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Democracy Dies in Darkness

The Fed is cracking down on big banks to guard against risk posed to the financial system from coronavirus

The pandemic downturn marks the first time the Fed has issued such across-the-board limits on the largest banks since the aftermath of the Great Recession

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For the first time since the aftermath of the Great Recession, the Federal Reserve is putting new restrictions on how the country's biggest banks spend capital, with an eye toward protecting the financial system from risks to the economy posed by the coronavirus pandemic.

The Fed ordered the country's 33 biggest banks, including JPMorgan Chase, Wells Fargo and Bank of America, to suspend their stock buyback programs and limit dividend payments to shareholders in the third quarter. The banks must also submit new plans for maintaining enough of the capital needed to survive a downturn.

A Fed analysis of the banks' finances showed that they are in good shape now but that some could struggle in the worst-case scenarios of the economic recovery. "The banking system remains well capitalized under even the harshest of these downside scenarios — which are very harsh indeed," Fed Vice Chair Randal Quarles said in a statement.

However, if there is slower U-shaped recovery or a W-shaped scenario in which a brief recovery is followed by a harsh second drop later this year, several financial firms "would approach minimum capital levels," according to a Fed statement. The banks reviewed could incur loan losses of $560 billion to $700 billion under some scenarios, the Fed found.

Not all Fed board members thought regulators have gone far enough in reining in the banks. Board governor Lael Brainard called on the Fed to block dividend payouts to shareholders during the third quarter, not just limit them.

"I do not support giving the green light for large banks to deplete capital, which raises the risk they will need to tighten credit or rebuild capital during the recovery," wrote Brainard, who was appointed by President Barack Obama. "This policy fails to learn a key lesson of the financial crisis, and I cannot support it."

The Fed's approach "creates a significant risk that banks will need to raise capital or curtail credit at a challenging time," she said.

The Fed was also criticized for not offering bank-by-bank results of its exams. Sens. Brian Schatz (D-Hawaii), Sherrod Brown (D-Ohio) and Elizabeth Warren (D-Mass.), in a Tuesday letter to Quarles and Fed Chair Jerome H. Powell, said that the decision was "highly disconcerting" and that "transparency surrounding the results of the tests is a bedrock principle of the stress testing framework."

The Fed's decision adds to the already bleak reality gripping the American economy during the worst recession since the Great Depression.

As of earlier this month, more than 30 million Americans had claimed unemployment benefits, and more major companies keep filing for bankruptcy each week. Despite trillions of dollars in government stimulus and unprecedented intervention from the Fed, many say an economic recovery hinges most on more intervention from the Fed, many say an economic recovery hinges most on more federal assistance and a vaccine or cure to end to the coronavirus pandemic.

This recession marks the first big test of banking-industry overhaul measures put in place after the last financial crisis. The industry has emphasized that it has significantly more capital to weather a downturn and has not stopped lending to corporations or retail investors.

One key measure has been the periodic “stress test” the largest banks undergo to prove they could survive a hypothetical financial crisis without needing a taxpayer bailout or being forced to stop lending. The scenario for this year’s traditional stress test was published in February, just as the coronavirus pandemic and its economic devastation began to take hold.

But the Fed quickly realized that the extreme scenario it had dreamed up paled in comparison with the escalating crisis. The traditional test looks at how the banks would perform, for example, if unemployment spiked to 10 percent. Now, the official unemployment rate is 13.3 percent, and the real rate is probably three percentage points higher.

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The Fed then developed a separate coronavirus-specific "sensitivity analysis" to test how the banks would perform if the economy recovered at different rates. Roughly a quarter of the banks tested hovered near the minimum threshold for the most severe W-shaped scenario, the analysis showed.

The analysis was used to set across-the-board restrictions on how banks could use their capital, including halting stock buybacks.

Eight of the country's biggest banks, including JPMorgan Chase and Bank of America, had already suspended buybacks earlier this year as the economy slowed down amid the coronavirus. But they had lobbied against restrictions on their dividends. "From our perspective, our dividend is sound, and we plan on continuing to pay it," Citigroup chief executive Michael Corbat told CNBC this week.

The test results "underscore the strength, safety and resiliency of the nation's largest banks," Kevin Fromer, president of the Financial Services Forum, which represents the country's eight largest banks, said in a statement. Big banks "have proven that they can absorb losses and continue to support U.S. businesses and consumers during a time of severe financial stress," he said.

Among the biggest U.S. banks, JPMorgan Chase and Wells Fargo have paid out the most in dividends to shareholders since 2008, about $80 billion each, according to

S&P Global Market Intelligence data. Bank of America paid out about $52 billion and Citigroup about $30 billion during that period.

The Fed board tightened up dividend payments in two ways. Banks cannot pay out more than what was already paid out in the second quarter. They also must limit dividends to a formula tied to recent earnings.

The Fed is requiring all large banks to resubmit and update their plans for holding a capital cushion later this year to account for the current crisis. The move will also help banks take stock of their needs and, down the line, be able to plan through such high uncertainty.

“This approach builds on our existing standards on capital distributions,” Quarles said. “If the circumstances warrant, we will not hesitate to take additional policy actions to support the U.S. economy and banking system.”

Still, given such extreme uncertainty about the economy's future, advocates say the Fed should be more stringent. Dennis Kelleher, chief executive of Better Markets, which advocates stronger market regulation, said the Fed should not allow any capital distributions by banks for at least a year.

"These aren't just stress tests for Wall Street banks," Kelleher said. "These are credibility tests for the Fed."

The Fed was also criticized over transparency. After the traditional stress test, the Fed typically discloses detailed information about how each bank performed and where the banks need to improve. But the "sensitivity analysis" aggregated data from all the companies to determine how the banking system would fare as a whole.

The Fed has said the reason it did not release firm-specific results was that the analysis was conducted differently than a typical stress test. The new approach made it difficult to incorporate specific, variable data, the Fed said. The "sensitivity analysis" also did not incorporate the effects of Congress's efforts to stimulate the economy, including expanded unemployment benefits.

Failing to disclose the individual results of each bank could also mask weaker financial institutions from needed scrutiny, said Gregg Gelzinis, a senior policy analyst for the Center for American Progress, a liberal think tank, who called the decision a "critical weakness."

"This is going to undermine the usefulness of the results," Gelzinis said.