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WEBINAR

FED VICE CHAIR MICHAEL BARR: MAKING THE FINANCIAL SYSTEM SAFER AND FAIRER

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PARTICIPANTS:

Welcome and Moderator:

DAVID WESSEL
Senior Fellow and Director
Hutchins Center on Fiscal and Monetary Policy
The Brookings Institution

Keynote Speaker:

MICHAEL S. BARR
Vice Chair for Supervision
Board of Governors of the Federal Reserve System

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P R O C E E D I N G S

MR. WESSEL: Good afternoon. Welcome. I'm David Wessel, director of the Hutchins Center on Fiscal and Monetary Policy here at Brookings. It's very good to see so many people actually in person. We haven't done an event like this in two and a half years, and I hope this is the beginning of more of them.

I have to say that one of the things about the pandemic is that you do things that you used to think were a hassle and now they seem like a luxury. And that's the way I felt when I got a suit out of my closet that I haven't worn in three years.

I'm very pleased today to host Michael Barr, vice chairman of the Federal Reserve Board for bank supervision. Michael has a very distinguished resume, a Rhodes scholar, Yale Law School, clerk to Supreme Court Justice David Souter. He worked in the State Department, the White House, and the Treasury in the Clinton administration and he was the assistant secretary for financial institutions in the Obama Treasury where he played an important role in crafting the Dodd-Frank Act that created the position that he now fills.

As you may know, Congress created, as I understand it, this position, vice chair for supervision, so that Congress would know who to blame if the Feds screwed up again, and so, Michael, good luck with that.

Michael first joined the University of Michigan faculty 20 years ago; he's taught and written quite a bit about financial regulation. His most recent job was dean of the Gerald Ford School of Public Policy at the University of Michigan.

Michael has a long relationship with Brookings, he's participated in all sorts of events and written for our website on financial relationship topics and his 2012 book, "No Slack: The Financial Lives of Low-Income Americans," was published by the Brookings Press in 2012.

But what stands out to me in Michael's background is patience. I recall when I was working for the Wall Street Journal that Michael's name was floating around to be the first director of the Consumer Financial Protection Bureau, and that didn't happen. And then came the Biden administration and his name was floating around for comptroller of the currency, and that didn't happen. So he stayed at Michigan and was patient, and now he has one of the most powerful jobs in financial regulation in the United States and he has a four-year term, so it doesn't even matter what happens in the 2024 Presidential election.

Michael's going to make some remarks, I'm going to join him here on stage. I have some questions, some of which have come in by email. We'll have some mics for people in the audience to ask questions. If you're online and you want to ask a question you can do it at #MichaelBarr, either on Twitter or on the website Sli.do, S-L-I-.-D-O, where you can put your question. I can't promise we'll get to all of them, but I have a good sense from the emails we've already gotten about what's on peoples' minds. So with that, Michael Barr.

MR. BARR: Thanks, David, for that warm introduction and patience is definitely a virtue. Thank you also to the Brookings Institution for the invitation to speak to you today.

As most of you know, on July 19th I had the honor or being sworn in as vice chair for supervision of the Board of Governors of the Federal Reserve System. This job was created after the global financial crisis to lead the Fed's work overseeing the safety and soundness of banks and in support of its financial stability mandate.

In the 12 years since then great progress has been made in strengthening the banking system and in strengthening oversight. I look forward to building on that work by helping to make the financial system safer and fairer in support of an economy that serves the needs of households and businesses.

On behalf of those who may be wondering what building on that work means, I will speak about some of my near-term goals and how I will approach achieving them. Starting with that word "building," which means to me more than just maintaining.

Success in financial regulation and supervision does not mean standing still because finance does not stand still. The regulatory and supervisory framework adopted after the crisis recognizes that innovation and change are constant in financial, that our understanding of existing and emerging risks can and should deepen over time. And that regulation and supervision must be evolving to be effective.

Many issues at the forefront of banking regulation today scarcely even existed a few years ago. Building means staying ahead of changes, evaluating how banks are managing risk, and making the financial system safer and fairer for households and businesses.

When I say that one of my top goals is to make the financial system safer, it is because keeping it safe involves an active and never-ending effort to analyze risks and make necessary adjustments. There's no responsible alternative to this approach because the stakes are too high to do otherwise.

The global financial crisis caused a terrible recession and brought the United States to the brink of an economic collapse that could have been worse than the Great Depression of the 1930s. A significant cause was excessive risk taking by banks and inadequate regulation and supervision by the Fed and other bank regulators.

A hard-won lesson from the crisis is that the savings of every retiree, the job of every worker, the payroll of every business, and the wellbeing of every individual depend on a safe and stable financial system.

In addition to making the financial system safer, I'm also committed to making it fairer. Fairness is fundamental to financial oversight, and I'm committed to using the tools of regulation, supervision, and enforcement so that businesses and households have access to the services they need, the information necessary to make their financial decisions, and protection from unfair treatment.

Safety and fairness may seem like distinct goals, but they are intertwined. Financial instability unfairly harms those who are economically vulnerable and so making the financial system safer is also making it fairer.

Nothing is more basic to the safety and soundness of banks and the stability of the financial system than capital. Capital enables firms to serve as a source of strength to the economy by continuing to lend through good times and bad.

To continue to perform these functions a bank must have a sufficient level of capital to ensure that they can absorb losses and continue operations during times of stress in the financial system when losses may be significant.

An important principle of the capital framework is that it must evolve through a continuous process of incorporating new risks that might emerge. And while history is a good guide to losses in the past, stresses that a bank may face in the future might be different. So capital policy may also be forward looking and responsive to changes in macroeconomic conditions, market structures, and financial activities.

A second principle is the capital framework should be risk focused. Different activities pose different potentials for loss, and a capital regime should calibrate requirements to account for the risks of specific activities.

At the same time simpler, non-risk-based approaches can serve as important backstops given the complexity and opacity of risk-based approaches and evidence that these approaches can be gained. As such, leverage ratios also serve an important role in this framework.

A third principle is that requirements should be tiered. As firms increase in systemic importance the social cost of their failure grows. Regulations should be designed to require firms to internalize the cost that their potential failure would impose on the broader financial system, and that's on businesses and households.

This means that firms must face higher costs through more stringent regulations as they grow in complexity, size, and interconnection. And rightly, that community banks face simpler regulations.

We are looking holistically at our capital framework now to understand how they are supporting the resilience of the financial system individually and in combination. When calibrating requirements we will work to minimize unintended consequences, limit opportunities for gaming, and avoid access compliance costs that do not result in risk reduction.

Taking a holistic view will help us consider adjustments, if any, to the supplemental leverage ratio, countercyclical capital buffer and stress testing. And within this context I'm also committed to implementing enhanced regulatory standards that align with the final set of Basel III standards for the so-called Basel Endgame. This process will involve working with other Federal banking agencies and soliciting public input. And I'll have more to say about that later this fall.

Sufficient capital in the financial system helps support the resilience of individual banks but it's also important to ensure that if a large firm gets into trouble, it can be resolved without a costly bailout.

The Dodd-Frank Act established a framework necessary to end those bailouts. It provides the FDIC with the authority to resolve any firm whose failure would pose substantial risk to our financial system in a way that will protect the economy while ensuring that large financial firms, not taxpayers, bear the cost.

In addition, the Fed and the FDIC require large banks to develop living wills on an annual basis for many of them, to demonstrate that they can be resolved in an orderly way. Many gains have been made from this process. While recognizing these gains, we need to continue to analyze whether firms are taking all appropriate steps to limit the cost to society of their potential failure. As such we will continue to work with the FDIC to rigorously review firms' plans, making clear where firms do not meet our expectations and where remediation may be necessary.

In addition, beyond globally systemically important banks or GSIBs, we 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.

As we consider future policy actions in this area the Fed will work with our colleagues at other banking agencies and seek public comment.

Mergers are a feature of great and vibrant industries but the advantages that firms seek to gain through mergers must be weighed against the risks that mergers can pose to competition, consumers, and financial stability.

Another priority of mine is to evaluate our approach to reviewing banks' proposed acquisitions. The board is required to consider a range of factors when reviewing proposed mergers. A merged institution may be able to provide more competitive products and services, but it could also have the potential to reduce competition and access to financial services in a geographic area by raising prices, narrowing the range of services offered, or reducing the supply of small business or community development loans that rely on local knowledge. Assessing these risks is a crucial component of reviewing proposed mergers.

In addition, we review the potential effects on the convenience and needs of the communities to be served by the merged entity, particularly low-income communities.

Under the Dodd-Frank we are also now required to consider financial stability risks. These risks may be difficult to assess but the consideration is critical. I am working with Federal Reserve staff to assess how we perform emerging analysis and where we can do better.

Another priority of mine as Vice Chair is the regulation and oversight of new forms of private money created through stable coins. Stable coins, like other unregulated private money, could pose financial stability risks. History shows that the absence of appropriate oversight, private money is subject to destabilizing runs, financial instability, and a potential for wide-spread economic harm.

In the 19th and early 20th Century before the advance of prudential bank regulation and deposit insurance and before action was taken to ensure private money creation by banks was appropriately regulated, repeated crises did substantial damage to the U.S. economy.

I believe Congress should work expeditiously to pass much needed legislation to bring stable coins, particularly those designed to serve as a means of payment, inside the prudential regulatory parameter. I look forward to continued partnership with other regulatory agencies and Congress to address the risk of stable coins.

Before I move away from the discussion of making banks safer, let me say a few words about the potential risk to banks posed by climate change.

As our nation and the world grapple with how to respond to climate change, banks are increasingly focused on the risk that climate change brings to their balance sheets. The Federal Reserve is working to understand how climate change may pose risks to individual banks and to the financial system as a whole.

The Federal Reserve's mandate in this area is important but narrow, focused on our supervisory responsibilities and our role in promoting a safe and stable financial system. In the near term we intend to work with the OCC and the FDIC 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 we're considering how to develop and implement climate risk scenario analysis. In that regard next year we plan to launch a pilot micro prudential scenario analysis exercise to better assess the long-term climate related financial risks facing the largest financial institutions.

These are a few of my near-term priorities to help make the financial system safer. I'll have more to say about these and other priorities for safety and soundness in the coming weeks and months.

Let me turn now to my other major objective as Vice Chair, which is to make the financial system fairer. In the past I've described the three essential elements of fairness in the financial system as a three-legged stool because all three are necessary for any aspect of fairness to work.

The three are financial capability, financial access, and consumer protection. In terms of financial capability, an important component is transparency in the cost of services. Which means making sure that consumers have the information they need to make good decisions.

Along with other banking agencies, the Federal Reserve has a role to play in ensuring banks disclose the cost and explain the conditions of the services they provide. More broadly though it means basing policy on a deeper understanding of human decision making and the context in which households and businesses make those choices.

Under financial inclusion, one example would be promoting access to low-cost and safe banking services for low- and moderate-income consumers. Such as through local Bank On initiatives. And consumer protection involves using supervision, regulation, and enforcement to fully implement laws to promote fair lending, consumer protection, and transparency in the consumer financial services marketplace.

Let me say a bit more about how innovation plays into this goal of making the financial system fairer. We should welcome financial innovation as a positive force that could increase access and lower costs for individuals and for businesses.

That said, innovation can also introduce new risks. We have already seen occasions for example when uses of new technologies and data can raise serious concern about violation of the fair lending laws. As innovative financial products develop and grow rapidly excitement can outrun the proper assessment of risk. As we have seen with the growth of crypto assets in a rapidly rising and volatile market, participants may come to believe that they understand these new products only to learn that they don't, and then suffer significant losses.

Crypto asset related activity both outside and inside supervised banks requires oversight so that people are fully aware of the risks that they face. We plan to work with other bank agencies to ensure that crypto activity inside banks is well regulated based on the principle of same risk, same activity, same type of regulation, regardless of the technology used for the activity.

I plan to make sure that the crypto activities of banks that we supervise 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 activates and to ensure compliance with all relevant laws, including those related to money laundering.

At a more basic level we need to focus on access to fast, efficient, digital payments. This is a matter both of efficiency and of fairness. Low-income households can ill afford to wait days for their income checks to clear, nor can small businesses. A three-day payment delay is an annoyance to someone with savings and ample credit. But it’s a costly burden and sometimes a serious problem for others. And overdraft and insufficient fund fees hit low- and moderate-income households hard.

I’ve been working on issues of financial inclusion for a significant portion of my career as a public official and as an academic. And I’m so pleased that we’ve made progress on instant payments under the leadership of Vice Chair Brainard and Chair Powell, and I’m looking forward to doing whatever I can to support this work, including the launch of FedNow service. The Federal Reserve has a responsibility to facilitate payments that work well for everyone, and we’re committed to doing so.

Rounding out my discussion today about access to financial services I will end my remarks by touching on the importance of the Community Reinvestment Act. The

CRA, first passed in 1977 encourages insured depository institutions to meet the credit needs of the communities in which they are chartered, including low- and moderate-income neighborhoods, consistent with safety and soundness.

The CRA was designed to address past abuses of financial institutions, such as redlining. And the CRA sends the unequitable message that there's no place for discrimination in the financial system. And that every community and every borrower deserves to be treated fairly.

Earlier this year the OCC, the FED, and the FDIC jointly invited comment on a proposal designed to strengthen the CRA to achieve the objectives of the law. I strongly support the goals of the proposal and look forward to contributing to the important work under way, again led by Vice Chair Brainard.

So to wrap up, I've tried to lay out my approach and a bit of my near-term agenda as Vice Chair for Supervision and for making the financial system safer and fairer for households and businesses. As I said at the outset, I believe these goals are related and mutually reinforcing so that progress in one area will advance the efforts in the other.

I've discussed a number of specific issues to illustrate these principles, but I'll have more to say about these ideas and other important reforms in the coming weeks and months.

Thank you all very much.

MR. WESSEL: Thank you very much for that very comprehensive agenda. What are you going to do in your second six weeks?

MR. BARR: That's the right question.

MR. WESSEL: I just want to assure people, if I'm looking at my phone it's only because that's the only way I know if people are asking questions online, it's not because I'm checking my email.

Michael, I want to start with a question about monetary policy before we get to financial stability and bank regulation.

It seems to me for much of the time monetary policy is about leaving room for fixing mistakes if the economy surprises, as it often does. It's this business that's sometimes called risk management. So given that, what is your bigger worry now, that the Fed will raise interest rates too much, hurt the economy, and have to pull back sooner than planned, or that you won't raise rates enough to restrain inflation and then end up having to raise them even more down the road? How do you weigh those?

MR. BARR: Well, David, right now I would say there's, you know, the basic fact that inflation in our country is just far too high. We're not close to the Federal Reserve's target for inflation and so I'm quite focused, and the Fed is quite focused on making sure we do the steps necessary to bring inflation back down to its target. So I am committed to doing that and I know my colleagues at the Fed are committed to doing that.

We understand that in doing that there may be a further slowdown in the economy or even as Chair Powell said, some pain in the economy. It's, you know, far worse to I think where we are right now to let inflation, you know, continue to be too high. So in terms of the balance of risks I think the balance of risks are on the side of making sure we keep at our commitment to fight inflation.

MR. WESSEL: And you have a view of about how far the Fed has to raise interest rates in order to bring inflation down?

MR. BARR: Yeah. David, I'm going to give you an answer that probably won't satisfy everybody's curiosity about precise basis points that they should expect to see. But I'm going to be driven, you know, by the data as it comes in. And trying to understand the data, get a sense of where inflation is, get a sense of what's going on in the labor market, what's going on overall with prices. And the information we've had to date is conflicting and I think that it will require, you know, a lot more very careful, very nimble, very humble work to figure it out.

MR. WESSEL: Okay. I think you passed that test. I want to talk a little bit about bank capital. As you note in a footnote to your speech, banks are a lot stronger than they were before the financial crisis of 2008 and 2009. You talk about a holistic look at bank capital, capital levels, whether to impose a kind of cyclical capital bubble, whether to review the supplementary leverage ratio, which Fed promised to do in March 2021.

I'm sort of curious what are you looking at here? Do you think that the level of capital is too low, or is it just a question of reassigning how we assign capital requirements, and what is this holistic review, and is this a six-week thing or a six-year project?

MR. BARR: It's not a six-year project. David, what we're doing is this fall taking a look at where we are with capital in the system. So that as we make judgments about a Basel III, the supplementary leverage ratio, counter cyclical capital bubble, it's with an overall sense of is capital in the system strong enough? It's strong. I think the question is, is it strong enough?

And to do that we're looking at, you know, history, we're looking at models of what optimal capital levels look like in the literature. We're looking at responses to past crises, we're looking at, you know, what might be a better level or a more appropriate level in the future. And we'll assess capital within that broader context.

You know, I've been very careful in my remarks not to comment on whether a rule in the future would need to be capital neutral. I don't think there's anything implicit in our review that would suggest that. We really want to take that holistic view.

MR. WESSEL: And are you going to do one big package changing capital rules, or are you going to take the SLR separately from the other things? How are you thinking about this?

MR. BARR: Yeah, I'm not sure, David, in terms of the approach with respect to a rule or guidance or other measures whether it will be all together or sequenced, but we're trying to do the review all at once. So we'll have a holistic picture of where we think things should go. I'll have some remarks I'll give publicly at that point to lay out the direction that I think capital should go in and then we'll do the rulemaking in that context.

MR. WESSEL: And your remarks on that, you're thinking about sometime in the calendar year --

MR. BARR: This fall.

MR. WESSEL: -- this fall. I see.

MR. BARR: Yeah.

MR. WESSEL: Okay. So much of the financial stress that we've experienced in the last couple of years, particularly at the beginning of the pandemic, didn't involve the banks, but involved the non-bank financial institutions, the shadow banking system. So I'm curious what role you think you can play in monitoring that part of the financial system, whether you think we have adequate macro prudential tools, if that's where the risk is, concentrating on the banks was not going to be sufficient.

MR. BARR: I think we have to really look at risk throughout the financial system, not just within the banking sector. It's an important part of my job to help with that work. I think that we have some windows into the non-bank financial institution world that are quite good and other areas where we don't really have even basic data, and we have to work on that in the future.

The tools that we have with respect to entities that are not regulated by the Fed or by other bank regulators depends a little bit on the technicality of where they fall in the system. Are they under the supervision, for example, of the SEC or CFTC where there might be an ability to take effective action directly, or do they fall even further outside the regulatory parameter where they are avoiding being subject to regulation where the efforts to get after them are more complicated?

So I think the answer to your question is it's essential that we look at risks throughout the financial system, including outside the banking sector. Our tools for addressing that are mixed or limited.

MR. WESSEL: Limited, yeah. In Dodd-Frank you gave the financial stability oversight counsel the authority to designate some institutions as financially significant, which would have brought them under the purview of the Fed. That combination of legal decisions and decisions that the Trump Administration made, that power has basically been neutered. Do you think that that's an important way, can that be reinvigorated, is that an important step, or is that not the way you think it's going to go?

MR. BARR: I do think it's important to have a vigorous financial stability oversight counsel process and to have a process that would permit designation of non-bank firms if they could pose a risk of financial stability.

And the FSOC, I'll us a little bit of jargon, but the FSOC could also use existing authorities, for example if it believes there's a systemic payment settlement or clearance activity, that can also be designated for supervision. And the FSOC can also make recommendations to member agencies with respect to activities that's going on across more than one agency for further action. I think it's important that that process be used when needed.

MR. WESSEL: Do you think the FSOC has the potential to actually do something here? So far, it's not done a whole lot.

MR. BARR: I think that it does have the potential to take action here. There was certainly a time in the FSOC's history where it was much more aggressive about using those authorities and I think those should be in the toolkit.

MR. WESSEL: So let me ask you a little bit about the tradeoffs inherent in regulation. You spoke quite a bit in your remarks about the need to have strong regulations of financial systems to protect individual consumers and businesses and also the financial stability of the systems.

But there are always tradeoffs. If you have too little regulation, you get 2008/2009; if you have too much you get what George Osborn, the former exchequer, called the stability of the graveyard. So when you think about these tradeoffs, what's going through your mind, how do you decide what's too much and what's not enough.

MR. BARR: I'm not sure I'd put it as too much and not enough as do you have the appropriate level of regulation addressing the right goal. And, you know, there is a tradeoff in doing that but it's not so much necessarily about the level of regulation, but have you tailored what you're trying to do to achieve an aim that's achievable in a way that makes sense.

I think innovation is really essential for our economy and you don't want to choke off innovation. And particularly with regulation sometimes incumbents will use regulation to block new entrance into the system. So you want to be very careful that you're not kind of blocking in the power of the dinosaurs.

So innovation is absolutely critical, but for innovation to be successful it needs guardrails. And those guardrails have to be clear and they have to protect consumers and they have to protect the safety of the financial system.

MR. WESSEL: So you spoke in your remarks about how important a role you assigned to financial inclusion. A couple of the examples you gave had to do with making sure that banks and other regulated financial institutions are serving the entire spectrum of American consumers, the Bank On, the Community Reinvestment Act, and so forth.

I'm curious whether you think that broadly defined decentralized finance, crypto, is the way to either get better financial inclusion or to provide the competition that forces the regulated system to do it.

MR. BARR: It's a great question, David. You know, as it's currently constituted these various systems who have distributed finance and also crypto, are not really predominately set up to serve and aren't predominately serving low and moderate-income households. There's not today primarily a financial access, a set of activities. And even worse in some cases where it is reaching individuals of modest means, they're potentially subject to misrepresentation, to fraud, to theft of their assets, to wild gyrations of the asset values of crypto currencies. So as it's currently constituted it's not really serving that purpose for that market.

You know, that being said, the underlying technology one day might be used for the purposes of expanding access or of lowering the cost of financial services or introducing competition. So there's a very large gap between, you know, the idealized form of what might happen with a lower cost payment system and what we currently have in the crypto markets, which is not, you know, not that.

So, you know, to answer your question, where we're thinking about financial access issues, the first handful of ways to do that, for me at least, would not start with crypto.

MR. WESSEL: You mentioned stablecoins in your remarks and you said that you thought we need legislation. So two questions on that. One is, is there anything that can be done to regulate stable coins short of legislation? And secondly, how do you address the question of a central bank digital currency? Do we need one or not?

MR. BARR: Well with respect to the first question, there are existing authorities at a number of the regulatory agencies, you know, to deal with these issues. So I think it's preferable for Congress to act, to step in to describe the framework that Congress thinks makes sense, balancing the kinds of risks and opportunities that stable coins present.

But there's already some regulatory authority certainly in existing regulatory structure to address these issues and they can be and should be used where appropriate.

With respect to central bank digital currency, I kind of think of that as a separate category, that is many of the potential use cases for central bank digital currency are supplements to the kinds of things people were thinking about using a private currency for. And so regardless of what everyone's views are about private stable coins, then you should think about central bank digital currency on its own terms.

I think what makes sense to do is what the Fed's doing right now is studying the issue, getting deep in it, looking at the technical issues, looking at what it would take to actually implement a central bank digital currency if the decision were made to move forward, to think then about the possible use cases and what those make sense for.

And then as Chair Powell has suggested, I agree that it makes sense to then talk to the Congress at the Executive Branch and make sure we're all on the same page before undertaking something that significant.

MR. WESSEL: So it doesn't sound like you see any urgent need for the Fed to --

MR. BARR: I don't see an urgent need for that.

MR. WESSEL: And what do you say to people who say oh, my gosh, if we don't do it the Chinese will get their first?

MR. BARR: The Chinese are already deploying a form of central bank digital currency; they've been piloting it for quite a while now. They're going to, I think for their own reasons, continue to do that for domestic reasons as well as their own views about the role of RNB and the global economy.

I don't think that the world is going to rush to the RNB just because you can use it on your cell phone.

MR. WESSEL: And our colleague, Eswar Prasad, made that point. Is it easier for the Chinese to freeze your assets if they're digital?

Finally before I turn to the audience, I want you to talk a little bit more if you would about your remarks on climate. What exactly are you talking about doing here in terms of this stress scenarios on the financial system? What's your objective?

MR. BARR: So next year we're going to launch this pilot, and the pilot will be to examine how financial institutions manage their own risks with respect to climate change, both what people call transition risks and physical risks. So physical risk is what climate change does to our lived-in environment and therefore to our economy, and the transition risk is the risk that happens between now and some future point in time as we move to a different world.

We're going to be exploring both of those. And in this scenario analysis we're going to be working with just a handful of the very largest financial institutions in the country. And it's going to be a very bottom-up effort, so if you think about stress testing today, so maybe stress testing's over here and what we're thinking about doing is over here by this pilot work. So stress testing is very top down in terms of inputs from the Federal Reserve, in terms of modeling, it has direct implications for capital and for supervision. And it's, you know, a systematic effort.

What we're talking about in this pilot is very, very different from that. It's really the beginning of beginning to understand how these risks are managed. It's going to be very bottom up, so we're going to be working with the financial institutions to create scenarios, we'll be looking at how the financial institutions themselves model. We're at a very early stage. It won't have direct capital or supervisory implications. And so it's a learning exercise to help us understand how the financial institution are thinking about these risks and to help us begin to develop capacity in this space.

MR. WESSEL: So as you know, a lot of people, for good reason, are worried about the risk that climate change pose and the inability of our political system to grapple with it in a fundamental way. The Inflation Reduction Act, one movement in the direction of dealing with it.

And I think sometimes those people think, well, what's the point of having a Federal Reserve, an independent agency which is supposed to worry about the big picture, if you don't do more on climate change.

So what is it that you see in your realm on climate change and what is it you think is someone else's job?

MR. BARR: David, I think we have really important work to do here but it is narrow work. We're going to be very focused on to what extent could climate change pose long-term risks to the financial institutions we supervise and to the financial system as a whole. So it's risk focused.

We're not going to be getting into broader questions of climate policy, that's for other agencies and for the Congress and for the President to get involved with. So you're not going to see us tell firms lend to this sector or don't lend to this sector, or to do credit allocation or to try and put the thumb on the scale on how financial institutions think about these issues. We want financial institutions to be thinking about financial risk and we'll be supervising for how they think about that financial risk.

MR. WESSEL: So do you think the markets underestimate the risk, the transition risk and the physical risks now, or is it already factored in?

MR. BARR: David, I think we're at such an early stage in this process that I couldn't begin to answer your question. And one of the things we're going to learn from this pilot exercise is at least how the financial institutions currently think about these risks, and we'll be able to do that in a more systematic way.

MR. WESSEL: Thank you. So I want to turn to some questions from the audience. My colleagues have microphones. I think what we'll do is we'll take two or three questions and then let Vice Chair Barr answer them. So if you have a question raise your hand. And remember that a question ends with a question mark. And if you don't have any, I got plenty more.

This one here. And why don't you, for the Vice Chair's benefit, identify yourself.

MR. REDMOND: Hi. Michael Redmond from Med Legal Advisors. So as a Vice Chair of Supervision you're also a voting member on the FOMC so I'm just wondering, do you think that you should bring kind of your unique regulatory experience to your monetary policy votes, or do you think that your job is more to focus on the regulatory issues and be more of a team player, follow along with others, you know, on the Committee for Monetary Policy? Thank you.

MR. WESSEL: Are you going to ask a question, Stephanie? No.

MR. ATORY: Hi, I'm Arvin Atory (phonetic) from (inaudible-46:53). I wrote my question down so I can say it faster. So you have mentioned fairness many times. It might be because of my background as a refugee from Iran, but I get very worried when a government entity or personnel starts using it as a justification for their regulatory policies. While the inflation has not gone up, gone down, the inflation has not gone down, the "fair policies" will only push it up. So my question is, if you think these fair policies are worth the fact that they will make the Feds and you guys crash the economy in six months to a year, using your interest rates. And the interest rate right now is 2.5 so you guys haven't even touched the market yet. So I'm wondering what's your take on that?

MR. WESSEL: Okay. So the first question is are you a monitory policy maker or a regulator? Which side of the bed did you get up on this morning?

MR. BARR: Yeah, that's an interesting way of thinking about it. I guess I don't really have the luxury of being only one or the other. The job as Vice Chair and Governor on the Federal Reserve Board and so I need to do both, put energy into both, care about both. And that's the way I think about my job. So in terms of having an independent voice or being a team player, I think you can be both, so the Fed is a very collaborative institution historically, I'd like to keep it that way.

But one of the reasons that it is I think a really effective institution is that each of the governors has their own, his or her own independent voice and ability to influence the decisions and that makes for a really good, respectful exchange of views and a dialogue, and I think it means it's more likely that the Federal Reserve will then end up with a result that is more effective.

MR. WESSEL: Let me reframe the second question a little bit. When you think about fairness and you think about monetary policy, what is the implication of one for the other?

MR. BARR: Yeah. I think that monetary policy to be effective has to meet the dual mandate that Congress set out for the Fed, which is to care about price stability and to care about employment. Both of those are really critical for having a functioning economy. We can't have an economy that works for everybody, we can't have an economy that's fair if inflation is too high and running out of control. And we can't have an economy that works for everybody if we have really, really super high unemployment. And so it's the Federal Reserve's job to take seriously both of those congressional mandates, and that to me in terms of monetary policy would be a fair way of thinking about a monetary policy.

MR. WESSEL: In the back, those two in the back.

MR. SHARGO: Thank you. Yevgeny Shrago with Public Citizen. And you've said a couple times that climate change you're very early on in the process. But of course your colleagues across the Atlantic and the European Central Bank and the Bank of England, are a little farther ahead. So I was wondering what you're taking away from their findings and their initial scenario analysis, their initial supervisory surveys, and sort of what you're doing to use their lessons to accelerate the work you're doing on climate change?

MR. WESSEL: Thank you. And you want to pass it to the woman to your right.

MS. PERRAULT: Thank you. Anne Perrault from Public Citizen. Following up on Yevgeny's question, so you've expressed concern for low- and moderate-income communities. I know you've written some great articles on that. You've expressed worry about climate change. It's clear in this context that community banks, smaller banks, regional banks, are disproportionately threatened by climate change and those are the banks these communities you've written about rely on the most.

At the end of the day tackling the risks they face will reply or reduce the emissions. It's pretty clear that they are limited in their capacity to deal with these risks otherwise. So my question for you is, what is the Fed thinking about doing to deal with these financed emissions to help banks transition away from that in a way that's science based? Thank you.

MR. BARR: Two great questions on climate finance and climate change more broadly. Let me say at the outset that at the Fed we're definitely in conversation with the European Central Bank and with the Bank of England and with other regulators around the world about climate change issues.

I was just in London at a meeting of one of the committees of the Financial Stability Board and we were talking about climate change as one of the issues that we're all working on. Different regulators have different statutory mandates so some regulators have an explicit mandate with respect to the environment that changes the way they think about their role with respect to the broad range of issues that might be taken on. I would say in our conversations with others who have looked at scenario analysis that they too are also really early in their work. They too would think of their work as really provisional. So we're learning from it, but I'd still describe it as really, really early in that process.

Let me say with respect to community banks, we're quite a way from being able to offer even good advice to community banks on the issue of climate change. And so the work that we're focused on and will be focused on this coming year is really focused at the very largest institutions, a handful of the globally systemically important banks to begin to wrap our arms around this and to think in a more systematic way about the risk that climate change could pose to the financial system or to individual banks.

We're also going to be issuing guidance joining with the FDIC and the OCC on how to help banks develop the risk management systems they need with respect to climate finance. And that'll be for large institutions so many more of the institutions in the country but not yet for community banks.

And we want to be I think in doing this, cognizant, as you said, of the risk that community banks face and the risk that low- and moderate-income people face from climate change but also cognizant of the burdens that community banks face when we decide to regulate in an area. So we want to be appropriately cautious, particularly as we're so early in our own work in this space.

MR. WESSEL: Picking up on your last point, there was a question from someone online asking do you worry at all that strengthening the community reinvestment bank will just become a burden and community banks will simply withdraw from communities rather than comply?

MR. BARR: That's not been my experience. I've been working on issues related to the Community Reinvestment Act now for a quarter century, and my sense is that overall it's had a positive impact on both banks and on local communities. That's what the research shows to date. Some of it I contributed to it, some others have done.

I think in looking at this proposal for strengthening the Community Reinvestment Act we got in lots of public comment on the draft.

MR. WESSEL: I bet.

MR. BARR: And we'll take that into account. From the regulated sector, from consumer community groups, from low-income communities, from civil rights organizations. And, you know, that public comment helps us, it makes us smarter and better, and we'll use that public comment to make sure that the final rule is as good as we can make it. But I think that when we're done it's going to have a very positive impact on lending in lower and moderate-income communities.

MR. WESSEL: And another question from our audience online. Are you at all concerned that the annual stress test, the conventional ones, not climate, may have become too predictable, more of a compliance exercise than a real test of the bank's capital strength?

MR. BARR: Well, David, I think stress testing is a really critical part of our overall framework for assessing the safety of the financial system and the capital that banks need to be healthy and to thrive. I think the stress tests need to continue to evolve. They're a lot different now than they were a few years ago, they're a lot different a few years ago than they were when they were first done in the middle of the financial crisis, the global financial crisis in 2009. So I think it's really critical that they continue to evolve.

It's one of the areas that's part of this holistic review I'm taking a careful look at. I want to make sure that the stress tests stay stressful. They're supposed to be stressful, they're supposed to be tough, and I want to make sure they are that way.

MR. WESSEL: I'll get little bumper stickers; stress tests should be stressful. I have time for a couple more. Okay. Dennis, and then right behind you.

MR. KELLEHER: Hi. Dennis Kelleher, Better Markets. Appreciate your remarks, Michael. Living wills resolution plan is one of the key pillars of Dodd-Frank and financial stability overall. The banks went through the exercise, I guess it's 15 months ago they submitted them. Big undertaking whether they're good, bad, or indifferent. They are now indefinitely postponed and on the shelf and on top of your inbox.

That also overlaps a little bit with the pending merger reviews because two of the top ten biggest banks have been approved by merger in the last three years, you got two pending. That will give you seven, eight, nine, 10 in terms of size banks in the U.S. when they're done. Any consideration to apply -- question one, what do you do with living wills in your in box. Question two, have you thought about applying the living will requirement in the merger review process for the post-merger too big to fail bank?

MR. WESSEL: So he had two questions. You can answer those before we got to the last.

MR. BARR: Okay. Thanks, Dennis. You know, I won't comment in any way on any particular firm. We are looking, you know, broadly, as I mentioned in my prepared remarks, at the resolvability of large banks. Large banks meaning banks that are not globally systemic banks but are large in relation to their absolute size and relative to others in the system. So we're doing that.

We're also as I mentioned in my remarks, taking a careful look at resolution plans. My inbox, as you can imagine, is filled, but certainly that is near the top of that inbox.

And as I said, you know, I think resolvability of large banks and of GSEBs is really a critical part of the post Dodd-Frank landscapes and reforms that were put in place. So I want to make sure that it is working and working well and as intended.

MR. WESSEL: Do you have some plan? Oh, sorry, go ahead.

MR. BARR: Go ahead.

MR. WESSEL: I was going to say, do you have, you talked about rethinking merger review standards. Is there some timing on that? Are you going to issue some guidance, or what's the --?

MR. BARR: Yeah. We're in the process of doing that right now. I haven't decided yet what form we're going to take to enunciate a set of principles that we might have learned, but I'll have some public opportunity to do that. And some of the output of that might relate to how we look at individual firms, some of them might relate to a broader set of guidance. Some of it might relate to resolvability as Dennis suggested. I'll have some more to say about that relatively soon.

MR. WESSEL: Thanks. I think there was a question right behind Dennis. You want to stand up so they can see you. And please again tell us who you are.

MR. BABA: Thank you. My name is Jackie Baba from JB. And my questions about CBDCs. And you say that the U.S. is not urgent need in CBDC, and people will not rush into Chinese yuan, but my question's about digital euros. And among advanced economies Europeans are more eager in terms of CBDC, and don't you think any chance that the digital euros might undermine the U.S. primacy in dollars. Thank you.

MR. BARR: You know, I think that there are multiple reasons why the U.S. dollar dominates the world in terms of its reserve currency status. But it's not exclusive and it never has been, and then that's true with other global currencies that have existed in the past.

So, you know, there is some relative role for other currencies in global trade. But when you think about the U.S. dollar, you know, it depends on things like stable policy and a strong system of governance and the fact that in international trade most people want to negotiate their terms in dollars. So the factors that go into that, some of that are about, you know, might be related one day to the question, can I, you know, use a token in this transaction or not. But that's not a today or tomorrow issue. That might be an issue for some years down the road.

So I think it's a good idea for the U.S. to explore a CBDC, as you said, get the research done, getting the technical capacity done, understanding the policy tradeoffs, thinking about issues of privacy, thinking about use cases, what would be appropriate and not appropriate. You know, I think for example if the Federal Reserve reports, you know, have focused on intermediated versions of the central bank digital currency rather directly offering digital currency, I think that kind of distinction makes sense.

So I'm all for doing the work but I'm not feeling the need to be, I'm not in crisis mode about the need to issue a CBDC.

MR. WESSEL: Is there anything that you are in crisis mode about?

I want to thank Michael for coming here today, for sharing his thoughts, for laying out the agenda for the next six speeches he's going to give. I think if you read the remark carefully, we know what the topic is going to be. We welcome you back at any time.

And I want to thank all of you for coming. As I said earlier, it's good to see so many people here at Brookings in person, and I look forward to welcoming you back. So thank you all.

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