May 30, 2018

The Honorable Sherrod Brown
United States Senate
Washington, D.C. 20510

Dear Senator:

Enclosed are my responses to the written questions you submitted following the May 15, 2018[1], hearing before the Committee on Banking, Housing, and Urban Affairs. A copy has also been forwarded to the Committee for inclusion in the hearing record.

Please let me know if I can be of further assistance.

Sincerely,

Enclosure

---

[1] Questions for the record related to this hearing were received on May 23, 2018.

Questions for Ms. Michelle Bowman, Member-Designate, Board of Governors of the Federal Reserve System on behalf of Ranking Member Brown:

1. What is your view on what caused the 2008 financial crisis? What responsibility does the Federal Reserve share in terms of failures in regulatory and supervisory policy?

A build-up of leverage and maturity transformation in the years leading up to the crisis left the U.S. and global economy vulnerable to shocks. When the housing market turned down, the effects of that shock were amplified as leverage was wound down and funding patterns shifted. The result was what we all painfully experienced as the financial crisis.

Since then, post-crisis reforms have been designed to reduce the likelihood and severity of future financial crises. These efforts have been aimed at shoring up issues in the private sector, in regulation, and in the mandates and tools of the various regulatory agencies, including the Federal Reserve.

The Federal Reserve's response to the crisis included boosting the resilience of the financial system through stronger capital, liquidity, and other prudential requirements for large banking firms. Capital is critical to ensuring resiliency, as are the availability of high-quality liquid assets, appropriate management of risks, and the presence of a plan for resolution in case it is needed. Progress has been made in all of these areas, and newer tools like the stress testing regime and the countercyclical capital buffer should also contribute to the resiliency of the financial system going forward. I believe these actions have, broadly speaking, increased the resilience of the financial system.

2. How did large bank and investment bank leverage contribute to the 2008 financial crisis?

The increase in leverage, along with the rise of other vulnerabilities, contributed to the negative effects that were felt when the housing market turned down sharply in the United States. As the crisis unfolded in the Spring of 2008, markets were focused on the firms that had the highest leverage ratios, and it was one of the factors that led to investors putting more pressure on some firms than others.

It would be a mistake, however, to focus only on leverage. Maturity transformation, for example, also played a critical role, as did other vulnerabilities. Many firms relied on short-term wholesale funding that they then used to purchase longer-term assets. When that funding dried up, firms had difficulty finding new financing for those assets. As a result, assets were sold, and the effects were felt throughout the financial system and in the real economy.

3. How would you characterize current risk-weighted and leverage capital levels for the largest U.S. banks – too low, too high, or the correct amount?

Maintaining the safety and soundness of the largest U.S. banks is fundamental to maintaining the stability of the U.S. financial system and the broader economy. To be safe and sound financial institutions, these firms must be well-capitalized. The U.S. banking agencies have substantially strengthened regulatory capital requirements for large banking firms, improving the quality and increasing the amount of capital in the banking system. Indeed, large U.S. banking firms have roughly doubled their capital positions from before the crisis to today, making them significantly more resilient, as well as able to support lending and financial intermediation in times of financial stress. If confirmed, I look forward to looking more closely at this question and consulting with my colleagues.

4. As you know, the Federal Reserve recently proposed reducing leverage requirements for the eight biggest U.S. global systemically important banks (GSIBs).1 In discussing the impact of its proposal, the Federal Reserve noted that it would reduce the amount of tier 1 capital required across the lead insured depository institution (IDI) subsidiaries of the GSIBs by approximately $121 billion.

- **Could a reduction in IDI capital pose any risks to depositors, taxpayers, or financial stability? Why or why not?**

While capital is good for absorbing losses, the manner in which capital requirements are determined can have important consequences. If a leverage ratio becomes a binding constraint, it can create incentives for banking organizations to reduce their participation in lower-risk, lower-return business activity, such as repo financing, central clearing services for market participants, and taking custody deposits, notwithstanding client demand for those services. Similarly, it can create incentives for firms to increase their participation in higher-risk, higher-return activities.

- **What is your view on raising the enhanced prudential standards threshold pursuant to Dodd-Frank section 165 from $50 billion to $250 billion in total consolidated assets, as contemplated in S.2155?**

I agree that regulation and supervision should be tailored in a manner that allows the financial system to more efficiently support the real economy. The Federal Reserve has been working for many years to tailor regulation and supervision to the size, systemic footprint, and risk profile of individual institutions. Recognizing the levels and types of risk of the different institutions in the financial system improves the quality and efficiency of regulation, but I believe more tailoring can and should be done.

It is reasonable for Congress to raise the $50 billion asset threshold to limit the scope of the enhanced prudential standards to larger bank holding companies. My understanding is that the Economic Growth, Regulatory Relief, and Consumer Protection Act (Act) preserves the ability of the Federal Reserve to reach below the new $250 billion line, if warranted, to subject a firm to more stringent regulation. In general, the Act preserves the Federal Reserve's ability to adequately monitor and regulate systemic risk of banking firms as well as its ability to regulate banking firms for safety and soundness objectives.

- **Federal Reserve Vice Chair Quarles has said that the Volcker Rule "is an example of a complex regulation that is not working well."2 Do you agree or disagree? Why?**

---

[1] https://www.federalreserve.gov/newsevents/pressreleases/bcreg20180411a.htm.

[2] https://www.reuters.com/article/us-usa-fed-quarles/u-s-considering-material-changes-to-volcker-rule-feds-quarles-idUSKBN1GH2U8.

While Congress recently enacted legislation excluding smaller firms from the Volcker Rule, there is still room for the Federal Reserve and the other responsible agencies to tailor and reduce regulatory requirements to more efficiently implement the policy objectives of the statute in a manner consistent with the safety and soundness of the banking system. It is worthwhile for the agencies to consider further tailoring the implementing rule as it applies to firms that do not engage in a large amount of trading activity, and to simplify the requirements for satisfying exemptions for permitted activities such as hedging, market making, and underwriting. These changes would provide clarity to banking organizations and help them more efficiently provide market liquidity and facilitate capital formation.

- **What is your view of the Community Reinvestment Act? Does it need to be altered or modernized by the Federal Reserve? If so, what changes do you support?**

The Community Reinvestment Act's (CRA) goal of encouraging banks to meet their obligation to serve their entire community, including in low-and moderate-income communities is critically important. All communities, particularly low-and moderate-income communities, thrive when they have access to credit on fair terms that increase opportunities for investing in homes, starting businesses, and education.

I believe that the current CRA supervisory and regulatory framework could be improved based on feedback from industry and community stakeholders, and that it is time to review the CRA regulations to ensure they are effective in achieving the important objectives set by Congress. In particular, the regulation's definition of "assessment area," should be revised to reflect significant changes in the banking landscape since CRA was enacted and the current CRA regulations were adopted.

Technology and other industry advancements have enabled banks to serve consumers in areas far from their physical branches. As such, it is sensible for the agencies to consider expanding the assessment area definition to reflect the local communities that banks serve through delivery systems other than branches.

I believe that additional input and analysis on this matter will be needed to determine how best to define such assessment areas and how to evaluate performance in those areas.

5. On May 23, the FDIC released their Quarterly Banking Profile. It shows that that bank profits increased 28 percent over the last year, and even more for community banks.

- **Do you think it is sound policy to reduce capital requirements for banks that have profit levels this high?**

We need a resilient, well-capitalized financial system that is strong enough to withstand even severe shocks and support economic growth by lending through the economic cycle. To that end, the U.S. banking agencies have substantially strengthened regulatory capital requirements for U.S. banking firms, improving the quality and increasing the amount of capital in the banking system. At the same time, it is important to monitor the capital rules on an ongoing basis, to determine whether the framework is effectively measuring and addressing risk and working as intended, and to adjust the framework as needed.

- **If confirmed, you will be a member of the Federal Open Market Committee. What experience will you bring to this role? Are there any changes in how monetary policy is currently conducted that you will advocate for?**

The Federal Reserve's mandate to promote maximum employment and stable prices is critically important to our economy, to businesses, families and communities, and if I am confirmed, I will be very focused on how we can do the best job possible to fulfill that mandate.

My views on employment and the labor market have certainly been shaped by the experience of the last 10 to 15 years. We've seen the nation go from high levels of employment and solid wage growth into a very deep recession. In the crisis, it was clear that many people who were able to work lost their jobs and could not find work, and businesses that had the capacity to produce and grow could not find a market for their goods and services. And when you have a huge gap between what the economy can do and what it is currently doing, I believe that is where policy makers like the Federal Reserve can take appropriate action, sometimes quite strong action, and help the economy get back to a more normal level of employment and output.

Of course, as I have seen in my career as a community banker and as a regulator, the labor market, in a large, diverse economy like ours, is quite complicated and there are many factors to consider in measuring its health. For example, who is available to work and what can they do? I have worked with businesses that have trouble hiring, because there may be a shortage of highly skilled workers. In some communities in my home state, there are demographic changes--an aging workforce, for example--that affects how much businesses can hire. My family's bank lends to many consumers, and often we have seen that a strong job market will bring people back into the workforce and that is a good thing. And, of course, when there is strong demand for workers and the economy is growing, we see wages begin to grow. A strong economy supports strong wage growth.

Given the complexity involved in looking at the labor market, common sense tells me to be careful in assuming there is a precisely right level of employment that we can be very confident in saying is the right level for all economic conditions. In general, my approach as a community banker and regulator has been to take a look at all the best evidence and analysis you can find, listen hard to many different views, and then make your best judgment. And that is how I will approach evaluating the health of the labor market, should I be confirmed.

Stable prices and the level of overall inflation is a critical part of the dual mandate and, should I be confirmed, I will be focused on achieving this important goal. When inflation gets too high or too low, or is too volatile, that hurts everyone--consumers, businesses, and communities--because making economic decisions and planning for the future becomes more and more difficult.

I think one of the most important things the Federal Reserve can do is make sure that the expectations that people have for where inflation is heading remain stable. As a banker, I never wanted people to be put in a position where they were coming into my bank and showing me a business plan where they were just unable to predict what price they would be paying for a very broad range of important goods and services a year or two from now. Of course, some prices will always be going up while others will be going down. That is just how markets work. What is important is that the general level of prices remains fairly predictable. When people borrow money or make plans, it is important that they feel confident that their future incomes will support that debt and those plans. I want people focusing on making good business decisions, not spending their time guessing about inflation. So keeping inflation and inflation expectations stable is very important to me.

I also think we have learned that inflation can be too low. If demand is weak for a prolonged period of time, businesses cannot sell goods, they lower prices further, lay people off, keep wages down. And we have seen that is a tough cycle to break free from. For the Federal Reserve, when you get interest rates very low, it is hard to create additional incentives for borrowing and investing. It is tough to go below zero. As a policy maker, I would want to make sure we keep inflation at an appropriate level, so we reduce our risk of getting back to the so-called Zero Lower Bound.

Finally, let me just say that there is a great deal of complexity that goes into understanding why the general level of prices change. For example, Kansas produces a lot of oil and natural gas, so I am well aware of how swings in the supply and demand for commodities can shape prices. But it is not always clear how businesses and consumers set their expectations for inflation. Productivity and technological change affect prices too. This is an important area for more research, and I look forward to learning more about these topics, if I am confirmed.

- **Since the crisis, do you think the Federal Open Market Committee has been on the right course by gradually increasing interest rates?**

I believe the Federal Open Market Committee's (FOMC) monetary policy decisions should be guided strictly by its responsibilities under current law to promote maximum employment and price stability. The FOMC has been raising its target for the federal funds rate since December 2015 and reducing the size of its holdings of Treasury securities and mortgage-backed securities since October of 2017. The FOMC's gradual approach to reducing monetary accommodation in this way has been instrumental in supporting the economic recovery and a return of inflation to the FOMC's 2 percent objective. The FOMC has also stressed and I also believe that it is appropriate that monetary policy is not on a preset course. Instead, it is data dependent and chosen to best achieve the objectives set forth by Congress. If confirmed, I would look forward to working with other members of the FOMC to further promote the attainment of the FOMC's statutory goals.

6. As you know, the Federal Reserve currently uses a variety of monetary policy rules, including the Taylor rule, in its analysis and monetary policy decisionmaking, but does not rely solely on rules to determine interest rate adjustments.

- **Do you agree with the Federal Reserve's current approach, or will you advocate that the Fed use a single rule?**

The economy is very complex, and monetary policy is determined in an environment in which a multitude of indicators and conditions must be taken into account. Simple rules, by definition, cannot accommodate such a wide variety of considerations. For example, simple rules generally do not accommodate variation in the expectations of investors and consumers, risks to the economic outlook, or deep economic conditions such as productivity growth that may be timevarying. All that said, simple monetary policy rules do have some appeal because they capture some key elements of appropriate policy, and I believe that it is useful for policy makers to routinely consult the recommendations from a variety of benchmark rules. I also believe it can be useful for the FOMC to explain to Congress and the public the differences between its policies and those prescribed by simple rules, and the reasons for those differences.

- **While the unemployment rate continues to fall, the labor force participation rate remains at about its lowest level in 40 years. What do you think is contributing to this?**

The labor market remains strong. Job gains have been solid, on average, in recent months, and the unemployment rate has fallen to 3.9 percent, the lowest level in many years. As you note, however, the labor force participation rate is still quite low by historical standards. To some extent, the downward trend in the overall participation rate reflects demographic forces, most prominently increased retirements among members of the large baby boom generation. However, the labor force participation rate for prime-age workers is also below its level prior to the financial crisis, although it has risen more recently in response to the tight labor market. Longer-term trends in globalization and automation have likely contributed to the decline in prime-age participation over time, but my hope and expectation is that a strong labor market will continue to pull many of these workers back into the labor force.

- **Do think the opioid addiction epidemic is related to the decline in labor force participation among prime-age workers?**

The opioid epidemic is a very serious crisis that has had severe consequences for the affected individuals and their families. In addition, the opioid epidemic undoubtedly has had adverse effects on the economy. For example, I think the evidence shows that opioid addiction adversely affects an individual’s ability to participate effectively in the labor market and thus has contributed to the decline in labor force participation among prime-age workers. Of course, causality may go the other way as well, with a lack of job opportunities, particularly in rural areas, contributing to both withdrawal from the labor force and increased opioid abuse.

- **Over the past forty years the link between productivity and wage increases has eroded. More and more, productivity gains aren’t shared with workers. Why do you think wage growth has not kept pace with productivity growth? Is there anything the Fed can do to increase wages? Can the Federal Reserve, through monetary policy or regulatory policy, do more for individuals and communities that have not experienced the benefits from the economic recovery?**

Wage growth is a very important issue, and while it is encouraging that wages seem to be rising a little faster than a few years ago, I would like to see stronger wage growth. In addition, I think that, as the economy improves, it is important that a wide range of individuals and communities benefit from a strong labor market. However, monetary policy is a blunt tool that is not well equipped to affect specific sectors of the economy. Rather, the Federal Reserve can best help individuals and communities by focusing on achieving its dual mandate of full employment and stable inflation.

- **If confirmed, how will you advocate for increased diversity in the Federal Reserve System?**

There is great value in having a diverse workforce at all levels of an organization. Diversity, including diversity of thought, perspective, and experience, is an important attribute of all successful organizations. Better decisions are made when we have a wide range of backgrounds and voices to draw from.

I am committed to achieving further progress, and to better understanding the challenges to improving and promoting diversity of ideas and backgrounds at the Federal Reserve Board (Board) and the Federal Reserve Banks (Reserve Banks), including in the senior leadership ranks. My position will provide opportunities to meet and speak with individuals and groups throughout the System, the financial community, and regional and community organizations. Those opportunities will enable me to express strong support for the System's initiatives to encourage individuals with diverse cultural, academic, and professional backgrounds to consider positions with the Federal Reserve. I will also welcome the opportunity to work with Board and System groups to enhance programs and initiatives to identify and recruit individuals with diverse backgrounds and perspectives for careers at the Board and the Reserve Banks, as well as to create an environment where all will be successful.

- **Federal Reserve Board of Governors nominee Marvin Goodfriend, has recommended that the "central bank put in place systems to raise the cost of storing money by imposing a carry tax on its monetary liabilities." Do you believe that there should be a currency tax, or that there are financial conditions that would call for a currency tax?**

The United States dollar enjoys a well-earned status as a store of value and a reliable means of exchange both domestically and across the world. Any new policy that could undermine the confidence that is placed in the dollar should be thought through very carefully and undertaken only after a great deal of study. Fortunately, the United States economy is strong and inflation is close to 2 percent, so there is no need to consider such a policy. Moreover, the Federal Reserve's main monetary policy tools have helped to meet the goals set forth for the Federal Reserve by statute.

- **Please provide a complete list of The Bowman Group's clients.**

The Bowman Group provided consulting services to the following entities in the United Kingdom and European Union between 2004 and 2009: UK Industry and Parliament Trust; Titan Corporation, UK LTD; Conservative Shadow Homeland Security Spokesman Patrick Mercer, MP (Homeland Security Advisory Panel); DKE Aerospace; Conservative Friends of America; and Localis.

- **Please describe in detail greater than you provided in your Office of Government Ethics letter how you will comply with the Federal Reserve Act requirement that you cannot hold stock in any bank, banking institution, or trust company?**

I will divest shares of bank stock currently held in my name in accordance with the ethics agreement following confirmation. In addition, following confirmation, in accordance with the ethics agreement, the two trusts containing bank stock will be rewritten with advice of counsel according to a provision in Missouri trust law that provides for "decanting"--or rewriting--the trusts to exclude me and my heirs as beneficiaries of the trusts. While serving as a member of the Board, I will not acquire any stock in a bank, banking institution, or trust company.

- **If confirmed, do you intend to serve for the entirety of your term?**

Should I be confirmed, I intend to serve the entirety of the term.

- **After your term as a member of the Federal Reserve Board of Governors, do you have any plans to resume employment or serve on the Board of your family's bank?**

At this time, I do not intend to, nor have I been asked to, return to employment or board service at my family's bank.

7. This is the first time this Committee has considered a nominee to fill the position on the Fed Board "with experience working in or supervising community banks having less than $10,000,000,000 in total assets."

- **If confirmed, do you believe it is your role to advocate for the community banking industry?**

The Federal Reserve seeks to foster a strong and stable financial system that serves banking needs in a fair and transparent manner. I believe that this objective can best be achieved when we have a diversified and competitive banking industry that includes a healthy community bank segment. My experience as a banker and state supervisor has shown me the vital role community banks play in providing credit and services to small businesses and communities both large and small. Consequently, I believe it is important to support the community bank model and avoid imposing regulatory burdens that are unnecessary to ensure their safe, sound, and fair operation.

- **If confirmed, what would you like to achieve for community banks?**

I am strongly committed to working to tailor the regulation and supervision of community banks in a manner that ensures their safety and soundness but is appropriate to their size and simplicity. I am particularly interested in working on simplifying capital rules for these banks and reducing the burden of their regulatory reporting requirements. As a community banker and state bank supervisor, I have seen small banks struggle with the burdens imposed by regulation. If confirmed, I want to ensure that the Federal Reserve Board fully considers the perspectives and challenges faced by these banks when it formulates and implements its regulations.

- **Can you clarify your answer to Senator Scott on whether or not you believe the stock market is a pillar of monetary policy?**

Current law requires the Federal Reserve's monetary policy decisions to be guided by its obligation to promote maximum employment and price stability. Many factors must be considered as inputs into monetary policy decision making, and the financial conditions facing business and households, including stock market performance, are often relevant aspects of the outlook for macroeconomic performance. However, the FOMC should not take into account stock market performance for any purpose outside of what is necessary to achieve its goals as established by Congress. Fortunately, the United States economy is strong and inflation is close to 2 percent, and financial market conditions currently appear sufficiently accommodative to further support macroeconomic performance.