Jerome H Powell: Current US regulatory regime and areas for reform

Remarks by Mr Jerome H Powell, Member of the Board of Governors of the Federal Reserve System, at the Salzburg Global Seminar, Salzburg, Austria, 26 June 2017.

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I appreciate the opportunity to speak at the Salzburg Global Seminar. Today I will discuss our current regulatory regime, and areas where we may be able to make adjustments. As always, the views I express here are my own.[1]

We need a resilient, well-capitalized, well-regulated financial system that is strong enough to withstand even severe shocks and support economic growth by lending through the economic cycle. The Federal Reserve has approached the post-crisis regulatory and supervisory reforms with that outcome in mind.

There is little doubt that the U.S. financial system is stronger today than it was a decade ago. Loss-absorbing capacity among banks is substantially higher as a result of both regulatory requirements and stress testing exercises. The banking industry, and the largest banking firms in particular, face far less liquidity risk than before the crisis. And progress in resolution planning by the largest firms has reduced the threat that their failure would pose. These efforts have made U.S. banking firms both more robust and more resolvable.

Evidence overwhelmingly shows that financial crises can cause severe and lasting damage to the economy's productive capacity and growth potential. Post-crisis reforms to financial sector regulation and supervision have been designed to significantly reduce the likelihood and severity of future financial crises. We have sought to accomplish this goal in significant part by reducing both the probability of failure of a large banking firm and the consequences of such a failure were it to occur.

As I mentioned, we have substantially increased the capital, liquidity, and other prudential requirements for large banking firms. These measures are not free. Higher capital requirements increase bank costs, and at least some of those costs will be passed along to bank customers and shareholders. But in the longer term, stronger prudential requirements for large banking firms will produce more sustainable credit availability and economic growth.

Our objective should be to set capital and other prudential requirements for large banking firms at a level that protects financial stability and maximizes long-term, through-the-cycle credit availability and economic growth. To accomplish that goal, it is essential that we protect the core elements of these reforms for our most systemic firms in capital and liquidity, stress testing and resolution.

With that in mind, I will highlight five key areas of focus for regulatory reform. The first is simplification and recalibation of regulation of small and medium-sized banks. We are working to build on the relief we have provided in the areas of call reports and exam cycles, by developing a proposal to simplify the generally applicable capital framework that applies to community banking organizations.

The second area is resolution plans. The Fed and the Federal Deposit Insurance Corporation believe that it is worthwhile to consider extending the cycle for living will submissions from annual to once every two years, and focusing every other of these filings on key topics of interest and material changes from the prior full plan submission. We are also considering other changes, as I discussed last week when testifying to Congress.

Third, the Federal Reserve is reassessing whether the Volcker rule implementing regulation most efficiently achieves its policy objectives, and we look forward to working with the other four Volcker rule agencies to find ways to improve that regulation. In our view, there is room for eliminating or relaxing aspects of the implementing regulation in ways that do not undermine the Volcker rule's main policy goals.

Fourth, we will continue to enhance the transparency of stress testing and the Comprehensive Capital Analysis and Review (CCAR). We will soon seek public feedback concerning possible forms of enhanced disclosure, including a range of indicative loss rates predicted by the Federal Reserve's models for various loan and securities portfolios, and information about risk characteristics that contribute to the loss-estimate ranges. We will also provide more detail on the qualitative aspects of stress testing in next week's CCAR disclosure.

Finally, the Federal Reserve is taking a fresh look at the enhanced supplementary leverage ratio. We believe that the leverage ratio is an important backstop to the risk-based capital framework, but that it is important to get the relative calibrations of the leverage ratio and the risk-based capital requirements right.

U.S. banks today are as strong as any in the world. As we consider the progress that has been achieved in improving the resiliency and resolvability of our banking industry, it is important for us to look for ways to reduce unnecessary burden. We must also be vigilant against new risks that may develop. In all of our efforts, our goal is to establish a regulatory framework that helps ensure the resiliency of our financial system, the availability of credit, economic growth, and financial market efficiency. We look forward to working with our fellow regulatory agencies and with Congress to achieve these important goals.

And finally, I would also like to note that work continues to address the risks identified with existing reference rates. Just last week, the Alternative Reference Rates Committee (ARRC) selected a new rate suitable for use with new derivative contracts. I am confident the broad Treasuries repo rate, which the Federal Reserve Bank of New York has proposed publishing in cooperation with the Office of Financial Research, is based on a deep and actively traded market and will be highly robust. With this choice, the ARRC has taken another step in addressing the risks involved with the LIBOR.

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1 These remarks are substantially similar to the testimony delivered at the Senate Committee on Banking, Housing, & Urban Affairs hearing titled "Fostering Economic Growth: Regulator Perspective" on June 22, 2017.