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NOMINATION OF JANET L. YELLEN

HEARING

BEFORE THE

COMMITTEE ON
BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

ONE HUNDRED THIRTEENTH CONGRESS

FIRST SESSION

ON

NOMINATION OF JANET L. YELLEN, OF CALIFORNIA, TO BE CHAIRMAN OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

NOVEMBER 14, 2013

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C O N T E N T S

THURSDAY, NOVEMBER 14, 2013

NOMINEE

NOMINATION OF JANET L. YELLEN, OF CALIFORNIA, TO BE CHAIRMAN OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

THURSDAY, NOVEMBER 14, 2013

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:01 a.m., in room SD–106, Dirksen Senate Office Building, Hon. Tim Johnson, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN TIM JOHNSON

Chairman JOHNSON. I call this hearing to order.

Today we consider the nomination of the Honorable Janet Yellen to be Chair of the Board of Governors of the Federal Reserve System for a term of 4 years.

Dr. Yellen is an extraordinary candidate to lead the Federal Reserve. She currently serves as a Member and Vice Chair of the Board of Governors; she previously served as a Member of the Board of Governors in the 1990s; she was the Chair of President Clinton's Council of Economic Advisers; and she served 6 years as the President of the San Francisco Fed.

In addition, Dr. Yellen has an impressive academic record. She is a professor at Berkeley's Haas School of Business and was previously a professor at Harvard University, as well as a faculty member at the London School of Economics. Dr. Yellen graduated summa cum laude from Brown University and received her Ph.D. in economics from Yale.

Dr. Yellen's nomination is especially timely as our Nation struggles with high unemployment in the wake of the Great Recession. She has devoted a large portion of her professional and academic career to studying the labor market, unemployment, monetary policy, and the economy.

Dr. Yellen also has a strong track record in evaluating trends in the economy; her economic analysis has been spot-on. The *New York Times* recently noted that she was "the first Fed official, in 2005, to describe the rise in housing prices as a bubble that might damage the economy. She was also the first, in 2008, to say that the economy had fallen into a recession."

These forecasts were not an anomaly. The *Wall Street Journal* recently analyzed 700 predictions made between 2009 and 2012 in speeches and congressional testimony by 14 Federal Reserve policy makers and found Dr. Yellen was the most accurate. Such accurate economic judgment would be a tremendous quality of a Fed Chair.

Dr. Yellen has proven through her extensive and impressive record in public service and academia that she is most qualified to be the next Chair of the Federal Reserve. We need her expertise at the helm of the Fed as our Nation continues to recover from the Great Recession, completes Wall Street reform rulemakings, and continues to enhance the stability of our financial sector.

I am excited to cast my vote to confirm her as the first woman to serve as Chair of the Federal Reserve, and when we vote on the nomination, I urge my colleagues to do the same.

I now turn to Ranking Member Crapo for his opening statement.

STATEMENT OF SENATOR MIKE CRAPO

Senator CRAPO. Thank you, Mr. Chairman, for holding today's hearing on the nomination of Dr. Yellen to be the next Chair of the Federal Reserve Board. Today's hearing is an opportunity not only to examine Governor Yellen's qualifications but also her views on the role and direction of the Federal Reserve.

In recent years the Fed has engaged in unprecedented policies, including purchasing trillions of dollars in Treasuries and mortgage-backed securities. Current Fed purchases total up to $85 billion a month. As a result, the next Fed Chair will inherit a balance sheet that currently stands at approximately $3.8 trillion, four times higher than before the financial crisis.

As I think everyone knows, I have been a long-time critic of the Fed's quantitative easing purchases. Now that a reduction in asset purchases finally seems to be on the horizon, I am concerned that markets have become overly reliant on them. That is why it is essential to know how Dr. Yellen, if confirmed, would manage the process of normalizing our monetary policy. The Fed has indicated that it will hold short-term interest rates low for an extended period. In a speech in April, Governor Yellen stated, "The policy rate should, under present conditions, be held lower for longer." But how long is too long?

The extended period of low rates is hurting individuals living on fixed-income investments and defined benefit pension funds. The International Monetary Fund cautioned that the actions taken by central banks are associated with financial risks that are likely to increase the longer the policies are maintained.

How would the Fed ensure that these risks are avoided under Dr. Yellen's chairmanship? In addition to unprecedented monetary policy, the next Fed Chair will finalize several key financial regulatory reform rules. These rules must balance the financial stability with the inherent need for markets to take on and accurately price risk. They must be done without putting the U.S. markets at an undue competitive disadvantage or harming consumers with unintended consequences.

The Chair of the Federal Reserve must understand how different rules interact with each other, what impact they have on the affected entities and the economy at large. Just as some worried that we did not have another regulations on the books to prevent the economic crisis, some of us worry now that the post-crisis response will result in a regulatory regime that stifles growth and job creation.

The Chair of the Federal Reserve must know and understand the need for that balance and how to carefully manage competing demands without harming the economy. The U.S. banking system and capital markets must remain the preferred destination for investors throughout the world.

During previous hearings, I have asked Chairman Bernanke what parts of Dodd-Frank could be revisited on a bipartisan basis. The Chairman identified the end user and swaps push-out provisions as well as the need for regulatory relief on small banks. Chairman Bernanke also commented in July that legislation is needed to allow the Fed flexibility to deal with the Collins amendment and tailor appropriate capital requirements for insurance companies.

I look forward to hearing Dr. Yellen's views on what Dodd-Frank fixes Congress ought to consider and how she intends to achieve an appropriate balance between the prudential regulation and economic growth, if confirmed.

In addition to the previously mentioned issues, the makeup of the Board itself will change in the near future. Governor Sarah Bloom Raskin has been nominated to a position at Treasury, and Governor Elizabeth Duke resigned in August. If Governor Yellen is confirmed as Chair, the Fed will need a new Vice Chair. Moreover, Dodd-Frank created a Vice Chair of Supervision, which has not yet been officially filled. These appointments will shape the direction of the Federal Reserve policymaking for years to come.

I look forward to working with the Chairman to see these positions are filled in a way that provides the proper balance and expertise at the Fed.

Thank you, Mr. Chairman.

Chairman JOHNSON. Thank you, Senator Crapo.

Senator Crapo and I have agreed that, to allow for sufficient time for questions, we are limiting opening statements to the Chair and Ranking Member. All Senators are welcome to submit an opening statement for the record.

We will now swear in Dr. Yellen. Please rise and raise your right hand. Do you swear or affirm that the testimony that you are about to give is the truth, the whole truth, and nothing but the truth, so help you God?

Ms. YELLEN. I do.

Chairman JOHNSON. Do you agree to appear and testify before any duly constituted committee of the Senate?

Ms. YELLEN. I do.

Chairman JOHNSON. Please be seated.

Please be assured that your written statement will be part of the record. I invite you to introduce your family and friends in attendance before beginning your statement.

Dr. Yellen, please proceed with your testimony.

STATEMENT OF JANET L. YELLEN, OF CALIFORNIA, TO BE CHAIRMAN OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Ms. YELLEN. Thank you. I would like to introduce my husband, George Akerlof; and my sister-in-law, Allison Brooks; and my friend and a former San Francisco Fed Director, Karla Chambers, who are here with me today.

Chairman Johnson, Senator Crapo, and Members of the Committee, thank you for this opportunity to appear before you today. It has been a privilege for me to serve the Federal Reserve at different times and in different roles over the past 36 years and an honor to be nominated by the President to lead the Fed as Chair of the Board of Governors.

I approach this task with a clear understanding that the Congress has entrusted the Federal Reserve with great responsibilities. Its decisions affect the well-being of every American and the strength and prosperity of our Nation. That prosperity depends most, of course, on the productiveness and enterprise of the American people, but the Federal Reserve plays a role too, promoting conditions that foster maximum employment, low and stable inflation, and a safe and sound financial system.

The past 6 years have been challenging for our Nation and difficult for many Americans. We endured the worst financial crisis and deepest recession since the Great Depression. The effects were severe, but they could have been far worse. Working together, Government leaders confronted these challenges and successfully contained the crisis. Under the wise and skilled leadership of Chairman Bernanke, the Fed helped stabilize the financial system, arrest the steep fall in the economy, and restart growth.

Today the economy is significantly stronger and continues to improve. The private sector has created 7.8 million jobs since the post-crisis low for employment in 2010. Housing, which was at the center of the crisis, seems to have turned a corner. Construction, home prices, and sales are up significantly. The auto industry has made an impressive comeback, with domestic production and sales back to near their pre-crisis levels.

We have made good progress, but we have further to go to regain the ground lost in the crisis and the recession. Unemployment is down from a peak of 10 percent, but at 7.3 percent in October, it is still too high, reflecting a labor market and economy performing far short of their potential. At the same time, inflation is running below the Federal Reserve's goal of 2 percent and is expected to continue to do so for some time.

For these reasons, the Federal Reserve is using its monetary policy tools to promote a more robust recovery. A strong recovery will ultimately enable the Fed to reduce its monetary accommodation and its reliance on unconventional policy tools such as asset purchases. I believe that supporting the recovery today is the surest path to returning to a more normal approach to monetary policy.

In the past two decades, and especially under Chairman Bernanke, the Federal Reserve has provided more and clearer information about its goals. Like the Chairman, I strongly believe that monetary policy is most effective when the public understands what the Fed is trying to do and how it plans to do it. At the request of Chairman Bernanke, I led the effort to adopt a statement of the Federal Open Market Committee's longer-run objectives, including a 2-percent goal for inflation. I believe this statement has sent a clear and powerful message about the FOMC's commitment to its goals and has helped anchor the public's expectations that inflation will remain low and stable in the future. In this and many other ways, the Federal Reserve has become a more open and transparent institution. I have strongly supported this commitment to openness and transparency, and I will continue to do so if I am confirmed and serve as Chair.

The crisis revealed weaknesses in our financial system. I believe that financial institutions, the Federal Reserve, and our fellow regulators have made considerable progress in addressing those weaknesses. Banks are stronger today, regulatory gaps are being closed, and the financial system is more stable and more resilient. Safeguarding the United States in a global financial system requires higher standards both here and abroad, so the Federal Reserve and other regulators have worked with our counterparts around the globe to secure improved capital requirements and other reforms internationally. Today, banks hold more and higher-quality capital and liquid assets that leave them much better prepared to withstand financial turmoil. Large banks are now subject to annual "stress tests" designed to ensure that they will have enough capital to continue the vital role they play in the economy, even under highly adverse circumstances.

We have made progress in promoting a strong and stable financial system, but here, too, important work lies ahead. I am committed to using the Fed's supervisory and regulatory role to reduce the threat of another financial crisis. I believe that capital and liquidity rules and strong supervision are important tools for addressing the problem of financial institutions that are regarded as "too big to fail." In writing new rules, however, the Fed should continue to limit the regulatory burden for community banks and smaller institutions, taking into account their distinct role and contributions. Overall, the Federal Reserve has sharpened its focus on financial stability and is taking that goal into consideration when carrying out its responsibilities for monetary policy. I support these developments and pledge, if confirmed, to continue them.

Our country has come a long way since the dark days of the financial crisis, but we have farther to go. I believe the Federal Reserve has made significant progress toward its goals but has more work to do.

Thank you for the opportunity to appear before you today. I would be happy to respond to your questions.

Chairman JOHNSON. Thank you for your testimony.

Will the clerk please put 5 minutes on the clock for each Member?

Dr. Yellen, you know, as I do, that unemployment is not just numbers but real men and women who are ready to work if given the chance. As Chair, how will you lead the Fed to continue reducing unemployment aggressively and improve the prospects of young Americans and others who are unemployed?

Ms. YELLEN. Thank you, Senator. I would be strongly committed to working with the FOMC to continue promoting a robust economic recovery. As you noted, unemployment remains high. A disproportionate share of that unemployment takes the form of long spells of unemployment. Around 36 percent of all those unemployed have been unemployed for more than 6 months. This is a virtually unprecedented situation, and we know that those long spells of unemployment are particularly painful for households, impose great hardship and costs on those without work, on the marriages of those who suffer these long unemployment spells, on their families. So I consider it imperative that we do what we can to promote a very strong recovery.

We are doing that by continuing our asset purchase program which we put in place with the goal of assuring a substantial improvement in the outlook for the labor market. We are taking account of the costs and efficacy of that program as we go along. At this point I believe the benefits exceed the costs. As that program gradually winds down, we have indicated that we expect to maintain a highly accommodative monetary policy for some time to come thereafter, and the message that we want to send is that we will do what is in our power to assure a robust recovery in the context of price stability.

Chairman JOHNSON. What are the dangers of tapering asset purchases too early? If confirmed, how should the FOMC move forward on an exit strategy?

Ms. YELLEN. Senator, I think there are dangers, frankly, on both sides of ending the program or ending accommodation too early. There are also dangers that we have to keep in mind with continuing the program too long or more generally keeping monetary policy accommodation in place too long. So the objective here is to assure a strong and robust recovery so that we get back to full employment and that we do so while keeping inflation under control. It is important not to remove support, especially when the recovery is fragile and the tools available to monetary policy should the economy falter are limited, given that short-term interest rates are at zero. I believe it could be costly to withdraw accommodation or to fail to provide adequate accommodation.

On the other hand, it will be important for us also, as the recovery proceeds, to make sure that we do withdraw accommodation when the time is appointed. My colleagues and I are committed to our longer-run inflation goal of 2 percent, and we will need to ensure that, as the recovery takes hold and progresses, we also exit or bring monetary policy back to normal in a timely fashion.

I believe we have the tools necessary to do so. We have been very careful to make sure that we have the tools available at our disposal and we also have the will and commitment, and I look forward to leading, when the time is appropriate, the normalization of monetary policy.

Chairman JOHNSON. Thank you.

Senator Crapo.

Senator CRAPO. Thank you, Mr. Chairman, and I would like to follow up on the Chairman's question with you, Ms. Yellen, with regard to quantitative easing. You have indicated that you feel that as long as the economy remains—well, I do not want to put words in your mouth. But as the economy remains fragile, that we need to continue the accommodation from the Federal Reserve.

According to the July quarterly survey of the primary dealers by the New York Fed, the Fed's balance sheet will reach almost 24 percent of GDP in the first quarter of 2014. And I am concerned about the size of the Fed's balance sheet and its impact on the economy and the unintended consequences of these accommodations.

It seems to me that there is a disconnect between what the Fed intended to accomplish and the results. A PIMCO executive recently stated that the $4 trillion in quantitative easing may have contributed as little as one-quarter of 1 percent to GDP growth. And even the Fed's own economists estimates that the QE2 added only about 0.13 percent to real GDP growth in 2010. And another expert has indicated that Fed policies contribute to bubble-like markets.

How do you respond to the concerns that quantitative easing has limited impact on economic growth and is, in fact, creating very serious risks in our financial markets?

Ms. YELLEN. A number of different studies have been done attempting to assess what the contribution of our asset purchases have been, and, of course, this is something we can only estimate and cannot know with certainty. But my personal assessment would be, based on all of that work, that these purchases have made a meaningful contribution to economic growth and to improving the outlook.

Certainly long-term interest rates. The purpose of these purchases was to push down longer-term interest rates. We have seen interest rates fall very substantially. Lower interest rates, lower mortgage rates particularly, I think have been a positive factor in generating the recovery of the housing sector. House prices, after having fallen very substantially, are moving up, and that is helping substantially many households, including the large fraction of American households who found themselves underwater on their mortgages. It is improving their household finances.

We have seen a very meaningful recovery in automobile sales, spurred in part by low interest rates.

Senator CRAPO. But how long can we artificially hold or operate monetary policy in what I consider to be such extreme levels of the quantitative easing?

Ms. YELLEN. Senator, when we initiated this program, the unemployment rate was 8.1 percent, and the committee was somewhat pessimistic about its expectations for what we would see in the labor market over the ensuing year. In fact, the committee expected little or no meaningful progress in bringing down unemployment. And when we began this program, we indicated that our goal was to see a substantial improvement in the outlook for the labor market.

So the progress of this program, it is not on a set course. It is data dependent, but we have seen improvement in the labor market.

Senator CRAPO. But can it just continue indefinitely? I mean, if the labor market does not improve to the point that you reach your target, how long can this continue? Do you agree that there has to be some point at which we return to normal monetary policy?

Ms. YELLEN. I would agree that this program cannot continue forever, that there are costs and risks associated with the program. We are monitoring those very carefully. You noted potential risks to financial stability, and those are risks that we take very seriously.

The committee is focused on a variety of risks and recognizes that the longer this program continues, the more we will need to worry about those risks. So I do not see the program as continuing indefinitely.

Senator CRAPO. Do you have any estimate right now as to when there may be a beginning of the tapering?

Ms. YELLEN. Well, we at each meeting are attempting to assess whether we have seen meaningful progress in the labor market, and what the committee is looking for is signs that we will have growth that is strong enough to promote continued progress. As the FOMC indicated in its most recent statement, we do see strength in the private sector of the economy, and we are expecting continued progress going forward. So while there is no set time that we will decide to reduce the pace of our purchases, at each meeting we are attempting to assess whether or not the outlook is meeting the criterion that we have set out to begin to reduce the pace of purchases.

Senator CRAPO. My time has expired. Thank you.

Chairman JOHNSON. Senator Menendez.

Senator MENENDEZ. Well, thank you, Mr. Chairman. Thank you, Dr. Yellen. I appreciated our visit together.

Let me ask you, as the Federal Reserve has engaged in measures to strengthen our economy, some critics have argued that any growth that results might somehow be artificial—I know we have heard that here—or that low interest rates and cheaper credit might lead to financial instability or asset bubbles if investors make riskier investments in order to "reach for the yield."

In the current environment, though, my question is: Isn't weak demand the greater concern? I look at consumers pulling back on their spending because of high debt burdens, underwater mortgages from the financial crisis, businesses holding off on investing because of weak consumer demand. Doesn't that change the relative costs, benefits, and risks of different monetary policy actions?

Ms. YELLEN. Well, Senator, I completely agree that weak demand for the goods and services that this economy is capable of producing is a major drag holding back the economy. And, of course, the purpose of our policies, all of them, is to bring down interest rates in order to spur spending in interest-sensitive sectors, and if we are capable of doing that, that will help to stimulate a favorable dynamic in which jobs are created, incomes rise, and more spending takes place, which will create more jobs throughout the economy. So I agree with your diagnosis, and our programs are intended to remedy the situation of weak demand.

On the other hand, it is very important for us to monitor financial risks that could be developing as a consequence of the program or of low interest rates more generally or even more broadly of developing financial risks in the economy. No one wants to live through another financial crisis, and the Federal Reserve is devoting substantial resources and time and effort at monitoring those risks.

At this stage I do not see risks of financial stability. Although there is limited evidence of reach for yield, we do not see a broad buildup in leverage or the development of risks that I think at this stage poses a risk to financial stability.

Senator MENENDEZ. Well, let me ask you—I appreciate that. Some commentators have suggested that, in addition to managing inflation and promoting full employment, the Fed should also monitor an attempt to fight asset bubbles. Do you think it is a feasible job and something that the Fed should be doing? And if so, how would you go about it?

Ms. YELLEN. Well, Senator, I think it is important for the Fed, hard as it is, to attempt to detect asset bubbles when they are forming. We devote a good deal of time and attention to monitoring asset prices in different sectors, whether it is house prices or equity prices or farmland prices, to try to see if there is evidence of price misalignments that are developing.

By and large, I would say that I do not see evidence at this point in major sectors of asset price misalignments, at least of the level that would threaten financial stability. But if we were to detect such misalignments or other threats to financial stability, as a first line of defense, we have a variety of supervisory tools, micro and macro prudential, that we can use to attempt to limit the behavior that is giving rise to those asset price misalignments.

I would not rule out using monetary policy as a tool to address asset price misalignments, but because it is a blunt tool and because Congress has asked us to use those tools to achieve the goals of maximum employment and price stability, which are very important goals in their own right, I would like to see monetary policy first and foremost directed toward achieving those goals Congress has given us and to use other tools in the first instance to try to address potential financial stability threats. But an environment of low interest rates can induce risky behavior, and I would not rule out monetary policy conceivably having to play a role.

Senator MENENDEZ. Thank you.

Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Shelby.

Senator SHELBY. Thank you. Welcome, Governor.

Would you describe the portfolio of the Federal Reserve as unprecedented, the size of it today?

Ms. YELLEN. Yes, Senator.

Senator SHELBY. You are an economist, and you have been on the Fed, and you were also the Chairman of the Economic Advisers of President Clinton. Looking back in history, recent history, the last 30, 40, 50 years, have you noticed any portfolio of the Fed approaching what it is today?

Ms. YELLEN. Not of the Federal Reserve, but——

Senator SHELBY. That is what I mean.

Ms. YELLEN. But other central banks——

Senator SHELBY. I am asking about the Federal Reserve of the United States of America.

Ms. YELLEN. No, I have not, Senator.

Senator SHELBY. OK. Would you describe what you are doing here by—you call it "quantitative easing," a term that has been made up, I guess. We all make up terms. But is that a stimulus toward the economy, a tool—you used the word, the term "monetary tool." Is that what you would call it?—to help augment, to stimulate the economy?

Ms. YELLEN. It is a tool that is intended to push down longer-term interest rates——

Senator SHELBY. Yes, ma'am. I understand that.

Ms. YELLEN. ——and to stimulate demand and spending in the economy, yes.

Senator SHELBY. Is this, in the area of economics, something that Keynes and Tobin and others have espoused over the years at times when you have got high unemployment, to use a monetary tool to stimulate the economy?

Ms. YELLEN. Well, Tobin and Friedman and others have——

Senator SHELBY. What about Keynes, too?

Ms. YELLEN. I do not know that Keynes actually thought about this.

Senator SHELBY. OK.

Ms. YELLEN. But a number of economists have written about something called the portfolio balance effect that is basically about supply and demand, that by buying up a class of assets, it may be possible to push up their prices and push down their yields and thereby affect financial conditions in the economy.

Senator SHELBY. You know, it was said several years ago that China was buying our bonds—in other words, we were totally dependent on China to buy our paper, finance our deficits, and so forth. But isn't it true that the Federal Reserve in the last—since you had quantitative easing, is basically the buyer of our bonds, our paper?

Ms. YELLEN. Well, Senator, we are purchasing——

Senator SHELBY. For the most part.

Ms. YELLEN. We are purchasing a substantial, at this point, quantity of both Treasury and mortgage-backed, agency mortgage-backed securities. But we are certainly not doing so for the sake of helping the Government finance the deficit. We are doing so to achieve the goals that Congress has assigned to the Federal Reserve in circumstances where we have run out of scope for conducting additional normal monetary policy. Once our overnight interest rate target has hit zero, we really have to rely on alternative techniques, and we are certainly not the only central bank that has recognized this and undertaken similar programs.

Senator SHELBY. Now, you have alluded to other central banks, but, of course, you look around the world, and I do not know of any central bank that I think we should follow myself, and a lot of economists do not. We should set the example here in the United States, and the Fed has historically.

I will run out of time in a minute. Unemployment, you mentioned unemployment, stated unemployment is, what, 7.2 or 7.3 percent?

Ms. YELLEN. 7.3 percent.

Senator SHELBY. What is the real unemployment, that is, people that have given up looking for a job, working part-time, frustrated by the whole system? Is it around 13, 14 percent?

Ms. YELLEN. Well, Senator, you are absolutely right that broader measures of unemployment are much higher. Part-time employment among people who would prefer full-time jobs or more work are at unprecedented levels, and we have seen a significant decline in labor force participation. Part of it reflects an aging workforce. But some of it may be a reflection of very weak labor market conditions where people who have been unemployed for a long time feel frustrated about their job prospects.

Senator SHELBY. Could you quickly mention your views on Basel III, how important Basel III is, how important it is for our banks to make the standards of capital and liquidity, and also the other banks in Europe? How important is that?

Ms. YELLEN. Senator, it is extremely important for our banks to have more capital, higher-quality capital. Basel III putting those rules into effect has been an important step, and there are further steps that we will be taking with other regulators down the line to make sure that the most systemically important institutions, those whose failure could create financial distress, will be asked to hold more capital and meet higher standards of liquidity and prudential supervision to make sure that they are more resilient.

Senator SHELBY. What have you learned since you were President of the San Francisco Bank? You were there during the housing bubble and the debacle. As a regulator, I hope that you and others have learned a lot, not just the Federal Reserve but others, that you cannot let a bubble continue to grow.

Ms. YELLEN. Senator, I think that in the aftermath of the crisis, all of us have spent a great deal of time attempting to draw the appropriate lessons. There have been many of them. The Federal Reserve is very focused on a broad financial stability mandate, both in terms of our monitoring of the economy, attempting to understand the threats that exist broadly in the financial system, and to improve our supervision especially of the largest institutions to make sure that we are identifying those threats that can be risks to the economy.

Senator SHELBY. Thank you.

Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Brown.

Senator BROWN. Thank you, Mr. Chairman. Welcome, Ms. Yellen.

When Chairman Bernanke came before this Committee 3½ years ago, he noted that the two sectors that typically pull us out of recession are housing and manufacturing—the Fed's monetary policy through large-scale purchases of mortgage-backed securities clearly aimed at stimulating and promoting housing. You have spoken compellingly about the real economy. I hope that that means a real emphasis on manufacturing, particularly because of its impact rippling through the entire economy.

But one of my concerns is that the Fed's monetary policy does not do enough to serve all Americans. Last year, a journalist described the execution of monetary policy as a sort of trickle-down economics; it boosts the price of assets like stocks and bonds and homes and can enrich the wealthy and Wall Street. But it is not clear to me and, more importantly, it is not clear to the many Americans who have not seen a raise in a number of years that this policy increases wages and incomes for workers on Main Street.

During your time as Chair, tell us how you will ensure that the Fed's monetary policy directly benefits families on Main Street in places like Cleveland and Mansfield, Ohio?

Ms. YELLEN. Well, Senator, the objective of our policy is to broadly benefit all Americans, especially those who were seeing harm come to them and their families from high unemployment in a recovery that has taken a long time and been, frankly, disappointing.

It is true that in the first instance the policies that the Fed conducts when we implement monetary policy drive down interest rates, affect asset prices, and you used the term "trickle down." We tend to affect interest-sensitive spending—automobiles, housing—but the ripple effects go through the economy and bring benefits to, I would say, all Americans, both those who are unemployed and find it easier to get jobs as the recovery is stronger, and also to those who have jobs. You mentioned that wage growth has been weak or nonexistent in real terms over the last several years. As the economy recovers, my hope and expectation is that would change, and if we can generate a more robust recovery in the context of price stability, that all Americans will see more meaningful increases in their well-being.

Senator BROWN. Thank you. I in my role on this committee spend a lot of time talking to bankers, to community bankers, to the regionals like bankers at Key and Huntington and PNC and Fifth Third and some of the largest six or seven or eight banks, which—and I hear a concern from so many of these bankers across the board that too big to fail still has not been solved. In March, Chairman Bernanke said too big to fail is not solved and gone, it is still here. Last Friday, you, I am sure, saw the comments of the President of the New York Fed, Bill Dudley, not exactly a populist firebrand. He said that there are deep-seated cultural and ethical failures at many large financial institutions. "They have an apparent lack of respect for law, regulation, and the public trust." He said our current regulatory efforts may not solve these problems. His view is reinforced by the fact that DOJ currently has eight separate investigations open against the largest U.S. banks alone.

Do you agree with what I assume you are hearing from bankers, too, and from others and do you agree with Chairman Bernanke and Mr. Dudley that a system where too-big-to-fail institutions have, in Dudley's words, "an apparent lack of respect for law, regulation, or the public trust," do you agree we have not solved the problem? And what do you do as Fed Chair to address too big to fail?

Ms. YELLEN. Senator, I would agree that addressing too big to fail has to be among the most important goals of the post-crisis period. That must be the goal that we try to achieve. Too big to fail is damaging. It creates moral hazard. It corrodes market discipline. It creates a threat to financial stability, and it does unfairly, in my view, advantage large banking firms over small ones.

My assessment would be that we are making progress, that Dodd-Frank put into place an agenda that, as we complete it, should make a very meaningful difference in terms of too big to fail. We have raised capital standards. We will raise capital standards further for the largest institutions that pose the greatest risk by proposing so-called SIFI capital surcharges. We have on the drawing boards the possibility of requiring that the largest banking organizations hold additional unsecured debt at the holding company level to make sure that they are capable of resolution.

Right now the FDIC has the capacity and the legal authority to resolve, possibly using orderly liquidation authority, a systemically important firm that finds itself in trouble, and they have designed an architecture that I think is very promising in terms of being able to accomplish that.

So we are working with foreign regulators to improve the odds of a successful resolution and continuing to put in place higher prudential standards, capital and liquidity requirements. We have put out a proposal for a supplementary leverage requirement for the largest banks. So I think that this agenda will make a meaningful difference, and we are hoping to complete this in the months ahead.

Senator BROWN. You said you look for something potentially—something maybe to do further. How will you assess the regs put out, the higher capital standards by the Fed, the OCC, and FDIC? How will you assess as they go into effect if you need higher capital requirements, not just—I mean, certainly the surcharges, but how will you assess the effectiveness of those?

Ms. YELLEN. There are, as you know, studies that attempt to estimate what the too-big-to-fail subsidy is in the market, and while there are a lot of question marks around those studies, we can look to see what is happening there.

Senator BROWN. Do you believe there is a subsidy, as——

Chairman JOHNSON. Would the Senator wrap it up?

Senator BROWN. I apologize. OK. That was the last question. Do you believe there is a subsidy, as Bloomberg and so many others have pointed out, of tens of billions of dollars a year for the largest banks?

Ms. YELLEN. I think there are different methodologies that are used in different studies, and it is hard to be definitive. But, yes, I would say most studies point to some subsidy that may reflect too big to fail, although other factors also may account for part of the reason that larger firms tend to face lower borrowing costs.

Senator BROWN. Thank you. I am sorry, Mr. Chairman.

Chairman JOHNSON. Senator Vitter.

Senator VITTER. Thank you, Mr. Chairman. Thank you, Dr. Yellen.

I want to pick up where my colleague left off because, as you know, I share his and many others' concerns about too big to fail being alive and well.

As both of you noted, there are many studies that document, even try to measure too big to fail and the market subsidy or advantage that the megabanks have. Another is coming out today. GAO is releasing its first study that Senator Brown and I asked for and again confirms this in general. It focuses on the huge discount that the Federal Reserve offered the megabanks during the financial crisis and the huge market advantage that they got. And, specifically, this GAO report coming out today said—it recommended "the Federal Reserve Board finalize policies and procedures related to its emergency lending authority and establish internal timelines for developing those procedures to ensure timely compliance with Dodd-Frank Act requirements."

What that means, really, is Dodd-Frank gives you the ability to wind down that emergency lending authority. The Board has not acted on that or even established, as far as I know, internal timelines to do that.

So one obvious question related to this study coming out today: Will you do that as Chairman? And when will you do it?

Ms. YELLEN. Senator, I think that that guidance is in the works, and we will try to get it out soon.

Senator VITTER. Do you have a general timeframe in mind?

Ms. YELLEN. I am not certain just what the timeframe is, but I will try to make sure that that happens.

Senator VITTER. OK. If I could just ask you to supplement the record following the hearing with more specifics about the Fed's plan to act on Dodd-Frank with regard to that.

Ms. YELLEN. Yes.

Senator VITTER. Thank you.

You also mentioned increased leverage ratios for the biggest banks. I agree that the action you supported in July in terms of supplementary leverage ratio for larger banks was very positive. I do not agree that it is enough, and I think even when you consider the SIFI surcharge and other things, more needs to be done.

Would you support going further in terms of leverage ratios for the largest banks or not?

Ms. YELLEN. I think we will have a very meaningful improvement in capital standards by going the approach that Dodd-Frank has recommended, which is higher risk-based capital standards. There will be a SIFI surcharge. We are contemplating a countercyclical capital surcharge that would add to that. We are contemplating additional ways of dealing with problems of reliance on short-term wholesale funding that could take the form of a capital charge that is related to reliance on that kind of funding, or it could take the role of margin requirements.

I think a belt-and-suspenders kind of approach in which we have a leverage requirement that serves as a backup because there are potential issues with risk-based capital requirements. Remember that we also have stress tests which are yet another approach to assessing whether or not the largest systemically important institutions have the wherewithal to be able to lend, and——

Senator VITTER. I do not mean to cut you off, but if I can follow up before my time is up, I understand those other categories, including the SIFI surcharge. But considering all those, including the SIFI surcharge, I personally, and others, think you should go further with the supplementary leverage ratio. Would you support that as we speak today or not?

Ms. YELLEN. I would want to see where we are when we have implemented all of the Dodd-Frank requirements that we need to put in place.

Senator VITTER. OK. A final question. You have said in the past, "Like Chairman Bernanke, I strongly believe that monetary policy is most effective when the public understands what the Fed is trying to do and how it plans to do it."

A lot of us would agree with that, and many of us think the best way to get there is through true openness and transparency at the Fed, not just a better sort of managed PR campaign but real openness and transparency.

Would you publicly support S.209? I am sure you are familiar with that. And if not, what specific changes to that would be required to earn your public support?

Ms. YELLEN. I strongly, as I have indicated, support transparency and openness on the part of the Fed, and I think with respect to monetary policy, in terms of the range of information and the timeliness of that information, we are one of the most transparent central banks in the world. What I would not support is a requirement that would diminish the independence of the Federal Reserve in implementing and deciding on implementing in monetary policy.

For 50 years Congress has recognized that there should be an exception to GAO ability to audit the Fed to avoid any political interference in monetary policy. I believe it is critically important to the economic performance of this country—and we have seen this around the world—that allowing a central bank to be independent in formulating monetary policy is critical to assuring markets and the public that we will achieve price stability. And I would be very concerned about legislation that would subject the Federal Reserve to short-term political pressures that could interfere with that independence.

Senator VITTER. Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Tester.

Senator TESTER. Yes, thank you, Mr. Chairman. I want to thank you for being here, Vice Chair Yellen.

At the end of October, the Federal Reserve formally applied for application in the—International Association of Insurance Supervisors for membership. The United States already has membership on that through the Federal Insurance Office created by Dodd-Frank. Can you tell me why the Fed should have its own membership on that board and, furthermore, why there should be a focus on that when domestic oversight challenges seem to be a much higher priority?

Ms. YELLEN. Well, my understanding, Senator, is that now that the Federal Reserve has been charged with supervising some of the largest insurance companies that have been designated by FSOC as systemic, that we want to be in a position to work with regulators in other countries, as we have in the case of banking rules, to make sure that we have internationally compatible——

Senator TESTER. And the FIO——

Ms. YELLEN. ——appropriate standards.

Senator TESTER. Excuse me, but the FIO cannot fill that need for you?

Ms. YELLEN. I am not certain. I think we felt it would be beneficial to participate in that group.

Senator TESTER. OK. In our conversations about ensuring capital standards are appropriately tailored to insurers, I raised concern in this same vein with the FSOC, who I have encouraged to develop industry-specific guidance and metrics for systemically important financial institutions.

Do you agree that the FSOC has and should exercise its authority to develop industry-specific guidance and metrics rather than forcing insurers or asset managing firms, for example, into a bank-centric regulatory model?

Ms. YELLEN. Senator, I do believe that one size fits all should not be the model for regulation and that we need to develop appropriate models for regulation and supervision of different kinds of institutions. Insurance certainly has some very unique features that make them very different from banks, and we are taking the time to try to study what the best way is to craft regulations that would be appropriate for those organizations.

Senator TESTER. So what I am hearing you saying is that a bank-centric regulatory model would not work for insurance companies in this country?

Ms. YELLEN. Well, there certainly are critical differences in terms of their business models that we want to understand and respond to.

Senator TESTER. OK. I want to express a serious disappointment with a recent decision by FSOC not to release for public comment a study produced by the Office of Financial Research regarding the asset management industry. While the Council has publicly indicated that it would release any metrics or guidance on this industry for public comment, it has declined to release this study, which will presumably provide formal basis for future consideration.

If you are confirmed as Chairman of the Fed and a member of the FSOC, will you ensure that the Council lives up to its commitment of transparency? And will the Fed support efforts to make any potential evaluation metrics and studies on which they may based available for public comment?

Ms. YELLEN. Senator, I have not participated in FSOC, but if I do so, I will try to take those concerns seriously.

Senator TESTER. If you are confirmed, you will be participating in FSOC.

Ms. YELLEN. I will.

Senator TESTER. And the question is about transparency, and it is the transparency of metrics that are going to be used that people need to have the ability to comment on before they are applied. And I guess my question to you is: Will you be willing to make that commitment to transparency as it applies to the FSOC?

Ms. YELLEN. I will need to study this issue more closely in terms of what FSOC's procedures are, but I feel it should be clear why a particular firm has been designated if that occurs.

Senator TESTER. And the metrics that they are using for that designation. OK.

In closing, I just want to say thank you for your willingness to work on the end user issue that we discussed last week. I very much appreciate it.

Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Kirk.

Senator KIRK. Dr. Yellen, I would like to ask you a technical question on behalf of large insurance employers in Illinois, to extract a commitment from you to do a cost-benefit analysis if we are to require them to switch from SAP to GAAP accounting, which they have warned me could cost a couple hundred million dollars.

Ms. YELLEN. Senator, I am aware that there is an issue around different accounting standards in insurance companies. I have not had a chance to study that myself, but I would certainly agree that this is something that we need to look into and to consider very carefully, and pledge to do so.

Senator KIRK. Thank you, Dr. Yellen.

Mr. Chairman, thank you.

Chairman JOHNSON. Senator Warner.

Senator WARNER. Thank you, Mr. Chairman, and thank you, Dr. Yellen, for being here. I have a series of quick questions.

One, I guess I would like to make a comment. I understand some of our colleagues' concerns about, you know, some of the extraordinary measures the Fed has had to take on quantitative easing. I guess I would simply make a comment and ask for a short response on this. Part of our political dysfunction in this town in terms of the ability to actually grapple with getting our country's balance sheet right in terms of a so-called grand bargain or even an actual budget in place, if we were able to actually perform our functions, wouldn't that allow you to move out of these extraordinary measures in a quicker manner?

Ms. YELLEN. Well, Senator, it is certainly the case that the economy has suffered over the last year a substantial drag from fiscal policy. The CBO estimates that the drag amounts to something like 1.5 percent on growth, and as we commented in our FOMC statement most recently, taking account of that large amount of fiscal drag, the economy, even though it has only been growing around 2 percent, is showing greater momentum. So I think it is fair to say and I would expect that if there were less fiscal drag—and I hope there will be less going forward—that the economy's growth rate is going to pick up.

So certainly that has been a headwind on the economy and something that we have tried to offset, but obviously our tools to do so—it is not perfect, not——

Senator WARNER. Right. And, obviously, Government shutdowns, which cost, the latest estimate, $24 billion or potential default threats, which result in spikes of interest rates, sure as heck do not provide that predictability.

I want to actually follow up as well where Senator Tester left off. I have to say, as someone, along with my friend Senator Corker, we are very involved in Title I and Title II, I have been personally disappointed in the FSOC's ability to kind of be that interagency arbiter around regulatory conflicts. I have also been somewhat disappointed with the actions so far of the OFR, and I simply would say I think it is a—I hope as you move into this role on the FSOC there will be financial institutions, nonbank financial institutions that will be SIFIs. Senator Tester mentioned asset management firms. It did seem to me as well that the OFR's report did not have a lot of collaboration, did not have a lot of clarity, and I would hope that in your role on the FSOC—and, again, I think one of the reasons why I wish we ended up with an independent chair on the FSOC, but you will clearly have an outsized role as the Fed representative—that we try to give some clarity that we do not think we are going to view everything through a bank-centric regulatory prism, that we realize as we look at nonbank institutions that maybe require that SIFI designation, that we give some clarity about how we are going to evaluate those nonbank institutions.

Ms. YELLEN. I think that is completely fair and a very reasonable and logical objective for FSOC to have. Our staff have been working very closely with FSOC and the OFR, trying to participate constructively and facilitate the works of those groups.

Senator WARNER. Well, I would just add my voice to Senator Tester's that we would like to see that transparency as we start to evaluate nonbank institutions for SIFI designation so we kind of all know the rules going forward. I think that would be helpful.

One of the things—as we think about balance sheets and stimulation or getting more private capital lent, one of the things I know that the Fed pays interest on excess reserves of the banks, but I believe now you are holding about $2.4 trillion of those banking excess reserves, and I think we pay 25 basis points. We have seen other central banks, I think Denmark and others, start to lower those payments. Would you consider that possibility of, in effect, incenting the banks to get this capital not on your balance sheet but back out into the marketplace to stimulate more loans and more private capital into the market?

Ms. YELLEN. Senator, that is something that the FOMC has discussed and the Board has considered on past occasions, and it is something we could consider going forward.

We have worried that if we were to lower that rate too close to zero, we would begin to impair money market function, and that has been a consideration on the other side. But it certainly is a possibility, Senator.

Senator WARNER. I would just say that I would ask you to look at this as well because it is one of the ways, without necessarily growing your balance sheet, that some of my colleagues have expressed a concern with.

Thank you.

Ms. YELLEN. Thank you, Senator.

Chairman JOHNSON. Senator Heller.

Senator HELLER. Thank you, Mr. Chairman, and, Dr. Yellen, thank you very much for being here today. And I also want to thank your family for taking time and showing their support. I think that makes a real difference.

Question: Do you follow gold prices?

Ms. YELLEN. To some extent.

Senator HELLER. Do you believe there is any economic indicator behind the rise and fall of gold prices?

Ms. YELLEN. Well, I do not think anybody has a very good model of what makes gold prices go up or down, but certainly it is an asset that people want to hold when they are very fearful about potential financial market catastrophe or economic troubles entail risks. And when there is financial market turbulence, often we see gold prices rise as people flee into them.

Senator HELLER. Well, that was a better than I got from Chairman Bernanke last July. I asked him the same question, and he said that nobody really understands gold prices, and he went on to say, "And I do not pretend to really understand them either." Do you share that view, clearly with the few extra tidbits that you just shared with us?

Ms. YELLEN. Beyond what I shared, I do not have strong views on what drives them. I have not seen a lot of models that have been successful in predicting them.

Senator HELLER. Thank you. You talked in your general statement at the beginning about the role of the Federal Reserve: promoting conditions that foster maximum employment, low and stable inflation, safe and sound financial system. Do you believe we have a safe and sound financial system today?

Ms. YELLEN. I think we have a much safer and sounder financial system than we had pre-crisis, but as I indicated, we need to do more. We are not at the end of the road in terms of putting in place regulations and enhanced supervision that will make the system as safe and sound as it needs to be to contain systemic risk.

Senator HELLER. The reason I raise the question is we had this discussion when you were in my office about community banks, and sitting as Chairwoman of the San Francisco Federal Board, you have a pretty good understanding of what is going on out West—California, Nevada. And as you are aware, and as I shared with you, we have lost half of the community banks and credit unions in our communities, making it very, very difficult for choices, making it very difficult for housing recovery, getting loans for small businesses. I guess the question is: What steps will you take to avert a culture of consolidation of these major banks and the loss of the small community banks?

Ms. YELLEN. Well, Senator, in the first place, to the extent that the large banks have an advantage because they benefit from a too-big-to-fail subsidy, I think our objective in regulation should be to put in place tough enough regulations and capital and liquidity standards that would level the playing field. Since those firms do pose systemic risk to the financial system, we should be making it tougher for them to compete and encouraging them to be smaller and less systemic.

And with respect to the community banks, we need a model for supervision of them that is different and much less onerous and has much less regulatory burden and is appropriate to their business model. We are obviously imposing on the largest systemic institutions much higher and more onerous prudential standards.

Senator HELLER. And I appreciate your comments, because I do believe the one size fits all is what is really at a disadvantage for the community banks and these smaller banks.

A quick question about quantitative easing. Do you see it causing an equity bubble in today's stock market?

Ms. YELLEN. Stock prices have risen pretty robustly, but I think that if you look at traditional valuation measures, the kind of things that we monitor akin to price equity ratios, you would not see stock prices in territory that suggests bubble-like conditions. When we look at a measure of what is called the "equity risk premium," which is the differential between the expected return on stocks and safe assets like bonds, that premium is somewhat elevated historically, which again suggests valuations that are not in bubble territory.

Senator HELLER. Do you believe there is a Federal role to support the stock market?

Ms. YELLEN. A Federal role to support the stock market?

Senator HELLER. A Federal role.

Ms. YELLEN. No.

Senator HELLER. Thank you.

Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Merkley.

Senator MERKLEY. Well, thank you, Mr. Chair, and thank you, Dr. Yellen. And I do not believe any nominee for this position has come with such an extensive set of qualifications, and it is fascinating to read the diversity of your writings over the last four decades.

I wanted to give a special welcome to Karla Chambers, who represented Oregon very well on the Board of Directors of the Federal Reserve Bank of San Francisco.

A number of issues have arisen in the international banking community just since the meltdown in 2008, including LIBOR rate manipulation, energy market manipulation, the London Whale, massive issues related to money laundering, robo-signing fraud on foreclosure documents. The Fed plays an important role in regulation and supervision. Can the Fed under your leadership help restore public faith in our regulatory system?

Ms. YELLEN. Senator, I feel that that is an exceptionally important goal and one that I am happy to espouse and work toward. I absolutely feel that that is essential and appropriate, yes.

Senator MERKLEY. Thank you very much. And, second, I wanted to ask you to address the rules that are being completed on the Volcker Rule or firewall, which creates a wall between hedge funds that make risky bets with funds from private investors and commercial banks that have insured deposits and access to the discount window and play an essential role in providing loans to individuals and businesses.

There has been a lot of concern that this firewall will be compromised with loopholes related to liquidity management, portfolio hedging, and market making. Can we count on the Fed under your leadership to work with the other regulators to produce a strong Volcker Rule? And perhaps it will be completed before you are there because they are in the final stages. But if so, to implement it in a fashion that keeps faith with this goal of reducing systemic risk by keeping the commercial banking world in the commercial banking sphere?

Ms. YELLEN. Yes, Senator, we are working very closely and I believe constructively on this rulemaking with the other agencies. We are certainly trying to be faithful to the intent of this rule, which is to eliminate short-term financial speculation in institutions that enjoy the protection of the safety net. The devil here is in the details. The rule does permit appropriate hedging in market-making activities, and we are trying to devise a rule that will permit those activities but absolutely be faithful to the intent that Congress had here.

Senator MERKLEY. Thank you. And, third, I wanted to ask you to ponder an issue that received considerable attention regarding commodities and the concern that under a certain situation, large banks will be able to put their thumb on the scale through their ownership of electric power generation facilities, pipelines, oil tankers, warehouses for key metals. And there is certainly a history in terms of Gramm-Leach-Bliley, in terms of grandfathered commodity investments, and in terms of related activities.

But there is concern that the ability to influence supply and demand and affect price while at the same time as having the ability to make bets on the price creates a conflict of interest that provides essentially a hidden tax on the American economy. And the Fed does have regulatory powers related to this, and can you maybe chew on this a little bit in terms of your perspectives?

Ms. YELLEN. Senator, we are involved in a very comprehensive review of commodities activities in financial holding companies. As you indicated, we allowed some activities that we deemed to be complementary to financial activities, and we are reviewing what is appropriate there. In addition, Congress, as you noted, grandfathered certain activities in firms that later become financial holding companies. We want to make sure that these are conducted in a safe and sound manner, and we may be involved in additional rulemaking as we complete this review.

With respect to market manipulation, I would just note, though, that it is the role and responsibility of market regulators, particularly the CFTC here, to be looking into possibilities of market manipulation and we would certainly cooperate in any look there. Our main role is prudential and safety and soundness.

Senator MERKLEY. Well, thank you so much for being willing to consider taking on this role at the Fed and bringing your expertise to bear and your past public service, and I certainly wish you well. Thank you.

Ms. YELLEN. Thank you, Senator.

Chairman JOHNSON. Senator Corker.

Senator CORKER. Thank you, Mr. Chairman. And, Dr. Yellen, thank you for being here, and I appreciate the time in our office and your transparency here today.

Just for the Committee's record, if you would, share with all of us how many rate increases you have voted for during your term on the Federal Reserve.

Ms. YELLEN. I served as a Governor from 1994 to 1997, and we had a cycle of rate increases during that time.

Senator CORKER. If you could just give me the number so I can——

Ms. YELLEN. I believe 20 or more.

Senator CORKER. Twenty or more. I think it was maybe 27 or so.

Ms. YELLEN. It could be.

Senator CORKER. And how many have you voted against?

Ms. YELLEN. None.

Senator CORKER. OK. I thought that was just good to get into the record, and I appreciate——

Ms. YELLEN. I appreciate that.

Senator CORKER. ——you very much for being here. We talked a little bit about monetary policy, maybe more than a little bit in the office, and I think one of the things that we discussed was my concern—and I think yours, too—that in many ways easy money is an elitist policy. It is the ultimate trickle-down, and that, you know, it is based on the premise that you are going to have this wealth creation. And what we have seen, obviously, is the largest Wall Street institutions have done the best and that fund managers have made a lot of money, but it generally has not trickled down to the economy. And as you were mentioning earlier, it is a blunt object.

Would you agree that while it has been an attempt to stimulate the economy, the more well off have benefited much better than those at the lower end of the spectrum?

Ms. YELLEN. Well, to the extent that low interest rates do have an impact on asset prices, these policies have probably to some extent boosted the stock market, which may be an example of what you are talking about. But it has also played an important role, I think, in helping the housing sector and boosting housing prices. And I think this is something that has been broadly beneficial to all those Americans who own homes and has improved their sense of financial well-being, and that is broad based.

Senator CORKER. We talked a little bit about the Fed in the early summer began to talk about moderating the pace at which it was going to be making purchases. And the market had a pretty stringent reaction, and the Federal Reserve appeared as if it had touched a hot stove and that this policy was going to greatly affect, if you will, the wealth effect that you were trying to create the policy of moderating. And so the Fed jumped back, and it seemed to me—and I think you discussed this a little bit in the office—that the Fed had become a prisoner to its own policy, that to really try to step away from QE3 was really going to shatter possibly the markets and, therefore, take away from the wealth effect.

I wonder if you could talk a little bit about some of the discussions that were taking place during that time.

Ms. YELLEN. Well, Senator, I do not think that the Fed ever can be or should be a prisoner of the markets. Our job——

Senator CORKER. But to a degree in this case, it did affect the Fed, did it not?

Ms. YELLEN. Well, we do have to take account of what is happening in the markets, what impact market conditions are likely to have on spending and the economic outlook.

So it is the case—and we highlighted this in our statement—when we saw a big jump in rates, a jump that was greater than we would have anticipated from the statements that we made in May and June, and particularly saw mortgage interest rates rise in the space of a few months by over 100 basis points, we had to ask ourselves whether or not that tightening of conditions in a sector where we were seeing a recovery, and a recovery in housing that could drive a broader recovery in the economy, we did have to ask ourselves whether or not that could potentially threaten what we were trying to achieve.

But overall we are not a prisoner of the markets. I continue to feel that we are seeing an improvement in the labor market, which was the goal of the program, and we will continue to evaluate incoming data and to make decisions on the program in that light going forward.

Senator CORKER. Thank you. I am just a little bit of a prisoner, maybe not fully. I understand. I would just—my last question is: You talked a little bit about monitoring sort of the financial markets, and I know that it is—again, monetary policy is a blunt instrument. I know that you have been credited with, back in 2005, signaling that the housing market was bubbling, if you will, in that part of the country.

I guess my question is: Do you believe that under your leadership the Fed would have the courage to, when it saw asset bubbles, even though you only have blunt instruments—and I realize that—would it have the courage to actually prick those bubbles and ensure that we did not create another crisis?

Ms. YELLEN. Senator, no one who lived through that financial crisis would ever want to risk another one that could subject the economy to what we are painfully going through and recovering from. And we have a variety of different tools that we could use if we saw something like that occur. They include tools of supervision and monetary policy is a possibility——

Senator CORKER. And you would have the courage to do that?

Ms. YELLEN. I believe that I would, and I believe that this is the most important lessons learned from the financial crisis, Senator.

Senator CORKER. Mr. Chairman, thank you for having this hearing, and, Dr. Yellen, I do want to tell you I very much appreciate your candor and transparency. I really do. I appreciate the conversation both in the office—and I want to thank you for giving the same answers to questioners here today that you gave in the office, so thank you very much.

Ms. YELLEN. Thank you very much, Senator. I appreciate that.

Chairman JOHNSON. Senator Hagan.

Senator HAGAN. Thank you, Mr. Chairman. Thank you, Ranking Member Crapo. I want to echo what I am sure everybody has stated. I have been impressed by the depth of your background, your experience, and your expertise. We are very honored to have you here and thank you for your testimony.

I wanted to talk about Section 716 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Section 716 requires that banks with access to deposit insurance or the Federal Reserve discount window to push out certain derivatives such as equity and commodity-based swaps in to separately capitalized affiliates.

This move would raise cost to the end users without significantly reducing risk to the financial system. Chairman Bernanke has consistently stated that the Federal Reserve had concerns about the swaps push-out rule prior to the enactment of Dodd-Frank and that they still have concerns about it today.

Are your views on this issue consistent with Chairman Bernanke's? Would you share the view that it is a good idea to repeal parts of the swaps push-out rule?

Ms. YELLEN. Senator, as you indicated, the Federal Reserve and other agencies did have concerns about this rule and they expressed them when Dodd-Frank was being considered. We are working very hard to address some of the concerns around this rule, and we think that we are likely to be able to do so. I certainly hope that in the final rule we will be able to effectively address some of the concerns that people had. That is my hope. We are certainly trying to do that.

Senator HAGAN. What is your timeframe on that?

Ms. YELLEN. I believe this is something we hope to get out, hopefully, later this year.

Senator HAGAN. You could address some concerns, but not all, without changing Section 716?

Ms. YELLEN. I believe that that is the case. We are hopeful that we will be able to find ways to address the concerns.

Senator HAGAN. OK.

Ms. YELLEN. We understand the concerns and we are trying very hard to——

Senator HAGAN. Do you share Chairman Bernanke's viewpoint?

Ms. YELLEN. I believe so. About the concerns that are there and the need to address them, I am hopeful that we will be able to do so in the rule.

Senator HAGAN. OK. Thank you. Since the start of QE the financial markets have responded to pronouncements by the Federal Open Markets Committee. Are you at all concerned that markets are too driven by speeches and official pronouncements from central banks around the world? If the suggestion of tapering can contribute to volatility in asset prices, can we expect more volatility in the future?

Ms. YELLEN. Well, at the Federal Reserve, and I think this is true of other central banks, we are trying as hard as we can to communicate clearly about monetary policy, both our goals and our intentions in terms of how we carry out programs. Now, this is challenging. We are in unprecedented circumstances. We are using policies that have never really been tried before, and multiple policies, and we are trying to explain to the public how we intend to conduct these policies.

So it is a work in progress, and sometimes miscommunication is possible. But I think my own view would be we certainly want to diminish any unnecessary volatility. Sometimes there is volatility because we all learn news about the economy that changes our views about the course of the economy and the course of policy, and there it is natural to see a response.

But to diminish unnecessary volatility, I think we have to redouble our efforts to communicate as clearly as we possibly can, and that will be my emphasis.

Senator HAGAN. Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Toomey.

Senator TOOMEY. Thank you, Mr. Chairman, and Dr. Yellen, thank you for being here. Thanks for our chat earlier this week. I appreciate that.

I want to get back to where—some of the issues Senator Corker was raising regarding monetary policy. But first, I just think it is important to stress, and I know you are very well aware of these, but the adverse consequences that we are already experiencing directly as a result of the extraordinary monetary policy is really problematic, I think.

We continue to have this artificially suppressed cost of funding these excessively large deficits that we run. It contributes to, I would argue, fiscal imbalances. We are punishing middle class savers for years now, people who spent an entire working lifetime choosing to forego consumption because they decided they would save and they would have a little sum, a little bit of income in their retirement and now they have no income because they earn nothing on their savings, but they do watch as it gradually gets eroded, even by a low level of inflation, when they have no income from it.

We have exacerbated the problems of under-funded pension plans and we have got distortions in financial markets. So these are all the things that have been occurring, I would argue, and continue to occur. And yet, what worries me perhaps even more is the point that Senator Corker was getting to, I think, which is, what happens when this morphine drip starts to end?

At some point, some time, this is going to be—we are going to move away from this, I assume. I think everybody believes that. And the assumption seems to be that the markets will behave very benignly when that occurs. And yet, we have seen, I think, some worry, some glimpses that maybe that is not a safe assumption.

Back in June, the mere suggestion that some of the members of the Fed might be contemplating stepping back a little earlier, and 10-year Treasury backs up 100 basis points. Yesterday, the release of your testimony and the equity markets rally.

Does this not feel like there is something a little artificial here, and is it not possible that while you have many tools available to begin and unwind, to retreat from this, that the markets may not respond very well and that we could end up creating a real problem as we try to exit from this?

Ms. YELLEN. Senator, you made a number of different points and I think the first point you mentioned is that low rates, in a way, give rise to fiscal irresponsibility, that it takes the pressure off Congress.

Senator TOOMEY. Make it easy.

Ms. YELLEN. You know, we have established low rates in order to get the economy moving, which is Congress's mandate to us. I think it is important for Congress to recognize that as the economy recovers and both short- and long-term rates move up, a situation in which the Government's funding costs remain as low as they are, if we are successful in achieving our goal of getting the economy back on track, this is a very temporary situation.

And so, I believe Members of Congress should be looking out a few years to a time when rates are going to be higher. Low interest rates harm savers; it is absolutely true. And this is a burden on people who were trying to survive on the income from a CD. There is not much they can get.

But if you think about, how can we get rates back up to normal, I would argue that we cannot have normal rates unless the economy is normal. At the moment, we have a lot of saving and not very much investment, and there are fundamental reasons here why rates are low.

So pursuing a policy of low rates to get the economy moving will be enable us to normalize policy and to get rates back to normal levels over time.

In terms of jumps in rates, we will, as the economy recovers, need to withdraw the monetary accommodation we have put in place, and we will make every effort to do so at a pace that is appropriate to continue the recovery and to maintain price stability, and to communicate that plan to markets.

But as we have seen, and as you indicated, it is possible for rates to jump. It is not just true now, but in previous tightening cycles like the one we had from 1994 to 1995, where long rates moved up over the span of 6 months over 100 basis points. We have tried to make sure the financial system is more resilient.

In our stress tests, we have tested and continue to do so in this round to make sure that banks are appropriately managing interest rate risk. And that is a risk that we will try to mitigate. But it is inherent in any tightening cycle.

Senator TOOMEY. Mr. Chairman, I know I am running out of time. Just two quick points I would like to make. One is, I would like to express my concern, which is the exact opposite of the concern that was raised by Senator Merkley, which is, I think, the danger of the implementation of the Volcker rule is actually—it could be too restrictive and increase the cost of especially corporate bond issuers.

I think the decision by Congress to exempt U.S. Treasuries was an implicit acknowledgment that when you ban proprietary trading in those instruments, you make them less liquid and more expensive for issuers. I am told that the next rule might very well also exempt other sovereign issuers, which is another implicit acknowledgment of this problem.

This is a problem for corporate issuers in America and I am very concerned that we not unnecessarily raise their cost of borrowing.

And the last point I would make is, I am deeply concerned about the consolidation that is happening in small banks, the lack of new small banks. As you know, we used to routinely launch sometimes hundreds of new community banks. I am told by the FDIC there is not a single new community bank that has been launched since 2010.

The regulatory compliance for institutions that have no systemic risk to the economy is way overboard, and I hope you will make an effort to diminish that burden.

Ms. YELLEN. I promise to do so, Senator.

Senator TOOMEY. All right. Thank you.

Chairman JOHNSON. Senator Warren.

Senator WARREN. Thank you, Mr. Chairman. Thank you, Dr. Yellen.

There has been a lot of talk today about the Fed's use of quantitative easing to try to help the economy get back on its feet. But the truth is, if the regulators had done their jobs and reigned in the banks, we would not need to be talking about quantitative easing because we could have avoided the 2008 crisis altogether.

So I want to focus on the Fed's regulatory and supervisory responsibilities to keep the big banks in check. Now, I am concerned that those responsibilities just are not a top priority for the Board of Governors. Earlier this year, the Fed and the OCC reached a settlement with 13 mortgage servicers that engaged in a long list of illegal foreclosure activities, and the settlement was for over $9 billion. It directly affected more than four million families. But the Fed's Board of Governors never voted on whether to accept the settlement.

Instead, this decision was just left to the staff. Now, the Fed has smart, hardworking staff, but the Board of Governors would never delegate critical monetary policy to them. And yet, even now, after the biggest financial crisis in generations, the Board seems all too willing to delegate critical regulatory and supervisory decisions.

So I think we need to make reigning in the banks a top priority for the Board. So I know the Board meets regularly to discuss monetary policy. Do you think the Board should have regular meetings on supervisory and regulatory issues as well, making it clear that both of those are important to the Fed?

Ms. YELLEN. Well, Senator, I absolutely believe that our supervisory responsibilities are critical and they are just as important as monetary policy, and we need to take them just as seriously and devote just as much time and attention to them as we do to monetary policy.

The Board operates under a variety of restrictions. You may know about the Government in the Sunshine Rule, and so when you suggest that the Board meet to discuss regulatory matters, our ability to do so outside of open meetings is very limited.

And so, we tend to handle those by meeting individually with staff or meeting in small groups. We have a committee system where committees are put in charge of managing particular areas and making recommendations to the Board.

I remember in the 1990s that the Board did regularly meet to discuss supervisory issues because there is confidential supervisory information and it is easier for us to have a meeting. I did consider those very valuable. And so, I think that is a very worthwhile idea.

I should just say, when there are delegations to staff and the Board of Governors does not vote, that does not mean that Board members are not consulted, and maybe those with expertise may have played a critical role and had very important input, even when there is no formal vote by the Board of Governors.

Senator WARREN. Fair enough. But I think it is an important signal here and I am glad to hear that you are thinking about this and thinking about the question of the appropriate delegation to staff and when it is appropriate to delegate to staff.

Could I ask you just to say something briefly about that, about when it is appropriate to staff and when you have to retain for the Board itself? Just very briefly, if you could, because I want to get on to one other question.

Ms. YELLEN. I believe there are certain matters that, under law, the Board must vote on, supervisory findings, mergers, and so forth, or rule changes. Typically, we delegate enforcement matters to the staff in the area of supervision.

Senator WARREN. And I am glad to hear, though, that you want to continue to think about that, particularly when we are talking about something this important.

Ms. YELLEN. Yes.

Senator WARREN. I want to ask you one other fundamental question here, and that is, do you think that the Fed's lack of attention to regulatory and supervisory responsibilities helped lead to the crash of 2008?

Ms. YELLEN. In the aftermath of the crisis, we have gone back and tried to look carefully at what we should have done differently, and there have been important lessons learned. We have massively revamped our supervision, particularly of the largest institutions, where we are simultaneously reviewing all of the largest institutions, and the Federal Reserve system works jointly on these reviews. We no longer delegate to individual Reserve banks the supervision of, say, one or two of these large institutions.

It has also become an interdisciplinary matter that the economists and lawyers and others are involved in. So we have learned a lot there about supervision. I would say, one of our top priorities now is ramping up our monitoring of the financial system as a whole to detect financial stability risks. I think that is something that we were not doing in an adequate basis before the crisis.

And so, we missed some of the important linkages whereby problems in mortgages would rebound through the financial system.

Senator WARREN. Thank you very much. Thank you, Mr. Chairman. I just want to say, Dr. Yellen, when you are confirmed, and I very much hope you are confirmed, that I am glad to hear you will make it a top priority for the Federal Reserve to engage in the supervisory and regulatory responsibilities that help keep our financial system safe, and that cannot be something that is merely an afterthought, but has to be a primary effort on your part.

Ms. YELLEN. Thank you, Senator. I completely agree with that.

Senator WARREN. Good. Thank you. Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Reed.

Senator REED. Well, thank you very much, Mr. Chairman, and Governor, you demonstrated your wisdom early by going to Brown University in Providence, Rhode Island.

Ms. YELLEN. Thank you, Senator.

Senator REED. Everything else after that is, I know, anticlimactic, but when you are confirmed as the Chairman of the Federal Reserve, it will be consistent with your record of wise selections and wise choices.

Chairman Bernanke has indicated that many times our fiscal policy and our monetary policy have been working at cross purposes. The Federal Reserve has been quantitative easing. They have been trying to get an expansive policy in place and we have been contracting, shutting the Government down. We anticipate—I hope we can avoid this—but we are going to end unemployment—mercy unemployment insurance abruptly at December 31st.

How would your job and, obviously, the size and scope of your portfolio and everything else, maybe the question has been asked today, be affected if our fiscal policy was complementary to your monetary policy?

Ms. YELLEN. Well, Senator, I agree that fiscal policy has been working at cross purposes to monetary policy. I certainly recognize the importance of the objective of putting the U.S. deficit and debt on a sustainable path. Congress has worried about that and I think it is important to do so.

But some of the near-term reductions in spending that we have seen have certainly detracted from the momentum of the economy and from demand, making it harder for the Fed to get the economy moving, making our task more difficult. And it certainly would be helpful, going forward, if it were possible for deficit reduction efforts to focus on achieving gains in the medium term horizon and addressing those aspects of fiscal policy that give rise to concerns about debt sustainability over the medium term while not subtracting from the impetus that we need to keep a fragile recovery moving forward.

Senator REED. And such a policy, a fiscal policy, would help you in terms of what we all anticipate is the point at which you have to begin your tapering, because basically this balance would allow you more flexibility and more confidence that when you start to taper it, it would not lead to a reverse to a poor economy. Is that fair?

Ms. YELLEN. I think that is fair, Senator, because we are worried about a fragile recovery and a more supportive fiscal policy or one that, at least, had less drag that did no harm would make life easier.

Senator REED. Let me switch gears slightly, and that is that we were a few weeks ago discussing the possibility of default on our debt and the markets were beginning to react. And given the central role that Treasury securities play, not just in funding the Government, but also the tri-party repurchase markets, the collateral markets across the globe. Were you beginning to see at the Fed sort of ominous signs of a potential catastrophic impact of the default?

Ms. YELLEN. Well, Senator, I do believe that a default on the U.S. debt would be catastrophic, and we did see some signs in the run-up to the debt ceiling that suggested that financial markets were taking notice and that there were preemptive protective actions that market participants were beginning to do to protect themselves from what could have been catastrophic consequences.

More generally, I think we did see an impact on consumer and business confidence that is not helpful to a general willingness to make investments in the economy.

Senator REED. And just a final point. We have been talking a lot about the size of your portfolio, but essentially—and I do not want to over-simplify it—the benchmarks that typically you are looking at is inflation and deflation and unemployment.

Ms. YELLEN. Correct.

Senator REED. And I think for a while under Chairman Bernanke there was a real fear, particularly in 2009 and 2010, of deflation, which would have had adverse consequences. We have avoided that. We have avoided inflation pressures.

Ms. YELLEN. We have.

Senator REED. And what we have not yet done is got the employment numbers at a suitable level. So I think the focus, the traditional and appropriate focus is on those measures, rather than just the absolute size of your portfolio. Is that sensible?

Ms. YELLEN. I think that is sensible, Senator. We are very focused on achieving our dual mandate, which is, we absolutely want to avoid deflation. We have a 2 percent price stability objective. We are trying to get the economy back to full employment. I do think we have made progress, but we are not there yet.

On the other hand, as we recognized from the outset of the asset purchase program, there are costs and risks associated with a large balance sheet.

Senator REED. Thank you. Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Johanns.

Senator JOHANNS. Mr. Chairman, thank you. It is good to see you again and thanks so much for stopping by the office the other day.

Ms. YELLEN. It is my pleasure.

Senator JOHANNS. I felt like we had a good conversation and I would like to continue, if I could, with a few questions along the lines of what we talked about in my office.

I found your testimony about asset bubbles to be interesting. Just before the Chairman turned to me, I looked at where the dollar is at. It is about 15,850, an economy that, quite honestly, most everybody would recognize as too much unemployment, an economy where people continue to struggle, an economy where it is kind of hard to see where the growth is going to be.

We are now starting to see real estate bidding wars, just like the old days. Now, that is confined to cities in certain areas of the country. We are now starting to see private equity firms, who I think are very good at looking where the economy is headed, and lo and behold, they are buying single family houses.

That was a shocker to me, having owned a few rentals in the past. I was kind of amazed that they would do that. But obviously, they see something there. And so, Dr. Yellen, I kind of look at these factors and I think I could go on and on with some other items, and I must admit, what am I missing here?

I see asset bubbles. And I think if you were to announce today that over the next 24 months you are going to bring that balance sheet down from $4 trillion to zero, or $1 trillion, I think if you even said over the next 4 years we are going to bring it down from $4 trillion to zero, I think we would see how big those asset bubbles are. Would you not agree with me on that?

Ms. YELLEN. With respect to real estate, we certainly are seeing, as you mentioned, private investors come in to invest and often use all cash in certain markets in the country. Is that evidence of an asset bubble?

If you look at the markets where that is occurring, it is in some of the hardest hit, the markets where prices went up the most like Las Vegas or Phoenix. In my part of the country that had the biggest crashes where you have the largest number of foreclosures with houses being put on the market and many of these housing markets where these investments are taking place are ones where you have a substantial fraction of underwater borrowers and individuals who have lost houses, whose credit is impaired, who are not in a position to be buying houses, and these investors are purchasing these houses often at very low prices for cash and appear to be in the business of renting them out over a reasonably long period of time.

I would say, we have to watch this very carefully, but I do not see that as an asset bubble. I see that as a very logical response of the market to generate a recovery in very hard-hit areas.

Senator JOHANNS. Dr. Yellen, I do not want to be rude and interrupt you, but I am also running out of time. Here is what I would offer, and I think you would agree with me, although you probably will not want to agree with me in a public hearing setting.

But I think if I were to say to you, Why do you not announce today that you are going to draw this down over the next 24 months from $4 trillion to zero? I think you would see the impact of your policies on the value of real estate all across the United States, not just in the hardest hit areas. I think the real estate that I own and others own would go down in value.

I also think that the stock market would have the same sort of reaction that it has had when Chairman Bernanke just suggested that there might be a phase-down here. Here is what I am saying, because now I am out of time. I think the economy has gotten used to the sugar you have put out there and I just worry that we are on a sugar high.

That is a very dangerous thing for the little person out there who is just trying to pay the bills and maybe put a buck away for retirement. The last thing I will say, the flip side of your policies that you are advocating for are very, very hard on certain segments of our society.

You know, explain to the senior citizen who is just hoping that CD will earn some money so they do not have to dig into the principal, what impact you are having on a policy that says we are going to, for as far as the eye can see or foreseeable future, keep interest rates low. They are hurt by that policy.

Ms. YELLEN. Senator, I agree and I understand that savers are hurt by this policy, but, if we want to get back to business as usual and a normal monetary policy and normal interest rates, I would say we need to do that by getting the economy back to normal. And that is what this policy, I hope, will succeed in doing.

The other thing I think is important is to recognize that savers wear a lot of different hats. They play many different roles in the economy. They may be retirees who were hoping to get part-time work in order to supplement their income. They may be people who have children who were out of work and who were suffering because of that, or grandchildren who were going to college and coming out of college and hoped to be able to put their skills to work, finding good jobs and entering the job market when it is strong.

I think when those people who worry about our policy, thinking about themselves as savers, take into account the broader array of interest they have in a strong economy, they would see that these policies, even though they may harm them in one respect, are broadly beneficial to them as I believe they are to all Americans.

Senator JOHANNS. My time has expired. Thank you, Mr. Chairman.

Chairman JOHNSON. Thank you. Senator Heitkamp.

Senator HEITKAMP. Thank you, Mr. Chairman. And thank you, Dr. Yellen, for hanging in there with us. Those of us at the end of the desk will love an opportunity to ask you some questions, as well.

I want to get back to the Fed goal of full employment, and I want to ask you just some quick questions. Give me a number on what you consider full employment?

Ms. YELLEN. We do not have a precise estimate, but every 3 months all of the participants in the FOMC indicate what they think the normal, longer-run level of unemployment is. And in our most recent survey, in September, the range of opinion was 5 to 6 percent.

Senator HEITKAMP. OK. And tell me, what do you believe the real unemployment rate is today?

Ms. YELLEN. Well, the measured unemployment rate is 7.3 percent——

Senator HEITKAMP. I know what the measured unemployment rate is. That was not the question.

Ms. YELLEN. ——but as we have discussed previously, we have very high incidents of involuntary part-time employment. We have all too many people who appear to have dropped out of the labor force because they are discouraged——

Senator HEITKAMP. I do not want to belabor this Committee hearing any longer than what I have to but would you agree that it is at least close to or probably over 10 percent?

Ms. YELLEN. Well, certainly by broader measures, it is that high.

Senator HEITKAMP. And would you also agree that right now in America we have the greatest income disparity that we have had since the Great Depression, right before the Great Depression?

Ms. YELLEN. We have had widening wage inequality and income inequality in this country going back to the mid- to late-1980s, and that continues.

Senator HEITKAMP. So I just want to take a moment to speak for maybe those folks who are on the lower end who look at the Fed policy and look at the stock market, do not have a stake as they see it—as you just explained to Senator Johanns. We all have a stake in this economy, but they are day-to-day. They do not see a stake. They do not see their economic condition getting any better. And certainly, they do not see their employment opportunities getting any better, especially for those with low job skills. I will not say low education but low job skills.

So what can you do or what you done to address income disparity, unemployment disparity in this country? And what would you suggest that the Fed pursue to avoid the consequences long-term of that income disparity?

Ms. YELLEN. Senator, I think that you are asking about something that is a very deep problem that has afflicted the U.S. economy and other advanced economies. Economists have spent a lot of time trying to understand what is responsible for widening inequality.

Many of the underlying factors are things that are outside of the Federal Reserve's ability to address.

Senator HEITKAMP. Do you believe your policies have added to the problem?

Ms. YELLEN. I believe that the policies we have undertaken have been meant to generate a robust recovery. I would like to see the U.S. economy and the job market recovering more rapidly than they are, but I believe our policies have helped.

I think, as we saw during the 1990s, when we still had trends toward widening inequality, we did have real wage gains and we did have a reduction in inequality when we had an exceptionally strong and getting ever stronger job market.

So faster growth in the United States is going to help, a stronger job market. And you know, when the economy recovers, we are going to see firms be more willing to undertake training when they cannot find workers. They are going to be willing more to invest in people, to hire, to make capital investments that will make workers more productive when they are on the job, and we will see greater wage gains.

Senator HEITKAMP. Just a final comment. I would suggest that those at the bottom are not feeling the effects of these policies. The trickle down has not happened for them. And so they struggle every day and they may not see their wealth grow because they do not hold a lot of assets.

And so anything that you can do, taking a look at this broader issue—because this is an issue that will affect the American economy for years to come and affect our competitiveness in years to come. They are the consuming class. When you look at why consumers are not consuming, because we are not getting resources to those who do consume.

And so I thank you for your willingness to serve and look forward to a long relationship with you.

Ms. YELLEN. Thank you, Senator.

Chairman JOHNSON. Senator Manchin.

Senator MANCHIN. Thank you, Mr. Chairman. And thank you, Ms. Yellen. I enjoyed our visit and you have done a great job today.

Let me just say this, that I look at you and think if there is a person who involved the last time we had a balanced budget, the last time that we would have been on track to be debt free, if you go back to those days I am sure there was naysayers then said we could not do it, it will never happen. But you all did it.

And then we went off the tracks. What I am asking is how we get back on the tracks.

I know quantitative easing, you and I have a little difference of opinion on this, or concern. I have a concern but you have a concern. You have a little, I think, broader view of what has worked or not worked around the world. I think we spoke about Japan and why you believe that what we are doing needs to be done.

I would only say this, if $85 billion a month in quantitative easing has not really given us the results that we desired, why would you not recommend doing $200 billion a month? Why just $85 billion? We know that has not worked.

Of course, I have concerns with continuing it because I do not think—as I think that Senator Johanns had said—we are on a sugar high. The bottom line is you all have done your job. You have done everything possible to prop up this economy. We have failed miserably, as Congress, to do our job.

And to me, to get even a budget—we do not even have a budget—and then to say that we could have a balanced budget where people think we are crazy, it cannot happen, it will be too harmful, a balanced budget.

Those of us who were Governors and come from the executive branch, that is all we understand. We had to, by law.

And then to even thing that we could be debt free in the next generation or beyond. Do you think those are impossible or unreachable goals?

Ms. YELLEN. Well, Senator, I feel achieving debt sustainability over the medium term for this country is an exceptionally important goal.

Senator MANCHIN. Could we balance a budget again?

Ms. YELLEN. It requires very tough decisions, as you know——

Senator MANCHIN. Well, you all made decisions back in the 1990s. I remember the dialog, it could not be done.

Ms. YELLEN. Well, we did make tough decisions. Congress and the Administration made very tough decisions in the 1990s. They did it in a way that I would think would set a model, in a sense, for this Congress. When President Clinton was elected, the economy had high unemployment. It was just beginning to recover. The Administration and Congress wanted to achieve deficit reduction but to do so in a way that would not harm the economic recovery.

And so they agreed on a set of tax increases and spending cuts, not all of which came into effect immediately but were phased in over time.

There has been, at that time, a lot of uncertainty among businesses and in the markets, among households, about whether or not the Government would ever balance its budget. And the response was very positive. Long-term interest rates came down. Now the Fed had scope to use monetary policy to offset any adverse impact on the economy. But we really did not see a lot of adverse impact because of the fiscal tightness was phased in over a period of years and the economy enjoyed a long and robust boom.

Senator MANCHIN. Let me just say this, that you having that experience and lived through it, worked through it, and was successful with it. And we have the utmost respect for the Reserve, yourself, and I am sure that you see the Committee has that much respect for you.

We just need you to speak out and help us a little bit more and challenge us to do our job. If people like yourself, who are in the know, are unwilling to challenge us I will guarantee you we do not have the political will, it seems like, to do what needs to be done.

We have got to get our financial house in order. Every citizen in America has to face a budget. Every one of them has to live within that budget. And we are unwilling to make that difficult decision. We are on not only a sugar high, we are going to go into sugar shock pretty soon. That is what I have been talking—but unless we hear the unbridled truth from people in the know, people who have been there. They said you could not do it and you did it.

So it is not like it is the impossible dream. We have had budgets—we have not had one for five, going on 6 years. We have balanced budgets. And we have had surpluses. I would like to get back to that again, and I think people like yourself can help us be steered in that direction.

So be bold.

Ms. YELLEN. Thank you, Senator.

Senator MANCHIN. Be bold.

Ms. YELLEN. Thanks, I appreciate that.

Chairman JOHNSON. Senator Schumer.

Senator SCHUMER. Hi, thank you, Madame Chair, and thank everybody.

I just want to follow up first on a question that Heidi Heitkamp talked about. And I agree with Senator Manchin that the deficit is a serious problem. It is less of a problem than it was a year or two ago, and I know you acknowledge that. But it is not our greatest problem.

Our greatest problem is that middle class incomes are declining in America for the first time in American history, in my judgment, in terms of our political economy. And the amazing thing is they declined not just because of the recession but they actually declined between 2001 and 2007. And serendipitously, if that is a word, the person who alerted me to this tension was a professor at Harvard Law School named Elizabeth Warren, who wrote articles about this long before being a Senator was a gleam in her eye.

But it is our most serious problem. And if middle class incomes continue to decline, they declined close to 10 percent between 2001 and today, this is going to be a different America. I tell this particularly to business executives I meet. I get in New York, "what is all of this populism about?"

Well, I say you know, the American people are a generous people. And they do not mind if the people at the top income goes up 20 percent if theirs goes up 3 or 4 percent. When theirs starts going down, it is a different story. We have never had that in America.

So my question to you is how concerned are you about this? What impact will it have on growth and our economic potential? And does the Fed have tools to do this? I understand this relates to some of my Republican colleagues' skittishness about continuing some policies that maintain growth, but I do think—given the seriousness, at least, which I regard this problem—that the Fed has really a dual mandate which I know you observe, which is not simply keeping inflation down and not simply monitoring the budget deficit and its effects on our economy, but in trying to get jobs and middle class incomes back up again.

It is so serious, and frankly no one gives it the attention that it needs.

Ms. YELLEN. Well, Senator, I want to echo my agreement with you that this is a very serious problem. It is not a new problem. It is a problem that really goes back to the 1980s, in which we have seen a huge rise in income inequality with, as you said, for many, many years the middle and those below the middle actually losing absolutely. And frankly, a disproportionate share of the gains. It is not that we have not had pretty strong productivity growth for much of this time in the country. But a disproportionate share of those gains have gone to the top 10 percent, and even to the top 1 percent. So this is an extremely difficult and, to my mind, very worrisome problem.

There is a lot of research, a lot of debate about exactly what the causes of this problem are, perhaps having to do in part with the nature of technological change with globalization, with institutional changes in the United States including the decline of unions. But there are many things that are involved in this problem.

What can the Fed do? We cannot change all of those trends. The solutions involve a multitude of things, including education, maybe early childhood education, job training, other things.

But what we can do is try to achieve, as we are, a robust recovery so that we create jobs, we have a stronger job market. And in a stronger job market people who are having a lot of trouble getting jobs will be drawn into jobs. They will get better jobs. There will be more training. People will move up job ladders and opportunities will increase.

It is not going to put an end to the problems, these long-term structural problems that are driving this. But it will be helpful. And I think it is the contribution the Federal Reserve can try to make.

Senator SCHUMER. Just related to that, but in a specific, some of my colleagues have criticized for keeping rates "artificially low." But is not the zero lower bound on the short-term interest rates in some way also artificial? So let us say rates were 5 percent today but we had high unemployment, very low inflation. Would you not lower rates? And is not QE2 just another way to influence interest rates when you get close to the zero mark?

So if you did not do QE, would not real interest rates be artificially high, so to speak?

Ms. YELLEN. I think that is fair, if you judge what is high or low by the needs of the economy. People sometimes talk about a concept called the equilibrium real rate, it is what is natural given the levels of saving and investment in the economy. When there is a lot of saving and not very much investment, which is where we are now in a weak economy, the natural forces of the economy are pushing interest rates down. And it is these forces that we are trying to go with to—if we were to try to push rates up when the economy has that much saving and such weak investment, we would truly harm the recovery.

And of course, having pushed rates to zero, according to many estimates we would ideally have negative short-term interest rates. Of course, we cannot achieve that. And as you indicate, that is why we are trying to push down longer term interest rates.

Senator SCHUMER. I think you will—I think you will make a great Chair and your Brooklyn wisdom shines through.

[Laughter.]

Ms. YELLEN. Thank you, very much. I never forget my roots and I appreciate that.

Chairman JOHNSON. Thank you, Dr. Yellen, for your excellent testimony.

I ask the Members of this Committee to submit any written questions for the record for Dr. Yellen by close of business tomorrow. Dr. Yellen, please respond promptly so that the Committee may proceed to a markup as soon as possible.

This hearing is adjourned.

[Whereupon, at 12:16 p.m., the hearing was adjourned.]

[Prepared statement, biographical sketch of nominee, and responses to written questions supplied for the record follow:]

PREPARED STATEMENT OF JANET L. YELLEN

TO BE CHAIRMAN OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

NOVEMBER 14, 2013

Chairman Johnson, Senator Crapo, and Members of the Committee, thank you for this opportunity to appear before you today. It has been a privilege for me to serve the Federal Reserve at different times and in different roles over the past 36 years, and an honor to be nominated by the President to lead the Fed as Chair of the Board of Governors.

I approach this task with a clear understanding that the Congress has entrusted the Federal Reserve with great responsibilities. Its decisions affect the well-being of every American and the strength and prosperity of our Nation. That prosperity depends most, of course, on the productiveness and enterprise of the American people, but the Federal Reserve plays a role too, promoting conditions that foster maximum employment, low and stable inflation, and a safe and sound financial system.

The past 6 years have been challenging for our Nation and difficult for many Americans. We endured the worst financial crisis and deepest recession since the Great Depression. The effects were severe, but they could have been far worse. Working together, Government leaders confronted these challenges and successfully contained the crisis. Under the wise and skillful leadership of Chairman Bernanke, the Fed helped stabilize the financial system, arrest the steep fall in the economy, and restart growth.

Today the economy is significantly stronger and continues to improve. The private sector has created 7.8 million jobs since the post-crisis low for employment in 2010. Housing, which was at the center of the crisis, seems to have turned a corner—construction, home prices, and sales are up significantly. The auto industry has made an impressive comeback, with domestic production and sales back to near their pre-crisis levels.

We have made good progress, but we have farther to go to regain the ground lost in the crisis and the recession. Unemployment is down from a peak of 10 percent, but at 7.3 percent in October, it is still too high, reflecting a labor market and economy performing far short of their potential. At the same time, inflation has been running below the Federal Reserve's goal of 2 percent and is expected to continue to do so for some time.

For these reasons, the Federal Reserve is using its monetary policy tools to promote a more robust recovery. A strong recovery will ultimately enable the Fed to reduce its monetary accommodation and reliance on unconventional policy tools such as asset purchases. I believe that supporting the recovery today is the surest path to returning to a more normal approach to monetary policy.

In the past two decades, and especially under Chairman Bernanke, the Federal Reserve has provided more and clearer information about its goals. Like the Chairman, I strongly believe that monetary policy is most effective when the public understands what the Fed is trying to do and how it plans to do it. At the request of Chairman Bernanke, I led the effort to adopt a statement of the Federal Open Market Committee's (FOMC) longer-run objectives, including a 2 percent goal for inflation. I believe this statement has sent a clear and powerful message about the FOMC's commitment to its goals and has helped anchor the public's expectations that inflation will remain low and stable in the future. In this and many other ways, the Federal Reserve has become a more open and transparent institution. I have strongly supported this commitment to openness and transparency, and will continue to do so if I am confirmed and serve as Chair.

The crisis revealed weaknesses in our financial system. I believe that financial institutions, the Federal Reserve, and our fellow regulators have made considerable progress in addressing those weaknesses. Banks are stronger today, regulatory gaps are being closed, and the financial system is more stable and more resilient. Safeguarding the United States in a global financial system requires higher standards both here and abroad, so the Federal Reserve and other regulators have worked with our counterparts around the globe to secure improved capital requirements and other reforms internationally. Today, banks hold more and higher-quality capital and liquid assets that leave them much better prepared to withstand financial turmoil. Large banks are now subject to annual "stress tests" designed to ensure that they will have enough capital to continue the vital role they play in the economy, even under highly adverse circumstances.

We have made progress in promoting a strong and stable financial system, but here, too, important work lies ahead. I am committed to using the Fed's supervisory and regulatory role to reduce the threat of another financial crisis. I believe that capital and liquidity rules and strong supervision are important tools for addressing the problem of financial institutions that are regarded as “too big to fail.” In writing new rules, however, the Fed should continue to limit the regulatory burden for community banks and smaller institutions, taking into account their distinct role and contributions. Overall, the Federal Reserve has sharpened its focus on financial stability and is taking that goal into consideration when carrying out its responsibilities for monetary policy. I support these developments and pledge, if confirmed, to continue them.

Our country has come a long way since the dark days of the financial crisis, but we have farther to go. Likewise, I believe the Federal Reserve has made significant progress toward its goals but has more work to do.

Thank you for the opportunity to appear before you today. I would be happy to respond to your questions.

STATEMENT FOR COMPLETION BY PRESIDENTIAL NOMINEES

Name:	Yellen	Janet	Louise
	(Last)	(First)	(Other)

Position to which nominated: Chairman of the Board of Governors of the Federal Reserve System

Date of nomination:

Date of birth: 13 (Day) 08 (Month) 1946 (Year) **Place of birth:** Brooklyn, New York

Marital Status: Married **Full name of spouse:** George Arthur Akerlof

Name and ages of children: Robert Joseph Akerlof, 32.

Education:

Institution	Dates attended	Degrees received	Dates of degrees
Brown University	1963-67	B.A	6/67
Yale University	1967-71	Ph. D.	12/71

Honors and awards: List below all scholarships, fellowships, honorary degrees, military medals, honorary society memberships and any other special recognitions for outstanding service or achievement.

Phi Beta Kappa, 1966
B.A. *summa cum laude* with highest honors in economics, Brown University, 1967
National Science Foundation Graduate Fellowship, 1967-71
Honorary Woodrow Wilson Fellowship, 1967
Guggenheim Fellow, 1986-87
Maria and Sidney Rolfe Award for National Economic Service, Women's Economic Round Table, October 1997
Wilbur Lucius Cross Medal, Yale University, May 1997
Honorary Doctor of Laws degree, Brown University, May 1998
Honorary Doctor of Humane Letters degree, Bard College, May 2000
Fellow, American Academy of Arts and Sciences, 2001
Berkeley Fellow, 2012
Distinguished Fellow, American Economic Association, 2012

Memberships: List below all memberships and offices held in professional, fraternal, business, scholarly, civic, charitable and other organizations.

Organization	Office held (if any)	Dates
Group of Thirty	Member	2009-2010
Children's Hospital of Oakland	Honorary Member, Board of Directors	2008-2010

Bay Area Council	Member of the Executive Committee	2007-2010
University of California	Professor Emeritus	2006-present
Council on Foreign Relations	Member	2005-present
	Term Member	1976-1981
National Science Foundation	Committee of Visitors	2004, 1996
	Economics Advisory Panel	1977-78, 1991-92
American Economic Association	Vice President	2004-2005
	Nominating Committee	1988-1990
	Advisory Committee to Pres.	1986-1987
	Member	1971-present
Pacific Council on International Policy	Board of Directors	2004-2008
Western Economics Association	President	2003-2004
Macroeconomic Advisers	Senior Adviser	2003-2004
Delta Dental of California	Member Bd of Directors	2003-2004
California Assembly Select Committee on Asian Trade	Advisory Board	2003
Jerome Levy Economics Institute	Board of Advisers	2002-2004
Economists for Peace and Security	Trustee	2002-2010
American Academy of Arts and Sciences	Member	2001-present
Yale University	Fellow of the Corporation	2000-2006
National Academy of Sciences	Panel Member	2000
The Faculty Club, University of California At Berkeley	Director	2000-2002
	Member	1982-present
Yale Club of San Francisco	Member	2000-2004; 1993-1996
National Bureau of Economic Research	Research Associate	1999-2010
Center for International Political Economy	Advisory Board	1999-2004
Brookings Panel on Economic Activity	Advisory Board	1999-2004
	Senior Advisor	1989-1994
	Member	1987-88, 1990-91
Women's Economic Roundtable	Advisory Board	1999-2004
OECD High Level Sustainable Development Group	Member	1999-2001
Barter Trust	Adviser	1999-2000
OECD Economic Policy Committee	Chair	1997-1999
President's Interagency Committee on Women's Business Enterprise	Chair	1997-1999
British Ambassador's Advisory Committee For the Marshall Fellowships	Member	1996-1997
Rollingwood Citizens Assn.	Member	1996-1999
Chevy Chase Recreation Assn	Member	1994-1999
Congressional Budget Office	Panel of Economic Advisers	1993-1994
International Trade and Finance Assn.	Member	1990-1994
Journal of Economic Perspectives	Associate Editor	1987-1991
Hadassah	Member	1987-present
Committee on the Status of Women In the Economics Profession	Member	1985-1996
Congregation Beth El	Member	1983-1994

Hiller Highlands Country Club	Member	1978-present
Yrjö Jahnsson Foundation	Lecturer on Macroeconomics	1977-1978

Employment record: List below all positions held since college, including the title or description of job, name of employment, location of work, and inclusive dates of employment.

2010 – present	Vice Chairman, Board of Governors of the Federal Reserve System, Washington, D.C.
2004-2010	President and Chief Executive Officer, Federal Reserve Bank of San Francisco, San Francisco, California
1999 – 2004	Eugene E. and Catherine M. Trefethen Professor of Business and Professor of Economics, University of California, Berkeley
1997-1999	Chairman, Council of Economic Advisers, The White House, Washington, D.C.
1994-1997	Member, Board of Governors of the Federal Reserve System, Washington, D.C.
1992-1994	Bernard T. Rocca Jr. Professor of International Business and Trade, Walter A. Haas School of Business, University of California, Berkeley
1985-1992	Professor, Walter A. Haas School of Business, University of California, Berkeley
1982-1985	Associate Professor, School of Business Administration, University of California, Berkeley
1980-1982	Assistant Professor, School of Business Administration, University of California, Berkeley
1978-1980	Lecturer, London School of Economics and Political Science, London, England
1977-1978	Economist, Division of International Finance, Trade and Financial Studies Section, Board of Governors of the Federal Reserve System, Washington, D.C.
1971-1976	Assistant Professor of Economics, Harvard University, Cambridge, MA.
1974-1975	Consultant, Division of International Finance, Board of Governors of the Federal Reserve System, Washington, D.C.
1969-1971	Teaching Fellow and Research Assistant,, Yale University, New Haven, Connecticut
1967	Summer Intern, Women's Bureau, U.S. Department of Labor, Washington, D.C.

Government Experience: List any experience in or direct association with Federal, State, or local governments, including any advisory, consultative, honorary or other part time service or positions.

2010-present	Vice Chairman, Board of Governors of the Federal Reserve System
2004-2010	President and CEO, Federal Reserve Bank of San Francisco (The Federal Reserve Banks were chartered by Congress to fulfill a public purpose and are part of the Federal Reserve System. The Federal Reserve Banks are not, however, considered Federal government agencies and are usually not deemed to be part of the Federal government.)
2003	California Assembly Select Committee on Asian Trade, Advisory Board, 2003
2000	National Academy of Sciences, member of a panel on Ensuring the Best Presidential Science and Technology Appointments
1997-1999	Chairman, Council of Economic Advisers, the White House
1994-1997	Member, Board of Governors of the Federal Reserve System
1993	Congressional Budget Office – Panel of Economic Advisers
1977-2004	National Science Foundation Committee of Visitors, Advisory Panel in Economics, Visiting Committee and other NSF review panels

1977-1978	Economist, Division of International Finance, Trade and Financial Studies Section, Board of Governors of the Federal Reserve System, Washington, D.C.
1974-1975	Consultant, Division of International Finance, Board of Governors of the Federal Reserve System, Washington, D.C.
1974-1975	Consultant, Congressional Budget Office
1967	Summer Intern, Women's Bureau, U.S. Department of Labor, Washington, D.C.

Published Writings: List the titles, publishers and dates of books, articles, reports or other published materials you have written.

I have done my best to identify titles, publishers and dates of books, articles, reports or other published materials, including a thorough review of personal files and searches of publicly available electronic databases. Despite my searches, there may be other materials I have been unable to identify, find or remember. I have located the following:

"Consequences of a Tax on the Brain Drain for Unemployment and Income Inequality in Less Developed Countries," (with Rachel McCulloch), *Journal of Development Economics*, September 1975; reprinted in J. Bhagwati, editor, *The Brain Drain and Taxation: Theory and Empirical Analysis*, North Holland, 1976.

"Commodity Bundling and the Burden of Monopoly," (with William James Adams), *Quarterly Journal of Economics*, August 1976.

The Limits of the Market in Resource Allocation (with Kenneth Arrow and Steven Shavell), Japan Trade Council, monograph, 1977.

"Factor Mobility, Regional Development and the Distribution of Income," (with Rachel McCulloch), *Journal of Political Economy*, February 1977.

"What Makes Advertising Profitable?" (with William James Adams), *The Economic Journal*, September 1977.

"Factor Market Monopsony and the Allocation of Resources," (with Rachel McCulloch), *Journal of International Economics*, January 1980.

"On Keynesian Economics and the Economics of the Post-Keynesians," *American Economic Review, Papers and Proceedings*, May 1980; reprinted in *John Maynard Keynes: Critical Assessments*, Vol. 4, John Wood, editor, Croom Helm Ltd., 1983.

"Can Capital Movements Eliminate the Need for Technology Transfer?' (with Rachel McCulloch), *Journal of International Economics*, May 1982.

"Technology Transfer and the National Interest," (with Rachel McCulloch), *International Economic Review*, May 1982.

"Efficiency Wage Models of Unemployment," *American Economic Review, Papers and Proceedings*, May 1984; reprinted in *New Keynesian Economics,* Vol. 2, *Coordination Failure and Real Rigidites,* N. Gregory Mankiw and David Romer, editors, MIT Press, 1991.

"Unemployment through the Filter of Memory," (with George Akerlof), *Quarterly Journal of Economics*, August 1985.

"A Near-Rational Model of the Business Cycle with Wage and Price Inertia," (with George Akerlof), *Quarterly Journal of Economics*, September 1985; reprinted in *New Keynesian Economics,* Vol. 1, *Imperfect Competition and Sticky Prices,* N. Gregory Mankiw and David Romer, editors, MIT Press, 1991.

"Can Small Deviations from Rationality Make Significant Differences to Economic Equilibria?" (With George Akerlof), *American Economic Review*, September 1985.

Efficiency Wage Models of the Labor Market (with George Akerlof), an edited collection of papers with an introduction by the authors, Cambridge University Press, 1986.

"Rational Models of Irrational Behavior," (with George Akerlof) *American Economic Review, Papers and Proceedings*, May 1987.

"Fairness and Unemployment," (with George Akerlof), *American Economic Review, Papers and Proceedings*, May 1988.

"Discussion" of "The New Keynesian Economics and the Output-Inflation Trade-off," (with George Akerlof and Andrew Rose) *Brookings Papers on Economic Activity*, 1988:1.

"Job Switching and Job Satisfaction in the U.S. Labor Market," (with George Akerlof and Andrew Rose), *Brookings Papers on Economic Activity*, 1988:2.

"Is There a J-Curve?" (with Andrew Rose), *Journal of Monetary Economics*, July 1989.

"Introduction" to "Symposium on the Budget Deficit," *Journal of Economic Perspectives*, Summer 1989.

"Discussion" of "The Beveridge Curve," (with George Akerlof), *Brookings Papers on Economic Activity*, 1989:1.

"The Fair Wage/Effort Hypothesis and Unemployment," (with George Akerlof), *Quarterly Journal of Economics*, May 1990.

"How Large are the Losses from Rule of Thumb Behavior in Models of the Business Cycle?" (with George Akerlof) in William Brainard, William Nordhaus and Harold Watts, eds., *Money, Macroeconomics and Economic Policy: Essays in Honor of James Tobin*, Cambridge, Mass: M.I.T. Press, 1991.

"East Germany In From the Cold: The Economic Aftermath of Currency Union," (with George Akerlof, Andrew Rose and Helga Hessenius), *Brookings Papers on Economic Activity*, 1991:1.

"Discussion" of "Unemployment, Non-Employment and Wages: Why Has the Natural Rate Increased through Time?" (with George Akerlof) *Brookings Papers on Economic Activity*, 1991:2.

Comment on "East German Economic Reconstruction," by Rudiger Dornbusch and Holger C. Wolf, in *The Transition in Eastern Europe*, Olivier Jean Blanchard, Kenneth A. Froot and Jeffrey Sachs, editors, NBER and University of Chicago Press, 1994.

"Gang Behavior, Law Enforcement and Community Values," (with George Akerlof), in Henry Aaron, Thomas Mann and Timothy Taylor, eds., *Values and Public Policy*, Brookings Institution, 1994.

"An Analysis of Out-of-Wedlock Childbearing in the United States," (with George Akerlof and Michael Katz), *Quarterly Journal of Economics,* May 1996.

"Technology Shock, Demise of Shotgun Marriage, and the Increase in Out-of-Wedlock Births", (with George Akerlof) *Brookings Review*, Fall 1996.

"An Analysis of Out-Of-Wedlock Births in the United States," (with George Akerlof) *Brookings Policy Brief*, August 1996, No. 5.

"Why Kids Have Kids: Don't Blame Welfare, Blame 'Technology Shock'," (with George Akerlof) *Slate*, November 15, 1996, http:/www.slate.com/Features /TeenPregnancy/TeenPregnancy.asp

"Monetary Policy: Goals and Strategy," *Business Economics*, July 1996.

"The 'new' science of credit risk management," *The Region*, Federal Reserve Bank of Minneapolis, September 1996.

"Plan Helps Families, Nation," *USA Today,* July 30, 1997 at 12A.

"Trends in Income Inequality and Policy Responses," *Looking Ahead*, October 1997 and James Auerbach and Richard Belous eds., *The Inequality Paradox: Growth of Income Disparity*, National Policy Association, 1998.

"The Continuing Importance of Trade Liberalization," *Business Economics*, January 1998.

Economic Report of the President, February 1998. (with Jeffrey Frankel and Rebecca Blank)

Economic Report of the President, February 1999. (with Jeffrey Frankel and Rebecca Blank).

The Fabulous Decade: Macroeconomic Lessons from the 1990s (with Alan Blinder), The Century Foundation Press, New York, 2001. Reprinted in *The Roaring Nineties: Can Full Employment be Sustained?* Edited by Alan B. Krueger and Robert Solow, Russell Sage Foundation and Century Foundation, New York, 2001. Korean translation published by the Korea Institute of Public Finance, 2003.

"Is He Making the Grade?" *The International Economy,* 15(5), 21 (2001).

"Overview Panel Commentary," in Economic Policy for the Information Economy, Proceedings of a Symposium Sponsored by the Federal Reserve Bank of Kansas City, Jackson Hole, Wyoming -- August 30 - September 1, 2001.

"Discussion" of "Capital and Migration Constraints on the Economic Integration of Eastern Germany" by Michael Burda and Jennifer Hunt, *Brookings Papers on Economic Activity*, 2001:2.

"Yale Economics in Washington," Foreword to James Tobin, *World Finance and Economic Stability*, Edward Elgar, London, 2002.

"The Binge Mentality in the Federal Budget," *The New York Times,* July 22, 2002.

"Government Needs a Return to Fiscal Discipline," *The Times Union* (Albany, NY), October 27, 2002, at B1.

"Discussion" of "Robust Monetary Policy Rules," by Athanasios Orphanides and John Williams, *Brookings Papers on Economic Activity*, 2002:2.

"Waiting for Work," with George Akerlof and Andrew Rose, in *Economics for an Imperfect World: Essays in Honor of Joseph Stiglitz*, edited by Richard Arnott, Bruce Greenwald, Ravi Kanbur, and Barry Nalebuff, M.I.T. Press, 2003.

Comments on Daniel Benjamin and David Laibson, "Good Policies for Bad Governments: Behavioral Political Economy," Federal Reserve Bank of Boston Conference: "How Humans Behave: Implications for Economics and Economic Policy," June 8-10, 2003.

"Putting State's Budget Conundrum in Perspective," with George Akerlof and Alan Auerbach, *Sacramento Bee,* July 23, 2003 at B7.

"Overview Panel Commentary," in Monetary Policy and Uncertainty: Adapting to a Changing Economy; Proceedings of a Symposium Sponsored by the Federal Reserve Bank of Kansas City, Jackson Hole, Wyoming – August 28-30, 2003.

"Coordinating Monetary and Fiscal Policies," in *Stabilizing the Economy*" edited by Adam S. Posen and Benn Steil, Blackwell Publishers, 2004.

"Foreword," to *Painting the White House Green: Environmental Policy inside the Executive Office of the President*," edited by Randy Lutter and Jason Shogren, Resources for the Future, 2004.

"Discipline and Judgment in Monetary Policy: The Greenspan Years," presented at AEA session on "Innovations and Issues in Monetary Policy: The Last 15 Years," January 3, 2004; *American Economic Review: Papers and Proceedings*, May 2004.

"Stabilization Policy: A Reconsideration," (with George Akerlof), Presidential Address to the Western Economic Association, *Economic Inquiry*, 2006 (44)1: pp. 1-22.

"Enhancing Fed Credibility," *Business Economics*, April 2006, pp. 45-51.

"Reflections on China's Economy," *Economic Letter*, Federal Reserve Bank of San Francisco, Nov. 5, 2004.

"Productivity and Inflation," *Economic Letter*, Federal Reserve Bank of San Francisco, February 18, 2005.

"Policymaking on the FOMC: Transparency and Continuity," *Economic Letter*, Federal Reserve Bank of San Francisco, September 2, 2005.

"2006: A Year of Transition at the Federal Reserve," *Economic Letter*, Federal Reserve Bank of San Francisco, January 27, 2006.

"Enhancing Fed Credibility," *Economic Letter*, Federal Reserve Bank of San Francisco, March 17 2006.

"Prospects for the Economy," *Economic Letter*, Federal Reserve Bank of San Francisco, April 28, 2006.

"Monetary Policy in a Global Economy," *Economic Letter*, Federal Reserve Bank of San Francisco, June 2, 2006.

"A Monetary Policymaker's Passage to India," *Economic Letter*, Federal Reserve Bank of San Francisco, July 7, 2006.

"Economic Inequality in the United States," *Economic Letter*, Federal Reserve Bank of San Francisco, December 1, 2006.

"Update on China: A Monetary Policymaker's Report," *Economic Letter*, Federal Reserve Bank of San Francisco, March 9, 2007.

"The U.S. Economy and Monetary Policy," *Economic Letter*, Federal Reserve Bank of San Francisco, July 13, 2007.

"Recent Financial Developments and the U.S. Economic Outlook," *Economic Letter*, September 13, 2007.

"The U.S. Economy and Monetary Policy," *Economic Letter*, Federal Reserve Bank of San Francisco, December 7, 2007.

"Prospects for the Economy in 2008," *Economic Letter*, Federal Reserve Bank of San Francisco, February 8, 2008.

"Economic Conditions in Singapore and Vietnam: A Monetary Policymaker's Report," *Economic Letter*, Federal Reserve Bank of San Francisco, February 22, 2008.

"The Financial Markets, Housing and the Economy," *Economic Letter*, Federal Reserve Bank of San Francisco, April 18, 2008.

"The U.S. Economic Situation and the Challenges for Monetary Policy," *Economic Letter*, Federal Reserve Bank of San Francisco, September 19, 2008

"The Mortgage Meltdown, Financial Markets, and the Economy," *Economic Letter*, Federal Reserve Bank of San Francisco, November 7, 2008.

"The Path to Recovery," Origination News, 17(12), 4 (September 2008).

"Economic Conditions in Korea and Japan: A Monetary Policymaker's Report," *Economic Letter*, Federal Reserve Bank of San Francisco, December 19, 2008.

" U.S. Monetary Policy Objectives in the Short and Long Run," *Economic Letter*, Federal Reserve Bank of San Francisco, January 9, 2009.

"A Minsky Meltdown: Lessons for Central Bankers," *Economic Letter*, Federal Reserve Bank of San Francisco, May 1, 2009.

"A View of the Economic Crisis and the Federal Reserve's Response," *Economic Letter*, Federal Reserve Bank of San Francisco, July 6, 2009.

"Linkages between Monetary and Regulatory Policy: Lessons from the Crisis," *Economic Letter*, Federal Reserve Bank of San Francisco, November 23, 2009.

"Hong Kong and China and the Global Recession," *Economic Letter*, Federal Reserve Bank of San Francisco, February 8, 2010.

Political Affiliations and activities: List memberships and offices held in and services rendered to all political parties or election committees during the last 10 years.

None.

Political Contributions: Itemize all political contributions of $500 or more to any individual, campaign organization, political party, political action committee or similar entity during the last eight years and identify specific amounts, dates, and names of recipients.

None.

Qualifications: State fully your qualifications to serve in the position to which you have been named.

I have served as Vice Chairman of the Board of Governors of the Federal Reserve System since October 2010, as President and Chief Executive Officer of the Federal Reserve Bank of San Francisco from 2004 to 2010 and as Governor of the Federal Reserve System between August 1994 and February 1997. Through this service, I have acquired experience in every area of responsibility of the Federal Reserve System including monetary policy, financial stability, banking supervision and regulation, consumer and community affairs, and the operation of the payments system.

With respect to monetary policy, I have participated both as a Governor and as a Reserve Bank President in the deliberations of the the Federal Open Market Committee. During the last three years, I have chaired the Communications subcommittee of the FOMC, which is committed to enhancing the transparency and clarity of monetary policy communications concerning the FOMC's forecasts, objectives and monetary policy strategy. My goal in the FOMC is to bring a thoughtful and independent view to the FOMC's deliberations on monetary policy. My views on policy are informed by economic analysis of macroeconomic trends relevant to assessing the economic outlook and risks to the forecast. As a Reserve Bank President, I shared the insights that I gained through my many contacts with business and community leaders in the Twelfth District. I have been committed to insuring that policy fosters the attainment of the dual goals assigned to the Federal Reserve by Congress—price stability and maximum employment.

During the last three years, I have overseen the Federal Reserve's work on financial stability, particularly its new Office of Financial Stability, Policy and Research. In addition, I've headed the Board's Payments System Committee, which oversees our supervision of Designated Financial Market Utilities as well as regulatory policy issues pertaining to the payments system. I also chair the Board's Bank Activities Committee, through which the Board exercises its oversight of the Reserve Banks. And I have represented the Board in a number of international fora, including the BIS, G7 and G20. In the area of banking supervision, I acquired first hand experience in its conduct through my oversight of the Federal Reserve Bank of San Francisco's banking supervision and regulation division. This division, which operated under delegated authority from the Board of Governors and subject to the Board's oversight and policy guidance, is responsible for supervising state member banks and bank holding companies in the nine district states comprising the Fed's Twelfth District. As President and CEO, I participated directly in this important supervisory work and oversaw its conduct. I believe this experience greatly enhanced my understanding of the challenges facing supervisors in both complex financial holding companies and smaller community banks and it has informed my thinking about the changes that are needed in supervision and regulation to enhance the safety and soundness of the banking system and the financial system more broadly to promote financial stability.

My training is as a professional economist with a specialty in macroeconomics and international economics. I have published original research on a wide variety of topics in international and macroeconomics. I am best known for my work exploring the causes of price and wage rigidity. This work provides a basic rationale for the use of monetary policy to stabilize the economy. My research has also focused on the causes and consequences of unemployment.

From 1980 until I joined the Federal Reserve Board as a Governor, and for five years after leaving the Council of Economic Advisers, I served on the faculty of the Walter A. Haas School of Business at the University of California, Berkeley where I taught international and macroeconomics in the MBA and executive education programs of the School. Beginning in 1999, I also held a faculty appointment in the Department of Economics.

I received my B.A. *summa cum laude* from Brown University in 1967 and my Ph. D. in economics from Yale University in 1971. From 1971 to 1976 I served on the faculty of the Economics Department at Harvard University, after which I served as an economist in the International Finance Division of the Federal Reserve Board. I was a faculty member at the London School of Economics and Political Science before moving to Berkeley.

Future employment relationships:

1. Indicate whether you will sever all connections with your present employer, business firm, association or organization if you are confirmed by the Senate.

If I am confirmed by the Senate for this position, I will remain with the same employer--the Board of Governors of the Federal Reserve System.

2. As far as can be foreseen, state whether you have any plans after completing government service to resume employment, affiliation or practice with your previous employer, business firm, association or organization.

I have no such plans.

3. Has anybody made you a commitment to a job after you leave government?

No.

4. Do you expect to serve the full term for which you have been appointed?

Yes.

Potential conflicts of interest:

1. Describe any financial arrangements or deferred compensation agreements or other continuing dealings with business associates, clients or customers who will be affected by policies which you will influence in the position to which you have been nominated.

I have accrued pension and retiree medical benefits due to my employment at the San Francisco Fed, in which I now have a vested interest. After moving to the Board of Governors in 2010, I have not accrued any additional benefits financed by the Federal Reserve Bank of San Francisco. The Board of Governors, which I will Chair, if confirmed, has oversight responsibility for the Federal Reserve Banks, including the Federal Reserve Bank of San Francisco.

2. List any investments, obligations, liabilities, or other relationships which might involve potential conflicts of interest with the position to which you have been nominated.

In connection with the nomination process, I have consulted with the Office of Government Ethics and the Federal Reserve Board's Designated Agency Ethics Official (DAEO) to identify potential conflicts of interest. Any potential conflicts of interest will be resolved in accordance with the terms of an ethics agreement that I have entered into with the Board's DAEO and that has been provided to this Committee. I am not aware of any other potential conflicts of interest.

3. Describe any business relationship, dealing or financial transaction (other than tax paying) which you have had during the last 10 years with the Federal Government, whether for yourself, on behalf of a client, or acting as an agent, that might in any way constitute or result in a possible conflict of interest with the position to which you have been nominated.

In connection with the nomination process, I have consulted with the Office of Government Ethics and the Federal Reserve Board's Designated Agency Ethics Official (DAEO) to identify potential conflicts of interest. Any potential conflicts of interest will be resolved in accordance with the terms of an ethics agreement that I have entered into with the Board's DAEO and that has been provided to this Committee. I am not aware of any other potential conflicts of interest.

4. List any lobbying activity during the past ten years in which you have engaged in for the purpose of directly or indirectly influencing the passage, defeat or modification of any legislation at the national level of government or affecting the administration and execution of national law or public policy.

None.

5. Explain how you will resolve any conflict of interest that may be disclosed by your responses to the items above.

In connection with the nomination process, I have consulted with the Office of Government Ethics and the Federal Reserve Board's Designated Agency Ethics Official (DAEO) to identify any potential conflicts of interest. Any potential conflicts of interest will be resolved in accordance with the terms of an ethics agreement that I have entered into with the Board's DAEO and that has been provided to this Committee. I am not aware of any other potential conflicts of interest.

Civil, criminal and investigatory actions:

1. Give the full details of any civil or criminal proceeding in which you were a defendant or any inquiry or investigation by a Federal, State, or local agency in which you were the subject of the inquiry or investigation.

None.

2. Give the full details of any proceeding, inquiry or investigation by any professional association including any bar association in which you were the subject of the proceeding, inquiry or investigation.

None.

2. List sources, amounts and dates of all anticipated receipts from deferred income arrangements, stock options, uncompleted contracts and other future benefits which you expect to derive from previous business relationships, professional services and firm memberships or from former employers, clients, and customers.

Janet L. Yellen

Signed:______________________________ Date: October 24, 2013

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CRAPO FROM JANET L. YELLEN

Q.1. The Federal Reserve is currently developing the regulatory framework for the first nonbank financial institutions designated by the Financial Stability Oversight Council. Chairman Bernanke and Governor Tarullo have stated that the Collins Amendment limits the Fed's ability to regulate insurance companies differently than bank holding companies. Do you agree that the Fed is constrained by the Collins Amendment? If the Fed is required to apply bank-like capital requirements to insurers, would you support bipartisan legislation to address that?

A.1. Section 171 of the Dodd-Frank Act, by its terms, requires the appropriate Federal banking agencies to establish minimum risk-based and leverage capital requirements for bank holding companies (BHCs), savings and loan holding companies (SLHCs), and nonbank financial companies supervised by the Board (supervised nonbank companies) on a consolidated basis. This statutory provision further provides that these minimum capital requirements "shall not be less than" the generally applicable capital requirements for insured depository institutions. In addition, the minimum capital requirements cannot be "quantitatively lower than" the generally applicable capital requirements for insured depository institutions that were in effect in July 2010. Section 171 does not contain an exception from these requirements for an insurance company (or any other type of company) that is a BHC, SLHC, or supervised nonbank company (Board-regulated company), or for a Board-regulated company that has an insurance company subsidiary. This requirement constrains the scope of the Board's discretion in establishing minimum capital requirements for Board-regulated companies.

The final capital rule approved by the Board earlier this year, [1] did, however, take into consideration differences between the banking and insurance business within these constraints. The final capital rule included specific capital treatment for policy loans and separate accounts, which are assets typically held by insurance companies but not by banks. Additionally, the Board determined to defer application of the final capital rule to SLHCs with significant insurance activities (i.e., those with more than 25 percent of their assets derived from insurance underwriting activities other than credit insurance) and to SLHCs that are themselves State regulated insurance companies.

To the extent permitted by law, the Board continues to carefully consider how to design capital rules for Board-regulated companies that are insurance companies or that have subsidiaries engaged in insurance underwriting in determining how to design an appropriate capital framework for these companies.

Q.2. The Dodd-Frank Act created an expanded regulatory structure in which the Fed plays a significant role. Dodd-Frank significantly expanded the Board's regulatory authority over banking institutions, financial firms, and their subsidiaries, and new authority over several types of other institutions, as well as to monitor finan-

[1] *See,* 11 FR 62018 (October 11, 2013).

cial system risk. How will you balance these expanded responsibilities with the Fed's traditional mandate and political independence?

A.2. The Dodd-Frank Act instituted substantial changes to financial sector supervision and regulation. For instance, the Act established the multiagency Financial Stability Oversight Council (Council), of which the Chairman of the Board is a member, in order to promote a more comprehensive approach to monitoring and mitigating systemic risk. In addition to the Board's role as a member of the Council, the Dodd-Frank Act gives the Board other new important responsibilities. These responsibilities include supervising nonbank financial firms that are designated as systemically important by the Council, supervising thrift holding companies, and developing enhanced prudential standards—including those for capital, liquidity, stress tests, single-counterparty credit limits, and living will requirements—for large bank holding companies and systemically important nonbank financial firms designated by the Council. In addition, the Dodd-Frank Act expanded the supervisory responsibilities of the Board and the other Federal banking agencies to include consideration of the effects on financial stability in the United States of the operations of banking organizations that we each supervise.

The Board's duty to supervise financial institutions for safety and soundness and financial stability is complementary to the Board's monetary policy mandate to pursue maximum employment, stable prices, and moderate long-term interest rates. While the Dodd-Frank Act expanded the Board's supervisory and financial stability duties, the Federal Reserve's role as a supervisor of banking organizations is longstanding and dates from the founding of the Federal Reserve System a century ago. The Federal Reserve has long operated in the role of a banking supervisor as an independent agency.

The Board has made a number of internal changes to better carry out its responsibilities. Prior to the enactment of the Dodd-Frank Act, we had begun to reorient our supervisory structure to strengthen supervision of the largest, most complex financial firms, through the creation of the Large Institution Supervision Coordinating Committee, a centralized, multidisciplinary body. Relative to previous practices, this body makes greater use of horizontal, or cross-firm, evaluations of the practices and portfolios of firms. It relies more on additional and improved quantitative methods for evaluating the performance of firms, and it employs the broad range of skills of the Federal Reserve staff more efficiently.

In addition, we have reorganized to more effectively coordinate and integrate policy development for and supervision of systemically important financial market utilities. As the Dodd-Frank Act recognizes, supervision should take into account the overall financial stability of the United States, in addition to the safety and soundness of each individual firm. Our revised internal organizational structure facilitates our implementation of this macroprudential approach to oversight.

Q.3. In December of 2012, the GAO issued a report on Dodd-Frank implementation and found deficiencies with most agencies' cost benefit analyses. One concern is that agencies are not considering the cumulative burden of the new rules. The Board does not have an express mandate to conduct economic analysis in connection with its rulemakings. However, economic analysis is a useful tool for tracking the impacts of all of these new rules. Are you willing to perform economic and regulatory analysis for new Fed rules?

A.3. I agree that economic analysis is a useful tool for evaluating the potential impacts of rulemakings and support the Federal Reserve's continued use of this tool.

The Federal Reserve takes quite seriously the importance of evaluating the burdens imposed by our rulemaking efforts. To become informed about these benefits and costs, before we develop a regulatory proposal we often collect information directly from parties that we expect will be affected by the rulemaking through surveys of affected parties and meetings with interested parties and their representatives. This helps us craft a proposal that is both effective and minimizes regulatory burden. In the rulemaking process, we also generally seek comment from the public on the costs and benefits of our proposed approach as well as on a variety of alternative approaches to the proposal. In adopting the final rule, we consider a variety of alternatives and seek to adopt a regulatory alternative that faithfully reflects the statutory provisions and the intent of Congress while minimizing regulatory burden. We also provide an analysis of the costs to small depository organizations of our rulemaking consistent with the Regulatory Flexibility Act and compute the anticipated cost of paperwork consistent with the Paperwork Reduction Act.

Q.4. With several rulemakings affecting foreign banking organizations, including under Section 165 of Dodd-Frank and the Volcker rule, some have argued that these proposals could risk a protectionist backlash from foreign Governments that could make it more difficult and costly for U.S. banks to operate abroad. What would you do differently to encourage and foster international cooperation?

A.4. Since the financial crisis, the Federal Reserve has consistently worked with its international counterparts to increase the stability of the global financial system and to promote economic growth. U.S. and global financial stability and the preservation of competitive equity among U.S. and foreign banks can be best achieved by reaching global agreements on the core financial sector reforms. In the core reform areas, our efforts have led to a number of internationally agreed regulatory approaches, such as the Basel III capital and liquidity frameworks for global banks. In some instances, however, it has been appropriate for countries to develop different solutions that are tailored to their unique risks, institutional situations, and industry structures.

The Board's foreign bank proposal under section 165 of the Dodd-Frank Act was designed to provide a consistent platform for the supervision and regulation of the U.S. operations of foreign banks and to help ensure that the U.S. operations of foreign banks have sufficient capital and liquidity. The proposal was responsive to the evolution of the foreign banking sector in the United States over the past couple decades and to lessons learned in the financial crisis. Although the impact of potential reciprocal actions in other markets on U.S. banking firms is difficult to forecast with precision, we do not expect the impact of such potential actions on U.S. banking firms to be significant—principally because most of the material foreign subsidiaries of U.S. banking firms are already subject to local, bank-like risk-based capital and other prudential requirements.

Q.5. In late 2011 the regulators issued a highly complex and lengthy proposal to implement the Volcker rule. Because of the size and complexity, it is essential that the regulators get this right. Otherwise, there will be significant unintended consequences for our financial system and economy. Some regulators are in favor or reproposing the rule if it differs significantly from the initial proposal. Are you in favor of reproposing the Volcker rule? How would you distinguish hedging from proprietary trading? Would you allow portfolio-wide hedging limit risks? How would you propose that financial firms comply by 2014?

A.5. The Federal Reserve is committed to getting the rules implementing section 619 of the Dodd-Frank Act right and has been working for some time with the FDIC, OCC, SEC, and CFTC to develop a final rule that effectively implements that section in a manner faithful to the words and purpose of the statute. We are striving to consider this rule before year-end in order to provide clarity and certainty to the affected members of the industry and to the public more broadly about the requirements of section 619. In developing the rule, the Federal Reserve has met with numerous members of the public about a wide variety of issues raised by the statute and the original agency proposal and has considered more than 18,000 comments on the proposal.

As you note, section 619 of the DFA provides an exception from the prohibition on proprietary trading for "risk-mitigating hedging activities in connection with and related to individual or aggregated positions, contracts, or other holdings of the banking entity that are designed to reduce the specific risks to the banking entity in connection with and related to such positions, contracts and other holdings." 12 U.S.C. 1851(d)(1)(C). By its terms, the statute permits risk-mitigating hedging of individual positions or aggregated positions of the banking entity. Risk-mitigating hedging focuses on reducing risk associated with individual or aggregated positions of the banking entity as distinguished from proprietary trading, which focuses on attempting to achieve short-term profits or gains. The agencies are working hard to ensure this exception is implemented as written.

By its terms, section 619 became effective on July 21, 2012. Section 619 provides banking entities an additional 2 year period following the statute's effective date to conform activities and investments to the prohibitions and restrictions of that section and any final implementing regulation.[2] Under the statute, the Board may, by rule or order, extend the 2-year conformance period for up to three, 1-year periods, if in the judgment of the Board, an extension is consistent with the purposes of section 619 and would not be detrimental to the public interest. The statute provides that the Board

[2] *See,* 12 U.S.C. 1851(c).

may grant these extensions for not more than 1 year at a time. As it considers the merits of adopting a final rule, the Board will also consider the public interest in granting an extension of the conformance period.

Q.6. With a number of Fed rulemakings affecting capital in a proposed or final stage, much emphasis has been placed on increasing the quantity of capital. Is it possible that we can end up with a higher capital ratio but lower quality of capital? If so, what would be the implication of that scenario on financial stability? Liquidity and capital rules work in concert but also serve overlapping ends. How do you view the trade-offs between higher capital and liquidity rules and, in that light, how do you view progress in both of these areas to date?

A.6. Higher capital and liquidity standards work in concert to bolster the stability of individual institutions and the financial system, and the Federal Reserve has made significant progress in both of these areas. We believe that it is important that large banking firms have both sufficient capital to absorb losses and a sufficiently strong liquidity risk profile to prevent creditor and counterparty runs. The financial crisis demonstrated that preventing the insolvency or material financial distress of large banking firms requires regulating both their capital adequacy and liquidity risk.

Our final Basel III capital rule strengthens the quantity and quality of banking organizations' capital, thus enhancing their ability to continue functioning as financial intermediaries, particularly during stressful periods. Accordingly, the Basel III capital rule should reduce risks to the deposit insurance fund and the chances of taxpayer bailouts and improve the overall resilience of the U.S. financial system. The capital requirements in the final Basel III rule would serve as the foundation for other key initiatives designed to strengthen financial stability, including the capital plan rule, Dodd-Frank Act stress testing, and capital surcharges for systemically important financial institutions. The Basel III capital reforms are a very important part of the global regulatory community's effort to improve financial stability.

Our recent Basel III liquidity coverage ratio (LCR) proposal is also a core element in our effort to strengthen the resiliency of large banking firms. The LCR would impose standardized minimum liquidity requirements on large banking firms for the first time. The LCR would require large banking firms to hold an amount of high-quality liquid assets that is sufficient to meet expected net cash outflows over a 30-day time horizon in a standardized supervisory stress scenario.

There is more to be done on both the capital and liquidity fronts, however. In particular, the Board intends to supplement the new Basel III capital rules with a proposal to implement a risk-based capital surcharge for the largest global systemically important banking institutions, and is working with the Basel Committee to develop a longer-term structural liquidity requirement.

Q.7. In the recent Basel III rule the Fed adhered to the standard set by the Basel Committee for banks. With regard to the capital standards for insurers, the Fed said that it is limited by the Collins amendment in Dodd-Frank. In the recently proposed liquidity coverage ratio rule, the Fed went beyond the criteria set forth by the Basel Committee. Can you explain when is it appropriate for the Fed to adhere to the Basel Committee, Dodd-Frank or go beyond the requirements set by either the Basel Committee or Dodd-Frank?

A.7. The Federal Reserve is bound by the applicable statutes in all cases; accordingly, our Basel III capital rules for bank holding companies and savings and loan holding companies reflect the requirements of section 171 of the Dodd-Frank Act (the Collins amendment) and section 939A of the Dodd-Frank Act, which prohibits references to credit ratings in Federal regulations. Future capital rules for such companies and nonbank SIFIs with substantial insurance activities will also reflect the requirements of the Collins amendment and section 939A.

We work with our international colleagues on the Basel Committee on Banking Supervision to develop global regulatory and supervisory standards for internationally active banks. However, the baseline standards developed by the Basel Committee do not always reflect the unique legal, supervisory, and market conditions present in the United States and do not always provide sufficient protection for the safety and soundness of U.S. banking firms or U.S. financial stability. Therefore, when drafting U.S. banking rules, we analyze the provisions of the relevant Basel standards and in cases where it is warranted, we decide to apply different requirements in the United States. When analyzing whether to go beyond the requirements of the Basel Committee in a particular regulatory regime, we weigh the safety and soundness and financial stability benefits of implementing stricter provisions against the competitive equity and other potential adverse effects of the stricter provisions.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR BROWN FROM JANET L. YELLEN

Q.1. On October 9th, the IAIS announced its plan to develop a "risk based global insurance capital standard" by 2016. These bank-like capital standards would be imposed on U.S. insurers that have not been designated nonbank systemically important financial institutions (SIFIs) under U.S. law and were not among the insurance groups designated as Global Systemically Important Insurers (G–SIIs) in July by the FSB. The IAIS stated in its announcement that the development and testing in 2014 of new capital requirements for the G–SIIs will be used to inform the development of the insurance capital standard for other internationally active insurers.

Does the Fed support this development? If not, did it voice its concerns? If so, why are we allowing the imposition of European-based, bank-centric capital standards on U.S. insurance companies that (a) were not responsible for the financial crisis, and (b) have not been designated as nonbank SIFIs under Dodd-Frank or among the insurance groups designated as G–SIIs in July by the FSB?

A.1. The Federal Reserve participated in, and supported, the FSB's July decision to endorse the enhanced policy measures promulgated by the IAIS for G–SIIs, including the plan to develop capital requirements for G–SIIs. As a new member of the IAIS, we plan to work in a coordinated manner with the other U.S. members on current IAIS initiatives, including development of international capital standards for G–SIIs and other internationally active insurance groups. The IAIS is comprised of insurance regulators, supervisors and central banks from more than 130 countries around the world, including the United States. The Federal Reserve recently became a member of the IAIS. The Federal Insurance Office, the National Association of Insurance Commissioners and the State insurance departments are also members of the IAIS. The IAIS works in a collaborative way to develop supervisory and regulatory standards to address the solvency and financial stability risks inherent in global insurance firms. Participation by the Federal Reserve and other U.S. members in the IAIS helps us to better understand the global insurance industry and to influence the development of global insurance supervisory and regulatory standards.

The IAIS is undertaking work to develop international capital requirements for G–SIIs and other internationally active insurance groups. The work of the IAIS is conducted principally by insurance supervisors—supervisory agencies with substantial insurance expertise and responsibility for the supervision of insurance firms. It is my understanding the capital requirements under development by the IAIS will be insurance-based and will address the types of assets held and liabilities incurred by insurance firms.

Q.2. What will the Federal Reserve's process be for developing capital standards for insurance savings and loan holding companies and insurance SIFIs? Will the Federal Reserve propose rules that are specific to insurance companies, and will there be a notice and comment period and opportunity for public input? How will the Fed ensure that these companies have a sufficient transition period to adjust to a new capital regime?

A.2. The Board is taking additional time to evaluate the appropriate capital framework for insurance nonbank SIFIs and savings and loan holding companies (SLHCs) that are significantly engaged in insurance activities. We have been carefully evaluating public comments (including industry feedback) on how to design such a capital framework. The business model and associated risk profile of insurance companies can differ materially from those of banking organizations, and the Board is taking these differences into account. The Board is committed to taking the necessary amount of time to develop workable capital requirements for insurance-related firms. To the extent permitted by law, the Board continues to carefully consider how to design capital rules for Board-regulated companies that are insurance companies or that have subsidiaries engaged in insurance underwriting in determining how to design an appropriate capital framework for these companies.

We do not have a specific deadline for issuing a proposal, but once we have developed a proposal, we will issue it for public notice and comment.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR HAGAN FROM JANET L. YELLEN

Q.1. In today's hearing you indicated that the Federal Reserve Board was taking steps to address certain concerns about Section

716 of the Dodd-Frank Act through rulemaking and that a final rule could be completed as early as this year.

As a clarification of your comments, were you referring to the Federal Reserve Board's interim final rule issued on June 5, 2013, regarding the treatment of uninsured U.S. branches and agencies of foreign banks under Section 716, or were you referring to some other regulatory effort to interpret or address concerns about Section 716?

A.1. I was referring in my testimony to the interim final rule issued by the Federal Reserve to address the problem created by section 716 for U.S. branches and agencies of foreign banks. As you know, U.S. branches and agencies of foreign banks, by statute, have access to the Federal Reserve discount window in the same manner as insured depository institutions. It is this treatment of U.S. branches and agencies of foreign banks that causes them to become subject to section 716. Consequently, the Federal Reserve proposed to treat these branches and agencies as insured depository institutions for all purposes under section 716. We have received a few comments on this interim rule and, as I mentioned at the hearing, we expect to consider final action on it by year-end.

Q.2. In today's hearing you discussed the Financial Stability Oversight Council's process for the consideration and designation of nonbank systemically important financial institutions with Senator Tester.

> *Senator Tester:* If you're confirmed, you will be participating in FSOC. And the question is about transparency and it's the transparency of metrics that will be used that people need to have the ability to comment on before they are applied. And I guess my question to you is will you be willing to make that commitment to transparency as it applied to FSOC?
>
> *Governor Yellen:* I will need to study this issue more closely in terms of what FSOC's procedures are, but I feel it should be clear why a particular firm has been designated if that occurs.

As a clarification, if you are confirmed, will you support a transparent process for the consideration and designation of nonbank systemically important financial institutions that includes the release of any determination metrics for asset managers before those metrics are applied—as Senator Tester stated and regulators have indicated—and not after the designation has occurred, as your answer suggests.

A.2. Designation has significant implications for a company, so it is important that the designation framework and process is careful and deliberative. To implement this authority, the FSOC developed a framework and criteria and sought public comments twice on the designation framework. After publishing guidance, FSOC began the process of assessing individual companies from a list of companies that met the quantitative criteria set out in the guidance. The guidance is available at: *http://www.treasury.gov/initiatives/fsoc/documents/nonbank%20designations%20-%20final%20rule%20and%20guidance.pdf.*

The OFR study on *Asset Management and Financial Stability* did not propose any metrics for the FSOC to use to consider asset management firms for designation. If the FSOC develops metrics for asset manager firms beyond the metrics in the current guidance, if confirmed, I would support that it provide the public an opportunity to review and comment on any proposed metrics.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR WARREN FROM JANET L. YELLEN

Q.1. As you know, Congress has mandated that the Federal Reserve use monetary policy to achieve maximum employment while maintaining price stability and moderate long-term interest rates. At its December 2012 meeting, the Federal Reserve stated that it would continue to keep interest rates low until the unemployment rate reached 6.5 percent. Yet a 6.5 percent unemployment rate does not reflect maximum employment. As you testified, members of the Federal Open Market Committee stated in response to a September 2013 survey that an unemployment rate of between 5 percent and 6 percent would more accurately represent maximum employment.

The difference between a 6.5 percent unemployment rate and an unemployment rate between 5 percent and 6 percent is hundreds of thousands of jobs. Do you think the Federal Reserve must lower its unemployment rate target to fulfill its statutory mandate of pursuing maximum employment?

A.1. In December of 2012, the FOMC established economic thresholds to provide greater clarity to the public about the period over which short-term interest rates could be expected to remain at current exceptionally low levels. In particular, the committee indicated that an exceptionally low range for the Federal funds rate would remain appropriate at least as long as the unemployment rate remained above 6.5 percent and projected inflation between 1 and 2 years ahead remains below 2.5 percent. It is important to note that these economic thresholds for the Federal funds rate are not our long-run goals for monetary policy. Rather, they are intended as useful benchmarks for the public in understanding how the level of the Federal funds rate may evolve over time.

Indeed, in its September economic projections, FOMC participants' estimates of the longer-run normal rate of unemployment had a central tendency of 5.2 percent to 5.8 percent. In essence, this is the unemployment range that the committee believes that the economy can achieve over the longer run.

It is also important to note that the thresholds are not triggers—that is, once a threshold has been crossed, the committee will not necessarily raise the Federal funds rate target immediately. Instead, crossing a threshold will lead the committee to consider whether an increase in rates would be appropriate, with the FOMC determining the appropriate stance of monetary policy based on its assessment of the economic outlook. We will, as always, follow a balanced approach in fostering our objectives of maximum employment and stable prices. Under that approach, as Chairman Bernanke has said, monetary policy is likely to remain highly accommodative long after one of the economic thresholds for the Federal funds rate has been crossed. For example, in their economic and policy projections prepared for the September FOMC meeting, many FOMC participants anticipated that the Federal funds rate at the end of 2016 would be at or below a level of about 2 percent, well below the anticipated long-run level of the Federal funds rate of about 4 percent. These FOMC participants judged that continued highly accommodative policy over an extended period would likely be appropriate to achieve and maintain our congressionally mandated objectives of maximum employment and stable prices.

Q.2. I am interested in your views on the following question, which I asked Governor Tarullo on July 11, 2013. Under 12 U.S.C. §1818(e), Federal banking agencies may remove "institution-affiliated parties" from participation in the affairs of an insured depository when they directly or indirectly violate banking laws or regulations. Were officers or directors of any bank that was party to the mortgage servicer settlements removed because they directly or indirectly participated in the violations that led to the settlements? If no officer or director was removed, can you explain why?

A.2. I fully support the use of the full range of the Federal Reserve's enforcement tools, including actions to bar insiders of banking organizations from the banking business, where appropriate. The statutory requirements to bring a removal or prohibition action are rigorous. Under 12 U.S.C. §1818(e), the Board must initially find that the insider engaged in a violation of law, unsafe or unsound practice, or a breach of fiduciary duty that resulted in a benefit to the insider, a loss to the institution, or prejudice to the bank's depositors. In addition, the Board must determine that the conduct involved personal dishonesty or willful or continuing disregard for the safety and soundness of the institution. This standard does not permit an action against an insider whose conduct only involved poor, or even negligent, business decisions that resulted in losses to an institution. There must be additional evidence showing heightened culpability, such as personal dishonesty or reckless or willful disregard for safety and soundness.

Applying these standards, the Federal Reserve has not, to date, taken any actions removing or prohibiting insiders of the mortgage servicing organizations that were subject to the 2011 and 2012 mortgage servicing enforcement actions for their conduct in connection with servicing or foreclosure activities. We are, however, continuing to investigate whether such removal or prohibition actions are appropriate.

In the past 5 years, the Federal Reserve has issued 68 prohibition orders, including several orders that also assessed a civil money penalty. Also in the past 5 years, the Federal Reserve has notified more than 200 individuals that they are banned by statute from banking under section 19 of the Federal Deposit Insurance Act (12 U.S.C. §1829). Section 19 prohibits a person convicted of a criminal offense involving dishonesty or a breach of trust from directly or indirectly owning, controlling, or participating in the affairs of any insured depository institution, or a bank or savings and loan holding company without the consent of the FDIC in the case of an insured depository institution, or of the Federal Reserve in the case of a holding company. The Federal Reserve has worked with the Department of Justice as it determines whether to bring criminal actions against individuals, including in connection with mortgage servicing and foreclosure activities.

Q.3. You testified that the Federal Reserve's supervisory responsibilities should be just as important as its monetary policy responsibilities. If that is to be the case, the Federal Reserve needs to dedicate enough staff to supervision—particularly for the largest, most complex financial institutions. Otherwise, significant problems will likely remain undetected until it is too late.

According to the Federal Reserve System's 2013 Budget, there are 412 staff budgeted for Bank Supervision and Regulation at the Board of Governors, and another 3,904 staff budgeted for Supervision and Regulation at the Federal Reserve Banks. How many of these staff are assigned full-time to supervision of the six largest bank holding companies (JPMorgan Chase & Co., Bank of America Corporation, Citigroup, Inc., Wells Fargo & Company, The Goldman Sachs Group, and Morgan Stanley), which collectively hold far more than half of the total banking assets in the country? Given that a bank holding company like Citigroup dedicates several thousand of its employees to risk management and internal auditing, do you think the Federal Reserve needs to significantly increase the number of staff dedicated to supervising the largest financial institutions in order to carry out its supervisory responsibilities?

A.3. As a result of lessons learned from the financial crisis, the Federal Reserve has taken a number of steps to strengthen its ongoing supervision of the largest, most complex banking firms. Most importantly, we established the Large Institution Supervision Coordinating Committee (LISCC) to ensure that oversight and supervision of the largest firms incorporates a broader range of internal perspectives and expertise; involves regular, simultaneous, horizontal (cross-firm) supervisory exercises; and is overseen through a centralized process to facilitate consistent supervision and the resolution of issues that may be present at more than one firm.

The LISCC is chaired by the Director of the Board's Division of Banking Supervision and Regulation and includes senior bank supervisors from the Board and relevant Reserve Banks as well as senior Federal Reserve staff from the financial stability, research and legal divisions, as well as from each of the other divisions at the Board and from the Markets and payment systems groups at the Federal Reserve Bank of New York. The LISCC provides strategic and policy direction for supervisory activities at the largest bank holding companies (BHCs) across the Federal Reserve System and, to date, has developed and administered important new supervisory exercises focused on the largest firms, most notably including the Federal Reserve's annual supervisory stress tests and the related annual reviews of capital adequacy and internal capital planning practices at the Nation's largest BHCs.

At the largest BHCs, the Federal Reserve has on-site teams in place full time. At the six firms mentioned in your question, there are approximately 215 Federal Reserve staff members on the on-site teams. The work of these teams, however, is just one piece of the supervision program for these firms. The work of the on-site teams is supported and complemented by System-wide teams of specialists, including those focused on credit, market and operational risk management, compliance, capital adequacy and capital planning assessments, liquidity and funding, and stress testing practices. All of these System-wide teams participate in the supervision of the firms in the LISCC portfolio.

In addition to the on-site teams, we have approximately 200 experts from across the Federal Reserve involved in the annual comprehensive capital analysis and review (CCAR) that focus on assessments of the risk measurement, stress testing and internal capital planning practices supporting the 8 largest firms' capital planning processes. Also, there are approximately 100 economists, supervisors, and other specialists that carry out the annual supervisory stress testing, which is applied to the 30 largest domestic BHCs, including those mentioned in your question. Furthermore, the Office of the Comptroller of the Currency also has supervisory staff that supervise large national banks, including Wells Fargo, JPMorgan Chase, Citigroup, Inc., and Bank of America Corporation. We coordinate with the OCC in supervisory planning and the execution of supervisory activities of these firms.

We are still adding more personnel that will be devoted to supervision of systemically important firms. Staffing needs are being driven by further focus on and enhancements to the supervision program for the largest U.S. banking firms, FSOC-designated nonbank SIFIs, and the U.S. operations of large foreign banking organizations.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR VITTER FROM JANET L. YELLEN

Q.1. The GAO reports that "Although the Dodd-Frank Act requires the Federal Reserve Board to promulgate regulations that establish policies and procedures governing any future lending under section 13(3) authority, Federal Reserve Board officials told us that they have not yet drafted these policies and procedures and have not set timeframes for doing so." At the hearing, I asked you to submit for the record the Federal Reserve's detailed plans for how the it will implement the Dodd-Frank requirements to limit the Federal Reserve's bailout including a time line for drafting and implementing these rules along with how the Fed proposes to implement these rules. Please submit those details here for the record.

A.1. The Dodd-Frank Act made several major changes to the statutory text of section 13(3). The Federal Reserve believes that the provisions enacted in the Dodd-Frank Act governing its emergency lending authority have governed the use of that authority since enactment of that act. The Federal Reserve has undertaken substantial work both internally and with other agencies on the policies and procedures intended to implement the Dodd-Frank Act amendments to section 13(3). The Board expects to issue a proposal for public comment on the section 13(3) policies and procedures shortly.

Q.2. I have heard from many, including Senator Collins and a number of lawyers, that the minimum capital requirements of Section 171 of Dodd-Frank, commonly referred to as the Collins amendment, that the Federal Reserve Board of Governors has sufficient flexibility as to how it will apply the minimum capital standards to nonbank financial companies primarily engaged in the insurance business that are designated as SIFIs by FSOC. It seems that the Federal Reserve lawyers are the only ones who believe the Fed needs additional legislation passed to give them flexibility in how to apply this capital requirement to insurance companies. Are you aware of the issue?

- Do you believe that insurance companies should have bank-like capital standards or is that a different industry, holding different assets and needing a different set of requirements?
- Some attorneys of insurance companies have argued that the Board could determine the application of bank-centric capital requirements under the Collins amendment would be duplicative of the Risk-Based Capital framework and that the Board could take appropriate action to avoid that duplication. Or, since section 171 does not provide proscriptive capital standards the Board has the ability to tailor standards for insurance companies differently. Have you looked at that issue and do you think that argument has merit?
- Has the Federal Reserve fully taken into consideration the clear congressional intent embodied in Section 165 of the Dodd-Frank Act that requires the Board to "tailor" prudential rules, including capital requirements, that are applied to nonbank SIFIs? Why exactly do you believe the Collins Amendment overrides the clear statutory language in Section 165?
- In addition to the clear directive to the Board in Section 165 to "tailor" the rules for insurer nonbank SIFIs, Section 616 of Dodd-Frank includes a general directive that gives the Board sufficient discretion to ensure that capital standards for insurers—both nonbank SIFI and thrift insurers—are appropriately aligned with insurance risk, rather than bank risk. It is clear that Congress did not intend for bank-centric capital rules to be applied to insurers. And no one seems to be arguing that a bank capital regime is appropriate for insurers. So what is the Board's plan for addressing this issue? Will you issue a proposed rule specifically for insurance capital requirements, and if so, when?

A.2. Section 171 of the Dodd-Frank Act, by its terms, requires the appropriate Federal banking agencies to establish minimum risk-based and leverage capital requirements for bank holding companies (BHCs), savings and loan holding companies (SLHCs), and nonbank financial companies supervised by the Board (supervised nonbank companies) on a consolidated basis. This statutory provision further provides that these minimum capital requirements "shall not be less than" the generally applicable capital requirements for insured depository institutions. In addition, the minimum capital requirements cannot be "quantitatively lower than" the generally applicable capital requirements for insured depository institutions that were in effect in July 2010. Section 171 does not contain an exception from these requirements for an insurance company (or any other type of company) that is a BHC, SLHC, or supervised nonbank company (Board-regulated company), or for a Board-regulated company that has an insurance company subsidiary. This requirement constrains the scope of the Board's discretion in establishing minimum capital requirements for Board-regulated companies.

The final capital rule approved by the Board earlier this year,[1] did, however, take into consideration differences between the banking and insurance business within these constraints. The final capital rule included specific capital treatment for policy loans and separate accounts, which are assets typically held by insurance companies but not by banks. Additionally, the Board determined to defer application of the final capital rule to SLHCs with significant insurance activities (i.e., those with more than 25 percent of their assets derived from insurance underwriting activities other than credit insurance) and to SLHCs that are themselves State regulated insurance companies.

To the extent permitted by law, the Board continues to carefully consider how to design capital rules for Board-regulated companies that are insurance companies or that have subsidiaries engaged in insurance underwriting in determining how to design an appropriate capital framework for these companies.

Q.3. On Tuesday, Andrew Huszar published a piece in the *Wall Street Journal* entitled "Confessions of a Quantitative Easer". It is a significant piece because of the job that Mr. Huszar used to hold. In 2009–10, he managed the Federal Reserve's $1.25 trillion agency mortgage-backed security purchase program. As the person responsible for executing the Fed's experimental and risky monetary policy known as "quantitative easing" he had a simple message, "I'm sorry, America." And, that the Fed "has allowed QE to become Wall Street's new 'too big to fail' policy."

Mr. Huszar described the primary goal in rolling the dice with QE was to "to drive down the cost of credit so that more Americans hurting from the tanking economy could use it to weather the downturn." And he laments that when the trading for the first round of QE ended on March 31, 2010, "[t]he final results confirmed that, while there had been only trivial relief for Main Street, the U.S. central bank's bond purchases had been an absolute coup for Wall Street. The banks hadn't just benefited from the lower cost of making loans. They'd also enjoyed huge capital gains on the rising values of their securities holdings and fat commissions from brokering most of the Fed's QE transactions. Wall Street had experienced its most profitable year ever in 2009, and 2010 was starting off in much the same way." However, more than 3½ years later the Fed continues to purchase about $85 billion in bonds each month and delaying any reduction in its purchases. Do you disagree with Mr. Hauser's assertion that QE is Wall Street's new "Too Big to Fail" policy, if so, why?

A.3. The FOMC's asset purchases are aimed at promoting the Federal Reserve's statutory objectives of maximum employment and stable prices. By putting downward pressure on longer-term interest rates and helping to make financial conditions more accommodative, the Federal Reserve's asset purchases have supported a stronger economic recovery, improved labor market conditions, and helped keep inflation closer to its 2 percent objective. In particular, lower interest rates have allowed many homeowners to refinance

[1] *See,* 11 FR 62018 (October 11, 2013).

their mortgages at lower rates and thus supported growth in consumer spending. Lower mortgage rates also have helped to strengthen home sales and housing construction. In addition, lower interest rates have boosted auto sales. Through these channels, our asset purchases have helped strengthen growth and employment. Moreover, the Federal Reserve's asset purchases have helped to guard against disinflationary pressures that could otherwise have exacerbated the debt burdens faced by some households and businesses. In all of these ways, our asset purchases have benefited American families and Main Street businesses.

It is important to emphasize our asset purchases have been conducted in the open market and have followed a competitive process. The changes in overall financial conditions spurred by our asset purchases have not been directed toward benefiting any particular institution or class of institutions. Rather, by strengthening the economic recovery, fostering improved labor market conditions, and maintaining stable inflation and inflation expectations, the Federal Reserve's asset purchase programs have benefited all Americans.

Q.4. At Jackson Hole speech Chairman Bernanke talked about the tradeoffs associated with this experimental monetary policy—namely higher liquidity premiums on Treasury securities, lack of confidence in the Fed's ability to exit smoothly from its extremely accommodative policies, and risk to financial stability by driving longer-term yields lower incentivizing risky behavior in the markets. It seems to me that Mr. Huszer and Mohammed El Erian at the PIMCO investment firm are right when they point out—"that the Fed may have created and spent over $4 trillion for a total return as little as 0.25 percent of GDP, that QE really isn't working." As someone who is viewed as very dovish, in favor of continuing or being more aggressive with these accommodative monetary policies, why haven't we reached the tipping point where the costs and risks associated with this experiment outweigh the benefits?

A.4. A growing body of research by economists at central banks and academic institutions has found that asset purchases by central banks help to lower longer-term interest rates and ease financial conditions. These developments, in turn, help to foster a stronger economic recovery, improved labor market conditions, and stable inflation and inflation expectations. While monetary policy is not a panacea for all of the Nation's economic difficulties, our economic situation would almost certainly be far worse had the Federal Reserve not acted aggressively to address the severe economic shock stemming from the financial crisis and the continuing headwinds that have slowed the economic recovery. The historical precedents of the United States in the 1930s and Japan since the 1990s provide sobering examples of the potential costs when central banks fail to adequately address severe economic and financial shocks.

While a strong majority of the FOMC judges that asset purchases have been effective in fostering its macroeconomic objectives, the committee is aware of the potential costs and risks associated with asset purchases. As noted in the minutes of recent FOMC meetings, policy makers have noted various potential risks of asset purchases, including possible challenges in removing policy accommodation at the appropriate time and the possibility of encouraging imprudent risk-taking in the financial sector. Regarding challenges associated with exit, the Federal Reserve has developed, and is continuing to refine, a range of tools that will allow the Federal Reserve to remove policy accommodation at the appropriate time. Regarding excessive risk-taking in financial markets, there are few signs to date of the types of financial imbalances and excessive reliance on leverage that were evident in the runup to the financial crisis. That said, the Federal Reserve is monitoring financial markets very carefully for signs of excessive risk-taking and is prepared to take supervisory and other policy actions as appropriate to address developments that could pose a threat to financial stability.

On balance, the FOMC has judged that the economic benefits of continued asset purchases outweigh the potential costs. However, asset purchases are not on a preset course and the pace of asset purchase will remain contingent on the economic outlook and the FOMC's ongoing assessment of their likely efficacy and costs.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR JOHANNS FROM JANET L. YELLEN

Q.1. How active is the Federal Reserve with the Financial Stability Board (FSB) on insurance issues? How does the Fed coordinate its insurance-related work within the FSB with Treasury and State regulators?

A.1. As a member of the FSB, the Federal Reserve participates actively in discussions and decisions with respect to insurance-related issues. The Federal Reserve recently joined the International Association of Insurance Supervisors (IAIS), the international standard setting body for insurance. The Federal Reserve is working with the other U.S. members of the IAIS to provide a coordinated U.S. perspective in the development of standards by the IAIS.

The FSB was established to coordinate at the international level the work of national financial authorities and international standard setting bodies and to develop and promote the implementation of effective regulatory, supervisory and other financial sector policies to promote financial stability. The U.S. Treasury, the Federal Reserve, and the SEC are the U.S. members of the FSB. Governor Daniel Tarullo serves as the Federal Reserve's representative to the FSB Plenary and is the chairman of the FSB's standing committee on Supervisory and Regulatory Cooperation (SRC).

As the international standard-setting body for insurance, the IAIS reports to the FSB through the SRC with respect to supervisory and regulatory matters. The IAIS includes insurance regulators, supervisors, and central banks from around the world, including the United States. The U.S. members of the IAIS include the Federal Insurance Office, the Federal Reserve, the National Association of Insurance Commissioners, and the State insurance departments.

Q.2. The bank-centric Basel 3 framework was developed by banking regulators for banks, not for insurers. Do you think it is appropriate for insurers to be subject to bank-centric Basel 3 capital rules that were never intended for them, or does it make more sense to have an insurance-based framework for insurers?

A.2. The Board's final revised capital framework for bank holding companies and savings and loan holding companies from summer 2013 does not apply to savings and loan holding companies that are engaged substantially in insurance activities. The Board decided to take more time to develop appropriate capital requirements for insurance holding companies, including insurance nonbank SIFIs. We want to get this right—it is important that we have strong consistent capital requirements for all depository institution holding companies and that we have a treatment for insurance risks that is economically sensible.

Q.3. Will you work with Congress to ensure that an insurance-based framework is applied to the insurance companies under Fed supervision? If you are confirmed, will you revisit the Fed's interpretation of the statute to determine if the Fed has the authority, as many in the Senate believe that it does, to avoid the negative impact of bank rules applied to insurance companies, and instead apply a more appropriate insurance framework? Do you support bipartisan legislation that my colleague Senator Brown and I drafted that clarifies that the Fed does have the flexibility to distinguish capital standards between banks and insurance companies?

A.3. The Board recognizes that insurance companies that are savings and loan holding companies (SLHCs) or are designated by the Council as nonbank financial companies may present different business models and risks than bank holding companies. Section 171 of the Dodd-Frank Act, by its terms, requires the appropriate Federal banking agencies to establish minimum risk-based and leverage capital requirements for bank holding companies (BHCs), savings and loan holding companies, and nonbank financial companies supervised by the Board on a consolidated basis. This statutory provision further provides that these minimum capital requirements "shall not be less than" the generally applicable capital requirements for insured depository institutions. In addition, the minimum—capital requirements cannot be "quantitatively lower than" the generally applicable capital requirements for insured depository institutions that were in effect in July 2010. Section 171 does not contain an exception from these requirements for an insurance company (or any other type of company) that is a BHC, SLHC, or supervised nonbank financial company (Board-regulated company), or for a Board-regulated company that has an insurance company subsidiary. This requirement therefore constrains the scope of the Board's discretion in establishing minimum capital requirements for Board-regulated companies.

The final capital rule approved by the Board earlier this year [1] took into consideration differences between the banking and insurance business within these constraints. The final capital rule included specific capital treatment for policy loans and separate accounts, which are assets typically held by insurance companies but not by banks. Additionally, the Board determined to defer application of the final capital rule to SLHCs with significant insurance

[1] *See,* 11 FR 62018 (October 11, 2013).

activities (i.e., those with more than 25 percent of their assets derived from insurance underwriting activities other than credit insurance) and to SLHCs that are themselves State regulated insurance companies.

To the extent permitted by law, the Board continues to carefully consider how to design capital rules for Board-regulated companies that are insurance companies or that have subsidiaries engaged in insurance underwriting in determining how to design an appropriate capital framework for these companies. The Board remains willing to work with Congress on this important matter.

Q.4. The Federal Reserve has oversight for nonbank financial institutions that are designated as systemically important by the Financial Stability Oversight Council (FSOC). How will you ensure that the Fed does not apply a one-size-fits-all approach to regulating these entities? Is the Fed limited in its ability to tailor requirements by the Collins Amendment or any other provision of Dodd-Frank?

A.4. The Dodd-Frank Act directs the Board to apply prudential standards to nonbank financial companies that have been designated by the FSOC for supervision by the Board that are more stringent than the standards applied to banking organizations that do not pose such significant risks to financial stability. The prudential standards must include enhanced risk-based capital, leverage, liquidity, stress test, resolution planning, and risk management requirements as well as single-counterparty credit limits, and a debt-to-equity limit for companies that pose a grave threat to the financial stability of the United States.

In establishing enhanced prudential standards for BHCs and nonbank financial companies under section 165 of the Dodd-Frank Act, section 165(a)(2) provides that the Board may tailor application of the standards imposed under that section on an individual basis or by category. The Board intends, in prescribing prudential standards for a particular nonbank financial company under section 165, to thoroughly assess the business model, capital structure, and risk profile of the designated company to determine how the proposed enhanced prudential standards should apply, and if appropriate, would tailor application of the standards by order or regulation to that nonbank financial company or a category of nonbank financial companies.

The Board recognizes that insurance companies that are SLHCs or are designated by the Council as nonbank financial companies may present different business models and risks than bank holding companies. The final capital rule the Board issued this summer implementing the Basel III capital standards included specific capital treatment for policy loans and separate accounts held by insurance companies, which are assets not held by banks. Additionally, the Board determined to defer application of the final capital rule to SLHCs with significant insurance activities (i.e., those with more than 25 percent of their assets derived from insurance underwriting activities other than credit insurance) and to SLHCs that are themselves State regulated insurance companies.

To the extent permitted by law, the Board continues to carefully consider how to design capital rules for Board-regulated companies that are insurance companies or that have subsidiaries engaged in insurance underwriting in determining how to design an appropriate capital framework for these companies.

Q.5. The U.S. Department of the Treasury's Office of Financial Research (OFR) recently delivered a report to the FSOC on ways that activities in the asset management industry may create, amplify, or transmit systemic risk. While the OFR report stops short of calling for SIFI designations for asset managers, it does lay out potential factors that could be used to determine if an asset manager poses systemic risk. Many have commented publicly that the process for the OFR study and FSOC's review of asset managers is flawed and lacks transparency.

As a voting member of FSOC, if the FSOC undertakes to designate asset managers as systemically important, would you support the metrics for designation being put out for public comment?

If the FSOC ultimately designates asset managers as systemically important, do you agree that asset managers should be regulated differently than bank holding companies and that a one-size-fits-all approach is not appropriate?

A.5. The study on *Asset Management and Financial Stability* was written by the OFR in response to a request by the FSOC to identify data gaps and provide analysis to better inform the FSOC's analysis of how to consider asset management firms for enhanced prudential standards and supervision under Section 113 of the Dodd-Frank Act. The study is not an FSOC publication. The OFR study did not propose any metrics for the FSOC to use to consider asset management firms for designation. If the FSOC develops metrics for asset manager firms beyond the metrics in the current guidance (available at: *http://www.treasury.gov/initiatives/fsoc/documents/nonbank%20designations%20-%20final%20rule%20and%20guidance.pdf*), if confirmed, I would support that it provide the public an opportunity to review and comment on any proposed metrics.

Section 165 of the Dodd-Frank Act requires the Federal Reserve to establish enhanced prudential standards both for bank holding companies with total consolidated assets of $50 billion of more and for nonbank financial companies designated by the Council. In the Federal Reserve's proposed rule, we may tailor the application of the enhanced standards to different companies on an individual basis or by category, taking into consideration each company's capital structure, riskiness, complexity, financial activities, size, and any other risk-related factors that the Federal Reserve deems are appropriate. This commitment to tailoring is reflected in the recently finalized capital rules in which the Federal Reserve excluded savings and loan holding companies that are predominantly engaged in insurance activities in order to allow for the development of more appropriate capital standards. Still, our ability to tailor the enhanced standards may be limited by the Collins Amendment and other provisions of the Dodd-Frank Act.

Q.6. As chairman of the Fed, what specifically will you do to increase the transparency of the Fed with regard to insurance regulators and the insurance industry? How will you consult with State insurance regulators before taking a position on insurance regulatory matters and will that position be consistent with the advice you receive from State insurance regulators?

A.6. The Federal Reserve has a long history of cooperation, consultation, and engagement with Federal and State regulators, key stakeholders, and other interested parties.

To raise transparency with respect to the development of our supervisory programs and regulations for the insurers under Federal Reserve supervision, Federal Reserve staff regularly meets with the Federal Insurance Office, insurance industry groups and company representatives, the National Association of Insurance Commissioners, State insurance regulators, and others regarding issues related to insurance capital requirements, supervision, risk management, and other insurance matters.

The Federal Reserve considers and assesses the views of industry groups and State regulators and has made adjustments in our approach to supervising and regulating insurers to reflect such input. The Federal Reserve recognizes the differences between banking and insurance, and is committed to tailoring its supervisory and regulatory regime for insurance holding companies to reflect the unique business lines and risks of insurance—to the extent permitted by law. We will continue to engage the industry and State regulators to further expand the Board's expertise and gain additional perspectives regarding the regulation and supervision of insurance companies, with the goal of continuing to promote a financially safe and sound financial system.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR KIRK FROM JANET L. YELLEN

Capital Rules for Insurance Companies

Q.1. While many of us believe that the Dodd-Frank Act already gives the Federal Reserve the authority to distinguish between insurance companies and banks when promulgating capital standards under the Collins Amendment, the Federal Reserve has made statements publicly that it does not believe it has the statutory authority to do so. Therefore, a number of Senators on this Committee introduced legislation, S.1369 to codify and clarify that the Federal Reserve can and should make distinctions between insurance companies and banks when setting capital standards. Is it your interpretation that this authority currently exists?

A.1. Section 171 of the Dodd-Frank Act, by its terms, requires the appropriate Federal banking agencies to establish minimum risk-based and leverage capital requirements for bank holding companies (BHCs), savings and loan holding companies (SLHCs), and nonbank financial companies supervised by the Board (supervised nonbank companies) on a consolidated basis. This statutory provision further provides that these minimum capital requirements "shall not be less than" the generally applicable capital requirements for insured depository institutions. In addition, the minimum capital requirements cannot be "quantitatively lower than" the generally applicable capital requirements for insured depository institutions that were in effect in July 2010. Section 171 does not contain an exception from these requirements for an insurance company (or any other type of company) that is a BHC, SLHC, or supervised nonbank company (Board-regulated company), or for a Board-regulated company that has an insurance company subsidiary. This requirement therefore constrains the scope of the Board's discretion in establishing minimum capital requirements for Board-regulated companies.

The final capital rule approved by the Board earlier this year, [1] did, however, take into consideration differences between the banking and insurance business within these constraints. The final capital rule included specific capital treatment for policy loans and separate accounts, which are assets typically held by insurance companies but not by banks. Additionally, the Board determined to defer application of the final capital rule to SLHCs with significant insurance activities (i.e., those with more than 25 percent of their assets derived from insurance underwriting activities other than credit insurance) and to SLHCs that are themselves State regulated insurance companies.

The Board continues to carefully consider how to design capital rules for Board-regulated companies that are insurance companies or that have subsidiaries engaged in insurance underwriting in determining how to design an appropriate capital framework for these companies.

Q.2. This ability for distinction should also transfer to the Fed's ability to distinguish between insurance companies and banks for purposes of accounting practices. I have at least two insurance companies in my State that are supervised by the Fed as savings and loan holding companies. These companies are not publicly traded and do not prepare financial statements in accordance with GAAP—but rather, in accordance with GAAP-based insurance accounting known as Statutory Accounting Principles (SAP). Every person I consult tells me that SAP is the most effective and prudential way to supervise the finances of an insurance company. It is my understanding that the Federal Reserve may want to force these insurance companies that have used SAP reporting for many decades to spend hundreds of millions of dollars preparing GAAP statements—primarily because the Fed is comfortable with GAAP and understands it since it's what banks use. Is this is true? If it is true, is it simply because the Fed is so accustomed to bank regulation and not insurance regulation that it simply wants to make things easier for itself? Do you agree with this one-size-fits-all approach to regulation? Can you provide a cost benefit analysis to this as it seems to not add any additional supervisory value and only adds astronomic costs to these companies?

A.2. The Federal Reserve is still considering regulatory capital and financial reporting requirements for companies with significant insurance activities in light of the Collins amendment requirement that we institute consolidated capital requirements for all bank holding companies (BHCs), savings and loan holding companies (SLHCs), and nonbank SIFIs. SLHCs with significant insurance activities are not covered by the new regulatory capital rules published this summer.

[1] *See,* 11 FR 62018 (October 11, 2013).

Our willingness to take more time to develop a capital rule for insurance holding companies is an acknowledgement that the business model and associated risk profile of insurance companies can differ materially from those of banking organizations and that further evaluation of the appropriate capital framework for these entities is warranted.

Because the calculation of insured depository institution capital requirements begins with consolidated GAAP measurements, and because statutory accounting has a legal entity rather than a consolidated basis, the Collins amendment is an impediment to use of statutory accounting as the basis for consolidated capital requirements for BHCs, SLHCs, and nonbank SIFIs with insurance operations.

Q.3. Each Chairman of the Federal Reserve can appoint other Governors to specific posts and issues—such as representation to the Financial Stability Oversight Council, representing the Federal Reserve to the Financial Stability Board (FSB), etc. Do you have a written list of any changes in Fed governors you will make to these posts that you can provide in writing?

A.3. No, I do not have a list at this point. If confirmed as Chairman, I look forward to working with my fellow governors to fulfill the important responsibilities of the Federal Reserve.

FSOC

Q.4. FSOC has been in existence for more than 3 years. Since that time, three companies have been deemed systemically significant and a second round of companies appear to be under consideration. There have been a number of calls, supported by a 2012 GAO report, on the FSOC to provide greater transparency about the process used for designation and the criteria followed. Can you provide greater details on why more transparency has not been achieved?

A.4. Although I have not participated in the Financial Stability Oversight Council (Council) matters, I understand it is firmly committed to promoting transparency and accountability in connection with its activities. In November 2012, the Council and the Office of Financial Research jointly provided a response to Congress and the GAO with a description of the actions planned and taken in response to each of the recommendations in the report. The report made a number of recommendations on ways in which the Council could further enhance its transparency, including improving the Council's Web site.

Subsequently, the Council's Web site was reintroduced, in December 2012, to improve transparency and usability, to improve access to Council documents, and to allow users to receive email updates when new content is added. The Council is firmly committed to holding open meetings and closes its meetings only when necessary. However, the Council must continue to find the appropriate balance between its responsibility to be transparent and its central mission to monitor emerging threats to the financial system. Council members frequently discuss supervisory and other market-sensitive data during Council meetings, including information about individual firms, transactions, and markets that require confidentiality. In many instances, regulators or firms themselves provide nonpublic information that is discussed by the Council. Continued protection of this information, even after a period of time, is often necessary to prevent destabilizing market speculation or other adverse consequences that could occur if that information were to be disclosed.

Congress authorized the FSOC to designate nonbank financial companies whose material financial distress could threaten U.S. financial stability. Congress provided the FSOC with a list of 10 factors for consideration but left it to FSOC to determine how these factors, such as interconnectedness, size, leverage, and activities, should be considered in determining whether a company posed a threat to financial stability.

Designation has significant implications for a company, so it is important that the designation framework and process is careful and deliberative. To implement this authority, FSOC developed a framework and criteria and sought public comments twice on the framework. After publishing guidance, FSOC began the process of assessing individual companies from a list of companies that met the quantitative criteria set out in the guidance. The guidance is available at: *http://www.treasury.gov/initiatives/fsoc/documents/nonbank%20designations%20-%20final%?0rule%20and%20guidance.pdf.*

As described in the guidance, FSOC screens companies through a three-stage process which provides a company with more due process than set forth in the enabling provisions of Dodd-Frank. This authority is focused on individual companies, not categories of activities or industries. Because being considered for designation is an important event for a firm, and the process may involve evaluation of proprietary information, there may be some costs to providing too much information to the public.

Q.5. The methodology and blanket statements made in the OFR Study on *Asset Management and Financial Stability* have been highly criticized as making broad assumptions, blanket statements, and for a misuse/misstatement and misunderstanding of data to analyze the industry. Can you speak to the reports' accuracies and/or if there are errors how best to address these since these reports are presumably part of the basis for designation?

A.5. The study on *Asset Management and Financial Stability* was written by the OFR in response to a request by the FSOC to identify data gaps and provide analysis to better inform the FSOC's analysis of how to consider asset management firms for enhanced prudential standards and supervision under Section 113 of the Dodd-Frank Act. The study is not an FSOC publication. In addition, because the designation authority is focused on individual companies rather than industries, it will be only one of many inputs used by the FSOC in its analysis.

Q.6. In terms of Asset Management companies, the Council has previously stated that in any additional metrics are developed "it intends to provide the public with an opportunity to review and comment on any such metrics and thresholds." Why was it the SEC then and not the FSOC that released these for public comment? Can you speak to other reports/studies that the OFR may do and if there will be some kind of open/regular process that will be followed for the public to review and comment? In terms of the OFR's Study on *Asset Management and Financial Stability,* do you know how many comments were received and the general nature/issues raised in these comments?

A.6. The study on *Asset Management and Financial Stability* was written by the OFR in response to a request by the FSOC to provide data and analysis to better inform the FSOC's analysis of how to consider asset management firms for enhanced prudential standards and supervision under Section 113 of the Dodd-Frank Act. The OFR study did not propose any metrics for the FSOC to use to consider asset management firms for designation. If the FSOC develops metrics for asset manager firms beyond the metrics in the current guidance (available at: *http://www.treasury.gov/initiatives/fsoc/documents/nonbank%20designations%20-%20final%20rule%20and%20guidance.pdf,* I would support that it provide the public an opportunity to review and comment on any proposed metrics.

Volcker

Q.7. Can you update me on the timing of the rule and will the conformance period be extended for firms to implement it?

A.7. The Federal Reserve is committed to getting the rules implementing section 619 of the Dodd-Frank Act right and has been working for some time with the FDIC, OCC, SEC, and CFTC to develop a final rule that effectively implements that section in a manner faithful to the words and purpose of the statute. We are striving to consider this rule before year-end in order to provide clarity and certainty to the affected members of the industry and to the public more broadly about the requirements of section 619.

By its terms, section 619 became effective on July 21, 2012. Section 619 provides banking entities an additional 2-year period following the statute's effective date to conform activities and investments to the prohibitions and restrictions of that section and any final implementing regulation.[2] Under the statute, the Board may, by rule or order, extend the 2-year conformance period for up to three, 1-year periods, if in the judgment of the Board, an extension is consistent with the purposes of section 619 and would not be detrimental to the public interest. The statute provides that the Board may grant these extensions for not more than 1 year at a time. As it considers the merits of adopting a final rule, the Board will also consider the public interest in granting an extension of the conformance period.

Q.8. Can you assure me that the rule will be structured so it doesn't negatively impact small issuers?

A.8. Among other things, section 619 of the Dodd-Frank Act prohibits banking entities from engaging in proprietary trading, which is defined by the statute to be trading in financial instruments for the purpose of selling in the near term or the intent to resell in order to profit from short-term price movements. Section 619 also provides an exception from this prohibition for underwriting activities and for market-making activities that are designed not to exceed the reasonably expected near term demands of clients, cus-

[2] *See,* 12 U.S.C. 1851(c).

tomers, and counterparties. Underwriting activities and market-making activities serve a very important role in providing capital to businesses and liquidity to markets.

The Federal Reserve has been working for some time with the FDIC, OCC, SEC, and CFTC to develop a final rule that effectively implements section 619, including the exceptions for underwriting and market-making activities and the other activities permitted by the statute, in a manner faithful to the words and purpose of the statute. In developing the rule, the Federal Reserve has met with numerous members of the public about a wide variety of issues raised by the statute and the original agency proposal, including the issues you have raised, and has considered more than 18,000 comments on the proposal. We are striving to consider this rule before year-end in order to provide clarity and certainty to the affected members of the industry and to the public more broadly about the requirements of section 619.

Enhanced Banking System: Ending Too Big to Fail and Protecting Against Future Collapses

Q.9. It is safe to say that in 2008 the U.S. Government did not have the tools to wind down a large failing financial institution. This inability is one of the primary reasons behind the Orderly Liquidation Authority (OLA) enacted in the Dodd-Frank Act. Recently, Bank of England's Paul Tucker stated, " . . . the U.S. authorities have the technology—via Title II of Dodd-Frank; and just as important, most U.S. bank and dealer groups are, through an accident of history, organized in a way that lends them to top–down resolution on a group-wide basis. I don't mean to it would be completely smooth right now; it would be smoother in a year or so as more progress is made, but in extremis, it should be done now. That surely is a massive signal to bankers and markets." Do you agree with Mr. Tucker's statement and what does progress on this front mean for those arguing large banks benefit from an implicit subsidy?

A.9. The Dodd-Frank Act and Basel III approach to addressing systemically important financial institutions (SIFIs) involves much stricter regulation of SIFIs and improving the resolvability of SIFIs. This is a sensible path that will lower the probability of failure of SIFIs, improve market discipline of SIFIs, and reduce the damage to the system if a SIFI does fail. The Board, the FDIC, and other regulators have made much progress on this path. Market participants and some rating agency actions for large bank holding companies have recognized this progress.

The FDIC's orderly liquidation authority (OLA) is effective today and its core regulatory implementation architecture is in place. The FDIC's single-point-of-entry approach to implementing Title II of the Dodd-Frank Act is a big step forward in this regard. More work remains to be done around the world to maximize the prospects for an orderly SIFI resolution, but the basic framework has been established in the United States.

Potential impediments to an orderly SIFI resolution remain—including the need for other countries to adopt workable statutory resolution regimes for SIFIs, the need to ensure that SIFIs have sufficient gone concern loss absorption capacity and resolution-friendly internal organizational structures, the need to provide host regulators of SIFIs with credible assurances that local operations will be protected in a resolution, and the need to address the potential disorderly unwind of cross-border derivative contracts. The Federal Reserve is committed to working with the FDIC and our supervised firms to remove these impediments.

The Fed, in consultation with the FDIC, has been developing a regulatory proposal that would require the largest, most complex U.S. banking firms to maintain a minimum amount of outstanding long-term unsecured debt that could be converted to equity in resolution. Such a requirement would increase the prospects for an orderly resolution under OLA by ensuring that shareholders and long-term debt holders of a systemic financial firm can bear potential future losses at the firm and sufficiently capitalize a bridge holding company in resolution. In addition, by increasing the credibility of OLA, a minimum long-term debt requirement should help counteract the moral hazard arising from taxpayer bailouts and improve market discipline of systemic firms.

U.S. regulators are in active discussions with their foreign counterparts with respect to crisis planning around potential future SIFI failures. In particular, the U.S. and U.K. resolution authorities—the FDIC and the Bank of England—together with the Federal Reserve Board, the Federal Reserve Bank of New York and the U.K. Financial Services Authority, have been working closely to develop contingency plans for the failure of global SIFIs with significant operations on both sides of the Atlantic.

Q.10. There have been some that have expressed concerns that winding down a large bank is impossible because of cross border problems. One solution offered has been the Single Point of Entry (SPOE) approach. Does this approach significantly mitigate the challenge posed by winding down a firm that has operations in multiple jurisdictions?

A.10. The FDIC's single-point-of-entry approach to resolution of a systemic financial firm does mitigate the challenges posed by winding down a large, cross-border banking firm. Under the single-point-of-entry approach, the FDIC will be appointed receiver of only the top-tier parent holding company of the failed firm. After the parent holding company is placed into receivership, the FDIC will transfer assets of the parent company to a bridge holding company. The firm's operating subsidiaries (foreign and domestic) will remain open for business as usual. To the extent necessary, the FDIC will then use available parent holding company assets to recapitalize the firm's critical operating subsidiaries. Equity claims of the failed parent company's shareholders will effectively be wiped out, and claims of its unsecured debt holders will be written down as necessary to reflect any losses or other resolution costs in the receivership. The FDIC will ultimately exchange the remaining claims of unsecured creditors of the parent for equity or debt claims of the bridge holding company and return the restructured firm back to private sector control.

This conceptual approach to resolution under Title II of the Dodd-Frank Act represents an important step toward addressing the market perception that any U.S. financial firm is too big or too complex to be allowed to fail. The aim of the single-point-of-entry approach is to stabilize the failed firm quickly, in order to mitigate the negative impact on the U.S. financial system, and to do so without supporting the firm's equity holders and other capital liability holders or exposing U.S. taxpayers to losses. The single-point-of-entry approach offers the best potential for the orderly resolution of a systemic financial firm under Title II, in part because of its potential to mitigate run risks and credibly impose losses on parent holding company creditors and, thereby, to enhance market discipline.

As noted in my previous answer, although use of the single-point-of-entry resolution approach materially improves the prospects for the orderly resolution of a cross-border banking firm as compared to alternative implementation paths, impediments to such an orderly resolution remain. The Federal Reserve is committed to working with the FDIC in the coming months and years to mitigate those residual impediments.

Q.11. Liquidity and capital rules work in concert, but also serve overlapping ends. How do you view the trade-offs between higher capital and liquidity rules and in that light, how do you view progress in both of these areas?

A.11. Higher capital and liquidity standards work in concert to bolster the stability of individual institutions and the financial system, and the Federal Reserve has made significant progress in both of these areas. We believe that it is important that large banking firms have both sufficient capital to absorb losses and a sufficiently strong liquidity risk profile to prevent creditor and counterparty runs. The financial crisis demonstrated that preventing the insolvency or material financial distress of large banking firms requires regulating both their capital adequacy and liquidity risk.

The new capital framework published by the U.S. banking agencies this summer will increase the quantity and quality of banks' required capital, whereas the proposed liquidity coverage ratio will establish for the first time a standardized minimum liquidity requirement for large banking organizations. Both measures enhance banking organizations' ability to continue functioning as financial intermediaries, particularly during stressful periods, thereby reducing risks to the deposit insurance fund and the chances of taxpayer bailouts and improving the overall resilience of the U.S. financial system.

There is more to be done on both the capital and liquidity fronts, however. In particular, the Board intends to supplement the new Basel III capital rules with a proposal to implement a risk-based capital surcharge for the largest global systemically important banking institutions, and is working with the Basel Committee to develop a longer-term structural liquidity requirement for global banks.

Macro Economic

Q.12. To what extent could potential challenges within the Chinese banking and "shadow" banking industry transmit credit risk into the global financial markets?

A.12. The Chinese economy has experienced very rapid credit growth in recent years. Along with bank loans, nonbank (shadow) financing has expanded substantially, which includes lending via trust companies, corporate bond issuance, and off-balance sheet lending undertaken by banks. This rapid and sizable credit expansion has raised concerns about asset quality at banks and in the shadow banking sector. A future rise in problem loans could lead to capital shortfalls in the banking sector and potentially large expenses for the Government. That said, currently banks report sound capital buffers, and the Chinese Government has extensive resources to meet potential shortfalls in capital. In addition, Chinese authorities appear to recognize the potential risks of excessive credit growth to their economy, and have signaled intentions to curb it. However, notable risks remain and the situation bears monitoring closely. Although China has a relatively closed financial system with fewer financial links to other countries than many other major economies, a sharp slowdown in the Chinese economy would slow growth in other countries as well.

Q.13. How do you view the bond purchase program orchestrated by the Bank of Japan? How does it differ from quantitative easing? Does it appear that the Japanese are attempting to manipulate their currency, or is this a proper response to Japan's more than 20 years of economic stagnation and deflation?

A.13. Japan has experienced low growth coupled with mild deflation or very low inflation for nearly two decades. It is important to address this problem, and the Bank of Japan (BOJ) has recognized that aggressive action is necessary. The BOJ has taken a couple of steps. In January, the BOJ introduced an inflation target of 2 percent, similar to that of other major central banks. In April, the Bank of Japan announced it would be greatly expanding its existing asset purchase program and increasing the maturity of its purchases (a break from prior quantitative easing, which was focused on shorter-term maturity assets) with the goal of raising inflation to the 2 percent goal in 2 years. These asset purchases are mainly concentrated in Japanese Government bonds.

These measures have already contributed to supporting economic activity in Japan—with real GDP accelerating in the first half of the year—and deflationary pressures have also begun to recede. However, ultimately Japan will need to take steps to restore fiscal sustainability and implement pro-growth structural reforms.

Q.14. Do you believe that the recent increases in mortgage interest rates this past summer—that went up nearly 100 basis points from May 2012 [3] were an overreaction to the Fed's June statements on "tapering" the stimulus? Do you believe that these moves are indicative that housing sector is being over-stimulated by economic policies?

A.14. The increase in longer-term interest rates over the summer reflected a number of factors. First, the incoming economic data suggested a somewhat stronger economic outlook, which boosted rates. Second, as you note, in June the FOMC provided additional information on its expectations regarding its current purchase pro-

[3] *http://www.bankrate.com/finance/mortgages/mortgage-analysis.aspx*

gram, offering a conditional outlook for reductions in the pace of purchases over coming quarters if the incoming economic data continued to be consistent with the outlook for ongoing improvement in labor market conditions. The committee was clear that the policy outlook was conditional on economic and financial developments—our purchases are by no means on a preset course. Nonetheless, some investors who had taken on leveraged positions in longer-term instruments reportedly decided to exit those positions, putting additional upward pressure on rates. While the resulting tightening of financial conditions was unwelcome, and could slow the recovery in the housing sector to some degree, the reduction in leveraged positions should reduce the risks to financial stability going forward. The committee will continue to adjust policy as appropriate to foster our dual objectives of maximum employment and price stability.

Q.15. After the initial round of the Federal Reserve's monetary measures to keep the financial system solvent during the financial crisis, the threshold for additional central bank easing action has become lower and lower, especially with each successive round of QE. We now see loose central bank policies in the U.S., Japan, Europe, and elsewhere. Policy makers appear to be relying on monetary manipulation as a substitute for necessary tough decisions to structurally reform our tax, spending, and trade policies that would make for long-term, true economic growth. Do you believe that the U.S. Federal Reserve can continue to be a shining example of Central Bank independence? Do you anticipate that you will have the courage to end the stimulus programs and make some of the more difficult decisions to get our economy back to a "true" functioning economy rather than an economy that only functions with Government stimulus?

A.15. Americans can be confident that the FOMC has both the ability and the will to slow our asset purchases and eventually end our asset purchase program, and ultimately to begin to remove policy accommodation, when the economy is strong enough to make doing so appropriate. We have clearly indicated that the purchase program is conditional on economic and financial developments. We anticipate ending our purchases once we have seen a substantial improvement in the outlook for the labor market in a context of price stability. More broadly, we are providing a high degree of monetary policy accommodation in order to support a stronger economic recovery and move inflation back toward its 2 percent longer-run objective—that is, to foster our congressionally mandated objectives of maximum employment and price stability.

That said, as economic conditions normalize, it will become appropriate to begin removing policy accommodation. In considering the timing of such a step, our objective will be to assure a strong and robust recovery while keeping inflation under control. On the one hand, it is important not to remove support too soon, especially when the recovery is fragile. On the other hand, it is crucial not to wait too long to withdraw accommodation, and so allow an undesirable rise in inflation. My colleagues and I are committed to our longer run inflation goal of 2 percent, and we will need to ensure that, as the recovery takes hold and progresses, we bring monetary policy back to normal in a timely fashion.

Q.16. The Federal Reserve's recent monetary actions have created somewhat of an unfair recovery, where investors and banks seem to be fairing quite well while the middle and lower classes seem to continue to struggle. Do you agree that the monetary policies put into place by the Federal Reserve since the financial crisis have been a "top–down" approach to bolstering the economy? Do you think that the Fed's easy money policies punish savers? We've seen a growth and love spawned in the equities market—Do you think that this artificial "boom" in equities will falter once the Fed begins tapering?

A.16. It is certainly true that savers and those who rely on investments such as certificates of deposit and Government bonds are receiving very low returns. However, savers typically wear many economic hats. For example, many savers are homeowners or would like to be homeowners, and low interest rates make it easier to own a home and contribute to rising house prices. In addition, many savers own stocks and other assets through pension funds and 401(k) accounts; low interest rates are supporting the economic recovery and are thus good for businesses' sales and earnings, and so for stock investors. And a stronger economy will help people who need jobs to find them. Without a job, it is difficult to save for retirement or to buy a home or to pay for an education, irrespective of the current level of interest rates.

More broadly, we cannot have a more normal configuration of interest rates until the economy returns to a more normal state. Currently, interest rates are low for fundamental economic reasons, not just because the Federal Reserve and other central banks are providing accommodative monetary policy. Those fundamental reasons include slow growth and low inflation in the U.S. and other major economies. Pursuing an accommodative monetary policy now will help to get the economy moving and so will best enable us to normalize policy and to get rates back to normal levels over time. Indeed, an improved economic outlook has contributed to the rise in interest rates we have seen of late, and most forecasters anticipate that rates will rise further as the economy strengthens.

Q.17. When does the Fed plan to begin tapering?

A.17. As we have emphasized, our purchase program is not on a pre-set course. Instead, our decisions regarding the purchase program are data dependent. Our goal for the purchase program, as stated in September 2012 and reiterated since then, is to achieve a substantial improvement in the outlook for the labor market.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MORAN FROM JANET L. YELLEN

Q.1. Community banking is undergoing a change, especially in rural America. There are fewer banks in Kansas, but the banks that remain are growing due to mergers and acquisitions. One consequence of this growth is that the bank holding companies absorbing these smaller institutions fall under greater regulatory thresholds due to their increasing asset size. These small bank holding companies (SBHCs) are increasingly exposed to the current $500 million threshold under the Federal Reserve's Small Bank Holding Company Policy Statement. For example, an SBHC located in Kansas has seven branches. These branches are located in rural communities where they are, in some instances, one of the only remaining businesses located on Main Street. But since an SBHC brought those small banks under its purview and kept a branch open for these small communities, that SBHC is now very close to exceeding that $500 million threshold. As I understand it, the Federal Reserve has the discretion to alter the Small Bank Holding Company Policy Statement and has exercised that discretion in raising the threshold in the past.

I have introduced legislation along with Sen. Tester and Sen. Kirk along with an additional 13 of our Senate colleagues as cosponsors. Section 3 of the CLEAR Relief Act, S.1349, would require the Federal Reserve to raise that threshold. This seems to me a commonsense reform we could make that would ensure that small communities across the country will maintain access to hometown banking services. This is only one example of a regulatory burden the Federal Reserve could lift for the betterment of community banking. Would you comment on how you will go about reducing the regulatory burden on small banks, utilizing the Federal Reserve's discretionary regulatory framework, so that communities in Kansas will still have access to a hometown bank?

A.1. Community banks play a critical role in the U.S. economy, and the Federal Reserve is committed to implementing a supervisory and regulatory regime for community banks that is appropriate for their business model and economic function. To better tailor our oversight framework to the specific characteristics of community banks, the Federal Reserve has formed a Community Depository Institutions Advisory Council and a small bank subcommittee of its Committee on Bank Supervision.

The Federal Reserve has been very focused on addressing too-big-to-fail (TBTF) and protecting financial stability by strengthening the regulatory regime for systemically important financial institutions (SIFIs). TBTF is a damaging economic phenomenon that corrodes market discipline of our largest banking firms and contributes to an unlevel playing field between large banks and small banks. The much stricter regulatory regime that the Federal Reserve and other U.S. and global regulators are implementing for SIFIs should help level that playing field. Consistent with this principle, our recent final Basel III capital rule also created substantial differences between the regulatory capital regime that will apply to large U.S. banking firms as compared to community banks.

The Federal Reserve periodically reviews the scope of application of its Small Bank Holding Company Policy Statement. The Federal Reserve raises the asset threshold when appropriate in light of changes to U.S. banking markets and the economy.

Q.2. The drafting process of the Volcker Rule has caused some confusion among investors and regulators alike. Without delving into the specifics of the rule, I would simply mention that I have heard concerns as to where market making ends and proprietary trading begins. As you well know, market making serves a very important role in providing liquidity. I am concerned that an overly restrictive Volcker Rule could damage a business's ability to operate and expand. I have also heard discussions about certain asset classes, namely non-U.S. sovereign debt, that may be under consideration for an exemption from the Volcker rule. If you believe the Volcker Rule is structured in a way to not have an overly negative impact on liquidity and the costs of issuing debt, for what purpose would certain asset classes require exemptions? Could not an asset class exemption of this nature be viewed as favoring foreign countries over American companies?

A.2. Among other things, section 619 of the Dodd-Frank Act prohibits banking entities from engaging in proprietary trading, which is defined by the statute to be trading in financial instruments for the purpose of selling in the near term or the intent to resell in order to profit from short-term price movements. Section 619 also provides an exception from this prohibition for market-making activities that are designed not to exceed the reasonably expected near term demands of clients, customers and counterparties. As you note, market-making activities serve a very important role in providing liquidity to markets.

The statute also provides exceptions from the proprietary trading prohibition for trading in certain asset classes. In particular, the statute permits trading by banking entities in obligations of the United States, obligations of any agency of the United States (including the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, the Federal Home Loan Banks, and the Government National Mortgage Association) and obligations of any State or political subdivision thereof.

The Federal Reserve has been working for some time with the FDIC, OCC, SEC, and CFTC to develop a final rule that effectively implements section 619, including the exception for market-making activities and the other activities permitted by the statute, in a manner faithful to the words and purpose of the statute. In developing the rule, the Federal Reserve has met with numerous members of the public about a wide variety of issues raised by the statute and the original agency proposal, including the issues you have raised, and has considered more than 18,000 comments on the proposal. We are striving to consider this rule before year-end in order to provide clarity and certainty to the affected members of the industry and to the public more broadly about the requirements of section 619.

Q.3. Among the concerns that have been raised about Basel III, the possibility of bank-centric capital standards being applied to insurance companies is among the most difficult to justify. I realize the Federal Reserve may feel it is obligated to regulate certain components of the insurance industry due to the Collins Amendment language of the Dodd-Frank Act. However, I believe, as do many of my Senate colleagues, that the Federal Reserve does have flexibility in the statute to develop insurance-based standards. I am concerned that the very different capital accounting methods utilized by the insurance industry will make bank-centric Basel III standards unworkable and disruptive if applied to insurers. Are you able to provide any insight as to whether the Federal Reserve intends to saddle insurance companies with bank-centric prudential standards, and do you believe there is a way to develop strong insurance-based standards that would make more sense? Could you elaborate on the process moving forward?

A.3. Section 171 of the Dodd-Frank Act, by its terms, requires the appropriate Federal banking agencies to establish minimum risk-based and leverage capital requirements for bank holding companies (BHCs), savings and loan holding companies (SLHCs), and nonbank financial companies supervised by the Board (supervised nonbank companies) on a consolidated basis. This statutory provision further provides that these minimum capital requirements "shall not be less than" the generally applicable capital requirements for insured depository institutions. In addition, the minimum capital requirements cannot be "quantitatively lower than" the generally applicable capital requirements for insured depository institutions that were in effect in July 2010. Section 171 does not contain an exception from these requirements for an insurance company (or any other type of company) that is a BHC, SLHC, or supervised nonbank company (Board-regulated company), or for a Board-regulated company that has an insurance company subsidiary. In addition, because the calculation of insured depository institution capital requirements begins with GAAP measurements, and because statutory accounting is on a legal entity rather than a consolidated basis, consideration of accounting methods is part of the analysis in determining whether capital regulations meet the requirements of section 171 of the Dodd-Frank Act.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR COBURN FROM JANET L. YELLEN

Q.1. Was there any task more important for the Fed since the 1930s than understanding the financial system, understanding the financial institutions which were using more and more leverage and building massive opaque books of complicated derivatives positions, and heading off the next financial collapse? Fed minutes from 2006 and 2007 show that the Fed did not understand the risks of the modern financial system. Now, the Fed contends that its policy of quantitative easing does not present a serious inflation risk. However, considering the failure of the Federal Reserve to anticipate broad changes in the economy—including the 2008 financial crash and the worst recession in 50 years—why should Americans have confidence in that judgment?

A.1. Americans can be confident that the FOMC has both the ability and the will to prevent inflation. Everyone on the committee, including myself, is firmly committed to our 2 percent longer-run goal for inflation. Over the past 5 years inflation has averaged near, but a bit below, our goal of 2 percent. More recently, inflation has generally been running more significantly below our 2 percent objective, and falling inflation has been a concern.

At some point as economic conditions normalize, maintaining price stability will require removing accommodation. At that time, the Federal Reserve will tighten the stance of monetary policy by raising its target for the Federal funds rate and the interest rate it pays on reserve balances, which will put upward pressure on short-term market interest rates to avoid an overheated economy and higher-than-target inflation in the historically normal and well understood way. The Federal Reserve has also developed a number of tools that it can use if necessary to help keep market rates near the interest rate on reserve balances. Moreover, the FOMC intends to gradually reduce its securities holdings once the economy is strong enough so that it no longer needs the support provided by the committee's large scale asset purchases. We are confident we have the tools to normalize the stance of policy when doing so becomes appropriate, and that we can do so in a way that will avoid inflationary consequences down the road.

Q.2. Fiat money is very difficult to preserve in value, and generations of central bankers have tried hard to project an image of sobriety and proprietary regarding the purchasing power of paper money. Do you think the Fed has put at risk the confidence of investors and citizens in paper money by its zero-percent-interest-rates and successive rounds of QE?

A.2. Investors and citizens can be confident that the FOMC has both the will and the ability to prevent rapid inflation. Everyone on the committee, including myself, is firmly committed to our 2 percent longer-run goal for inflation. The FOMC has employed its nontraditional policy tools in order to support a stronger recovery and move inflation back toward its longer-run goal—that is, to better foster its Congressionally established goals of maximum employment and price stability. Investors would only have reason to lose confidence in the purchasing power of the dollar if inflation had been excessive or was at risk of being excessive in the future. However, as described in my answer to the previous question, inflation has been low in recent years and remains below our 2 percent target, and the committee has the tools necessary to remove policy accommodation when doing so becomes appropriate.

Q.3. Are the Fed's statements that it could snuff out inflation in 15 minutes by raising rates consistent with past historical experience? This past spring the mere mention of slightly reducing the Fed's pace of bond-buying sent global fixed income markets into a panic, and prices of long-term debt reversed almost all of the price elevation caused by QE since the spring of 2009. It is impossible to know whether this market reaction was the beginning of an anticipation of serious inflation, or the beginning of a loss of confidence in long-term claims on paper money that are seen as being debased by the Fed's policies. What do you think about what happened in the markets this past spring, and what is the support for the Fed's statement that if inflation arises, the Fed can get rid of it in 15 minutes?

A.3. As you note, last spring, the FOMC provided additional information on its expectations regarding its purchase program, suggesting a conditional outlook for reductions in the pace of purchases. That outlook was explicitly conditional on economic and financial developments—our purchases are by no means on a preset course. Partly in response to the information the committee provided about the possible path for policy, but also reflecting some strengthening in the economic data at that time, interest rates rose. In addition, some investors who had taken on leveraged positions in longer-term instruments reportedly decided to exit those positions, putting additional upward pressure on rates. However, measures of inflation expectations, such as the difference between yields on nominal Treasury securities and those on Treasury Inflation Protected Securities, did not change appreciably and remained close to 2 percent, indicating that investors did not anticipate high inflation.

As I noted above, the FOMC is firmly committed to its 2 percent longer-run goal for inflation. The committee has the tools it needs to address incipient inflation risks, should they develop, and it can take steps to address unwelcome increases in inflation very rapidly if required. Such steps would include increases in our target for the Federal funds rate and in the interest rate paid on reserve balances as well as the use of other tools to tighten the relationship between short-term market interest rates and the rate paid on reserves.

Q.4. After the first round of the Fed's emergency monetary measures to keep the financial system afloat, the threshold for additional central bank easing action has become lower and lower with successive rounds of QE. As a result, loose central bank policies in the U.S., in Japan, and elsewhere, has resulted in policy makers relying on monetary policy as a substitute for necessary tough decisions to structurally reform our tax, spending, and trade policies that would allow for long lasting growth. Do you believe it is a critical role of the Fed Chair to tell the President and Congress that monetary policy can only go so far, and that it is up to the President and Congress to do everything they can to remove the impediments to strong sustainable growth so that the Fed can discontinue its unprecedented monetary accommodations and their associated risks?

A.4. Policy makers should understand that monetary accommodation is not a panacea, and that other parts of the Government need to take the necessary steps to address the challenges our economy faces. In particular, I have emphasized that it would be helpful to the economy to put in place a strategy for fiscal policy that is not as restrictive in the near term, but that focuses on the longer-term fiscal issues that are at the heart of achieving fiscal sustainability, and that over the longer run can boost the capacity of the economy through greater national saving, higher investment and, in turn, increased productivity and long-run economic growth.

Q.5. The Fed's policies of zero-percent interest rates and QE have created a distorted, unfair recovery. Investors in bonds and stocks are doing great, with record highs in stock prices and very high prices of bonds across the yield curve. At the same time, ordinary people are experiencing just about recessionary unemployment and underemployment conditions, and millions of Americans have become discouraged by long-term unemployment and are no longer even looking for work. Moreover, QE has boosted the prices of some of the necessities of life and has made it impossible for savers to earn a safe fair return on their savings, forcing them to take higher risks. This set of distortions naturally creates resentment in those not experiencing a full economic recovery. Do you count this widening of inequality as a cost of QE and zero-percent interest rate policy?

A.5. Too many people remain unemployed or have stopped looking for work, and the extent of long-term unemployment is still very troubling. However, only a stronger economy will allow people who need jobs to find them. It is certainly true that savers and those who rely on investments such as certificates of deposit and Government bonds currently are receiving low returns. But savers also participate in the economy in many other ways as well. Many are workers or would-be workers, and low interest rates boost economic growth and help create jobs throughout the economy. Many are borrowers or would-be borrowers, and Federal Reserve policy has kept mortgage and other interest rates lower than they would have been otherwise, helping those who want to buy homes, automobiles, and other durable goods. Many are investors in stocks and other financial investments, and a stronger economy will naturally generate better returns on those other investments. More generally, in light of the continued headwinds restraining economic growth, the FOMC judges that low interest rates are needed at this time to provide support to the ongoing recovery. Unequivocally, the goal of our accommodative monetary policy is to foster a more rapid return to an economy that works better for everyone, by promoting a return to maximum employment in a context of price stability.

Q.6. Since 2008, our Nation's largest banks are even larger than prior to the crisis, and studies have found they can raise money at lower rates due to their TBTF status. A major reason these firms retain the perception of TBTF is that even the most sophisticated market participants cannot understand the complex risks embedded in their derivatives books, which were at the heart of the recent crisis and which still contain trillions of dollars of potentially volatile positions. In the absence of adequate derivatives disclosures, the market will continue to lack confidence that these firms are actually safe and sound and won't threaten a breakdown of the financial system. Dodd-Frank gave the Fed vast new powers to end TBTF. A key component of ending TBTF is ensuring that the market understands the risk exposures of these multi-trillion dollar derivatives books. Will you commit to using the Fed's new powers to make sure that the market has significantly more robust access to the derivatives exposures of financial institutions?

A.6. I agree that TBTF is a damaging economic phenomena, and regulators around the world need to work to address TBTF. We have made progress in reducing the TBTF problem since the financial crisis by reducing the probability of failure of systemically important financial institutions (SIFIs), by reducing the damage to the system if a SIFI were to fail, and by strengthening the broader financial markets and infrastructure. For example, we have substantially raised bank capital requirements, implemented stress tests for large bank holding companies and disclosed results, strengthened our approach to large bank supervision, and agreed on new liquidity rules for global banking firms. Progress also has been made to address the failure of a SIFI, through the resolution planning process and through the development of the FDIC's single-point-of-entry approach to orderly liquidation authority. In addition, the Federal Reserve is now required to consider financial stability when reviewing merger and acquisition applications by bank holding companies. Finally, we have strengthened financial markets and infrastructures by, among other things, improving the tri-party repo settlement infrastructure, strengthening the supervision of financial market utilities, moving more over-the-counter derivatives to central clearing, and substantially improving transparency in the derivatives markets.

Market participants and some rating agency actions for large bank holding companies have recognized this progress. But we still have work to do to eliminate residual TBTF subsidies. We are committed to that work. If the existing regulatory reform efforts in train prove to be insufficient to solve the TBTF problem, we are willing to look at the costs and benefits of other approaches.

On the specific issue of disclosure of bank derivatives activities, the Federal Reserve has been working in concert with other agencies—in particular the CFTC and SEC—to implement the broad set of derivatives reforms mandated by the Dodd-Frank Act. These reforms should substantially increase transparency regarding banking firms' derivatives activities, as more derivatives trading takes place through central counterparties (CCPs) and data regarding such activity is stored and accessible via trade repositories (TRs). This information should augment existing data on firms' derivatives activities publicly disclosed in regulatory filings (e.g., Y–9Cs and 10–K/Qs).

In addition, firms' derivatives exposures are included in the Federal Reserve's Dodd-Frank Act Stress Test and Comprehensive Capital Analysis and Review (CCAR) exercises, the results of which are released publicly each year.

The Federal Reserve has a long history of supporting enhancements in bank disclosure practices.

Q.7. The Bank for International Settlements noted in its annual report that "in the years ahead, exiting from the extraordinarily accommodative policy stance will raise significant challenges for central banks. They will need to strike the right balance between the risks of exiting prematurely and the risks associated with delaying exit further. While the former are well understood, it is important not to be complacent about the latter just because they have not yet materialized." Do you believe there could be a tendency to delay exiting because the risks related to waiting too long (asset bubbles, inflation, misallocation of credit) are not clear until it is too late?

A.7. There are risks associated with both keeping monetary policy accommodative for too long and tightening policy too soon. As you note, keeping policy accommodative for too long could result in an unwelcome increase in inflation and could encourage excessive risk-taking that might eventually lead to financial instability. Tightening policy too soon could cut off an incipient strengthening of the recovery, preventing a beneficial decrease in unemployment, and possibly causing inflation to move further below the FOMC's target of 2 percent. In order to determine the appropriate setting of monetary policy, the Federal Reserve assesses the outlook for economic conditions as well as the risks around that outlook on an ongoing basis.

I agree that there are unique risks associated with the unconventional monetary policy instruments the FOMC is currently employing, including its large-scale asset purchases and forward guidance for the Federal funds rate, but I do not believe those risks result in a tendency for the FOMC to keep policy accommodative for too long. The Federal Reserve is carefully monitoring the sources of risk associated with accommodative policy. In particular, the Federal Reserve has increased considerably the resources it is devoting to monitoring risks to financial stability. While there are currently some indications of "reach for yield" in the low-rate environment, there does not appear to be a widespread increase in excessive risk taking.

It is important to note that there are also unique risks associated with removing policy accommodation too soon because of the current policy situation. Indeed, I think the best way to bring about an expeditious end to unconventional monetary policy is to avoid a premature removal of accommodation.

Q.8. In a speech this spring, Fed Board Governor Jeremy Stein indicated that certain sectors of the credit market are showing signs of overheating due to the extended period of low interest policy. He noted these risks are developing in the corporate junk bond markets, the mortgage REIT sector, and commercial bank securities, and he concluded that these risks may need to be dealt with through rate increases. FSOC also identified the extended period of low-interest as potentially causing banks to push further out along the risk curve to "reach for yield," increasing credit risk for near-term earnings but sacrificing long term stability in the event of a sudden large rise in rates or widening in credit spreads. Do your views of the overheating of certain markets differ from Governor Stein's? Do you believe there is a potential that we can experience a boom and bust in asset prices without ever experiencing a full economic recovery?

A.8. We follow a great many markets and overall, I do not think we see very much evidence of troubling excesses. I agree with Governor Stein, however, that we saw some issues in some markets this spring and that these warrant careful monitoring. The rise in interest rates over the summer may have helped reign in some behavior that might otherwise have grown even more concerning. Still we continue to monitor a number of areas. We are mindful of the fact that financial excesses can appear even before a full recovery is complete.

As Governor Stein noted, we have a number of tools for dealing with such problems should they reach the point that a response is required. My preferred first lines of defense involve supervisory and regulatory tools. This is because monetary policy is a very blunt tool for addressing excesses in particular markets. Raising the price of credit for everyone in the economy may help to reign in some troubling behavior, but would also impose costs on all those behaving prudently. Thus, while it is important to maintain the monetary policy option for dealing with financial excesses, I believe it should be a backstop used if more directed approaches fail.

Q.9. How much are the Fed's tools to lower interest rates to stimulate consumer spending on durable goods and mortgages diminished by the fact that the private sector is deleveraging from recent overleveraging and massive asset bubbles? To what extent is incentivizing consumer debt counterproductive to a stable long-run economy? How could fixing our fiscal, tax, and regulatory policies impact the economy as compared to accommodative monetary policies?

A.9. One key factor shaping the contours of the recovery has been the effort of the private sector to reduce its leverage. Substantial progress in that direction has been accomplished, and that progress helps lay the groundwork for a more secure economic expansion going forward. Another important factor helping to lay that groundwork is a highly accommodative monetary policy. These factors are complementary, in that they both help to boost consumer confidence, boost hiring above where it would otherwise be, and increase business demand for capital. That said, monetary policy is not a panacea, and policy makers of all types should be endeavoring to align their policies similarly toward bolstering the recovery and ensuring a solid foundation for growth and stability going forward.