks to the American economy. An experienced publicly accountable Senate-confirmed appointee who has the responsibility and remit of the Vice Chair for Supervision is the only legitimate official to make hard judgments having to do with the fate of financial businesses and the implementation of dynamic provisioning under stress in specific situations. The Vice Chair for Supervision is also the only official who can credibly prioritize decisions and discussion of risk scenarios for the full Board or Governors or entire FOMC – leaving it to career civil servants will weaken the ability of the Committee to confront risks and discuss them credibly.

b. Second, management of financial stability in the U.S. is not solely up to the Federal Reserve Board or FOMC. This reflects the real-world diversity and complexity of our financial system, and Congressionally mandated diversity of regulators and supervisors in our government, This is why the FSOC was created. For that reason, our system works best when there is a strong Federal Reserve presence in inter-agency discussions, both to bring the analytical and data firepower to bear which is unique to the Fed, and to bring the perspective of the institution raising interest rates and assessing macroeconomic impact. Having the Vice Chair for Supervision chair empty distorts the decision making across the government, and it strengthens the hand of regulators with more partial views (important for them to have a voice, but they should not be left to be dominant).

c. Third, the global financial system is of direct importance to the well-being of U.S. households and non-financial businesses. This comes through risks of debt crises abroad, volatility in capital flows (including funding of U.S. Treasuries, and short-term financing for systemically important financial institutions), financing of criminal activities and hostile state actors, regulatory arbitrage reducing security for small savers, and technological shifts in finance having unintended or unforeseen consequences. International information sharing, coordination on rules and enforcement, setting of common standards, and making sure that financial actors do not elude the system all directly benefit U.S. security. That requires strong U.S. engagement at the G20, the FSB, and other international bodies. That role is played in large part by the Vice Chair for Supervision – in her or his absence, international standards and enforcement can be biased by parochial interests or even hostile powers. Given geopolitical tensions with states that are known to engage in financial crime and subversion, this is all the more important right now.

3. A confirmed Vice Chair of Supervision could undertake several steps to reduce the financial stability risks to the U.S. economy and to improve our resilience in response.

   a. S/he should develop a comprehensive oversight framework for nonbank financial intermediation, including enhanced supervision of both entities and activities. While the Dodd-Frank regulations and following implementation have made the core safety-net banking system demonstrably more resilient, such measures have not been extended far enough into the nonbanks of various kinds. This is not only an uneven playing field, which encourages the migration of riskier activities outward, it hides those activities from the public and from supervisors, and it leads to leverage which is under-provisioned.

      i. As my PIIE colleague Anna Gelpern has argued, "Financial stability requires both entity and activity regulation. These are no more mutually exclusive than traffic lights and licensing drivers. With access to its emergency lending on the line, the Fed should press for a more holistic approach to managing systemic risk in the financial markets—even where it does not have direct supervisory authority. FSOC should coordinate the development of a comprehensive analytical framework, instead of leaving it to functional regulators and their limited tools."

b. The risk of cyberattacks, financial crime, and attacks on vulnerable parts of the investment system (such as crypto currencies) is manifest given Russian involvement and capacities in those areas. The Fed Vice Chair in consultation with the FSOC should be engaged in off the record check ins with systemically important and event just critically located financial institutions, and publicly be advocating for greater oversight of crypto and greater funding (reallocation or reappropriation) for U.S. government and related payment systems hardening of targets.
c. Past stress tests and their results should be reviewed at the Vice Chair level, and re-examined for whether plausible interest rate hikes by the Fed – which now must realistically include 450+ basis points from here given inflation trend and risks – and cutoff of Russian and therefore some European and Chinese financial flows were adequately covered. If not, then new stress testing with these interest rate conditions needs to be set out. If yes, then supervised institutions need to be checked with and reminded to prepare accordingly.
d. The Vice Chair for Supervision should be reaching out to FSB and Euro member counterparts (as well as UK due to Russian money flows there) to create greater information exchange and coordination.
e. The Vice Chair for Supervision should be gathering assessments from the IMF, OECD, World Bank and private-sector sources of which emerging market and developing economies are most vulnerable to the level of interest rate increase likely, and the nature of these vulnerabilities (private sector versus sovereign; dollar or RMB or local currency debt; duration of debt) in a rising interest rate and rising commodity inflation environment. Informal pre-positioning of official sector liquidity provision and of creditor committees should be underway immediately.
f. Again, citing Anna Gelpern, "technology firms that deliver financial services outside the regulated financial sector will continue to challenge regulators, especially in areas such as payments and small-scale consumer lending…Increasingly diverse actors will demand access to payment systems, raising thorny questions of operational and counterparty risk, and prudential supervision, even when no deposit-taking is involved." A full risk assessment to consumers as well as to the financial system led by the Vice Chair and the Fed is necessary, as well as an action plan for skilling up the supervision capabilities and making clear decisions on central bank digital currency and the like.

4. I believe it is reckless and irresponsible for Congress to delay the confirmation of a Vice Chair for Supervision of the Federal Reserve Board. At any time, depriving critical U.S. government agencies of qualified officials at the level of seniority to be Senate accountable and to pursue effectively a public interest agenda exposes the American public to avoidable serious risks. This is particularly true of policy areas where missed challenges or failures can do rapid widespread significant harm and feed on themselves – financial stability is in this category along with pandemic prevention and military readiness. Given today's combination of high inflation, rising interest rates, geopolitical stress, and technological change in the financial sector, delaying the appointment of a Vice Chair puts the American economy in danger.

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February 24, 2022

The Honorable Elizabeth Warren
United States Senate
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Washington, D.C. 20510-2105

Re: February 22, 2022 Letter

Dear Senator Warren,

I am writing in response to your letter dated February 22, 2022. I appreciate the opportunity to discuss the role of the Federal Reserve Board's Vice Chair for Supervision (VCS).

1. *In your view, do current economic conditions – including elevated inflation, potential interest rate increases, the threat of additional COVID-19 variants, and geopolitical instability – present heightened risks to financial stability today? Please describe your assessment of the vulnerabilities currently facing the financial system and economy.*

This is indeed a precarious time for financial stability, and you have identified the main potential near-term risks on which markets and the authorities are now focused. Inflation and monetary tightening, the potential for new virus variants, and contagion from China ranked at the top of the Fed's semiannual market outreach survey in its latest *Financial Stability Report*;[1] the events in Ukraine have introduced a new set of risks that were not on the radar just a few months ago. Since the beginning of the pandemic lockdown, the Financial Stability Oversight Council (FSOC) has judged financial stability risks to be "elevated," a departure from the typically more sanguine tone of these reports.[2]

Financial stability analysts tend to focus on the vulnerabilities in the financial system that could allow unexpected shocks to trigger a broader financial crisis, including fire sales in asset markets and runs on financial institutions. Regulatory reforms and improved risk management have fortified the U.S. banking system since the Global Financial Crisis of 2007-09 (GFC). But the pandemic shock revealed significant vulnerabilities that remain, particularly in the nonbank financial sector. As we all reevaluated the implications of a

[1] Federal Reserve, *Financial Stability Report*, November 2021, https://www.federalreserve.gov/publications/files/financial-stability-report-20211108.pdf
[2] FSOC, *Annual Report*, December 2021, https://home.treasury.gov/system/files/261/FSOC2021AnnualReport.pdf

deadly pandemic and an unprecedented global lockdown in March 2020, asset prices plunged and market participants rushed to cash. In that month, U.S. prime money market funds experienced $125 billion of outflows,[3] while open-ended bond funds saw net outflows of $111 billion.[4] The U.S. Treasury market, the largest and most liquid bond market in the world, experienced extraordinary selling pressure from mutual funds, hedge funds, and foreign official accounts.[5] Only unprecedented monetary and liquidity actions by the Fed and extraordinary fiscal support from the Treasury and Congress allowed the financial system and broader economy to weather these shocks without a broader meltdown in consumer and investor confidence.

While credit markets have largely returned to pre-crisis conditions, the vulnerabilities in the nonbank financial sector remain and need attention. Meanwhile, many of the same vulnerabilities in the financial sector that the authorities focused on prior to the pandemic are reemerging. For example, leveraged lending—relatively risky loans to nonfinancial corporations—surged in 2021, led by investors in collateralized loan obligations (CLOs), as CLO issuance hit record levels. While this sector has been resilient to past shocks, financial stability analysts must remain vigilant to evolving risks. New challenges have also emerged from financial innovations such as stablecoins, accelerated by societal changes during the lockdown.

2. *The Dodd-Frank Act created the role of the Federal Reserve's Vice Chair for Supervision to "develop policy recommendations for the Board regarding supervision and regulation of depository institution holding companies and other financial firms supervised by the Board" and "oversee the supervision and regulation of such firms." This position has been vacant since October 2021. Given current economic conditions, why would it be helpful to have a Vice Chair for Supervision in place?*

It would certainly be very helpful to have a Vice Chair for Supervision (VCS) in place. Banks remain the most important financial intermediaries in the U.S.; the Fed is the supervisor and regulator of bank holding companies, including all of our largest and most systemically important banks; and the Vice Chair for Supervision is ultimately responsible for the Fed's activities in this area.

More specifically, the VCS sets the agenda for the Fed's oversight responsibilities. Congress created the position in the 2010 Dodd-Frank Act to elevate the profile of supervision and regulation within the Fed, ensure strong leadership of these functions across the Federal Reserve System, and promote accountability to Congress and the public. Importantly, Dodd-Frank requires the Vice Chair to testify semiannually on the

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[3] IOSCO, "Money Market Funds during the March-April Episode," November 2020, https://www.iosco.org/library/pubdocs/pdf/IOSCOPD666.pdf
[4] Nellie Liang, "Corporate Bond Market Dysfunction During COVID-19 and Lessons from the Fed's Response," Brookings, October 1, 2020, https://www.brookings.edu/wp-content/uploads/2020/10/WP69-Liang_1.pdf
[5] Lorie K. Logan, "Treasury Market Liquidity and Early Lessons from the Pandemic Shock," Remarks, at Brookings-Chicago Booth Task Force on Financial Stability, October 23, 2020, https://www.newyorkfed.org/newsevents/speeches/2020/log201023

Fed's supervisory and regulatory activities; since 2018, the Fed has published a detailed semiannual report to accompany that testimony.

Banking supervision and regulation improved immeasurably after the GFC. The Fed and other federal regulators enhanced their supervisory capacity and stepped up the intensity of their supervision of the largest banking organizations. Working with their overseas counterparts, they set more rigorous international standards for capital, liquidity, and governance. Regular stress tests organized by the Fed have entrenched a forward-looking approach to capital and engaged company boards and management more in the capital planning process. Supervisors have noted marked improvement in risk-management practices at the largest banks.

The Fed's Vice Chair for Supervision is singularly positioned to lead the Fed in making adjustments to its supervisory approach. There is always the risk of complacency as the memory of the GFC fades and risks seem benign. In the years before the pandemic, Congress and the regulators started to chip away at the post-crisis regulatory framework with the goal of reducing regulatory burden on relatively less systemically important banking organizations. It is certainly sensible to avoid excessive regulatory burden on the smallest banking organizations. But the changes limited supervisory activities over some very large banking organizations. For example, banks with between $50 billion and $100 billion in assets are no longer subject to supervisory stress tests and resolution requirements, and banks with between $100 billion and $250 billion in assets are no longer subject to annual stress tests. The Fed no longer supervises any foreign banking organizations through the Large Institution Supervision Coordinating Committee (LISCC), which coordinates supervision of the most systemically important banks.[6] At the same time, FSOC has reversed its earlier designations of selected nonbank financial institutions as "systemically important," which had required the Fed to oversee their safety and soundness. In 2020, the International Monetary Fund noted the recent deregulatory trend in the U.S. with some concern in its five-year review of our financial system. "While these reforms… preserve the core of the approach to regulation that was legislated under the [Dodd-Frank Act] in the aftermath of the GFC, the recent trend has been a steady sequence of 'fine-tuned' steps that reduced the stringency of some standards for a range of firms at a time when financial stability risks within the system as a whole are elevated by historical standards and rising."[7]

The VCS chairs the Federal Reserve Board committee that oversees its Division of Supervision and Regulation and serves as a key ex officio member of the LISCC. In those roles, the VCS can choose to exert leadership on any number of supervisory and regulatory questions—such as the design of stress test scenarios, the topics that may require greater supervisory attention at the largest banks, the guidance that supervisors may issue to banks to address emerging risks, and the regulation of banks' capital and

[6] Federal Reserve, "Large Institution Supervision Coordinating Committee," https://www.federalreserve.gov/supervisionreg/large-institution-supervision.htm

[7] IMF, "Technical Note—Banking Supervision and Regulation," United States Financial Sector Assessment Program, IMF Country Report No. 20/248, August 2020, https://www.imf.org/en/Publications/CR/Issues/2020/08/07/United-States-Financial-Sector-Assessment-Program-Technical-Note-Banking-Supervision-and-49657

liquidity. The VCS is also the Fed's leading international diplomat for supervisory and regulatory affairs. Most recently, the Fed's Vice Chair served for three years as the Chair of the Financial Stability Board (FSB). This position allowed him to set the agenda in the global policy conversation about regulatory reform, a conversation that focused increasingly on the oversight of nonbank financial institutions. He also played a very important role in helping coordinate the international regulatory response during the pandemic crisis.[8]

Although a financial crisis does not appear imminent (they rarely do), if one does occur, the Fed will need its key decision-makers in place and up to speed. The VCS is one of those key decision-makers. While most of the attention during the pandemic crisis focused on the Fed's massive asset purchases and liquidity provision, the quieter supervisory response—temporarily easing capital and liquidity requirements, urging banks to go easy on troubled borrowers—was also critical in keeping credit flowing during the dicey early months of the pandemic.[9]

3. *What steps could a Vice Chair for Supervision take to help mitigate heightened macroeconomic and financial stability risks today?*

In my view, the Vice Chair's agenda should include:

- Working with FSOC and overseas counterparts on the FSB to establish sensible reforms addressing the vulnerabilities in money market funds, open-ended mutual funds, and hedge funds.
- Launching a review of the next generation of Fed stress tests, to include, for example, further investigation of liquidity feedback effects and any lessons learned from the pandemic crisis-era stress test and sensitivity analysis exercises.
- Reconsidering recent measures that reduced the scope of application of post-crisis capital and liquidity standards.
- Involving the Fed in a review of the FSOC's approach to designation of systemically important nonbanks.
- Supporting initiatives by the Fed, FSOC, and overseas regulators to improve the reporting and analysis of financial sector exposures to climate risk, including climate stress tests for Fed-supervised banks.

There is also the data problem. Although regulators today have far better data about financial institutions and markets than they had before the GFC, those data remain incomplete and often not fit for purpose. I proposed in a 2020 paper that the FSOC ask the Office of Financial Research (OFR) to draft a data strategy for identifying and closing data gaps; improving data standards; safely sharing data, both among FSOC member

[8] FSB, "Klaas Knot takes office as FSB Chair," December 2, 2021, https://www.fsb.org/2021/12/klaas-knot-takes-office-as-fsb-chair/

[9] Sigridur Benediktsdottir, Greg Feldberg, and Nellie Liang, "What macroprudential policies are countries using to help their economies through the Covid-19 crisis?," April 6, 2020, https://www.brookings.edu/blog/up-front/2020/04/06/what-macroprudential-policies-are-countries-using-to-help-their-economies-through-the-covid-19-crisis/

agencies and with the public; and accelerating the adoption of new technologies.[10] Each of the FSOC member agencies should have input into that strategy and a role in executing it. The Fed would be a key FSOC member for such discussions and the Fed's VCS could use his or her influence helpfully, for example, to promote data-sharing among FSOC members and the use of data standards such as the Legal Entity Identifier by the Fed.[11]

4. *Do you believe it is appropriate for Congress to delay the confirmation of a Vice Chair for Supervision?*

For the reasons noted above, the Vice Chair for Supervision is a critical role and should be filled. While the professionals in the Federal Reserve Board's supervision and regulation division can continue to perform their essential work supervising banks, assessing risks, and developing policy without a Vice Chair, it is simply impossible for them to play in some arenas without their quarterback. The Fed is unlikely to seriously take on all of the issues discussed in this letter before a new Vice Chair is in place. Moreover, the absence of a Vice Chair creates an obvious gap in accountability; last fall, for the first time, the Fed published its semiannual supervision report without a Vice Chair to discuss it before Congress.

Of course, the confirmation process is also a key component of the accountability of the office and part of the reason that Congress elevated the role in the first place. Ideally, the confirmation process should allow an airing of the candidate's views on the issues noted in this letter. That would include, for example, a discussion of the appropriate emphasis that regulators should place on burden and efficiency concerns and how the Fed should balance those concerns with its overarching responsibility to oversee a stable financial system.

Sincerely,

Greg Feldberg
Director of Research
Yale Program on Financial Stability

[10] "Fixing financial data to assess systemic risk," Brookings, December 2020, https://www.brookings.edu/wp-content/uploads/2020/12/ES-12.4.20-Feldberg.pdf

[11] Indeed, then-Vice Chair for Supervision Randal Quarles acknowledged the challenges of getting supervisors to share data in a 2020 seminar: "The more data is shared, the more people will have an opinion that could differ from the people in charge who have a view." Center for Financial Policy, "Fed's Quarles Discusses Global Financial Stability and Data Gaps," University of Maryland, October 13, 2020, https://www.rhsmith.umd.edu/news/feds-quarles-discusses-global-financial-stability-and-data-gaps