The Independence of Central Bank Supervision

The Hoover Institution

Monetary Policy Conference

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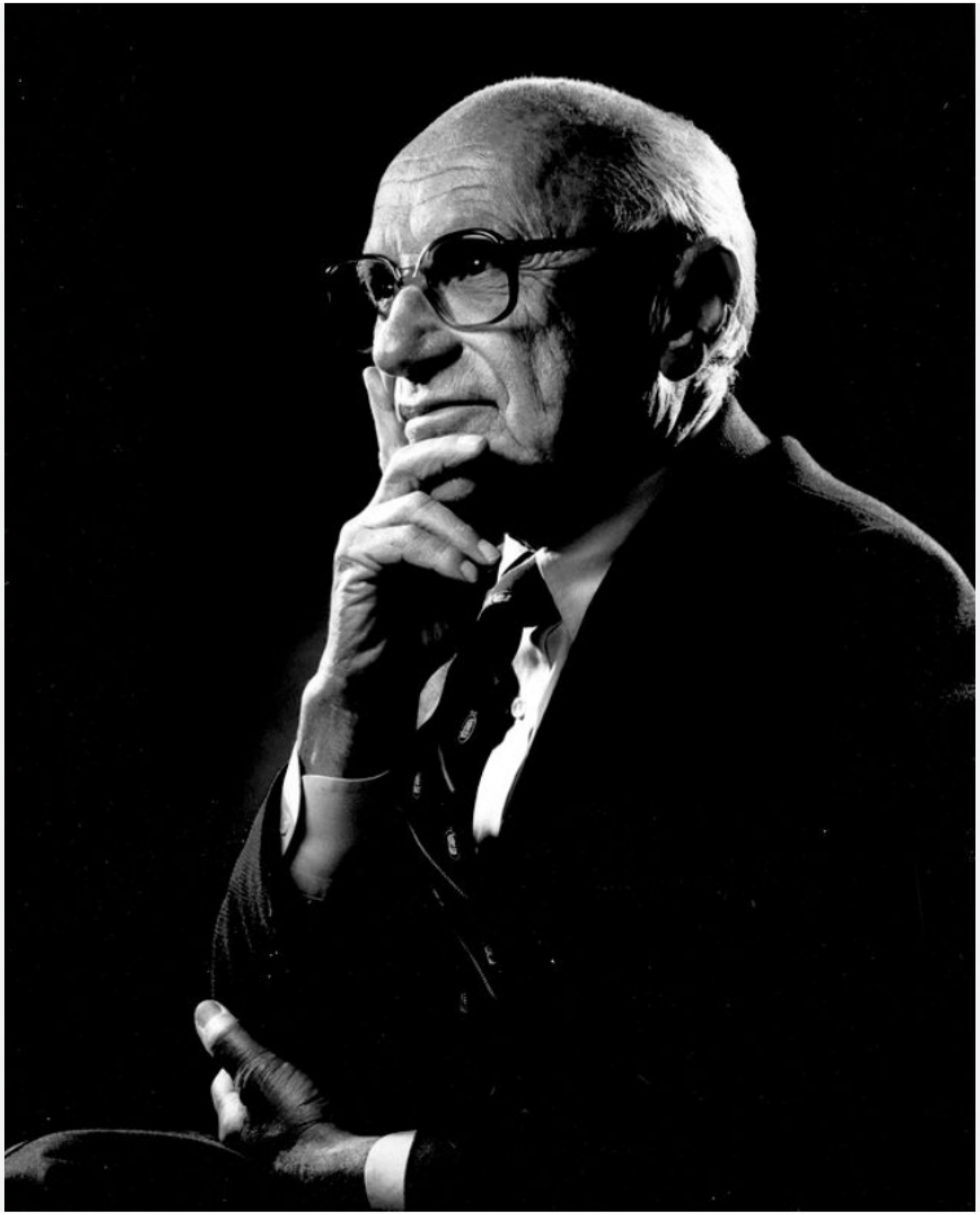
Wharton
University *of* Pennsylvania



A New Era of Supervision and Regulation in Central Banks

- **Central Banks**: "Banking supervision needs to up its game. It needs to identify weaknesses at an early stage and act forcefully to ensure that banks address them. "To do this, supervisors will need to have operational independence, strengthen their forward-looking culture and adopt a more intrusive stance." Agustín Carstens, BIS, June 2023
- **The U.S. Supreme Court**: is "adher[ing] to the general rule that the President possesses the authority to remove those who assist him in carrying out his duties," (Seila Law), and revisiting whether "statutory silence concerning controversial powers expressly but narrowly granted elsewhere in the statute does not constitute an ambiguity requiring deference to the agency" (Loper Bright, cert. petition)

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Supervision vs. Monetary Policy: Summary of the Argument

- Supervision is a **coercive power** of the state.
- "Financial Stability" and "Safety and Soundness" are **undefined** (and thus capable of conferring limitless discretion).
- S&R policy is closely aligned with global policy set at Basel, which has **no democratic input** from Congress.
- S&R policy does in fact often **track administration** policy.
- The VCS is a de facto **single director.**

The Vice Chair for Supervision and Presidential Removal

- "The Vice Chairman for Supervision shall develop policy recommendations for the Board regarding supervision and regulation of depository institution holding companies and other financial firms supervised by the Board, and shall oversee the supervision and regulation of such firms." **Dodd-Frank Act, § 242**
- Four-year term of office as VCS, fourteen as BOG member. Enjoys "for cause" protection from removal.
- **Senator Warren**: The press also reported this as your agreement to defer to the Vice Chair for Supervision, so I want to ask you a specific example of how that deference would work in practice.
- **Chair Powell**: So, let me just say that what the law does is, the law gives the Vice Chair for Supervision the authority to set the regulatory and supervisory agenda, and I would expect to have a perfectly normal, good, constructive working relationship with a new Vice Chair for Supervision. I would not see myself as stopping those kinds of proposals from reaching the Board, since the law seems to indicate that that's the job of the Vice Chair for Supervision.

The Vice Chair for Supervision and Presidential Removal

- "[T]he President's power to remove—and thus supervise—those who wield executive power on his behalf follows from the text of Article II" and is therefore "the rule, not the exception." Seila Law v. CFPB, 140 S. Ct. 2183, 2206 (2020)
- Exception 1: a "group of principal officers" – the VCS is effectively a single director of Fed supervision.
- Exception 2: "inferior officers" – the VCS wields paradigmatic 'executive power.'

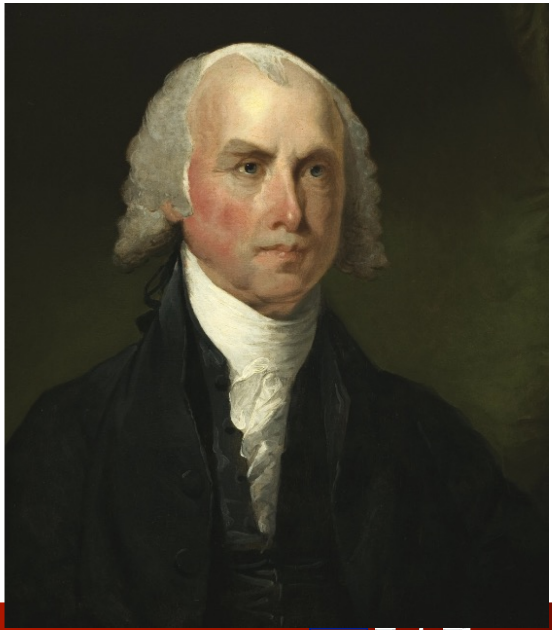
Supervision and Discretion

- Since 2020, tremendous pressure on central banks to engage in **greening**.
- Fed lacks a mandate for climate/sustainability; Chair Powell confirms in January 2023 that, where monetary policy is concerned, the Fed will be "**sticking to our knitting**."
- Financial stability is much woolier and can be flexed to explore climate risk as a financial stability risk, despite **the lack of express mandate to do so**.
- Hence, the creation of two supervisory committees to **study climate risk in banks,** climate **scenario analysis** pilot, issuance of **supervisory principles** (i.e., guidance) on climate risk management, **Basel III endgame** super-charges for 'operational risk'.

But financial stability risk presumes the risk of insolvency at a large or critically interconnected bank(s) – in 2021, these banks had <5% of their balance sheets exposed to big carbon producers. Equity capital 2-3x hypothetical write-downs; so, these banks would be plenty solvent even assuming 100% losses on those loans. *The state must justify its interventions in private life in a society bound by the rule of law.*

Supervision and the Rule of Law

- If only a "general conveyance of authority, without laying down any precise rules," could justify sweeping agency action, "it would follow, that the whole power of legislation might be transferred by the legislature from itself, and proclamations might become substitutes for laws."
- **James Madison, Report of 1800**



What to do?

- At will removal of the VCS
- Structural separation of supervision and monetary policy
- Better line-of-sight from Congress to RB's implementation of supervisory policy