Senate Banking Committee Holds Semiannual Humphrey-Hawkins Hearing

Executive Summary

On March 7, the Senate Banking Committee held a semiannual Humphrey-Hawkins hearing to receive testimony from Federal Reserve Chair Jerome Powell on the central bank's semiannual Monetary Policy Report. **Chair Sherrod Brown (D-OH)** and some Democrats focused on corporate practices contributing to inflation, such as "price gouging" and "shrinkflation," and advocated for legislative measures to address these issues, including the Shrinkflation Prevention Act (S.3819) and the Recovering Executive Compensation Obtained from Unaccountable Practices (RECOUP) Act (S.2190). Most Democrats generally expressed support for the stronger capital requirements outlined in the Basel III proposal. However, a few Democrats raised concerns about reports that the proposal is being modified and the capital requirements are being weakened. Democrats also extensively voiced their concerns about housing prices and supply.

Many Republicans focused their remarks on inflation, attributing high prices to government spending. GOP lawmakers also blamed the 2023 bank failures on mismanagement, supervisory failures, and interest rate hikes. Further, Republicans were highly critical of the Basel III proposal, arguing that it could increase lending and borrowing costs. Of note, Chair Powell indicated that, while the central bank does not currently have plans to repropose the Basel rulemaking, the Fed could choose to do so if officials feel it is necessary.

Fed Chair Powell also fielded questions about the central bank's efforts on central bank digital currencies (CBDCs), assuring lawmakers that the Fed will not move forward without congressional authorization. There was also some discussion of other banking regulations, nonbank lending, the federal deficit, emergency lending, insurance coverage, and commercial real estate. Notably, Chair Powell indicated that the Fed is examining "liquidity innovations" in light of the 2023 bank failures, though he did not provide additional details.

Opening Statements

Chair Sherrod Brown (D-OH) blamed inflation on corporate "price gouging," and he criticized the Fed's high interest rates as raising housing costs, hindering wage growth, and stifling small businesses. In particular, Chair Brown touted his Shrinkflation Prevention Act to address incidents where food and beverage companies decrease the size of their products but maintain the same price. The Chair applauded prudential regulators' recently finalized updates to the Community

Reinvestment Act (CRA) and the Basel III proposal. Finally, Chair Brown pushed for passage of the RECOUP ACT to claw back bank executive compensation when their firms fail.

Ranking Member Tim Scott (R-SC) blamed Silicon Valley Bank's (SVB) collapse on mismanagement, supervisory failure, and high inflation that resulted in "drastic" interest rate hikes. Ranking Member Scott also voiced several concerns about illegal immigration and policy at the U.S.-Mexico border. Finally, the Ranking Member voiced opposition to the Basel III proposal, arguing that it could increase lending and borrowing costs.

WITNESS TESTIMONY

Fed Chair Jerome Powell (testimony) highlighted continued progress on lowering high inflation. Additionally, the Fed Chair referenced positive indicators regarding the strength of the economy and labor market. Chair Powell stated that interest rates have likely reached their peak and that the central bank could start to lower rates when they are "confident" that inflation is decreasing in a sustainable manner.

DISCUSSION AND QUESTIONS

Basel & Other Regulations

- **Sen. Robert Menendez (D-NJ)** raised concerns about the potential impact of the Basel III proposal on mortgage lending, especially for Black, Hispanic, and low- or moderate-income borrowers. Chair Powell agreed that this is a risk and that the central bank is "working on it."
- **Sens. Mike Rounds (R-SD)**, **Thom Tillis (R-NC), J.D. Vance (R-OH), Steve Daines (R-MT),** and **Cynthia Lummis (R-WY)** criticized the Basel proposal, contending that it could raise borrowing costs, decrease lending, and fail to address the root cause of the 2023 bank failures. Notably, in response to Sen. Rounds' questions, Chair Powell indicated that the central bank does not currently have plans to repropose the rulemaking but could come to such a decision if the modifications to the Basel proposal justify it. Further, when responding to Sen. Tillis, Chair Powell stated that he expects Basel to be worked out before the end of the year.
- Sen. Rounds asked whether there is a consensus at the Fed behind the Basel proposal. Chair Powell expressed his belief that there will be a consensus when the proposal is finalized.
- Sen. Tillis explained that he does not completely oppose increasing capital requirements, though he believes it should be balanced with lowering regulatory compliance costs for banks.
- **Sen. Elizabeth Warren (D-MA)** blamed the 2023 bank failures on the Fed weakening regulations, including for large regional lenders. Sens. Warren and **John Fetterman (D-PA)** pushed for finalization of the Basel III proposal as currently written, pushing against calls to weaken the proposed capital requirements. She raised concerns about reports that Chair Powell is leading efforts within the Fed to weaken the Basel proposal. In response, the Fed Chair emphasized that the central bank is undertaking other efforts to address causes of the 2023 bank failures, including by strengthening its supervisory program.
- **Sen. Chris Van Hollen (D-MD)** expressed support for the Basel proposal, though he continued to highlight his concerns regarding the potentially negative impact of the rulemaking on clean

energy tax credit investments. Chair Powell stated that the Federal Reserve is addressing this particular issue.

- **Sen. Kevin Cramer (R-ND)** contended that prudential regulators' principles for climate-related financial risk management for large financial institutions are outside their statutory authorities. Chair Powell countered that the principles are part of the Fed's mission to ensure the safety and soundness of banks.
- Sen. Daines raised concerns about the impact of prudential regulators' long-term debt proposal, arguing that it would disproportionately impact small regional lenders. Chair Powell explained that the proposal is intended to make regional lenders more resolvable since they are not subject to the living will process.
- Sen. Daines observed upcoming changes to liquidity ranks, including a new "ultra short-term" liquidity requirement. Chair Powell indicated that — in response to the 2023 failures — the central bank is examining liquidity innovations but caveated that the Fed is still weighing timing as it deals with other rulemakings.

Emergency Lending & Supervision

- Sen. Warner remarked that he plans to introduce legislation that would mandate that banks use the Fed discount window. Further, he pondered whether the discount window should be kept open 24 hours every day. Chair Powell agreed that the discount window needs to be updated technologically and that the stigma surrounding its use must be eliminated.
- **Sen. Catherine Cortez Masto (D-NV)** asked how the Fed is working with the Federal Home Loan Banks (FHLB) to establish protocols to ensure that banks establish protocols to borrow from the discount window prior to stress. Chair Powell stressed the importance of ensuring that banks understand how to tap the discount window, as well as having sufficient collateral. He remarked that the FHLB system is ahead of the Fed in terms of technology, underscoring the importance of improving the technology behind the central bank's emergency lending.
- Chair Brown asked about steps the Federal Reserve has taken to strengthen its supervisory efforts in the aftermath of the 2023 bank failures. Chair Powell indicated that the Fed is taking a comprehensive approach to shoring up its supervisory efforts, including developing a new rule book and practices.

Housing & Insurance

- Sen. Menendez noted that the Fed's Monetary Policy Report attributes the housing supply shortage to restrictive zoning laws, high interest rates, and tighter underwriting by banks. Sen. Menendez also believed that underfunding of the Department of Housing and Urban Development (HUD) affordable housing programs has contributed to the supply shortage. Chair Powell agreed that the supply shortage will continue to put upward pressure on housing prices.
- **Sen. Tina Smith (D-MN)** urged congressional action to expand the housing supply. She also asked Chair Powell whether interest rates are sufficiently high to bring housing demand in greater balance with supply. The Fed Chair explained that homeowners who have purchased houses with low interest rates are hesitant to sell, thereby constraining the supply and contributing to inflation. While he expected lower interest rates to bring down housing prices, he continued to raise concerns about the underlying supply problem.

- **Sens. Laphonza Butler (D-CA), Jon Tester (D-MT)**, and Warnock echoed concerns voiced by other Democratic senators about housing and rental affordability.
- As insurance providers withdraw from California, Sen. Butler stressed her worries regarding gaps in homeowner insurance coverage because of climate change. She asked the Fed Chair to speak on the impact of gaps in insurance coverage on the financial stability of the economy. Chair Powell described home and auto insurance as a "significant" source of inflation in the last few years.

Nonbanks & Commercial Real Estate

- **Sen. Mark Warner (D-VA)** observed that nonbank lending has exceeded loans from regulated banks, and he asked Chair Powell to opine on the implications of the growth of the nonbank sector. Chair Powell explained that many of the loans from nonbanks are not subject to run risk since the firms are structured as limited partnerships. However, Chair Powell warned that there may be unexpected risks from the nonbank sector that could contribute to a future crisis.
- Sen. Cortez Masto observed potential financial stability risks from the commercial real estate sector. Chair Powell attributed weakness in this sector to an increasing trend toward work from home, which further puts pressure on restaurants and retailers near office buildings. He noted that many banks have made loans to these types of commercial buildings and that the Fed is working with these banks to address concerns.

CBDC

- Sen. Cramer asked Chair Powell to elaborate on CBDCs, which Sen. Cramer opined should seek to emulate cash. Chair Powell remarked that the Fed is "nowhere near" recommending or adopting a CBDC is any form. The Fed Chair noted concerns that the federal government would be able to see all CBDC transactions because they would be conducted through accounts at the central bank, but he assured lawmakers that the Fed would not accept a CBDC designed in this fashion. Instead, Chair Powell indicated that a CBDC would be implemented through banks.
- Chair Powell assured Sen. Lummis that the Federal Reserve cannot introduce a CBDC without congressional authorization.

Interest Rates, Inflation, & Corporate Practices

- Chair Brown pushed Fed Chair Powell to lower rates to prevent an increase in the unemployment rate. In response, Chair Powell reiterated that the central bank is monitoring inflation rates and the economy to determine its interest rate decisions. Additionally, he expected rate cuts this year.
- Chair Brown raised concerns about the use of algorithms by companies that combine competitors' price information to engage in dynamic or surge pricing, which Chair Brown viewed as "price gouging" strategies. Chair Powell indicated that the Fed is monitoring the adoption of this technology and its potential impact on inflation, though he did not seem to believe that dynamic or surge pricing is the same as price fixing.
- Chair Powell answered in the affirmative when Chair Brown asked if it would have helped prevent high inflation if companies — such as auto manufacturers — created more resilient supply chains.

- When Sen. Tester asked Chair Powell whether the Fed can do anything to address food costs, the Fed Chair explained that increasing food costs are largely due to supply chain costs and the price of commodities. Chair Powell anticipated that food inflation would flatten once the labor market cools off.
- Sen. Tillis disagreed with the "shrinkflation" arguments raised by Chair Brown. Instead, he believed that rising food costs are largely due to increasing input costs.
- **Sen. Bill Hagerty (R-TN)** stressed his concerns regarding the federal deficit and its impact on inflation, and he noted that the Fed is engaging in quantitative tapering to reduce its balance sheet. He asked how long it would take for the central bank to shift its holdings toward a larger share of short-term treasuries. Chair Powell responded that it will "take a while," explaining that this is a longer-term aspiration of the central bank.
- Sens. Daines and Lummis echoed concerns about the federal deficit. Later in the hearing, Sen. Fetterman commented that not extending the Tax Cuts and Jobs Act (TCJA) would help to decrease the federal deficit.
- Sen. Lummis was concerned that there is a "disconnect" between how the Fed measures inflation and how consumers experience inflation. Chair Powell countered that the Fed's inflation goal is not based on core inflation but is based on overall inflation, which includes food and energy costs.
- Sen. Van Hollen echoed Chair Brown's comments about corporate "price gouging" and "shrinkflation."
- Chair Powell answered in the negative when **Sen. Raphael Warnock (D-GA)** asked if the Fed is examining whether banks are actually increasing interest rates to benefit consumers' bank deposits.

<u>Other</u>

- When responding to a question from Chair Brown, Fed Chair Powell stated that the central bank is working through recommendations from its Inspector General (IG) to implement guardrails protecting against insider trading by officials.
- **Sen. John Kennedy (R-LA)** raised concerns about reports and allegations of professional misconduct and a toxic work environment at the FDIC.
- Ranking Member Scott continued to voice concerns about the impact of illegal immigration and crime on inflation and the fiscal soundness of local governments. Sen. Menendez later countered the Ranking Member's comments, arguing that immigration has contributed to the growth of the U.S. economy and decreasing inflation.
- Sen. Menendez applauded increasing diversity in the leadership of the Fed.