Opinion **Coronavirus**

Force global banks to suspend bonuses and payouts

This simple step would free up trillions of dollars of additional lending capacity

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Sheila Bair is calling for systemically important banks to follow the example of eight US institutions and suspend share buybacks, then go even further © FT montage; Bloomberg; AP; Getty Images

Sheila Bair YESTERDAY

This article is part of a series in which leading commentators and policymakers give their views on alleviating the devastating global slowdown

The writer is a former chair of the US Federal Deposit Insurance Corporation

As the coronavirus pandemic shuts down international commerce, central banks must act decisively to prevent it from triggering a global financial crisis. So far, they have cut interest rates, expanded asset purchases and pumped trillions of dollars into short-term debt markets. But flooding the financial system with liquidity, while important, is not enough. They also need to shore up the capital base of the banking system. To help do that, they should require that all global systemically important banks suspend discretionary bonuses, dividends, and share buybacks, as recommended by the Systemic Risk Council of former regulators.

Big banks throughout the world are substantially exposed to the pandemic, particularly as it hurts corporate borrowers. At approximately $70tn, debts owed by non-financial businesses have rocketed. These "real economy" companies span every industry, including the hard-hit energy, transportation, retail, and hospitality sectors. To survive, they are increasingly hoarding cash and tapping into their massive back-up lines of credit, placing additional strain on the banking system. As bond markets seize up, access to bank credit may be their only source of financing to support operations and avoid wholesale lay-offs.

Big banks need to be positioned to absorb impending losses, while simultaneously expanding their balance sheets to support the real economy. They need to remain solvent so that they can continue to lend as the crisis unfolds.

As an important first step to achieve this, the US Federal Reserve and other central banks should take co-ordinated action to require systemically important banks to build their capital buffers by retaining their earnings. This means that such banks would suspend all capital distributions, including discretionary bonuses to top executives, until the global economy starts to recover.

This simple step, which would include dividends and share buybacks, would potentially free up trillions of dollars of additional loan capacity.

To give a sense of the magnitudes involved, last year big banks globally paid out about $325bn in share buybacks and dividends. In the US alone, regulators have approved buybacks and dividends at the eight largest banks for the 12 months beginning 1 July 2019 totalling approximately $155bn. As a rule of thumb, $1 of capital supports $16 of lending. If that $155bn was kept on US bank balance sheets, it could increase lending capacity by $2.4tn.

These eight banks recently said that they will suspend share buybacks until at least the end of the second quarter of 2020. This is a welcome gesture, but it is too little too late — and it only applies to share buybacks, not dividends or executive bonuses. Moreover, it only lasts for a few short months, with each bank free to reinstate buybacks at any time.

We should be wary of such voluntary measures given the relentless (and successful) lobbying by big banks in recent years to chip away at capital rules. A longer, comprehensive and co-ordinated central bank-directed suspension of capital distributions is necessary.

Calls to increase bank capital and curb bonuses are nothing new. For years current and former regulators — including former Fed chair Janet Yellen and myself, a former chair of the US Federal

Deposit Insurance Corporation, plus many others — have urged the US central bank to trigger so-called countercyclical capital buffers. This is a financial stability tool that requires banks to hold higher levels of loss-absorbing capital towards the end of an economic cycle.

Had the Fed deployed this tool, the big US banks would now have a stronger capital base to support the economy. Instead, the Fed has allowed them to reduce capital with shareholder distributions exceeding earnings, on average.

In fact, just this month, the Fed finalised a rule that relaxes certain stress testing standards, substantially reducing current minimum requirements, including a $100bn reduction in required tier one capital. With astonishingly bad timing, the Fed eliminated a requirement that banks have sufficient capital to expand lending in a period of economic stress, such as this one.

In the years leading up to the 2008 financial crisis, big banks were among corporate America's most generous dividend payers. Indeed, Citigroup — which received the biggest bailouts among the large banks — did not even halt dividend payouts until it was forced to do so by the government in November 2008.

This time around, central banks should act before banks start falling into trouble. Requiring them to retain their earnings will be an important step in ensuring that the banking system does not let the public down again.

Gaurav Vasisht contributed to this article