SEMI-ANNUAL TESTIMONY ON THE FEDERAL RESERVE'S SUPERVISION AND REGULATION OF THE FINANCIAL SYSTEM

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SEMI-ANNUAL TESTIMONY ON THE FEDERAL RESERVE'S SUPERVISION AND REGULATION OF THE FINANCIAL SYSTEM

Wednesday, September 28, 2016

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Jeb Hensarling [chairman of the committee] presiding.

Members present: Representatives Hensarling, Royce, Lucas, Garrett, Neugebauer, Pearce, Posey, Fitzpatrick, Luetkemeyer, Huizenga, Duffy, Stivers, Mulvaney, Hultgren, Ross, Pittenger, Wagner, Barr, Rothfus, Messer, Schweikert, Guinta, Tipton, Williams, Poliquin, Love, Hill, Emmer; Waters, Maloney, Velazquez, Sherman, Meeks, Capuano, Hinojosa, Lynch, Scott, Green, Cleaver, Moore, Ellison, Perlmutter, Himes, Carney, Foster, Murphy, Delaney, Sinema, Beatty, Heck, and Vargas.

Chairman HENSARLING. The Financial Services Committee will come to order.

Without objection, the Chair is authorized to declare a recess of the committee at any time.

Today's hearing is entitled, "Semi-Annual Testimony on the Federal Reserve's Supervision and Regulation of the Financial System."

I now recognize myself for 3 minutes to give an opening statement. As we all know, the Dodd-Frank Act vastly increased the powers of the Fed way beyond its traditional monetary policy responsibilities. The Act has made the Fed omnipotent, but it cannot make it omniscient. No act can. Through the exercise of so-called heightened prudential standards, the Fed can now functionally control the largest financial institutions in our economy.

Former Fed Governor Kevin Warsh recently wrote, "Central bank power is permissible in a democracy only when its scope is limited, its track record strong, and its accountability assured." None of that do we observe today.

Where has the Fed omnipotence taken us? The big banks are now bigger. The small banks are fewer. Economic growth lags. And there is scant evidence that our economy is more stable.

Two new Fed expanded authorities granted under Dodd-Frank, living wills and stress tests, have been particularly controversial and problematic. The secrecy surrounding the stress test makes it almost impossible to measure the effectiveness of the Fed's regulatory oversight or the integrity of the test findings. As Columbia University professor Charles Calomiris has testified, “It is hard to believe that the current structure of stress test could occur in a country like the United States, which prizes the rule of law, the protection of property rights, and the adherence to due process.”

Dodd-Frank’s living wills grant the FDIC and the Fed unbridled and unreviewable discretion to fundamentally restructure private businesses under a standardless process that relies entirely upon the personal discretion of Washington regulators.

Indeed, the Fed stands at the center of Dodd-Frank’s codification of too-big-to-fail. It functionally occupies the boardrooms of the largest financial institutions in our Nation and decides how they can deploy their capital, sending a clear signal that Washington will bail them out if they get in trouble.

And despite claims by the Fed that it tailors regulations to fit the size of financial institutions, we know small banks are suffering disproportionally under Washington’s thumb. As we lose, on average, one community financial institution per day, consumers lose options to help them achieve financial independence, small businesses lose opportunities to grow jobs, and the big banks just keep getting bigger. There is a better way.

Former Fed Chair Alan Greenspan has said, “Lawmakers and regulators, given elevated capital buffers, need to be far less concerned about the quality of the banks’ loans and security portfolios since any losses would be absorbed by shareholders, not taxpayers. This would enable the Dodd-Frank Act on financial regulation of 2010 to be shelved, ending its potential to distort the markets—a potential scene in the recent decline in market liquidity and flexibility.”

Tom Hoenig, current FDIC Vice Chair has said, “U.S. banks engaged in core banking activities and operating with reasonable levels of capital should not incur the same regulatory burden as those that do not.”

Former FDIC Chair Sheila Bair has also expressed support for the use of higher capital levels in place of regulatory risk-weighting. She has said, “The Fed doesn’t know what’s risky. The FDIC doesn’t know what’s risky. Didn’t we learn anything from the crisis?”

The Financial CHOICE Act approved by this committee offers a better way. It has been endorsed by renowned economists nationwide, including three Nobel Prize winners, by promoting substantially higher loss-absorbing bank capital in exchange for relief from job-killing regulations. The Financial CHOICE Act fosters economic growth for all, bank bailouts for none, and ensures that the Fed is accountable and remains focused on good monetary policy.

The Chair now recognizes the ranking member for 5 minutes.

Ms. WATERS. Thank you, Mr. Chairman, for holding this hearing.

And thank you, Chair Yellen, for making yourself available to testify today. Just a few weeks ago, we passed the ninth anniversary of the Lehman Brothers’ failure. Leading up to 2008, much of the risk in our banking system went entirely unchecked by regulators. Failure to quickly address fraud and mismanagement resulted in the loss of more than 8 million jobs as unemployment topped 10 percent. Millions of families lost their homes, and entire industries were on the brink of collapse. Congress responded to this devastation by passing the most comprehensive overhaul of our financial system since the Great Depression: the Dodd-Frank Wall Street Reform and Consumer Protection Act.

The Dodd-Frank Act greatly increased the Fed's responsibility and authority for safeguarding the financial system but also set minimum standards to ensure that regulators didn't lose sight of emerging risk again.

The Dodd-Frank Act has required regulators to increase capital and liquidity standards, reduce interconnection in the financial markets and more closely scrutinize large financial firms' risk management. However, there is much work left to be done.

As we have seen from the enormous failure of risk management at Wells Fargo, it is important to remind the committee and the public why these reforms were necessary in the first place. Fraudulent retail banking practices may not in and of themselves pose systemic risk, but they surely indicate mismanagement that could be catastrophic in riskier and more complex divisions of a bank holding company. Supervisors and law enforcement must continue to hold both institutions and individuals accountable.

Chair Yellen, I know you will keep that in mind over the next several weeks as you review living wills from the five banks that failed their submissions in April, and that includes Wells Fargo. Chair Yellen, I am eager to hear about the Fed's progress in implementing Wall Street reform and how the Board's supervision practices have evolved over the last several years. Specifically, I am interested to hear more about how the Fed is using the flexibility embedded in Dodd-Frank to tailor regulations appropriate to the sizes and risk of different types of banks.

Dodd-Frank also provided the Fed, in consultation with the Financial Stability Oversight Council, with new responsibility to regulate the activities of systemically risky nonbanks, entities such as the insurance company AIG, whose near failure imposed dire systemic consequences on our economy just 8 years ago. Since the passage of Dodd-Frank, Congress has given the Federal Reserve additional authority in setting capital standards for insurance firms subject to enhanced supervision. I look forward to hearing about the Board's progress on regulating insurers.

Yet, just a few weeks ago in this committee, the Republicans pushed a bill that would severely undermine efforts by the Fed to regulate the financial system. The chairman's misguided legislation would repeal the Financial Stability Oversight Council's ability to designate nonbanks for enhanced supervision by the Fed, creating a huge swath of unmonitored risk in our financial system. The legislation would also replace carefully considered limits on banking activities with nothing but an insufficient 10 percent equity cushion, encouraging the reckless and risky behavior that nearly destroyed our economy in 2008.

Moreover, as we in Congress consider another funding resolution, we must be mindful of continued attempts to defund regulators' work implementing Dodd-Frank. For the first time in recent memory, economic data indicates that the middle class is benefiting from the recovery. Failure to heed the lessons of the past will put that progress in jeopardy.

Thank you, Mr. Chairman, and I yield back the balance of my time.

Chairman HENSARLING. The Chair now recognizes the gentleman from Texas, Mr. Neugebauer, chairman of our Financial Institutions Subcommittee, for 2 minutes.

Mr. NEUGEBAUER. I thank you, Mr. Chairman. Today's hearing is fundamental to understanding developments in the prudential supervision and regulation of our Nation's financial institutions. The role of Vice Chair of Supervision serves as the statutorily designated official within the Federal Reserve to oversee supervision and regulation. In 2010, former Fed Chairman Paul Volcker, champion of the Volcker Rule, noted that the creation of this spot might turn out to be one of the most important things in here, meaning the Dodd-Frank. It focuses the responsibility on one person.

Yet President Obama has failed to nominate anyone to fill this important position, a position that sets prudential regulatory policy and represents the United States in international banking forums like the Financial Stability Board. I remain concerned that Governor Dan Tarullo continues to exercise these authorities outside the statutory construct in mandated oversight of Congress.

Today, I hope to understand better many of the recent regulatory actions taken by the Federal Reserve. For example, how does the Federal Reserve's posture on reducing bank leverage interact with its recent recommendations to repeal the merchant banking authority? On what type of risk that the Fed is trying to mitigate in a recent capital proposal for commodities activity? Similarly, what would the impact be on end users if physical commodity activity decreases or stops? And, finally, does the Federal Reserve recognize the exposure-reducing characteristics of segregated margin, and does it plan to reevaluate its position in the leverage ratio rule given recent Basel Committee discussions?

While Chair Yellen may not be in the best position to answer these questions, it is incumbent upon her to do so, given the Presidential inaction.

With that, Mr. Chairman, I want to say this is my last time to be in this committee with Chair Yellen, and I would like to thank the Chair for her making herself available to us. And thanks again for her service in her capacity.

And, with that, I yield back.

Chairman HENSARLING. The gentleman yields back.

Today, we welcome the testimony of the Honorable Janet Yellen. Chair Yellen has previously testified before our committee on a number of occasions, so I believe she needs no further introduction.

Without objection, Chair Yellen, your written statement will be made a part of the record, and you are now recognized for 5 minutes to give an oral presentation of your testimony.

Thank you.

STATEMENT OF THE HONORABLE JANET L. YELLEN, CHAIR, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mrs. YELLEN. Thank you. Chairman Hensarling, Ranking Member Waters, and other members of the committee, I appreciate the opportunity to testify this morning on the Federal Reserve's regulation and supervision of financial institutions.

One of the Federal Reserve's fundamental goals is to make sure that our regulatory and supervisory program is tailored to the risk that different financial institutions pose to the system as a whole. As we saw in 2007 and 2008, the failure of systemically important financial institutions can destabilize the financial system and undermine the real economy. The largest, most complicated firms must therefore be subject to prudential standards that are more stringent than the standards that apply to other firms. Small- and medium-sized banking organizations, whose failure would generally pose much less risk to the system, should be subject to standards that are materially less stringent.

The Federal Reserve has made substantial progress in building a regulatory and supervisory program that is consistent with these principles. We have implemented key standards designed to limit the financial stability risks posed by the largest, most complex banking firms. We continue to work on some remaining standards and to assess the adequacy of this package of measures.

With respect to small- and medium-sized banks, we must build on the steps we have already taken to ensure that they do not face undue regulatory burdens. Looking forward, we must continue to monitor for the emergence of new risks since another key lesson from the crisis is that financial stability threats change over time.

The Federal Reserve's post-crisis efforts to strengthen its regulation and supervision of large banks have focused on promoting the safety and soundness of these firms and on limiting the adverse effects that their distress or failure could have on the financial system in the broader economy.

We have aimed to increase the resiliency of the largest banking organizations by establishing a broad set of enhanced prudential standards, including capital liquidity requirements for large domestic and foreign banking organizations. And we have aimed to make large financial institutions more resolvable through, for example, the living will process and our proposed long-term debt requirements.

The introduction of capital stress testing for large banking organizations has been one of our signature regulatory and supervisory innovations since the financial crisis. As events during the financial crisis demonstrated, capital buffers that seem adequate in a benign environment may turn out to be far less than adequate during periods of stress. For this reason, the Federal Reserve conducts supervisory stress tests each year on banking organizations with $50 billion or more in total assets to determine whether they have sufficient capital to continue operations through periods of economic stress and market turbulence and whether the capital planning frameworks are adequate to their risk profiles. The expectation embodied in our stress testing program that large banking organizations should maintain sufficient capital buffers to withstand a period of significant stress promotes the resilience of those firms and of the financial system more generally.

While our stress testing program has been successful since it was first introduced in 2009, the crisis reinforced the need for regulators and supervisors to continually revisit the effectiveness of their tools and adjust as needed over time. As my written testimony indicates in more detail and as my colleague Governor

Tarullo discussed in his speech earlier this week, we are now considering making several changes to our stress testing methodology and process.

A leading idea that has emerged from a substantive review of our Comprehensive Capital Analysis Review, or CCAR, program is to integrate CCAR with our regulatory capital framework, thus effectively including GSIB surcharges in the stress test. We are also considering making certain changes to the stress test assumptions used in CCAR. In addition, we are considering exempting from the qualitative portions of CCAR any bank holding company that has less than $250 billion in total assets and that does not have significant international or nonbank activity as well as reducing the amount of data that these firms are required to submit for stress testing purposes.

On this and other changes to CCAR that we are considering, we will, of course, seek public input before moving to adopt them.

I know that community banks play a vital role in many of your districts. Among the lessons of my years of experience at the Federal Reserve have reinforced is that when it comes to bank regulation and supervision, one size does not fit all. To effectively promote safety and soundness and to ensure that institutions comply with applicable consumer protection laws without creating undue regulatory burden, rules and supervisory approaches should be tailored to different types of institutions such as community banks.

The Federal Reserve has already done a considerable amount to reduce regulatory burden on community banking organizations, but we are looking for additional opportunities, including potential simplifications of the regulatory capital framework for community banks.

In conclusion, our post-crisis approach to regulation and supervision is both forward-looking and tailored to the level of risk that firms pose to financial stability in the broader economy. Standards for the largest, most complex banking organizations are now significantly more stringent than the standards for small- and medium-sized banks, which is appropriate, given the impact that the failure or distress of those firms could have on the economy.

As I have discussed, we anticipate taking additional actions in the near term to further tailor our regulatory and supervisory framework. Yet, even as we finalize the major elements of post-crisis reform, our work is not complete. We must carefully monitor the impact of the regulatory changes we have made and remain vigilant regarding the potential emergence of new risks to financial stability. We must stand ready to adjust our regulatory approach where changes are warranted. The work we do to ensure the financial system remains strong and stable is designed to protect and support the real economy that sustains the businesses and jobs on which American households rely.

[The prepared statement of Chair Yellen can be found on page 58 of the appendix.]

Chairman HENSARLING. Thank you, Chair Yellen.

The Chair now recognizes himself for 5 minutes for questions.

First, Chair Yellen, please know that I was encouraged by many aspects of your testimony. I believe that there is, hopefully, growing bipartisan consensus that we need more tailoring of regulations, and particularly on page 13 of your testimony, your recommendation that Congress consider carving out community banks from the Volcker Rule and incentive compensation limits in Section 956. I was also encouraged by your announcement today and what we heard from Governor Tarullo a couple of days ago concerning CCAR's qualitative review exemption. I think that is wise and a very small step in the right direction.

Chair Yellen, before we get to the application of heightened prudential standards, I want to take a step back to how we do the SIFI selection process in the first place. As a member of FSOC, as you probably know, Dodd-Frank demands that there are 11 different factors that must be considered in the SIFI selection process, such items as leverage, and off-balance-sheet exposures.

In the SIFI designation process, do you weigh each of these 11 factors equally?

Mrs. YELLEN. Are you talking about the nonfinancial firms—

Chairman HENSARLING. Yes.

Mrs. YELLEN. —the FSOC has designated?

Chairman HENSARLING. Yes.

Mrs. YELLEN. In the case of those firms, as required, the FSOC prepares an analysis taking—

Chairman HENSARLING. I know, but my question is, of the 11 statutory factors you must consider, do you consider each one equally? Or, for example, is leverage more important to systemic risk than factor four, importance of source of credit liquidity?

Mrs. YELLEN. When it comes down to looking at an actual firm, the question that FSOC has to consider, taking those factors into account, is special to that firm and—

Chairman HENSARLING. So it is individual to the firm?

Mrs. YELLEN. It is individual. The question is what—

Chairman HENSARLING. I guess where I am going with this is—

Mrs. YELLEN. What would be the systemic impact on the U.S. financial system of the distress of that particular firm?

Chairman HENSARLING. Well, with 11 different factors that are considered, combined, that leads to 2,048 different ways in which these 11 criteria can be combined. The statute says you, "shall consider," these, but can I safely assume that you and other members cannot process 2,048 different combinations of this, these 11 criteria?

Mrs. YELLEN. What the analysis presented to FSOC does is look at the specifics of the balance sheet and exposures of an individual firm under consideration and analyzes how those factors would come into play and impact financial stability.

Chairman HENSARLING. I guess my point, Chair Yellen, is it is hard not to conclude that ultimately this becomes a very discretionary process among members of FSOC.

Let's now move to the living wills and CCAR process. So 11 banking organizations submitted rather voluminous living wills in 2014 and the GAO found that the Fed and the FDIC had not reviewed those submissions. I understand many of these submissions are thousands of pages long with respect to living wills. I have had at least one testimony that the CCAR reports are tens of thousands of pages long; I have heard of one that is 42,000 pages long. So I guess my first question is, does anybody at the Fed actually read these reports, and can I safely assume you don't?

Mrs. YELLEN. You can safely assume that many people at the Fed read these reports. And—

Chairman HENSARLING. Does somebody really read a 42,000-page report cover to cover and know what to do with it?

Mrs. YELLEN. Our staff and the FDIC staff do. And I think it is fair to say that all of the Governors reviewed—

Chairman HENSARLING. I find that very difficult to believe, but the GAO has said that these living wills can cost up to $105 million. The SBA estimates the average small business is capitalized with $30,000. So, de facto, you are taking away the opportunity to capitalize 3,500 small businesses with a living will that may or may not be read, that may or may not be useful.

Do you consider the cost of this process as you impose it upon the financial institutions?

Mrs. YELLEN. We consider eliminating too-big-to-fail to be a key objective of Dodd-Frank so that the American taxpayers will not be forced to bear the burden of a failure of a large firm. And I will tell you that the full Board of Governors met on the order of 12 times. We had around 12 Board meetings to consider in great detail all of the key aspects of the living wills of each of these firms.

Chairman HENSARLING. I see my time has expired.

The Chair now recognizes the ranking member for 5 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman.

As you know, the reforms we have passed to make the financial system are constantly under attack, and many accuse us of one-size-fits-all regulations. As you know, the Dodd-Frank Act has provided the Federal Reserve with broad discretion to adjust the rules based on your evaluations of bank risk. I cannot count the number of Republican deregulatory bills that have passed the House Floor which were not serious enough to even be considered in the Republican-controlled Senate.

However, I know that I, as well as other Democrats on this committee, have worked very constructively with you to identify areas of improvement and use your discretion to tailor regulations when necessary.

Governor Tarullo's announcement regarding reforms to the stress testing process is a recent example of that cooperation. And I think you just said in your testimony that you were taking a look at banks with less than $250 billion in assets and that you were considering some changes, provided they were not involved in a lot of trading and international trading in particular.

Would you tell us what that is all about again?

Mrs. YELLEN. Yes. There are two portions to the stress testing program for the institutions over $50 billion. One is a quantitative stress test to see what the impact in a severely adverse scenario would be on the firm's capital position. And we expect to continue subjecting all of the firms over $50 billion to that quantitative part of the stress test. But there is also a qualitative part relating to a firm's capital planning process. And that is something that currently all of the firms above $50 billion are subject to, and we are proposing eliminating that and reducing some of the reporting requirements associated with stress testing for the banks under $250 billion, as you said, that don't have a lot of international activity or nonbanking—nonbanking business.

And we think that our normal supervisory process where we would look at the capital planning processes of these firms is adequate and that many of these firms are meeting our expectations, and this is a significant burden that we think we can relieve these firms of.

Ms. WATERS. I would like to thank you for paying attention to the concerns that have been addressed by members of this committee, and I would like to thank you for recognizing that not only do we have concerns, but these are concerns that can be addressed if we would but work with you, rather than coming up with all of this legislation that really interferes with your ability to exercise the authority that you have. I am very appreciative for that. Let me go on to the next question.

Chair Yellen, I have been closely following the progress on the living wills at the largest banks over the last 5 years. And I must say that I have not been encouraged by that progress. In April of this year, you and the FDIC finally took the important step of officially declaring five living wills as noncredible: JPMorgan Chase, Bank of America, Bank of New York Mellon, State Street, and Wells Fargo. These banks are required to submit their wills to you in the next week. These banks have had 5 years to identify and address problems within their organizations. If any of their living wills are still insufficient in October, will you use your additional authority under the Dodd-Frank Act to quickly and severely reduce the risk these banks present to our economy?

Mrs. YELLEN. We certainly do stand ready to use the authority that we have to impose higher capital and other standards on these firms if they have not corrected the deficiencies that we have identified. We have been very specific with the five firms in indicating what the deficiencies are. We have released to the public the letters that detail those deficiencies. We will carefully and quickly review the submissions that are due by October 1 to see if those deficiencies have been remedied.

But I would say more broadly, for all of the firms, the FDIC and the Board identified a range of shortcomings, things that we did not think rose to the level of deficiencies but nevertheless are things that we want to see corrected. And we will be reviewing the next round of submissions due in 2017 to see if they have been corrected or not. And it is conceivable that if there has been no progress, those things could later rise to the level of deficiencies.

Ms. WATERS. Thank you very much.

I yield back.

Chairman HENSARLING. The time of the gentlelady has expired.

The Chair now recognizes the gentleman from Texas, Mr. Neugebauer, chairman of our Financial Institutions Subcommittee.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

Chair Yellen, this month the Fed along with the OCC and the FDIC put out its required report on bank investment activities required under section 620 of the Dodd-Frank. The Fed raised several concerns with physical commodity activity of financial holding companies under both the complementary authority and section 40 authority.

Last week, the Fed issued a Notice of Proposed Rulemaking whereby it would impose significant capital requirements on covered physical commodity activities that would effectively prohibit many of these activities. In both of the documents, the Fed relies on the term, "environmental catastrophic risk" or "catastrophic risk."

How does the Fed define that risk and how does the Fed measure it?

Mrs. YELLEN. Well, the Fed has been motivated in this rulemaking by looking at the enormous environmental consequences of things like oil spills, the BP disaster, and other things, and the kinds of consequences that those can cause financially for firms and also reputationally. And we are concerned and have done a rulemaking on physical commodity activities, as you indicated, that attempt to address the risks that we think exist in that area and have recommended to Congress repeal of the merchant banking authority for essentially the same set of reasons.

Mr. NEUGEBAUER. So, but I guess the question is, when you are analyzing risk, you go back and you look at past activities to determine, do I hedge my risk against that? I guess the question is, what past environmental catastrophes have posed a problem for financial holding companies? Can you point to something that said, "Gosh, if that happens again, there is a problem?" I can't think of an event that happened that impacted those financial holding companies.

Mrs. YELLEN. Well, under the merchant banking authority—

Mr. NEUGEBAUER. Yes, but this is a different—there are two different authorities here, the merchant banking and them being able to hold the commodities. I want to specifically talk about the commodities.

Mrs. YELLEN. We look at what is permissible and see that there could be environmental risks associated with it. It is not a question of just going back through history to see what has happened in the past. It is a forward-looking concern that the permissible activities could pose risks.

Mr. NEUGEBAUER. Yes, I am a little afraid that we are just trying to think of things that could happen, and then trying to make all of these financial institutions somehow pay a punitive penalty in either capital or regulation for events that may not have happened and may never happen again.

I want to then turn to the GSIB surcharge and stress test. Some commentators have stated that the GSIB surcharge effectively works as a tax on capital market activities.

Can you kind of name the components that make up the surcharge and what activities tend to increase the score?

Mrs. YELLEN. There are a set of factors that are considered in determining the GSIB surcharge, including things like interconnectedness and reliance on short-term wholesale funding factors that would increase the likely systemic repercussions of the failure of the firm. And as you said, the GSIB surcharges can be thought of as taxes imposed on these firms that serve two purposes. First, by insisting that firms hold more capital to address the risks that their failure could impose on society on the broader economy, they ought to be less liable to fail, and holding more capital accomplishes that. And it may create an incentive for these firms to restructure their activities in a way to—

Mr. NEUGEBAUER. So, when you look at that, for example, complexity is one of those. And that, I think talks about the size of the bank's asset that is involved in market making. And then interconnectedness components are primarily dealer-to-dealer trading assets used for hedging and market-making activity and then cross-jurisdiction components of dealer-to-dealer trading similar to the interconnectedness factor. And when you start to look at all of those things that you are penalizing those entities for, it is making markets in the capital markets. And I think what many of us are concerned about is the message to the banks right now is: just get out of the capital markets area because the regulators are making it very punitive to be in those activities.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentlelady from New York, Mrs. Maloney, ranking member of our Capital Markets Subcommittee.

Mrs. MALONEY. Thank you. Thank you, Mr. Chairman.

I believe that Chair Yellen's performance so far has been nonpartisan, admirable, and has proven that she is more than capable of navigating these difficult waters and guiding the U.S. economy back to robust economic growth. So I am disturbed by anyone in a recent debate or anywhere who suggests that Chair Yellen is somehow acting politically. Nothing could be further from the truth.

And I would like to thank you for the service to our country over your long career in government.

Mrs. YELLEN. Thank you, Congresswoman.

Mrs. MALONEY. And I would like to begin with a question on monetary policy before we get to regulation. You said last week at the FOMC meeting that one of the reasons the Fed didn't raise rates was because more people had come back into the labor force without the unemployment rate going down, which suggested to you that the economy "had a little more room to run."

But you also said that if things stay on the current course, you expect one increase in interest rates before the end of this year. So what does that mean? Does that mean that you expect the unemployment rate to start falling again soon? So, in other words, does this mean that you think that the economy has a little more room to run but not that much room to run? Exactly what did you mean?

Mrs. YELLEN. Let me try to clarify. For this entire year, job creation has been running at a pace of about 180,000 jobs per month. And that is a pace—it is a little bit less than we saw in 2015, but nevertheless, well above the pace of job creation that is sustainable over the longer run given trends in the labor force.

Now, I have been pleasantly surprised to see that the unemployment rate actually, as I mentioned, hasn't fallen over that time because people have been drawn back into the labor force and that really means—and with inflation running below 2 percent—we are really not seeing meaningful upward pressure on inflation, and we haven't seen the unemployment rate fall.

But monetary policy is accommodative. Eventually, continued job creation at that pace would cause the economy to overheat and would push the unemployment rate down to lower levels than now.

So monetary policy is accommodative. We want to make sure that the expansion is won and the good performance of the job market is sustainable over the medium term. If we allow the economy to overheat, we could be faced with having to raise interest rates more rapidly than we would want, which could conceivably jeopardize that good state of affairs that we have come close to achieving.

So we expect to see the unemployment rate fall farther. We expect to see solid job growth continue, but we do need, if things continue on their current course, to gradually remove the accommodation that is there.

Now, it is probably not that much. Our estimate of how much accommodation there is has come down over time as economists have reconsidered what is a neutral stance of policy, but nevertheless, there is accommodation. And while there is no fixed timetable for removing it, many of my colleagues indicated in their recent projections, the majority, that they would see it as appropriate to make a move to take a step in that direction this year if things continue on the current path and no significant new risks arise.

Mrs. MALONEY. Okay. Thank you. Now, I would like to ask you about the stress test also. Some people have argued recently that the Fed should put the economic scenarios it develops for the stress test out for formal notice and comment for the public and for interested parties in order to let industry and others weigh in on the assumptions that you use. And of course, the fact that the Fed can tweak these scenarios every year to account for new market developments is one of the main reasons why I would say they are useful. So could you respond to that quickly? My time is up.

Chairman HENSARLING. Very briefly, please.

Mrs. YELLEN. Just very briefly, we want to make sure that those scenarios are based on timely information and address the most significant risks we see. We have put out for comment both the principles underlying our stress tests and information about how we construct the scenarios so firms have quite a good idea of what they can expect in terms of a scenario that they will face. But all of the details, we don't put out for comment. It would cause large delays.

Chairman HENSARLING. The time of the gentlelady from New York has expired.

Mrs. MALONEY. Thank you very much.

Chairman HENSARLING. The Chair now recognizes the gentleman from New Jersey, Mr. Garrett, chairman of our Capital Markets Subcommittee.

Mr. GARRETT. I thank the chairman.

Thanks, Chair Yellen.

As you know, last week, there was the big FOMC meeting and surprise—to no surprise, the Fed decided to do what? To continue the extraordinary accommodative monetary policy. Now, I know you have taken the position that the Fed's position are all purely data-driven and that is where some of the questions were before and that it has absolutely nothing to do with politics. But fewer and fewer people really do believe that. Let me just give you two or three headlines out of last week regarding the FOMC meeting. From Politico, right around here: "Yellen helps Clinton dodge a bullet." From the LA Times: "Is the Fed politically biased? Look at its interest-rate decisions as elections near." From MarketWatch: "A Fed rate hike and other important decisions again being put off until after the election."

See, Chair Yellen, you have told our committee and the public on countless occasions that the Fed is not subject to undue political pressure. But as the saying goes, perception is reality. And whether you like it or not, the public increasingly believes that the Fed independence is nothing more than a myth. And the Fed has an unacceptable cozy relationship both with the Obama Administration and with higher-ups in the Democratic Party.

Now, I brought this up a year ago, and let me run through some of those points that I raised then. You personally have weekly lunches with political and partisan heads over at the Department of Treasury. There is, in fact, a revolving door between the Treasury appointees and the Board of Governors. Your predecessor, Chairman Bernanke, had made a decision literally just weeks before the President had to go before the voters in 2012. And looking at your record, your speech on income inequality, something you never talked about before but which became a major political theme for the Administration, and you gave it just weeks before that last election.

Now, let me give you one most recent one, and maybe you can just comment on this with a couple of yes and noes. There is little doubt about last week's FOMC meetings have potential implications for the markets and therefore the election, but it was reported earlier this year that Fed Governor Lael Brainard contributed the maximum amount to the Hillary Clinton campaign, and she did so while she was a sitting member of the Fed Board. And there were numerous reports that have come out, media reports, stating that the Governor is angling for a top job with the Clinton Administration if Hillary wins.

So some basic questions. Knowing that is all out there on the table, because of the appearance of conflict and impropriety there, has Governor Brainard ever offered to recuse herself from voting at the FOMC? Has she?

Mrs. YELLEN. Governor Brainard, like all of us, is subject to the restrictions of the Hatch Act.

Mr. GARRETT. Right. And so has she offered to recuse herself because of her political involvement?

Mrs. YELLEN. No.

Mr. GARRETT. The answer is no. Have you ever asked the Governor—

Mrs. YELLEN. No.

Mr. GARRETT. I am sorry.

Mrs. YELLEN. The Hatch Act does not prohibit political contributions.

Mr. GARRETT. I get that, and so but we see the appearance of the conflict, and so it is a basic question. Has Governor Brainard ever offered to recuse herself? And the answer is no.

Have you ever asked Governor Brainard to recuse herself because of her close involvement with the campaign in making contributions? Have you ever asked?

Mrs. YELLEN. She is acting in a way that is permitted by the rules we are subject to—

Mr. GARRETT. So your answer is—right.

Mrs. YELLEN. And each one of us has to decide—

Mr. GARRETT. I understand that, so the answer is—

Mrs. YELLEN. —for ourselves—

Mr. GARRETT. The answer is she has never offered to recuse herself. The answer is you have never asked her to recuse herself.

To your knowledge, has Governor Brainard been in contact with the Clinton campaign regarding a potential job in a potential future Administration? Are you aware of that at all?

Mrs. YELLEN. I have absolutely no awareness of that.

Mr. GARRETT. There have been published media reports talking about that. So you are not familiar with those media reports?

Mrs. YELLEN. I have—what is important to me is whether or not in our decisionmaking, our collective decisionmaking, I see politics being brought to bear in reasoning about our decisions, and I have never seen that on the part of any of my colleagues.

Mr. GARRETT. So, if you learned that she has had communications with Clinton as far as trying to get a job, would that change your opinion as to whether she should be asked to recuse herself?

Mrs. YELLEN. I don't think that there is a conflict of interest there.

Mr. GARRETT. So someone can—a Federal Governor can be in direct negotiations with a political campaign looking for a future job, and that is not a conflict, as far as you are concerned?

Mrs. YELLEN. You know, we do have—

Mr. GARRETT. No. Is that a conflict or not, if they are having direct negotiations with either political party to ask for a job next year while they are a sitting Governor? Do you see that as a conflict?

Ms. WATERS. Will the gentleman yield?

Chairman HENSARLING. There is no time.

Mr. GARRETT. I would like to have an answer. Is that a conflict?

Ms. WATERS. Will the gentleman yield?

Mr. GARRETT. If it is a conflict, will you be asking the Governors whether they are engaged in such activity?

Ms. WATERS. Will the gentleman yield?

Chairman HENSARLING. The time of—the gentleman is apparently not yielding. The time of the gentleman has expired.

Can the witness give a brief answer?

Mrs. YELLEN. I would have to consult my counsel. I am not aware that that is a conflict, but I would—

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentlelady from New York, Ms. Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Chair Yellen, Puerto Rico is currently facing a historic crisis: 46 percent of the population is below the poverty line, which is 3 times that of the U.S. mainland. Employment in Puerto Rico stands at roughly 1 million, down nearly 300,000 from 2007. In the meantime, the U.S. economy has gained almost 10 million jobs in the same timeframe. On top of this challenge, the island is struggling with Zika virus, and last week, a blackout swept the island.

When the U.S. mainland faced severe challenges from 2007 to 2009, Congress passed and the President signed sweeping stimulus legislation, the American Recovery and Reinvestment Act. Do you believe that this legislation was helpful in fostering an economic recovery for the U.S.?

Mrs. YELLEN. Well, I do think Puerto Rico faces very serious economic and fiscal problems, as you have described. They have been building for a long time, and the Commonwealth faces very significant challenges. I think the framework that Congress passed provides tools that maybe enable the Commonwealth to avert some worst-case scenarios. The ability to restructure debt should make it possible to put in place a fiscal adjustment that will be one that is less uncertain and hopefully entails smaller cuts to government spending.

Ms. VELAZQUEZ. I understand all that, Chair Yellen. It will take time for the Fiscal Control Board to do its work. And the situation in Puerto Rico is really very difficult at this time. My question to you is, how can we spur investment in Puerto Rico? How can we foster economic growth and not wait for the Fiscal Control Board, because the reality is people are leaving the island? The most productive workforce is leaving the island. They are facing serious problems with a healthcare system that is broken. And my question to you is, do you believe that a Puerto Rico-focused stimulus plan will have a similar effect on the island's economy like we did here in 2008-2009?

Mrs. YELLEN. So this is really something I am not an expert on, what the appropriate programs are for Puerto Rico to deal with its longstanding problems, and I think that is squarely a matter for Congress and the Administration to consider.

Ms. VELAZQUEZ. Okay. Thank you for that answer.

We cannot forget that Puerto Rico is part of the United States, that we have a responsibility and moral obligation. After all, we don't provide parity in some of the important issues that they are facing, such as Medicaid and Medicare.

Chair Yellen, last Friday, the Federal Bank of Philadelphia launched a research and advocacy initiative to examine the interaction between economic inequality in the United States. And its implication for macroeconomic prosperity and growth. What is the Fed hoping to learn from this initiative, and how is the Fed hoping its findings will further the economic inequality discussion?

Mrs. YELLEN. So—

Ms. VELAZQUEZ. I don't see it as a political plot. I see it as a contribution in terms of promoting economic growth among those who have been left behind.

Mrs. YELLEN. Yes. I think the high level of poverty and inequality in the United States is a concern, should be a concern to all Americans, and an important challenge that our Nation hopefully will address. And this initiative is really focused on trying to understand what some of the key factors are that are driving those outcomes and looking at practice to see, based on real-world experiences with programs that are attempting to address poverty, what works and what lessons can be learned that might be of use to communities trying to deal with entrenched poverty.

Ms. VELAZQUEZ. Thank you.

Chairman HENSARLING. The time of the gentlelady has expired.

The Chair now recognizes the gentleman from Missouri, Mr. Luetkemeyer, chairman of our Housing and Insurance Subcommittee.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

And Chair Yellen, welcome.

We spoke a lot about the sheer volume of rules coming out of the Federal Reserve. It is rule after rule, layer of regulation after layer of regulation, and that is really impacting financial institutions across this country, whether they serve a small community in Missouri or customers across the globe.

Now we have the merchant banking and physical commodities involvement by the Fed, as my colleague Mr. Neugebauer has indicated. And I hope that you work with this body with regards to those rules. Fed officials have made statements to the effect that the benefits of merchant banks outweigh the potential risks, yet we seem to be intent on trying to find a solution where there is no problem. That concerns me greatly, and I can assure you we intend to have a number of questions, written questions, for you to respond to with regards to that issue.

Today, though, I want to discuss some the SIFI designation stuff that Mr. Tarullo announced this past week. I think it is important. We certainly now recognize that the SIFI should be designated based on risk, not just on size. That is an important thing. Secretary Lew was here last week, made that same comment, basically, that we need to look at other factors rather than size. And that seems to be your position as well now.

With regards to that, can you tell me what administrative costs will be incurred by the Fed to remove the CCAR requirement?

Mrs. YELLEN. I am sorry—

Mr. LUETKEMEYER. Can you tell me what the costs by the Fed would be to remove the CCAR requirement of being a SIFI, the stress test?

Mrs. YELLEN. Well, we believe that stress tests are a very important way—

Mr. LUETKEMEYER. I am not asking— I am not talking about whether you do or do not do them. What is the cost that—what is the savings that you are going to have, or is there a cost to de-designate? Is there a cost to administratively remove the CCAR requirement? Is there a cost to do that?

Mrs. YELLEN. Is there a cost in terms of dollars and cents that we spend on it?

Mr. LUETKEMEYER. Yes. Does the Fed have to—does it cost you something to administratively remove the CCAR designation—requirement?

Mrs. YELLEN. Does it cost us to implement it and to run the tests? And would we—are you asking me—

Mr. LUETKEMEYER. I am asking you if you don't—to remove the requirement, does it cost you money?

Mrs. YELLEN. Does it cost us money to remove the requirement? It does not.

Mr. LUETKEMEYER. Yes. The CCAR requirement, does it cost you money to do that?

Mrs. YELLEN. Does it cost us money? No.

Mr. LUETKEMEYER. Okay. That is what I want to know.

Mrs. YELLEN. But I think it would be a cost in terms of safety and soundness. I think that—

Mr. LUETKEMEYER. No. I am not talking about that. I am talking about the Fed. Does it cost you money to remove the CCAR requirement? You said no. That is what—that is the answer to my question.

Mrs. YELLEN. Well, any cost also that we incur in carrying out CCAR in the stress testing is passed on to those institutions who pay for the cost of their supervision.

Mr. LUETKEMEYER. Okay.

Last February, the Office of Financial Research conducted an analysis of the systemic importance of 33 U.S. bank holding companies based on basically the tenets of my bill, H.R. 1309, and given that all of this work has been done, can you tell me what you think the costs would be for FSOC to de-designate and redesignate a financial institution—

Mrs. YELLEN. For FSOC to what?

Mr. LUETKEMEYER. —for FSOC to de-designate or redesignate these institutions if they are no longer SIFIs, according to the bill? I have a bill that says you have to look at these things and if the bill—if it shows that the institutions are not SIFIs, you have to de-designate them and then redesignate them if they are just in analyzing them. Is there a cost to that?

Mrs. YELLEN. Well, yes, I think it is clear that these institutions—

Mr. LUETKEMEYER. Can you give me a figure?

Mrs. YELLEN. No, I cannot give you a figure.

Mr. LUETKEMEYER. Okay. Can you give me a ballpark? Is it 100 bucks, a thousand bucks, a million bucks, $10 million?

Mrs. YELLEN. I can't give you an estimate.

Mr. LUETKEMEYER. Okay. Well, the problem is that the FSOC staff, which includes the Federal Reserve, informed the CBO that the de-designation and potential redesignation of banks where they are over $50 billion in assets would have an administrative cost of over $60 million.

Do you think that is reasonable?

Mrs. YELLEN. I honestly don't know. I have not looked at it.

Mr. LUETKEMEYER. Do you have any idea how your staff arrived at that figure?

Mrs. YELLEN. This is the FSOC staff.

Mr. LUETKEMEYER. Well, no, they did it in conjunction with the Federal Reserve staff, which is part of FSOC. Your staff came up with this figure. Do you have any—

Mrs. YELLEN. I have not reviewed how they came up with that figure.

Mr. LUETKEMEYER. Okay. So if we write you a letter, you will be able to give a response to that as well?

Mrs. YELLEN. I can try to do that.

Mr. LUETKEMEYER. Okay. Very quickly, you made the comment a minute ago with regards to what you have all done for community banks to help them with the regulatory problems with this inundation of rules and regulations. Can you give me several examples of that, please?

Mrs. YELLEN. Examples of what we have done?

Mr. LUETKEMEYER. Yes.

Mrs. YELLEN. We have changed the small bank holding company policy statement to raise the threshold for capital regulation.

Mr. LUETKEMEYER. I think we did that in Congress, if I am not mistaken, though.

Mrs. YELLEN. You did. But we put that into effect. We have—

Mr. LUETKEMEYER. Well, I am glad to know that you implemented our law. Thank you very much.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from California, Mr. Sherman.

Mr. SHERMAN. Madam Chair, good move or nonmove earlier this month at the FMOC.

Now, some in politics on Monday will say that our economy is in such terrible shape that those who make economic policies are obviously incompetent. Then they will come back on Wednesday and say it is urgent that we raise interest rates because our economy may overheat and economic growth could get out of hand. Only in this room can you juxtapose those two positions.

We need to allow small-business loans. I have been told by many bankers if there is a 2 percent or 3 percent risk that a business will go under, they can't make the loan. Jamie Dimon was sitting where you are now and said, well, he couldn't find qualified small-business borrowers under that standard. So he sent his money to London where it was eaten by a whale.

It would do a lot for the security of our financial system and also hope the economy of this country if banks were able to make prime plus 3, prime plus 4 loans to businesses that had a little risk and, of course, provide a reasonable reserve. Instead, I am told if you don't qualify for prime plus two, you leave the office.

I join the Chair in saying that it is a good idea to tailor your regulations. And I would say that the more SIFIs you designate, the less significantly you will regulate SIFIs. And it is the hugest institutions that are really systemic risks.

But Madam Chair, I want to address the elephant in the room, or maybe I should say the stagecoach. I will remind you that the FSOC has the authority to break up the biggest banks. And for that—I have said that before in this room and people said, you must have animus to the true global SIFIs. No, studied microbiology. The protozoa reaches a certain size and then it divides. That is healthy. That is normal. If a protozoa can divide in a healthy manner, you would think the smartest minds on Wall Street could as well. Too Big To Fail is too big to exist. Let's look at the elements of that.

Too big to fail is too big not to bail, that is why we bailed them out in 2008. Too big to fail is too big to jail, that is why Eric Holder said he can't indict certain executives and institutions, because if he did, it would have too big an effect on the economy. Too big to fail is too big to compete with, that is why some studies say they get 80 basis points off their cost of capital—it might be less—because of the expectation of those providing the capital that if they get in trouble, we will bail them out.

But Wells Fargo has identified two additional reasons to break these institutions up. Because you—they created a system where they hired good Americans and turned 5,300 of them into felons. Two million felonies. They failed to monitor the system. When they saw that there was a—that some individuals had created phony accounts, they fired 1,000 of them and didn't change the system and didn't fire the executives that created the system that created the first thousand felons that led to 5,300 felons.

Now, from a Democratic side, I say too-big-to-fail is too big to manage. From a Republican side, I have heard too-big-to-fail is too big to regulate. But whether the fault is the regulators who can't regulate it or the managers who can't manage it, too-big-to-fail is too big to exist.

So my question for you is, will you seriously consider using your authority, as I think you are required to review and consider using your authority, will you at least seriously consider breaking up Wells Fargo?

Mrs. YELLEN. We will hold the largest organizations to exceptionally high standards of risk management, internal controls, consumer protection. We expect the—

Mr. SHERMAN. But if you broke Wells Fargo up, then instead of trying to hold them up to those really high standards, people could choose which financial institution to go with. They wouldn't pose a systemic risk. By saying you are going to hold the giant institutions up to standard, something you have not been able to do, 2 million times, 2 million phony accounts, so you are saying you are just going to do—you are going to continue to do a great job of regulating the too-big-to-fail because you are not going to break them up?

Mrs. YELLEN. Well, we believe it is possible, even though it is extremely challenging for organizations to comply with the law.

Mr. SHERMAN. Two million phony accounts not detected by the regulators. Break them up.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Michigan, Mr. Huizenga, chairman of our Monetary Policy and Trade Subcommittee.

Mr. HUIZENGA. Thank you, Mr. Chairman.

And Madam Chair, I appreciate you being here, but quite honestly—no offense—I wish you weren't. We need to have the Vice Chair of Supervision here. This is a position that the Administration has refused to appoint for 6 years now.

You know, Governor Tarullo has essentially fulfilled the function as position of the—from his position as Chair of the Feds Board's committee on supervision, but he is not in this position. And quite honestly, by refusing to fill this position, I believe that the President has deprived Congress and the American people an opportunity to hold the Fed accountable through these semiannual hearings.

And this is a requirement of Dodd-Frank, the much vaunted Dodd-Frank, that some of my friends believe is somehow holy script that can't be changed or altered in any way. But they conveniently refuse some of those other areas.

Do you believe that there should be a nomination to fill this position?

Mrs. YELLEN. We would certainly welcome a nomination.

Mr. HUIZENGA. Have you brought that up with Secretary Lew in your weekly lunches?

Mrs. YELLEN. This is a matter for the Administration to decide.

Mr. HUIZENGA. That is not my question. Have you brought it up? You are having to be here in somebody else's stead. Have you brought it up with the Administration or specifically with Secretary Lew or anybody else?

Mrs. YELLEN. I am not going to discuss what I have discussed or haven't with the Secretary.

Mr. HUIZENGA. Okay. Well—

Mrs. YELLEN. As I say, it is an Administration responsibility, and we would certainly welcome a nomination.

Mr. HUIZENGA. Well, I guess we will continue to hold you responsible for that obligation, which is something that you shouldn't be held for. But that is your decision.

Mrs. YELLEN. Well, I think—

Mr. HUIZENGA. I am going to go on. But do you believe that any and all rulemaking regarding regulatory or supervisory—or supervision should be suspended until this Vice Chair is actually named?

Mrs. YELLEN. No. Because I think the Board of Governors is charged with supervision and putting in place regulations. And we are carrying that out.

Mr. HUIZENGA. And then who do we hold responsible for that? Who do we hold responsible for that then?

Mrs. YELLEN. Well, I am responsible and my colleagues are responsible, and I am—

Mr. HUIZENGA. Okay. Well, as long as you are willing to fulfill that obligation, that is an additional burden on you, but—

Mrs. YELLEN. We are. Congress assigned the Board of Governors that responsibility, and I am certainly sharing that responsibility with my colleagues.

Mr. HUIZENGA. Okay. This is going fast so I need to move on. I want to talk a little bit about monetary policy versus regulatory and supervision and supervisory roles. The fact is, is that in my Fed Oversight Reform and Modernization Act, the FORM Act, and by extension the CHOICE Act, we are trying to bring some separation to your function as monetary policymakers as well as your regulatory and supervisory roles.

Former Senator and Banking Committee Chairman Dodd-Frank—or Chris Dodd as well as Chairman Frank at the time had advanced legislation or advanced the notion that those ought to be separate duties and that your regulatory and supervisory roles ought to be put on budget. And I am curious, were they wrong in that assessment?

Mrs. YELLEN. Well, Congress decided to—

Mr. HUIZENGA. So you would welcome, then—if Congress decided, you would welcome having that separation and putting your regulatory and supervisory roles under budget and with review just like everybody else, every other regulator versus the separation of your monetary policy duties?

Mrs. YELLEN. The banking agencies do not have their budgets mandated by Congress. They are covered by collections from the industry. I would very much worry that we would lack the flexibility under congressional appropriations to ramp up our supervision at times when it appears to be—

Mr. HUIZENGA. But we have an alphabet soup of all these other regulators that are there as well. And so it seems to me you are wanting to have your cake and eat it too. You want to have this super-duper regulatory role where it is Fed uber alles on this stuff. But you are not willing to subject yourselves to what the other regulators go through, and that just seems that—rarely do I say that I agree with Barney Frank, but I believe that Chairman Frank at the time had this right and that there is that separate role.

My last issue as we are quickly closing out here, some have believed that Dodd-Frank cannot be changed at all in any way, shape, or form. You said on page 14, page 4 a number of times that there ought to be these adjustments. Have you spoken to these Senators or other reps who disagree with you and say that we cannot touch Dodd-Frank?

Chairman HENSARLING. A very brief answer, please.

Mrs. YELLEN. Well, we have said that those would be desirable changes.

Mr. HUIZENGA. I hope you are expressing that to the members.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from New York, Mr. Meeks.

Mr. MEEKS. Thank you, Mr. Chairman.

And it is a pleasure to welcome you back to this committee. And let me just say at the outset, I also thank you for staying with who you are, being nonpartisan and independent, despite there being some, especially in the presidential politics which we are currently engaged in, who is trying to say that your decisions are based upon a partisan way. In fact, I think that it is good when you are criticized from both the left and the right and from everyone. That probably means that you are doing the right job because you are not focused on either side.

And we in this committee specifically reinforced the banking supervision's powers of the Federal Reserve in Dodd-Frank because there was clearly a need to heighten our banking examinations and regulatory framework. I think that that is clear from what took place back in 2008.

The good news is that we are seeing banks taking bolder steps to reduce risk, as you have indicated, and to exit out of certain risky activities. We do see some of that happening. Even if some would say that banks are bigger today than there were before the financial crisis, that probably may be true from a simplistic perspective, but it is not a complete and accurate picture because, not only have banks exited some of their riskier businesses, they have also boosted their capital and liquidity buffers, which surely increases the size of their balance sheets, but it makes them safer and sounder institutions. So this is the complicated stuff, which is true. And then yet we still have Wells Fargo, which causes us to have great concerns as to what and where we need to go next, as we will have questions with him. So there has been some progress.

But then there is also unintended consequences. And I want to shift to that now just because it is well-documented that one of those unintended consequences of banks derisking has been that banks are getting out of certain communities and countries, and they are also denying services to millions of lower income Americans, not because the risk is too high, but simply because the profit margins are not considered high enough. There have been serious consequences on vital correspondent banking relationships that are critical to international financial flows also.

But another major problem happening in several communities here, including in a district like mine, is that banks are closing branches. In fact, economists from the Federal Reserve Bank of New York released a report last March entitled, "Banking Deserts, Branch Closings, and Soft Information," showing that U.S. banks have shut nearly 5,000 branches since the financial crisis as a result.

Residents of low-income neighborhoods have become somewhat more likely to live in a banking desert. That is why I have called for the revamp of the Community Reinvestment Act in a letter that was just mailed to a number of banking regulators and cosigned by 40 of my colleagues. Some are still signing on.

So Chair Yellen, it is obvious that CRA is not working as it was meant to work when it was passed 40 years ago. And I have had this discussion with OCC Comptroller Curry, and I strongly believe that part of the solution resides in enabling greater collaboration between large banks and CDFIs, including minority deposit institutions, so that these institutions can take over assets and branches before they close, and more importantly, so they can preserve banking services and relationships in low-income communities of color.

So the comptroller and I are in constant dialogue on this, and I would love to get some of your thoughts on this matter.

Mrs. YELLEN. Well, I am concerned about banking services in low-income communities. And we are working with minority depository institutions to provide support to them in enhancing the very important and valuable role that they play in ensuring the provision of services to these communities.

Mr. MEEKS. So do you believe that we should—40 years ago there was one thought of you: Banking in CRA was put in so that we could make sure that you had institutions. Do you believe that there is ways that we can revitalize or revamp CRA to deal with the institutions and what is taking place today so that these communities are not neglected and then become part of banking deserts?

Mrs. YELLEN. Well, we are having a look at CRA and the agencies who have put out additional guidance in recent years that is meant to address issues that have arisen, and we will continue to look at what further guidance might be appropriate.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Wisconsin, Mr. Duffy, chairman of our Oversight and Investigations Subcommittee.

Mr. DUFFY. Madam Chair, welcome. Obviously, looking back to 2008, the crisis had a huge impact, not just on the financial service sector, but had a huge impact across our country and on many of the families that we represent. And I would argue that this massive Dodd-Frank bill was passed in a time of fear, where people were concerned about the future of our country and the future of their family. And a 2,300-page bill was passed before the dust had even settled and we had a full analysis on what caused the crisis.

And we were told by our friends across the aisle, who I would argue opened up their cabinets, their file cabinets and dumped in every wish bag issue that they had for probably a decade, but they made a promise to the American people that when they passed that bill, they would be ending too-big-to-fail. Because people were concerned not just about the economy but the fact that the taxpayer, their money was going to bail out large financial institutions.

Do you agree now, almost a decade on, that we have ended too-big-to-fail?

Mrs. YELLEN. Well, I think we have taken very significant steps toward—

Mr. DUFFY. No, no, no, no, Madam Chair, that is not my question. We were promised that we would end too-big-to-fail—I wasn't here—that they would end too-big-to-fail. So I think the American people have a right to know what you think. Have we ended too-big-to-fail? Yes or no.

Mrs. YELLEN. So as I said, I think too-big-to-fail is a less significant problem now than it was before. I don't—

Mr. DUFFY. So you are saying it is a still a problem. We haven't eradicated the threat, have we? Too big to fail still exists. Yes?

Mrs. YELLEN. I think we have made very, very important and meaningful strides toward ending it.

Mr. DUFFY. Madam Chair, these are simple questions.

Mrs. YELLEN. I am sorry, I don't think it is a black or white thing, yes or no.

Mr. DUFFY. You can say, I can tell you, Congressman Duffy, we have ended too-big-to-fail. America is better off for Dodd-Frank and the fact that I am the Chair of the Fed. Or frankly, no, we haven't. We haven't ended too-big-to-fail. We have made progress, but we haven't ended it.

Mrs. YELLEN. We have done a great deal to make it possible for a systemic institution to be resolved successfully.

Mr. DUFFY. So I am going to take that—

Mrs. YELLEN. The odds of accomplishing that are much better.

Mr. DUFFY. You are not answering my question. I think what you are—if I am going to clear the smoke, you are saying, we have made progress but we haven't ended too-big-to-fail, and I think you are in a safe zone because Elizabeth Warren even admits we haven't ended too-big-to-fail. The ranking member and my friends across the aisle will admit, clearly in hearings here, we haven't ended too-big-to-fail.

So my question for you is a 2,300-page bill giving you and other prudential regulators significant authority that had a huge impact on the financial sector and on our economy, if we haven't ended too-big-to-fail, is it a failure of Dodd-Frank or is it a failure of the Fed?

Mrs. YELLEN. I am sorry, I am not willing to describe it as a failure, because, number one—

Mr. DUFFY. We haven't ended too-big-to-fail.

Mrs. YELLEN. I am sorry, we have made great progress in trying to achieve that, and it is not a black or white issue.

Mr. DUFFY. Does that answer work for my constituents? When I go home and said, this was a devastating crisis, it had a huge impact on your family, we are 10 years on, we had a 2,300-page bill, you can't get a loan from your credit union or your community bank—I am not done—or from your community bank, and Chair Yellen came in and she said we have made progress.

Mrs. YELLEN. So we have a system that is much safer and sounder. It is much more resilient. It has much more capital, much more liquidity, and better, although certainly not perfect, risk management.

Mr. DUFFY. I wholeheartedly disagree on many issues with Elizabeth Warren, but at least she is truthful on that.

Larry Summers recently—I am sure you read his piece—said that, to our surprise, capital information is at least superficially inconsistent with the view that banks are far safer today than they were before the crisis and some support for the notion that risks have actually increased. Larry Summers. Do you disagree with Mr. Summers as well?

Mrs. YELLEN. Yes, I do, I disagree significantly with that conclusion because it is based on the notion that markets properly evaluated the risks in banking organizations before the crisis, and nothing could be further from the truth.

Mr. DUFFY. I am going to give you one quote. In 1788, James Madison worried that laws may become so voluminous that they cannot be read or so incoherent that they cannot be understood. 2,300 pages in Dodd-Frank, 30,000 new regulatory restrictions, a 900-page Volcker Rule, 600 pages of Basel III, and you can't tell me with all that rule and regulation that you haven't eradicated the threat of too-big-to-fail.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Massachusetts, Mr. Capuano.

Mr. CAPUANO. Thank you, Mr. Chair.

Thank you, Madam Chair, for being here again. I just want to clarify a few things I think some of my colleagues made. I am not aware of anybody who doesn't want to amend Dodd-Frank, including me. I want to amend it; I just don't want to gut it. Good amendments, thoughtful amendments, all for them. Gutting it, totally against. And that is pretty much the only bills we have been offered is the offered bills that would gut—

Mr. HUIZENGA. Will the gentleman yield?

Mr. CAPUANO. Not right now, no, but thank you.

Mr. HUIZENGA. Hold my request.

Mr. CAPUANO. Too big to fail? I agree. We should do more on it. That is why I offered the bill to bring back Glass-Steagall. All my colleagues are welcome to join that bill. That is why I offered H.R. 888 that the community bankers support. All my colleagues are welcome to join that bill. And that is why I joined my colleague on the other side, Mr. Garrett.

Now, my God, if you are not paying attention, when Garrett and I can agree on H.R. 2625 that directly relates to the Fed's ability to bail out banks. All my colleagues are welcome to join that bill as well. I know Mrs. Yellen wouldn't like that bill, and I appreciate that, but it doesn't kill you. It just kind of squeezes a little harder.

There are bills that are out there to do more. All you have to do is read them and join us. If Garrett and I can do it, you sure as hell can find a way to do it. Don't get used to me and Garrett working together either, but that is a different issue.

Mrs. Yellen, let's assume for the sake of discussion that we had a large bank, a big SIFI, one you are keeping a very close eye on, that over the last 5 years has had 16 enforcements actions against them, including one from the Fed. Let's assume the bank had a Fed fine of $85 million, and in that agreement, the consent agreement that they signed with you, they said—well, you said, "Internal controls are not adequate to detect and prevent instances when certain of its sales personnel, in order to meet sales performance standards and receive incentive compensation, altered or falsified income documents and inflated perspective borrower's incomes to qualify those borrowers for loans that they would not otherwise have been qualified to receive." That was 2011. Obviously, hypothetical, of course.

And since that time, we have had 15 other violations across the Board with pretty much every alphabet agency you can find—DOJ, CFPB, OCC, FinCEN, FHA, SEC, NCUA, and pretty much every State in the Nation—totaling $10 billion, almost $11 billion in fines. Those actions included defrauding student loans, mortgage holders, credit unions, identity protection, kickbacks, insider trading, defrauding Freddie, defrauding Fannie, worker health issues, discriminating against African Americans and Hispanics, defrauding investors, foreclosure abuses, and on and on and on.

And then just this year, earlier, when you rejected their living will, your letter cited concerns about quality control, senior management oversight, accuracy, the consistency of financial and other information reported, even though the firm's leadership steering committee had input to the plan.

And now we have a—same bank, same bank, just defrauded 2.5 million of its own customers. Its own customers. I am sorry, 1.5 million. Don't you think it is time the Fed does something? How long does this stuff go on before you get outraged and take action?

Mrs. YELLEN. As you pointed out, we have done something. The action that you described in 2011—

Mr. CAPUANO. You know that an $85 million fine to this bank is laughable. You know that. I know you know that. It is a lot of money to me and everybody I know, but to this bank, they made $23 billion last year. God bless them. They are a very successful bank. An $85 million bank is barely a footnote in their annual report, and you know that.

Mrs. YELLEN. Well, as you pointed out, many regulators have been involved in—

Mr. CAPUANO. Oh, I am going to have my fun with them too. It is just your turn today.

Mrs. YELLEN. So we are—in the case of this institution, we are the supervisor of the holding company. We have already instituted a review of all of the largest banking organizations because we are very concerned with all of the compliance problems and violations of laws that have occurred.

Mr. CAPUANO. You know they are laughing at you, right? You know they are laughing at you.

Mrs. YELLEN. Well, we will—

Chairman HENSARLING. The time of the gentleman from Massachusetts has expired.

The Chair now recognizes the gentleman from New Hampshire, Mr. Guinta.

Mr. GUINTA. Thank you, Mr. Chairman.

Chair Yellen, to your right. Thank you. Thank you for being here today. I want to talk a little bit about community banks. You and I know the importance and the role that they play in our financial ecosystem. My State of New Hampshire is a small State yet a resilient State, 1.3 million people, and we have very close relationships with our community banks. We have 10 Federally chartered banks, we have 16 State chartered banks, and we have 10 out-of-State chartered banks. So it is not a significant number, but they are very important and critical to consumers.

But due to the severe regulations that community banks in my State are subject to, they are now limiting products and loans and services to their customers and my constituents. When community banks should be focused on providing access to credit for consumers, their focus and attention on meeting compliance with the burdensome regulatory requirements seems to take the priority of their time.

I get reports from my community bankers on a regular basis that they can spend up to 25 percent of their time and resources on compliance, and this has been increasing as a result of the growth in the regulatory requirements that continue to be placed on them.

So my first question would be, do you believe that there is a disproportionate impact of regulatory compliance on community financial institutions, institutions that are smaller that service customers in New Hampshire?

Mrs. YELLEN. So we want to do everything we can to reduce burdens on community banks and recognize that they are laboring under a significant set of regulatory burdens. We are going through the EGRPRA process and looking at a number of concrete ways in which we can reduce that burden. And we have taken a number of steps on our own to reduce the frequency and intrusiveness of exams to make it more risk focused, to do more work not on the premises of the bank to try to reduce burden.

You asked if the burdens had fallen disproportionately—

Mr. GUINTA. Right.

Mrs. YELLEN. —on community banks. The fact that they are smaller means that these burdens can be significant relative to their budgets. But the most restrictive requirements have been focused on the larger institutions, particularly the U.S. G-SIBs that are subject to a much more stringent set of—

Mr. GUINTA. But you do think there is a disproportionate impact on smaller banks, community banks?

Mrs. YELLEN. There is quite a bit of research that is taking place. In fact, we have a conference that is taking place at the moment that is looking at those burdens but—

Mr. GUINTA. Well, the reason I ask—

Mrs. YELLEN. —they are significant burdens for a very small bank. There is a certain fixed cost involved in doing that.

Mr. GUINTA. The reason I am asking is we have had two mergers in the last 6 months in the State of New Hampshire. And my fear is that that is going to continue. So I hope that you could identify very specifically and very quickly before the end of the year areas where we can reduce that regulatory burden. New Hampshire bankers are going to be coming to Washington tomorrow to meet on this very subject. They are very interested in it and—because our economy requires and relies on them.

A different point I want to bring up, in your written testimony, you recommended that Congress consider carving out community banks from the Volcker Rule and the Dodd-Frank Act's incentive-based compensation rules. Regarding your recommendation that community banks be carved out of the Volcker Rule, would you agree in concept that an approach worthy of consideration would be to exempt the Volcker Rule those banking institutions that do not engage in a material way in the activities that the Volcker Rule seeks to regulate, but keep those entities that engage in trading activities subject to the Volcker Rule?

Mrs. YELLEN. So we have certainly said that we thought smaller institutions should be exempt, and the exact definition I would have to look at—I would have to look at more carefully.

Mr. GUINTA. Okay. You also talked earlier about the 80,000 jobs per month that this economy is generating. Can you tell me—and you said the labor participation rate is changing. Can you tell me what percentage the labor participation rate is right now? Is it below 62 percent?

Mrs. YELLEN. No, I don't believe so. Let me just have a look.

It is currently 62.8 percent.

Mr. GUINTA. Okay. I am sorry, my time has expired, but I don't think that that has changed over the last several months.

Chairman HENSARLING. The time of the gentleman has expired.

Mrs. YELLEN. It hasn't changed over the last several months.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Texas, Mr. Hinojosa.

Mr. HINOJOSA. Thank you, Chairman Hensarling and Ranking Member Waters, for convening this hearing.

Welcome, Chair Yellen, and please accept my sincere gratitude for your leadership at the Fed. I commend you for acting in the absence of a Vice Chair of supervision or regulation of bank holding companies and nonbank financial institutions.

Confidence in the safety and stability of our financial system continues to strengthen, even in the face of global market unpredictability and other emerging threats. We can attribute continued growth in stronger and more resilient economy to your leadership and the protections afforded by Dodd-Frank Act.

My first question, Chair Yellen, is, in your opinion, do our financial regulators currently have the discretion they need to correctly tailor regulatory and supervisory standards or should we in Congress take action?

Mrs. YELLEN. Well, I think by and large, we do have the scope we need to tailor these regulations. We have pointed out a few areas where we have limitations—the Volcker Rule is one and the incentive compensation rules are another—where we can do some tailoring, but not as much as we would like.

Congress did act to address our—the restrictions we faced in the area of insurance in designing an appropriate set of capital standards for insurance-centered savings and loan holding companies. And we appreciate that and have used it to propose a set of capital standards for those companies that we think is appropriate.

So there are some areas where we have needed Congress' help, but by and large, we have a good deal of scope to tailor as we see appropriate.

Mr. HINOJOSA. You need to know that I continue to hear from banks of all sizes in my congressional district that they are burdened by regulations and costly stress tests. Several changes to the yearly stress test, known as the Comprehensive Capital Analysis and Review, were announced on Monday. Can you tell us what changes are being made to this review process and how that is expected to help community banks that are not internationally active nor participating in risky nonbank activities?

And also, there are regulatory relief—is rather—there was in the Wall Street Journal an article that talked about trying to have some regional bank systems given some—if they are from $200 billion in assets or less, being given some relief.

Mrs. YELLEN. Yes.

Mr. HINOJOSA. Talk about that for me.

Mrs. YELLEN. So at the moment, banks—over $50 billion have been part of our so-called CCAR, comprehensive capital and stress testing regimes. And the proposal that we put out on Monday that Governor Tarullo described would exempt from the qualitative parts of that process bank holding companies under $250 billion that do not have significant foreign activities or significant nonbanking activities.

So the list complex of those banking organizations, they would need to conduct the quantitative stress test, and we would conduct that, but the remainder of the capital evaluation, the qualitative part, they would no longer be subject to.

Mr. HINOJOSA. I am also wanting to address the problems in Wall Street and some of the investors, especially working families investing in their 401(k)s. How are China's economic troubles affecting the United States' economy? And as the largest foreign holder of U.S. Treasuries with over $1 trillion in reserve, is the Federal Reserve concerned that recent selling of large quantities of treasuries by China could significantly and negatively affect the U.S. dollar?

Mrs. YELLEN. Well, China's economy has been slowing from decades of very rapid growth. That is something to be expected, given all the progress they have made and the desirability of transforming their economy to a more consumer-based economy. By and large, that process is proceeding and it is a good one from the standpoint of the United States, but it is very challenging.

And earlier in the year and last year, there were disruptions in markets related to their currency, their approach to managing their exchange rate. They sold treasuries mainly to support their currency, which was under downward pressure. And in recent months, I think markets have been much calmer, I think, as the—

Chairman HENSARLING. The time of the gentleman from Texas has expired.

Mr. HINOJOSA. Thank you.

Chairman HENSARLING. The Chair now recognizes the gentleman from Oklahoma, Mr. Lucas.

Mr. LUCAS. Thank you, Mr. Chairman.

And thank you, Chair Yellen, for being here. I share, along with my colleagues, Mr. Neugebauer and Mr. Luetkemeyer, concern over a proposed rule that the Fed released on Friday increasing the cost for financial companies to engage with their clients in physical commodity markets.

As a member of this committee and a former chairman of the House Agriculture Committee, I have worked with a number of end users on issues associated with reform and regulation within the derivatives markets. And you and I have discussed on various occasions the nature of my district, or district of Oklahoma, and the importance of stable commodity markets to my district. Over the past few years, I have heard from a number of commodity end users about their concerns on this issue. And I too am concerned about the impact this will have on our businesses and municipalities and their ability to participate in commodity markets.

While we should, of course, continue to address risk to safety and soundness within our financial system, it appears that this rule simply seeks to discourage a company's participation in these activities through capital requirements rather than through an actual effort to target and mitigate risk within the system.

In crafting this proposal—I guess my questions would be the following: In crafting this proposal, did the Fed examine historic loss data for banks engaged in physical commodity activities as well as how losses in this business related to losses in other parts of the bank's business?

Mrs. YELLEN. We did take a very careful look at the nature of banks' involvement in these areas and considered the risks that that activity entails. And it is important to recognize that financial holding companies would still, under these proposals, be permitted to engage in physical commodities trading with end users. That is not something that would change.

What this proposal does is put in place additional risk-based capital requirements for activities that involve commodities for which Federal or State law would impose liabilities if the commodity were released into the environment. So we are worried about environmental risk.

Mr. LUCAS. Well, Chair Yellen, if you could provide us with the information on how you made those determinations, what the historic perspective was, how it has actually affected businesses, I think I and the rest of the committee would appreciate what the historic foundation was.

It also appears that you are raising risk weighing to 300 percent for companies that engage in this business, which will, of course, make it much more expensive for all of these companies. Could you also provide the committee with the analysis that was used to arrive at this 300 percent as an appropriate amount? How did you get there?

Mrs. YELLEN. We will get back to you on some details.

Mr. LUCAS. And I would simply note again, Chair Yellen, I commented earlier, you and I have discussed this on many occasions, my district is agriculture and energy. We are wheat and cattle, we are pork, we are cotton, we are oil and gas, we are electricity, more and more every day generated by wind power.

Having the tools to be able to hedge our products, having more participants in the markets, give us, we believe, a much better price situation. If we restrict our tools to protect ourselves, if we restrict access to the markets by others, there is a great concern we will suffer and, of course, ultimately, the consumer who benefits from that supply will suffer too.

One last thought or maybe a comment. And I would like to reinforce one more time with you, Chair, of my interest and concerns regarding how Basel III treats derivative customers and their margin. I understand that the Basel Committee negotiations continue, but recent reports are not encouraging for the end users in my district and the clearing infrastructure that has long supported their hedging needs.

In this complicated world we live in, I guess what I am saying is, we need more tools, not fewer. We need more cost-effective tools, not more expensive tools, as in the case with Basel III, help protect us from those kind of consequences if it gets out of hand.

And with that, Mr. Chairman, I guess I yield back.

Chairman HENSARLING. The gentleman yields back.

The Chair now recognizes the gentleman from Massachusetts, Mr. Lynch.

Mr. LYNCH. Thank you, Mr. Chairman.

And, Madam Chair, thank you for being here. Really appreciate it. I want to go back to Mr. Capuano's questions around the Wells Fargo scandal. Now, I do understand that there has been a small fine paid by Wells Fargo. But in light of what they did here—2 million fraudulent accounts, I know they fired 5,000 lower-level employees, there has been a little bit of claw back by the bank itself—but in terms of your role, you are the primary regulator for the Wells Fargo holding company, right?

Mrs. YELLEN. We are the primary regulator for the holding company, but these abuses occurred in the bank.

Mr. LYNCH. I understand.

Mrs. YELLEN. And the Comptroller of the Currency and the CFPB have authority, and they are the ones who brought these actions. We weren't involved in it.

Mr. LYNCH. And I give them great credit for that, as well as, I think the L.A., Los Angeles authority was involved as well.

Is there anything that you can do, looking at what happened here? This was widespread. This is a disgrace, really, what happened. Two million fraudulent accounts. And the low-level employees who were fired didn't just think this up themselves. They obviously had incentives that were put in place.

Any ideas from your standpoint as what might be done as a regulation or as legislation to prevent this from happening again?

Mrs. YELLEN. Well, the Comptroller of the Currency and the CFPB have demanded in their actions that remedies be put in place. We now have initiated a broad-based review for all the largest banking organizations of their compliance regimes and governances—

Mr. LYNCH. Okay. Well, let me just ask you, this is a huge, huge thing here, again, 2 million fraudulent accounts. Can you think of any circumstances where a bank might be required to admit guilt? There was no admission of guilt here at all by the CEO or the bank itself. There was no admission of guilt. If it didn't happen here, how can we even imagine ever that a bank might be required to take responsibility for what they are doing?

And I think by doing this, by continually letting the banks off the hook and nobody has to admit guilt, you actually build a perverse incentive for this stuff to happen. And I just—it blows my mind that they are getting away with this and they are paying a little slap-on-the-wrist fine that is not bothersome.

And the CEO the other day said, well, it was only 5,000 employees. We have 100,000 employees and 5,000 did this, and sort of just blowing it off. It just—

Mrs. YELLEN. I think it is very important that senior management be held accountable and that when there are individuals, identifiable individuals who have been involved in wrongdoing, that—

Mr. LYNCH. Yes. I know they are all lawyered up, but I think there is value in just getting after them, just getting—I don't care if you get a conviction or not, just get after them and make their life hell. That is—and we have to create a disincentive in this system at some point for these CEOs to do the wrong thing. They completely—they completely ignored any of the safety and soundness and just basic responsibilities here. And I would like to see somebody held accountable for that at some point.

Let me ask you, it is a very clubby environment, the banks. And I would be amazed if this practice were just limited to Wells Fargo. I think it is probably the practice at a lot of banks. There is a lot of cross-pollinization going on, people work for one bank, go to another bank. Are we looking at any other big banks doing this type of thing?

Mrs. YELLEN. Well, as I said, yes, we are. The CFPB is in all the largest banks. And we have undertaken—we are undertaking a look comprehensively, not only in the consumer area, but compliance generally, because there have been a very disturbing pattern of violations. They occurred in the mortgage area, in foreign exchange trading, in many different areas, sanctions violations, LIBOR, and we are taking a comprehensive look at the biggest banks at their control—

Mr. LYNCH. All right. Thank you. I have 17 seconds.

I just want to say, in closing, what a wonderful job the OCC and especially CFPB did on this. This is why they are there. And I very seldom hear great things about the CFPB. They did an amazing job here. This is a huge, huge win for the CFPB, and it redoubles my faith in that agency.

Thank you. I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from California, Mr. Royce, chairman of the House Foreign Affairs Committee.

Mr. ROYCE. Thank you, Mr. Chairman.

Thank you, Chair Yellen. It's good to see you today. I had a question—maybe it is a bit to follow up on Mr. Guinta's point—about the unprecedented consolidation that we have seen in community financial institutions, where there are fewer and fewer of them. And these smaller institutions have fewer assets over which to spread their ever-growing compliance costs. So they often seek those economies then through mergers, and that is what leads to this conundrum now of a situation where we have fewer banks today than we did during the Great Depression.

And are you worried about the consequences of consolidation in for communities and for our economies, and eventually for overleverages you end up with just a few big institutions having so much weight in them?

Mrs. YELLEN. Well, I do think it is essential that we have a vibrant set of community banks serving America's communities. They play a very special role in our financial system, and it is important that they remain healthy. Reducing regulatory burden, it is important. It is something that we will seek to foster using every available tool that we have.

Community banks face a challenging environment, though, for reasons that go beyond regulation. The low level of interest rates and flat yield curve and slow pace of growth in the economy are also factors that are making it difficult for them to thrive. But they are tremendously important in the role they play for American households and businesses, and we will certainly do everything that we can to relieve burdens on them.

Mr. ROYCE. Yes. And some of that is true by monetary policy, some of that is true by fiscal policy. So that is another way in which they are adversely impacted by decisions made in Washington.

So it seems to me at the heart of the consolidation, as you say, are these—well, it is really an avalanche of rules that have forced small institutions to hire extra staff. That is the situation, the economy is a scale for them but—

And with that in mind, you said earlier that you are looking for concrete ways to reduce regulatory burdens on community banks, and you gave us some very specific recommendations on merchant banking and commodities activities in the section 620 report that you released.

Can you promise to send up specific legislative ideas that relate—as it relates to regulatory relief for community banks, if we could ask that of you?

And then, for now, I have some questions on the report we received because it is part of the section 620 report. Did you study the effect that a repeal of merchant banking authorities and the loss of $27 billion in capital would have on small and mid-capped companies? And are you confident that if we act on those recommendations that are in that report, there will be alternative sources of capital for portfolio companies? That is one question I wanted to ask.

And another is, based on your answer to my colleague earlier, is it correct to conclude that the recommendations for legislation in the report are based not on historical risks, they are based on, I guess, a projection of the possibility of potential future risks? And the reason I ask those questions is because, as we look back at the financial crisis, there is no evidence that merchant banking and commodity activities were part of the crisis. What was at the heart of the crisis was a concentration of risk in bad home loans and securities tied to those loans.

So as you limit activities of these community banks, are you concerned that you are limiting the diversification of risk and thus adding to the concentration? The harder we make it on these banks, the more concentrated the risk in the big investment banks or the larger institutions. And that could have a very negative impact on safety and soundness. And that was what I was going to ask you.

Mrs. YELLEN. Our valuation was with respect to alternative sources of equity financing, that private equity venture capital would be alternative sources, and that the merchant banking ontribution here is not very large, that it would not have a significant negative affect. Of course, banks would still be able to provide a wide range of lending, advisory, and other financial services to customers, that would include startup firms, technology firms, and others. And they would have the ability to continue making investments in financial firms. So—

Chairman HENSARLING. The time of the gentleman from California has expired.

The Chair now recognizes the gentleman from Georgia, Mr. Scott.

Mr. SCOTT. Thank you, Mrs. Yellen. It is wonderful having you back again. You know, each time you come, we talk about an issue that is dear to my heart and that is the overwhelming unemployment rate facing young African American men.

Last time we talked, you said your monetary policy was a blunt instrument, and you urged Congress to introduce legislation to target this. Well, I took your direction, and I and my cosponsors have introduced two pieces of legislation that I certainly hope you will say a kind word for. Because if you—and knowing your dual duty as both inflation as well as unemployment, if you say a word of support here, you can help us pass these two pieces of legislation.

Now, the first one is the deal with our crumbling infrastructure. That is coming. That is a big, big, big issue. What we want to do on this first bill is to address and develop jobs and on-the-job training apprenticeship program, targeting African American young men, ages 18 to 39. Eighteen to 39, they are the hardest hit for unemployment nationally at 38 percent, and in some of our inner cities at over 50 percent, as you well know—it is in the news every day—of the condition that many of our African American communities are facing.

And so we want to set that up. It will come under the Secretary of Labor, who will coordinate these programs. It will work with the labor unions, like the IBEW, the plumbers and pipe fitters, the ironworkers, steel workers, all of those unions who will be helping to build our crumbling infrastructure. And we will bring these training programs and job programs. And let me just say, they will be in high technology areas, because you can't do all this without computer coding, computer systems, the technical aspects that are so desperately needed. Very important for us to get those in there and get that program started.

The second one has to do with the education component. As you know, every year, every 5 years we have to reinvest in our what we call land grant universities. Those 1890s and 1860s that were set up after the Civil War, schools like Tuskegee University in Alabama, Prairie View in Texas, Florida A&M, all of those. While we want to create a new area, now they can only spend the money in education research and extension. We want scholarships to get these young kids in there.

The big jobs are opening in agriculture business. It is the food we eat, the clothes we wear, now energy, high finance with derivatives and all of that. So we want to do that, give each of these schools $1 million, which they can spread over that 5-year period for scholarships.

Now, these bills are bipartisan. We have some excellent cosponsors, folks like Kevin Cramer of North Dakota, Marcia Fudge of Ohio, Brad Ashford of Nebraska, Mia Love of Utah, Alma Adams of North Carolina, Gwen Graham of Florida, now Pete Sessions, who is our House Rules Committee chairman, all are on this bill.

So a fine word from you would be very, very helpful. And I am going to ask my assistant if he may give you—would you take those to them right now, Tanner—so you could have those.

All I am asking—now, I am not asking you to use a blunt instrument. I am asking to use your golden voice. And if you speak and say a kind word, it will help us get these bills passed. And not only will the African American community thank you, but all of America, white people, everybody. We all know that these young black men with this highest unemployment rate of 18 to 39 are also the child-producing ages. This goes directly at helping us deal with that family breakdown structure, so we thank you for that.

Now, Madam Secretary, I want to ask you one other thing. You have an opportunity to do something very significant because I understand that your Fed regional bank president in my hometown of Atlanta, Dennis Lockhart, is retiring. We have never had an African American regional Fed president. I am asking you, take this opportunity to make history. We have many excellently qualified African Americans who could do this.

And finally, I want to applaud you and Frank Tarullo for what you are doing with the CCAR stress test and committing to working with this continuing flexibility. Thank you.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from New Mexico, Mr. Pearce.

Mr. PEARCE. Thank you, Mr. Chairman.

And thank you, Chair Yellen, for being here. I just want to kind of catch up now that the gentlelady from New York has mentioned the problems in Puerto Rico. If you were to just summarize those in a phrase, basically, what is the root of the problem there?

Mrs. YELLEN. I think deep-seated structural problems pertaining to Puerto Rico's fundamental economic situation that have given rise and exacerbated fiscal problems—

Mr. PEARCE. Okay. All right, thanks. Now, when I am looking back through the 2008 crisis, I notice that your balance sheet jumped from about $900 billion to $2.2 or something like that. What was the reason your balance sheet jumped during that period of time?

Mrs. YELLEN. Primarily because we engaged in a program of purchasing long-term assets, both U.S. Treasury securities and—

Mr. PEARCE. So you got assets from the banks who were having problems and kind of stabilized the banks so you—

Mrs. YELLEN. Well, no, we didn't buy assets from the banks.

Mr. PEARCE. Bought assets from maybe Fannie or somebody. You bought MBS, right? You had mortgage-backed securities that you were purchasing that might have been toxic?

Mrs. YELLEN. Well, I don't know that they were toxic. They were put in receivership by the U.S. Government and—

Mr. PEARCE. The general perception is that they were toxic. Okay. All right. That is fine.

Now, we were treated to Mr. Lew testifying to us a couple of day ago, and he identified in his testimony that he is required as head of the FSOC committee to identify and respond to emerging threats to U.S. financial stability. Now, I pointed out to him that one of the doves on low interest rates, Mr. Rosengren, came out with a statement on the 21st in The Wall Street Journal saying: I think we need to rethink that there is a cost—there is a cost to full employment, basically. So and he is talking about bubbling prices that might be caused by easy money. And so my question to Mr. Lew is, have the two of you ever talked that maybe one of the emerging threats to financial stability might be the easy-money policy? You all haven't had a discussion, or you have?

Mrs. YELLEN. We do discuss threats to financial stability. We monitor them closely.

Mr. PEARCE. About your easy-money policy. Have you specifically talked about that? If he is going to identify it, he ought to identify the easy-money policy. That is not coming from me. That is coming from the guy that is most often on the side of easy money.

Mrs. YELLEN. President Rosengren has singled out commercial real estate as an area that he is concerned with and—

Mr. PEARCE. He says that easy-money policies could be letting markets get out of hand. That sounds a little bit broader than REITs. Easy-money policies could be letting markets get out of hand.

Mrs. YELLEN. Well, there is the possibility that, in a world of very low interest rates, that investors will search for yield and take on additional risks. And we are very much aware of that. And—

Mr. PEARCE. Okay. So we got a difference of opinion among Board members. But then you get something like Virtu, says we are going to stay out of the bond market completely because it is hard to price the assets.

Mrs. YELLEN. Because of what?

Mr. PEARCE. Virtu, the largest e-trader signaling that his company is going to stay away from many securities because the underlying assets are hard to trade, setting the volatility of the trades, the inability to sell or trade heads of positions.

Mrs. YELLEN. What is he talking about? Corporate bonds, or what?

Mr. PEARCE. In my opinion, maybe the bond market overall. And so it just looks like that things aren't quite as stable. Maybe there are underlying problems. Maybe there are bubble prices, and remember that the housing market began as a bubble problem stimulated by government policy. And so to have everybody sort of looking the other way and saying everything is good, and then I look at your—I look at your asset, you typically increase—I just look at the fact that your balance sheet is now up to $4 trillion, so you have almost doubled in the last 4 or 5 years. So you are continuing to buy something, and generally if the market—and then I look at the debt. So Puerto Rico has a 76—roughly 76 percent debt-to-GDP ratio, and ours is 1 to 1.

I am sorry, but I think somebody ought to be talking about stability of the financial market in the United States because it looks desperately unstable.

Thank you, Mr. Chairman. I appreciate your indulgence.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Texas, Mr. Green, ranking member of our Oversight and Investigations Subcommittee.

Mr. GREEN. Thank you, Mr. Chairman.

Thank you also, ranking member.

Madam Chair, thank you for being here today. I believe history will be kind to you as well as to Chairman Bernanke. What you did was extraordinary in a time of great crisis. And I just don't believe those who look back, those who look through the vista of time, I don't believe that they will see these as unkind, unfair, unwanted, or imprudent things. I think that they will judge you well and you will be treated very well by history.

Now, just a few things. I am going to do my best to stay away from Wells Fargo. But I must tell you that it is difficult simply because for one reason, if I may just mention this one: the $185 million in penalties is, according to some standards, about 3 days of profits. So this becomes a line item under the cost of doing business. So it is hard.

I have some other things, but first let me do this. Let me just discuss with you the whole notion of too-big-to-fail. Madam Chair, there is a bit of double speak taking place because a good many people, when they speak of too-big-to-fail, they mean that there will never be another bank that will fail as opposed to what I believe most people understand the case to be, not have a bank that is so big that when it fails, it creates misery throughout the economic order. That is what we are talking about. It can fail. We will put it out of its misery without it creating economic misery. That is what too-big-to-fail is all about. That is what Dodd-Frank does.

Mrs. YELLEN. Yes.

Mr. GREEN. We haven't finished Dodd-Frank yet. We are still implementing aspects of it. But too-big-to-fail is addressed in Dodd-Frank, and it is addressed in a very profound way: the living wills. That helps us to understand how to put these big institutions out of their misery. Dodd-Frank allows us to separate them if we need to and eviscerate them, if necessary. So too-big-to-fail is all about winding down these big AIGs of the world without them taking the economic order with them.

I would like to make a point if I may before your respond to the question of community banks. Madam Chair, the big banks have hijacked the term "community bank." They have hijacked this term. You and I understand that most banks in this country are under a billion dollars. Most of them. Probably 89 percent or thereabout.

Mrs. YELLEN. That is right.

Mr. GREEN. Under $1 billion. Well, the big banks have concluded that you can be a $50 billion bank, a $100 billion bank, and still be a community bank. Therein lies the problem because when we make efforts to help the community banks, which are smaller banks, the big banks step in and they want all of the benefits that we would accord the smaller banks, the real community banks—a bit more double speak—the real community banks. They want those benefits. I applaud you for what you are looking at. I have looked—I have read your statement and you want to do something about this: an 18-month examination cycle.

Look, there are people in Congress who would like to help community banks, but we cannot do it at the risk of bringing in the big institutions who would benefit from it to the detriment of what we have been trying to do in Dodd-Frank. So I am sharing these thoughts with you because I honestly believe that you have some great insight into these things. But my question has to do with something else.

Here is my question. Given what we have done with the QE and all of the tools that you have utilized, how important is it for us to have some investment in infrastructure? Both Presidential candidates have talked about it. Interest rates are exceedingly low at this time. How important is it for us to invest in infrastructure? Or maybe I should put it another way. Would infrastructure investments be helpful in promoting sound economic growth? I welcome your answer.

Mrs. YELLEN. Well, I guess my perspective is that we have had a very disappointing pace of growth in the U.S. economy and productivity growth. The growth in output per worker has been exceptionally slow. A half percent per year for the last 5 years, maybe twice that over the last decade, but low in historical terms. And that is critical to living standards, and investments of all sorts I think are essential to raise growth and promote improved living standards for Americans in the years to come.

Chairman HENSARLING. The time of the gentleman has expired.

Mr. GREEN. Thank you, Madam Chair.

Chairman HENSARLING. The Chair now recognizes the gentleman from South Carolina, Mr. Mulvaney.

Mr. MULVANEY. Chair Yellen, I have a couple of questions consistent with the hearing. Almost all of them are regulatory. But Mr. Neugebauer just actually handed me one that is monetary policy, so I want to ask one very brief question about that, which is: There has been some attention the last few months about the recent decision by the Bank of Japan to start purchasing equities.

And my question to you is fairly simple. Is the United States Federal Reserve looking at the possibility of adding the purchase of equities to its toolbox as it looks at monetary policy?

Mrs. YELLEN. Well, the Federal Reserve is not permitted to purchase equities. We can only purchase U.S. Treasuries and agency securities. I did mention in a speech in Jackson Hole, though, where I discussed longer term issues and difficulties we could have in providing adequate monetary policy, accommodation maybe somewhere in the future down the line, that this is the kind of thing that Congress might consider. But if you were to do so, it is not something—

Mr. MULVANEY. It would take—

Mrs. YELLEN. —that the Federal Reserve is asking for, and there are—

Mr. MULVANEY. It would take a change in the law to do that is what you are saying?

Mrs. YELLEN. It would take a change in the law, and there would certainly be costs to take into account.

Mr. MULVANEY. That is one part of the regulatory question, and I appreciate that. Thank you for straightening that out.

Earlier, Mr. Neugebauer and Mr. Lucas both asked you about the proposed changes in the ways that you want to regulate commodities trading. And I guess my question then is fairly simple. Why are you doing this?

Mrs. YELLEN. Because we are worried about the risks that some forms of commodity activities pose to banking organizations.

Mr. MULVANEY. I heard that, and I heard you give examples about environmental hazards and so forth. But the truth is that has never happened yet. Has it? That risk has never actually been incurred. No one trading in the commodities markets has ever been sued for an environmental—Exxon Valdez didn't end up in the commodities trader getting sued. The BP oil spill didn't end up with a commodities trader being sued. So there has never actually been that occurrence of that risk being incurred.

Mrs. YELLEN. Well, it doesn't broadly prohibit commodities trading. It is focused on activities where there are significant environmental hazards.

Mr. MULVANEY. And we can save for another day whether or not 1,200 percent ratios prohibit. But the fact of the matter is you are trying to regulate a risk that has never actually in the real world been incurred by a commodities trader. Is that correct?

Mrs. YELLEN. Well, we have had huge environmental accidents that have created enormous liability, and we do have a couple of banking organizations that Congress has grandfathered broad rights to engage in commodities storage and distribution, and those risks certainly exist.

Mr. MULVANEY. You could make the argument that there are other risks that banks incur that are actually more tangible and perhaps more likely than an environmental disaster leading to a claim against them based upon commodities trading. It is—and no offense intended to any of my colleagues who are from the New York City area—it is risky for banks to be in New York, right? It is a target for terrorism. They have actually incurred that particular risk in the past.

Could the Federal Reserve decide, in order to make banks safer, that they couldn't do business in New York City?

Mrs. YELLEN. No. We have certainly not decided that.

Mr. MULVANEY. Could you, in theory?

Mrs. YELLEN. I don't know. I am not sure.

Mr. MULVANEY. I would suggest that you probably could. If you could do this, if you could say, "Look, we are going to require you to change your rules because of this risk that we perceive you might incur, even though you have never incurred this risk before," that that same line of reasoning could be applied to something as esoteric as terrorism.

Mrs. YELLEN. What we do require is that banks have robust business continuity plans and that they have backup authorities. So, for example, when we had Hurricane Sandy—that greatly affected New York—that there are backup sites—

Mr. MULVANEY. Backup systems. Thank you for that.

My last line of questioning has to do with something entirely different, which is cryptocurrencies and the blockchain technology. You a spoke at an international conference in June. I think there were 90 central bankers in the IMF, and you talked specifically about blockchain. And I wonder if you want to take this opportunity to talk about the Fed's commitment to a light regulatory touch and then also speak to whether or not you yourself at the Fed are looking at implementing blockchain technology in your operations?

Mrs. YELLEN. We are not looking ourselves at implementing it, but we are studying a whole set of FINTECH innovations and the ways in which blockchain is being considered for use by banks and nonbanks. It could have very significant implications for the payment system and for the conduct of business. We want to foster innovation. I think innovation using these technologies could be extremely helpful and bring benefits to society. At this point, we are simply trying to understand the nature of these innovations. At the same time, consumer protection will also be something that is important. But we are not doing rule writing in the setting where we are trying to understand the ways in which these innovations are shaping the financial—

Chairman HENSARLING. The time of the gentleman from South Carolina has expired.

The Chair now recognizes the gentleman from Delaware, Mr. Carney.

Mr. CARNEY. Thank you, Mr. Chairman.

And thank you, Chair Yellen, for coming in today to answer some of our questions. I have just a couple myself. Hopefully, I will be able to get to them. The first, under the Volcker Rule, Dodd-Frank allowed an additional period of time for groups to divest of illiquid assets, and the Fed has acknowledged that they will need to make adjustments to the timeline, which currently ends July 2016.

These investments—I think there was a question earlier about the commodities—are largely commodities, physical investments which are difficult to sell, illiquid, by definition. I joined 11 other members, Democrats and Republicans, on the committee on a May letter to you asking you to refine your definition of illiquid asset and provide clarity on the timeline for institutions, so they are not forced in a fire sale situation, which actually could help pension funds and others that are holders of these.

So you have extended the time, I understand, to July of 2017, but further guidance and decision hasn't been made. And we did get a letter yesterday where you said the Federal Reserve Board in July indicated it would consider applications by firms for extension of the period to conform with these illiquid fund investments.

Could you expand on that? Is that a case-by-case basis? You will you come out with a more general rule to provide some greater certainty for these institutions?

Mrs. YELLEN. Well, I think we are trying to establish some guidelines that would provide greater certainty. We are looking at that very carefully. I can't give you details, but we recognize there is a significant issue there, and we will try to provide clarity.

Mr. CARNEY. Yes, that would be great. Just to provide some guidance so that they are going to have to start otherwise selling these assets, unwinding them—

Mrs. YELLEN. We understand. We understand that.

Mr. CARNEY. That is great.

So I read through your testimony, and I was pleased to see some of the things that were done—and we have had some discussion about this—with respect to modifying regulations, I guess CCAR in particular, for smaller banking institutions.

Do you have a sense as to what—the complaint that we all hear from the smaller banks is that these regulations require and they incur additional costs, mostly with staff that they have to bring on. Do you have any sense as to whether this will enable the banks to reduce their costs of regulatory compliance?

Mrs. YELLEN. I think that this change to CCAR should be quite meaningful for the banking organizations that will be affected and make it a significantly less onerous process for them.

Mr. CARNEY. And I guess at the end of the day, the question is whether or not they will actually be able to reduce their staff that is dedicated to that function right now. I have talked to local banks in my area, in my State, and other places and asked them. When they said, "Look, this is additional cost," I said, "Well, help me understand." And they, obviously, went through individuals that were hired to address compliance.

Mrs. YELLEN. So I can't give you an estimate—

Mr. CARNEY. Sure.

Mrs. YELLEN. —of what the resource implications will be. They will still be required to conduct the quantitative portions of the stress test, but we are looking at ways for those smaller institutions to reduce data reporting burdens as well.

Mr. CARNEY. That is great, and we appreciate your efforts in that respect.

The last question is really kind of pretty general, but you have been through this and have provided in your testimony your supervisory activities. We all talk about what happened in 2008 the last time. Where are you going forward? Do you think about going forward with respect to the current institutional banking framework as well and there has been some discussion of that in terms of too-big-to-fail. But what are the concerns that you have looking ahead.

Mrs. YELLEN. So I do think we have made progress within the regulated banking sector. I think it is safer, and I think we have begun to deal with too-big-to-fail and made progress there. I think we have addressed some things in the shadow banking sector that are of concern as well. Money market fund reform is going forward. Areas of concern, like the tri-party repo market. I think that has become safer. But I do worry about the migration of activities into less regulated parts or unregulated parts—

Mr. CARNEY. So outside of the banking—

Mrs. YELLEN. —of the financial system. And new threats that may be different than the ones we have addressed in the past, like cyber threats, of course, are of tremendous concern.

Mr. CARNEY. Thank you, Madam Chair. Keep up the good work.

Mrs. YELLEN. Thank you.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentleman from Florida, Mr. Ross.

Mr. ROSS. Thank you, Mr. Chairman.

Chair Yellen, thank you very much for being here. I want to talk to you specifically about SIFI designations and I know that FSOC has the opportunity to designate SIFIs and the Financial Stability Board does it with G-SIFIs. When the FSB does that, if they were to suggest that there was an institution that was globally significantly important, does that permeate or otherwise affect or influence the designation as a SIFI for FSOC?

Mrs. YELLEN. No. FSOC has its own specific—

Mr. ROSS. Guidelines?

Mrs. YELLEN. —guidelines and does its own reviews.

Mr. ROSS. Let's talk about those guidelines because I know they were brought up earlier, and they are statutorily put in there. But, really, FSOC has had a tendency to deviate from those, haven't they?

Mrs. YELLEN. To do what?

Mr. ROSS. To deviate with those guidelines. In other words, let's look at the MetLife decision. The MetLife decision I think exposed something that we have been concerned about for quite some time, and that is the deviation from regulatory requirements that, for example, FSOC consider the actual losses of which, if a nonbank financial institution were to go under. And in the MetLife decision, I think the court found that that wasn't done. In fact, I think the court in that particular decision said that one of the reasons they were overturning that designation is because there was no assessment of costs or losses—I am sorry; that is another part—no assessment of losses that would have been sustained had MetLife experienced the financial trouble. Is that correct? Is that your understanding?

Mrs. YELLEN. Well, FSOC did a detailed study of what the potential consequences—

Mr. ROSS. But they didn't calculate the losses, and I think that's one of the reasons—so they basically went at this very capriciously. And what concerns me about this—and I think that is probably pretty much what the court said too—what concerns me about this—

Mrs. YELLEN. I was involved in the process, and I don't think it was capricious at all.

Mr. ROSS. And I understand that, Chair Yellen, which is why you would look to those who have the expertise in a particular field to rely upon making these decisions. And Roy Woodall, who is the only member of FSOC who has an insurance background, is the only one who voted to not designate MetLife, and yet that was ignored. I think he is getting a little bit of recognition from the court there, but why did you ignore his recommendation with his background, insurance commissioner, understanding of the requirements, a different set of risk than bank and other financial institutions have to have? It just seems like it wasn't—

Mrs. YELLEN. Well, there was a very detailed analysis done of the risks that MetLife's failure could pose to the U.S. financial system. Much of that analysis has been made available and is on the FSOC website.

Mr. ROSS. There has never been a run on an insurance company. Let's face it: they have a 30-year risk assessment there as opposed to a bank that has a day-to-day, minute-to-minute. And I guess that—and I think this is what we are finding out from the MetLife decision is that we have to address these nonbank financial institutions in a whole different way than we address the banking industry. For example, would you not agree that if we are trying to prevent too big-to-fail, that we keep these institutions solvent, that we have some kind of criteria where they can be assessed, corrected, and then be able to not be designated if they are following a process or procedure that prevents them from being assessed as a SIFI.

Mrs. YELLEN. Well, only a few firms have been designated.

Mr. ROSS. But they don't know they are designated until they are in, what, stage 3?

Mrs. YELLEN. They find out earlier than that that they are being designated.

Mr. ROSS. But there is no off-ramp for them I guess is what I am suggesting.

Mrs. YELLEN. Well, there is obviously an off-ramp. GE Capital is—

Mr. ROSS. Well, they sold out. Now, GE Capital, that was an example—they basically said: We are just going to get rid of this because we don't even want to have that regulatory control to interrupt our book of business. That wasn't an off-ramp. That was a divestiture.

Mrs. YELLEN. If they changed their business model in a way that significantly alters the risks that they pose to the U.S. financial system, that is an off-ramp. FSOC reconsiders every year whether or not designations remain appropriate. It is an annual review process, and if a firm wants to, understanding why they were designated, make significant changes that reduce the risk they pose to the U.S. financial system, they can be redesignated.

Mr. ROSS. Thank you. And wouldn't it be in the best of the U.S. financial system to put them on notice as soon as possible so the correction can be made to keep them from having to be even considered as a SIFI?

Mrs. YELLEN. Well, I think that the firms understand what it is about their activities that causes them to be designated.

Mr. ROSS. Thank you. And I appreciate your testimony.

I yield back.

Chairman HENSARLING. The time of the gentleman has expired. The Chair now recognizes the gentlelady from Ohio, Mrs. Beatty.

Mrs. BEATTY. Thank you, Mr. Chairman.

Thank you, ranking member.

And thank you, Chair Yellen, for being here today. I just have a few things. But, first, let me say thank you for clearing up what we can and can't do under the Hatch Act, when my colleague from New Jersey was asking about Federal Reserve Governor Brainard and that. But, also, let me just say that I imagine, in your historic position, that you get a lot of people who want to have lunch with you or come and meet with you because of your scholarship and your brilliance.

I can remember being over in the Rayburn room and could barely get in there when someone announced that you were there—high-powered people, more security in that room. And people just wanted to pick your brain and hear from you. So let me personally say to you: I am glad that people in high places want to come and learn about what we do.

Also, I probably, and you can nod or not, can probably safely assume that no one has pressured you from the White House or with President Obama to hold interest steady to have some political influence. But it reminds me of 1972, during the Richard Nixon Administration, when Burns was in your position. And if you go back and you play those Nixon tapes, he succumbed to doing that because pressure was put on him by Republicans that he was meeting with to have an effect on that upcoming election. And I am pretty sure you have not been asked to do that by our President or Presidential candidate.

Mrs. YELLEN. I have certainly never been pressured in any way by the Administration. The Administration, in my experience, greatly respects the Fed's independence to make decisions in accord with our congressional mandate.

Mrs. BEATTY. Thank you so much, Mr. Chairman.

I just wanted to make sure we got that entered, that while maybe my colleague from New Jersey brought it up because he was thinking about what Republicans had done in the past.

But let me move on and say: I too join that letter that hundreds of Members of Congress sent to you and let me just say thank you for that quick response. So often, people in your positions will come in and repeatedly we have to hear about the letters that were written and how typically Democrats don't respond. Not only did you respond; it wasn't a form letter. You actually acknowledged the concerns we had about minorities, specifically African Americans and women.

And, Mr. Chairman, she actually gave us not one but three suggestions of what we could do to meet this challenge. So I wanted to personally thank you because I have been very hard on you and all of the other Federal organizations about working with minorities to improve the unemployment rate and to make sure that we have more women and minorities working in your organization.

But let me just say this. I would like to discuss the diversity of the 12 Reserve regional banks around the country, especially as it relates to the presidents of those organizations. Recently, there was an article that points out that we have had no African American presidents. We have had zero Latino presidents out of 134. So I want to make sure that we stay focused on that. I think we can do better than that.

My staff and I were reminded of the Rooney rule, and I don't know if you get that sports analogy or not. But let me just say to you and my colleagues: I am going to have something that is called the Beatty rule where we would like to start with Federal organizations like yours and simply say that, as you look at these positions, you actually identify and at least interview one person who is a minority.

Mrs. YELLEN. Congresswoman, I am very focused on diversity in the Federal Reserve. And it is a key priority. We have made some progress, but we need to do better. And I have created a workstream at the Board to think about all of the different ways in which we can promote diversity in the work that we do. At the level of Presidential appointments, I very much hope that we can see greater diversity in the FOMC. And in the search process, we require the banks to seek public input. We make sure we at the Board ensure there is a broad national search, that every attempt is made to assemble a diversified pool, and that qualified candidates are considered. And I really do hope that—

Chairman HENSARLING. The time of the gentlelady from Ohio has expired.

The Chair now recognizes the gentleman from North Carolina, Mr. Pittenger.

Mr. PITTENGER. Thank you, Mr. Chairman, Chair Yellen.

Chair Yellen, in his speech on Monday, Governor Tarullo notes improvements in the resolvability of GSIBs in recent years. He states that adjustments in all aspects of the program should be made as conditions and practices evolve. Well, the Fed has passed several rules pointing to resolvability: for example, margin requirements, a rule prohibiting derivatives, closeouts, and therefore a Lehman-like run, and single counterparty credit limits. In light of that, will you be recalibrating the GSIB surcharge before you consider including it in GSIB's post-stress minimums?

Mrs. YELLEN. Well, we will put out a proposal. We are likely to approve a proposal that would affect the treatment of GSIB surcharges in our stress-testing regime. We are not reconsidering at this time the calculation of those surcharges, but as Governor Tarullo explained, we have created an integrated system for incorporating those surcharges in our risk-based capital requirements and integrating the losses we identify in the stress test as part of the risk-based capital regime.

Mr. PITTENGER. To clarify, the GSIB surcharge, should it be recalibrated? I am sure that interacts with the other bank regulations.

Mrs. YELLEN. Well, I don't see a reason why it should be recalibrated at this time.

Mr. PITTENGER. Okay. Following up on Chairman Hensarling's questioning regarding the statutory factors, are you aware of any firmly grounded research that measured how each of the 11 statutory factors that require your consideration contributes to systemic risk?

Mrs. YELLEN. Those are a set of factors that generally do contribute to systemic risk.

Mr. PITTENGER. Let me ask you this: What research did you have that measured how each of the 11 contributed? Did you have research that related to that? What helped you determine that?

Mrs. YELLEN. I believe there is a wide body of research that looks at factors bearing on financial instability that identifies those factors as relevant.

Mr. PITTENGER. The legislative authority demands that each factor be considered. So, yes or no, just please tell us, are you aware of any such research for each of these factors?

Mrs. YELLEN. That quantifies its importance?

Mr. PITTENGER. Yes. Yes, can you state with clarity the research, firmly grounded research that was attributed to establishing these factors?

Mrs. YELLEN. Well, there are lots of research papers on this topic, but I would not say ones that quantify the impact of each factor.

Mr. PITTENGER. Madam Chair, as you know there has been some controversy over the settlement of the longstanding dispute with Iran regarding the transfer of the $1.7 billion in currency to Tehran. I know the Fed helped facilitate this through the transfer pursuant to a comfort letter that was sent by Secretary Lew to Bill Dudley at the New York Fed. I don't care to really get into that, but I would like to address the issue that the Administration told members of this committee yesterday that Iran needed those bank notes to help support the value of the Iranian rial. You are an expert in international monetary currency flows, so I would like to ask you if there is any reason you can imagine why Iran having several pallets of euros and Swiss francs in the Central Bank of Tehran would help support the rial better than having that value on an account in, say, the New York Fed or Central Bank of the Netherlands?

Mrs. YELLEN. Sir, I don't have an opinion about that. We acted as fiscal agent of the Treasury and have no involvement beyond following instructions that they give us with respect to payments.

Mr. PITTENGER. You don't have an opinion on that?

Mrs. YELLEN. I don't have an opinion.

Mr. PITTENGER. It follows, then, wouldn't it be actually more difficult and more expensive to try to support a country's currency with pallets of cash, especially if they were inside a country still largely outside the normal financial system?

Mrs. YELLEN. I am sorry. It is just something I haven't looked at.

Mr. PITTENGER. Well, I ask this because some people believe that the real reason Iran wanted the cash was so that it could be used to enable acts of terrorism. And the committee has had a difficult time getting the Administration to explain why they didn't just wire the settlement money as they had made on previous other payments.

Mrs. YELLEN. I am sorry. That is something you are going to have to address to Treasury.

Mr. PITTENGER. Chair Yellen, we have dealt with the insurance factor some. Will the Fed first consult with the insurers primarily—well, my time has passed.

Chairman HENSARLING. The time of the gentleman from North Carolina has expired.

Due to Chair Yellen's departure time, the Chair anticipates clearing Ms. Moore, Mr. Ellison, and Mr. Heck on the Democrat side; and Mrs. Wagner, Mr. Barr, and Mr. Rothfus on the Republican side.

The gentlelady from Wisconsin, Ms. Moore, ranking member of our Monetary Policy and Trade Subcommittee, is now recognized.

Ms. MOORE. Thank you so much, Mr. Chairman.

And thank you, Honorable Chair Yellen, for joining us here today.

I have a lot of questions, so I am going to move through them very quickly. You have had a lot of questions and concerns here today about why you have maintained interest rates so low, when you are going to raise them, and the inevitability of having to do that, but there is a growing chorus of community folk and workers who have challenged the Fed and their toolkit. They say that you have spent so much time worrying about inflation and being less concerned about labor market participation of vulnerable populations. Like people like to brag about the recovery of our economy, but African American labor market participation is still fledgling. So I wanted to give you an opportunity to sort of explain to us what other tools you may have in your toolkit and how you are not ignoring that problem.

Mrs. YELLEN. Well, the state of the economy and the labor market matters enormously to African Americans and disadvantaged groups. And it is very clear that, as the labor market improves, African Americans see outsized gains, and that is where we are right now, that they are seeing those gains, which is not to say they don't have much higher unemployment rates and there remain, obviously, significant forms of disadvantage. But there clearly are gains taking place for African Americans as the labor market is—

Ms. MOORE. How does that fit in with your decisions to raise interest rates?

Mrs. YELLEN. So Congress has charged us with pursuing maximum employment and price stability, and we have been very focused on our employment mandate and remain so. We are pursuing a policy that will result in further strengthening of the labor market, and that is a very good thing. We also have to keep our eye on inflation, and inflation is running under our 2-percent objective. That gives us some headroom and some running room to remain focused on the employment side of our objective, but we have to keep both things in mind and are keeping both things in mind because we do have a 2-percent inflation objective.

Ms. MOORE. Chairwoman Yellen, I want to ask you something that perhaps I haven't asked you before. I was here when we put Dodd-Frank together, when we put in place the Volcker Rule, and I spent a lot of time studying the efficacy of that. And yet we continue to hear calls to reinstate Glass-Steagall. Could you just share with us briefly about the importance of the Volcker Rule and the limitations—or the importance of reinstalling Glass-Steagall if you think that is the case?

Mrs. YELLEN. Well, the Volcker Rule does prohibit proprietary training, and the agencies that are charged with enforcing it are supervising to make sure that market making can continue. We have discussed liquidity in markets. And making sure that these firms can continue to make markets is important, but it does preclude proprietary trading.

Ms. MOORE. And Glass-Steagall, on the other hand, does not allow them to make markets. What would a Glass-Steagall look like in 2016?

Mrs. YELLEN. I guess what a Glass-Steagall would require would be the separation of commercial banking and investment banking and require restructuring of companies that now have substantial investment bank subsidiaries.

Ms. MOORE. Is that a practical thing that we should look at?

Mrs. YELLEN. Well, people have different views on this. We are trying to make sure that these combinations can operate in a safe and sound manner.

Ms. MOORE. Right.

Mrs. YELLEN. I would say that that is not what was really responsible, at least in my opinion, for the financial crisis. In fact, some of the most serious problems took place in standalone investment banks—

Ms. MOORE. Right.

Mrs. YELLEN. —like Lehman and Bear Stearns, that weren't part of bank holding companies at all.

Ms. MOORE. That is right.

Mrs. YELLEN. And now they are subject to consolidated supervision, which is arguably a safer system.

Ms. MOORE. Okay. And I have 10 seconds left. I am wondering, these, you have a proposal to meet loss-absorbing capacity and long-term debt requirements for—

Mrs. YELLEN. Yes.

Ms. MOORE. Sorry about that.

Chairman HENSARLING. The time of the gentlelady has expired.

The Chair now recognizes the gentlelady from Missouri, Mrs. Wagner.

Mrs. WAGNER. Thank you, Mr. Chairman.

And welcome, Chair Yellen. As I know you are aware, the EU late last year issued a call for evidence to help provide data and feedback for a cumulative review of all of the post-financial crisis regulations that have been issued in the past 8 years. When asked whether the U.S. should implement a similar review, Governor Tarullo pushed back on the idea. Given that Governor Tarullo has not been appointed vice chairman for supervision, what are your thoughts on the U.S. doing such a review, Chair Yellen?

Mrs. YELLEN. Well, I think we are continuing to finalize these regulations and want to come to the end of implementing them, and targeted reviews of different aspects of the work that we have done become appropriate over time. As Governor Tarullo mentioned, I mentioned in my testimony, we have undertaken a comprehensive review of our stress testing program. We have consulted with the organizations that are affected by it, with outside academics. We have looked at its costs and burdens carefully, and we are going to be recommending and already have to some extent, changes that we think are appropriate in light of those reviews. And over time, my guess is that other areas will deserve reconsideration. But—

Mrs. WAGNER. Ma'am, what is your timing on some of the recommendations you will be making regarding some of the reviews that you have already taken?

Mrs. YELLEN. Well, we already put out earlier this week a proposal that would exempt the institutions that are under $250 billion and don't engage in significant foreign or nonbanking activities to be exempt from the qualitative part of our CCAR review. So that is already out, and other aspects of the proposal should go out shortly.

Mrs. WAGNER. If I can continue, given that many foreign bank regulators, such as those in Europe, in Japan, and others on the Basel Committee, are pushing back against some of the capital rule proposals from the U.S., wouldn't it make sense for the U.S. to conduct such a kind of a comprehensive, I will say, review as they are doing in the EU, particularly since the U.S. regularly gold plates their regulations beyond what Basel calls for?

Mrs. YELLEN. Well, we have carefully looked at what is appropriate as we have undertaken these capital regulations. Some cost-benefit analysis has been done, and in the case of the GSIB surcharges, there was careful analysis done of the levels at which they should be set. And I don't think it is time now for a comprehensive rethink.

Mrs. WAGNER. Well, and you talked about the stress test—and let me get to that. Governor Tarullo specifically said a U.S. call for evidence would be difficult to conduct in that it would require a very big model that would require a lot of assumptions.

How is this any different, Chair Yellen, from the Fed's stress test, which also incorporates a lot of kind of macro assumptions?

Mrs. YELLEN. Well, in the case of the capital regulations and other aspects, what we are mainly talking about is reducing the probability and severity of a financial crisis. And one of the reasons that it becomes difficult to do the type of analysis that you are discussing is that financial crises fortunately are few and far between, and there is no clear rigorous way to establish what is the probability and how does a particular regulation affect the probability of what is a tail risk.

Mrs. WAGNER. In my remaining short time here, it has been 8 years, 8 years, Chair Yellen, and certainly, the EU is calling vigorously, as are other countries, for a call for evidence and a review. Shouldn't the Fed at least attempt to understand the cumulative effects its rules are having on the economy? What are the other ways the Fed monitoring—monitors the impact its regulations are having on growth?

Mrs. YELLEN. Well, we are carefully monitoring how our regulations are working, and by and large, my conclusion is that we have a safer and sounder banking system.

Chairman HENSARLING. The time of the gentlelady has expired.

The Chair now recognizes the gentleman from Minnesota, Mr. Ellison.

Mr. ELLISON. I want to thank the Chair and the ranking member.

Chair Yellen, thank you for your great service. I definitely appreciate it. And I am of the opinion that some of the criticism that you have to endure from certain quarters is really shortsighted, considering that the Congress has certain responsibilities to provide fiscal stimulus as well, and I think we have not done it. I think we have really kind of failed on it. In fact, all we really ever talk about around here is how we can cut budgets as opposed to do things that I think really grow the economy.

Anyway, that is just my opinion. I will leave that on the side.

It is quite clear that Wells Fargo misused employment incentives, setting up an unattainable cross-selling goal, Eight is Great. I think it is a terrible corporate practice. Section 956 of Dodd-Frank directed the Federal Reserve, as well as other regulators, to finalize incentive-based compensation rules for financial institutions, such that those rules don't encourage "material losses" or "inappropriate risks." Those rules were supposed to be completed 9 months after the passage of the Act. Can you give us a status update on when we can expect to see those rules?

Mrs. YELLEN. The regulation went out for comment. Comments have been received, and I believe the staffs of the agencies are working through those now. I very much hope that we can finalize this rule. It has been a very long time, and I will do everything that I can for the Federal Reserve to be ready to act on this as soon as possible.

Mr. ELLISON. And recognizing the sensitivity of this whole situation, one of the things that has occurred to me is that the CEO, the Chair of Wells Fargo, is pretty well-compensated. The number I found was like $19 million. He is not losing his job—apparently not yet. And yet we still see about 5,300 people who were let go. I make no comment on whether they should have been let go or whether they deserve to be, but when you set up a situation where you are incentivizing them moving accounts the way that they were and some of the demands that were put on them, you can kind of see how it could happen.

I guess my question to you is, how can line level workers be held accountable to the degree that they clearly have been and yet nobody in middle or upper management seems to be taking responsibility for it? They haven't lost their jobs. Can you give us some insight as to how some of our banking management practices are being practiced so that only the people at the bottom end of the food chain end up bearing all of the responsibility?

Mrs. YELLEN. Senior management has a responsibility, and it is essential that they be held accountable. Compensation schemes that, for example, are based solely on volume are prohibited under the rule that the six agencies have proposed, but even prior to the adoption of that, the banking agencies have put out, back in I think 2010 or 2011, supervisory guidance on compensation that had the same expectation. The Board of directors should be reviewing compensation schemes and performance plans throughout the organization at all levels to make sure that they don't result in compliance failures, in ill treatment, that they have to be consistent with fair treatment of customers and consider risks, and this is an expectation. And it will be formalized in a rule hopefully when the six agencies are able to finalize that. But senior executives are responsible, and they are responsible for setting up risk-management schemes in their organization that would be detecting such problems, that they have a strong internal audit function that would be reviewing and detecting compliance problems, and that these problems would not only be acted on by senior management but escalated to the Board of directors that has an important responsibility here.

Mr. ELLISON. Thank you, and I really appreciate your answer, because I agree with it.

Now, my good friend from Wisconsin, Congressman Duffy, was asking you to respond about an opinion piece by Larry Summers. I got the sense that you might want to elaborate a little bit more on what he asked you. Would you like to take the last 20 or so seconds just to sort of stretch out on your answer a little bit?

Mrs. YELLEN. Yes, so thank you for that. So Summers finds that measures of riskiness of bank debt haven't diminished since the financial crisis. Two reasons. He finds that one is that, prior to the crisis, clearly market participants underestimated risk, and, second, we are dealing with too-big-to-fail, and investors can no longer expect that they will be shielded from risks if things go wrong in their firm.

Chairman HENSARLING. The time of the gentleman from Minnesota has expired.

The Chair now recognizes the gentleman from Kentucky, Mr. Barr.

Mr. BARR. Thank you, Mr. Chairman.

Chair Yellen, I want to touch first on monetary policy and then shift over to the Federal Reserve supervision and regulation of the financial system. Briefly, on monetary policy, in your press conference last week, you stated that the recent pickup in economic growth and continued progress in the labor market have strengthened the case for an increase in the Federal funds rate, and then you went on to say conditions in the labor market are strengthening, and we expect that to continue. And the headline on Bloomberg's website covering this hearing, this very hearing, is that, "Yellen Sees Solid Job Growth." But in response to my colleague, Mr. Guinta, I think I heard you say that the labor force participation rate has not moved, and of course, we all know that economic growth is weak. The Bureau of Economic Analysis reports the GDP output in the first quarter of this year was only .8 percent; and the second quarter of this year, only 1.1 percent. And productivity, which is a real important indicator of economic growth, is in retreat. It has been decreasing by almost a half a percent over the last four quarters. So the question is, on monetary policy, how does your comments about economic growth and progress in the labor market square with these stubborn facts?

Mrs. YELLEN. Well, economic growth has been very slow, and that is extremely disappointing. Productivity growth in particular has been really very, very low, and as you mentioned, in recent years, negative, which is a very depressing finding. And in that sense, the economy is not doing well. But we are creating a lot of jobs. The unemployment rate has declined to the neighborhood of what most of us would consider to be full employment. And there is a very significant downward pressure on labor force participation that is coming from the aging of the population.

Mr. BARR. Well, let's just say—okay, if I can just interject there—aging of the population may be one factor. The other factor is that unemployment is coming down, not for a good reason but for the wrong reason, namely that there is a frustrated workforce out there that has completely given up looking for work. Let me talk about maybe some of the causes of the drag on the economy. Obviously, you all have a role in conducting monetary policy, and one of the dual mandate functions is maximum employment. That is an objective of the Federal Reserve. But also supervision and regulating of banking institutions to ensure safety and soundness is another important mission. But what I am worried about, and maybe what might explain some of the drag in our economy, is that a regulatory overreach can be at cross purposes with your interest rate policies, and the left hand may not know what the right is doing. Let me give you an example of what I am talking about. In the post-Dodd-Frank world, financial firms are supervised by multiple agencies. More than ever before, the Federal Reserve, the FDIC, the OCC, the NCUA, the SEC, the CFTC, the CFPB, the FSOC, these agencies are promulgating regulations. They are performing examinations. With respect to rulemakings, the approach of market regulators sometimes conflicts with the safety and soundness regulators, which in turn can conflict with the consumer protection regulator. And on supervision, often the substance of examinations overlap, but the timetables don't, and so data collection among financial regulators can be duplicative and uncoordinated. So this is not only a burden on financial firms, an undue burden on financial firms, that may be a drag on our economy, but it also may lead to gaps in supervision, and so when you look at Wells Fargo and the scandal that we have seen there and the consumer fraud that went unpunished for 5 years, based on the timeline we have seen, and the primary consumer protection agency is coming in on the tail end of that, again, according to the timeline we have seen, do you acknowledge that maybe the lack of regulatory coordination and inefficiency may be a problem?

And, secondly, what do you think about proposals to consolidate or at least reduce the number of financial regulators to reduce regulatory incompetence, to reduce regulatory duplication or conflict, or at least consolidate examinations and data collection efforts between and among regulators?

Mrs. YELLEN. Well, we have a complicated regulatory system. There is no doubt about it. And we recognize that the issues you are discussing can create a great deal of burden. For our part, we work very closely with the controller, with the FDIC, and also with the CFPB.

Mr. BARR. Yes. In my remaining time, and I don't have much time, but on the merchant banking activities rule, will you commit to the committee that before the rule is finalized, you will provide us with an analysis of the type of costs that this could impose on companies?

Mrs. YELLEN. It was a recommendation to Congress and not a rule.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair wishes to remind all members that the Chair intends to recognize the gentleman from Washington and the gentleman from Pennsylvania, and then adjourn the hearing.

The gentleman from Washington, Mr. Heck, is now recognized.

Mr. HECK. Thank you, Mr. Chairman.

Chair Yellen, thank you so very much for being here.

We are obviously moving toward a healthier economy. We are not quite there yet. But that notwithstanding, I think it is kind of useful to look even further ahead to the next economic cycle. And that is why I read with interest that the committee projected last week that the Fed funds rate will top out at two and three-quarters to 3 percent. That didn't give you a lot of room to deal with the next recession, and as I am fond of saying, neither God nor anyone else has outlawed the business cycle. We will have another recession.

So my question is, why don't you consider raising the inflation rate so that you have more bullets in your most powerful weapon to combat the next recession?

Mrs. YELLEN. Well, this is something that researchers are looking at and are talking about. And for the reasons that you gave, I think it is an appropriate subject for research and for consideration if we remain in a low interest rate environment for a very long period of time. It is not something that the FOMC is actively considering, not at this time.

Mr. HECK. Are you open to it?

Mrs. YELLEN. At the moment, I think it is not a priority for us to consider that right now, but I would not say "never." I think it is appropriate for researchers to consider the cost and benefits of it carefully. It is not something we are actively looking at, but I wouldn't say that it is something that we could never look at.

But we are focused on trying to achieve our 2 percent objective. We want to emphasize the 2 percent is not a ceiling on the inflation rate. It is the target where we would like to be that inflation can be above and below 2 percent at different times. We don't expect to always be there.

I think we have realized—

Mr. HECK. Are you not concerned? The basis of my question is you don't have enough bullets in your most powerful weapon. Are you not concerned at all?

Mrs. YELLEN. I am concerned, and I gave a speech at Jackson Hole that addresses this issue. First of all, I think that we may be required to use the same kinds of tools we used during the crisis in the event of a future downturn. And I emphasized that, that those probably need to be permanent parts of our arsenal.

And beyond that, yes, further things, it is important to do research on other things. And I emphasize that Congress should also consider what its role should be, if you are in this—

Mr. HECK. Thank you. I actually read the speech. Thank you.

Last time you were here, I asked you, when does America get a raise?

Mrs. YELLEN. When does what?

Mr. HECK. When does America get a raise. I want to go down this road with you a little bit again briefly. Obviously, the economy is moving, although not there in a healthy direction. Car sales are up. Home sales are up. Median household income was up fairly materially. But wage growth still stuck, I think, at about 2.5 percent. Even in the last—last—weak recovery, wage growth was 4 percent.

Chair Yellen, when does America get a raise?

Mrs. YELLEN. So wage growth has increased a little bit, and I think, as the recovery progresses, we will see some more pickup in wages. But productivity growth is a very important determination of real wage growth or inflation-adjusted wage growth. If nominal wage growth were to pick up and inflation picked up in tandem, that wouldn't be a real wage increase.

So what we want to see is wages going up without its involving inflation going up. And, ultimately, the size of those paycheck increases in the long run are driven by productivity growth, and productivity growth has been very low.

And I think that is one of the things that is holding down the improvement in living standards. So we are seeing some signs of a pickup, but ultimately, if productivity growth doesn't pick up, then faster nominal wage growth would just prove to be inflationary. So that is a fundamental driver.

Mr. HECK. So, quickly, what would you define as full employment as measured by U6, currently stuck at about 9.7?

Mrs. YELLEN. So I don't have a definition. It is not—it is higher than it was before the crisis, even though U3 is down to normal levels. And I think that does signify some remaining underutilization.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Pennsylvania, Mr. Rothfus.

Mr. ROTHFUS. Thank you, Mr. Chairman.

Chair Yellen, I just want to touch on one thing following up on Mr. Mulvaney's question. I think you testified with respect to needing legal authority in the event that the Fed wanted to purchase corporate equities. Is that right?

Mrs. YELLEN. Yes. I said we do not have legal—

Mr. ROTHFUS. You do not have. So you would need additional legal before you did something.

Mrs. YELLEN. Right.

Mr. ROTHFUS. Does that same hold true for corporate bonds?

Mrs. YELLEN. Yes. We cannot purchase corporate bonds.

Mr. ROTHFUS. I want to take a few minutes to address some of the issues that I raised in my letter to you earlier this week. I am concerned about the level of influence that the FSB has on the FSOC SIFI designation process.

In a letter in February 2015 to the G20 Finance Ministers and Central Bank Governors, Mark Carney, the FSB Chair, made clear that member Governors had "ongoing commitment" to implement FSB's policies, and that, "full, consistent, and prompt implementation" was essential. Though some may dismiss this as inconsequential prose, evidence suggests that FSOC operates in the spirit of Mr. Carney's words.

Three U.S.-based insurers that the FSB identified as GSIIs have also been designated by FSOC for Fed supervision. With that in mind, I wanted to ask you a few specific questions about the relationship between FSB and FSOC decisionmaking. What is the role of the U.S. members of the FSB in considering whether to designate U.S. insurance companies under the GSII process?

Mrs. YELLEN. Well, a number of agencies take part in the FSB. The Federal Reserve, the Treasury, and the SEC are all members of the FSB and engage in their work.

Mr. ROTHFUS. Under the FSB charter, member countries commit to implement international financial standards. What steps has the U.S. taken to implement FSB's designation of U.S. insurance companies—AIG, Prudential, and MetLife—as systemically important?

Mrs. YELLEN. Well, none, because the FSB designations have no impact in the United States, and the United States has to go through its own rulemaking process. The FSOC analysis is completely separate and focused on slightly different things than the FSB analysis. And they are entirely separate processes.

Mr. ROTHFUS. Did the Federal Reserve support the FSB's designation of Prudential and MetLife as GSIIs before FSOC had designated them?

Mrs. YELLEN. The Federal Reserve only joined the IAIS that played a role here in 2013. And to the best of my knowledge, we didn't participate in their analysis that were the basis for some of the original designations.

Mr. ROTHFUS. But the Federal Reserve does participate with the FSB, yes?

Mrs. YELLEN. We may—we do participate in the FSB.

Mr. ROTHFUS. And in the process of the FSB designating these as GSIIs, what would the Federal Reserve's position have been?

Mrs. YELLEN. I believe that the—I have to check this out, but I believe that the FSOC designations of these firms occurred before the final—the designations by the FSB, but I have to look at that more carefully.

Mr. ROTHFUS. Yes, we want to follow up on that, because my understanding is that it happened—the FSB designated them and then FSOC went and designated them. Because it seems that if you agree to designate a U.S. company as globally significant under the FSB regime, that that would end up influencing that the company is going to be designated as systemically important within the United States. Wouldn't you agree with that?

Mrs. YELLEN. Well, as I said, the FSOC process is separate, and I believe that the FSOC designations took place before the list of GSIIs was put out.

Mr. ROTHFUS. Could an FSB GSII designation be considered an "other risk-related factor" under section 113 of the Dodd-Frank Act?

Mrs. YELLEN. I am sorry. I didn't get that.

Mr. ROTHFUS. Could an FSB GSII designation, if the FSB designates an insurance company as a GSII, could that designation be considered an other risk-related factor under section 113 of the Dodd-Frank Act?

Mrs. YELLEN. Not to the best of my knowledge.

Mr. ROTHFUS. I yield back, Mr. Chairman.

Chairman HENSARLING. The time of the gentleman has expired. I would like to thank our witness for her testimony today.

The Chair notes that some Members may have additional questions for this witness, which they may wish to submit in writing.

Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to this witness and to place her responses in the record. I would ask our witness to please respond as promptly as you are able.

Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

This hearing stands adjourned.

[Whereupon, at 1:11 p.m., the hearing was adjourned.]

APPENDIX

September 28, 2016

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Statement by

Janet L. Yellen

Chair

Board of Governors of the Federal Reserve System

before the

Committee on Financial Services

U.S. House of Representatives

September 28, 2016

Chairman Hensarling, Ranking Member Waters, and other members of the committee, I appreciate the opportunity to testify on the Federal Reserve's regulation and supervision of financial institutions.

One of the Federal Reserve's fundamental goals is to make sure that our regulatory and supervisory program is tailored to the risk that different financial institutions pose to the system as a whole. As we saw in 2007–08, the failure of systemically important financial institutions can destabilize the financial system and undermine the real economy. The largest, most complicated firms must therefore be subject to prudential standards that are more stringent than the standards that apply to other firms. Small and medium-sized banking organizations--whose failure would generally pose much less risk to the system--should be subject to standards that are materially less stringent.

The Federal Reserve has made substantial progress in building a regulatory and supervisory program that is consistent with these principles. We have implemented key standards designed to limit the financial stability risks posed by the largest, most complex banking firms. We continue to work on some remaining standards and to assess the adequacy of this package of measures. With respect to small and medium-sized banks, we must build on the steps we have already taken to ensure that they do not face undue regulatory burdens. Looking forward, we must continue to monitor for the emergence of new risks, since another key lesson from the crisis is that financial stability threats change over time.

Strengthening the Regulation and Supervision of the Largest Financial Institutions

The Federal Reserve's post-crisis efforts to strengthen its regulation and supervision of large banks have focused on promoting the safety and soundness of these firms and on limiting the adverse effects that their distress or failure could have on the financial system and the broader economy. This orientation is consistent with section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), which directs the Board to impose enhanced prudential standards on large banking organizations "in order to prevent or mitigate risks to financial stability." Our efforts to mitigate financial stability risks posed by large financial institutions generally fall into one of two categories. First, we aim to make large financial institutions more resilient in order to reduce the likelihood of their failure or distress. And second, we aim to make large financial institutions more resolvable to limit the damage that their failure would have on the rest of the financial system and on the broader economy.

Resiliency

To increase the resiliency of the largest banking organizations, the Federal Reserve has established a broad set of enhanced prudential standards for large domestic and foreign banking organizations. Together with the Federal Deposit Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency, we have implemented capital rules that require large banking organizations to hold substantially larger amounts of high-quality capital than they were required to hold before the 2007–08 crisis, and we have adopted a liquidity coverage ratio (LCR) that requires these organizations to hold a buffer of high-quality, liquid assets sufficient to meet liquidity outflows during a 30-day period of severe funding stress. We have also proposed single-counterparty credit limits that are designed to guard against the build-up of excessive concentrations of credit risk and, along with the other federal banking agencies, proposed a Net Stable Funding Ratio that would require banks to maintain a minimum level of stable funding relative to the liquidity of their assets over a one-year horizon.

In addition to strengthening the regulation of the largest, most complex financial institutions, we have also transformed our supervision of firms that pose elevated risk to U.S.

financial stability through the creation of the Large Institution Supervision Coordinating Committee (LISCC).[1] The LISCC is distinguished by several characteristics. First, the LISCC has implemented a centralized, multidisciplinary approach to supervision by bringing together experts from around the Federal Reserve System in the areas of supervision, research, legal counsel, financial markets, and payments systems. Second, major areas of focus for the supervision of firms in the LISCC portfolio are capital and liquidity resiliency under normal and potentially adverse conditions in the future, as well as recovery and resolution preparedness. And third, the LISCC complements traditional, firm-specific supervisory work with annual "horizontal" programs that examine these firms at the same time and on the same set of issues in order to promote better monitoring of trends and consistency of assessments across all of the LISCC firms.

With regard to capital adequacy, the introduction of capital stress testing for large banking organizations has been one of our signature innovations since the financial crisis. As events during the financial crisis demonstrated, capital buffers that seem adequate in a benign environment may turn out to be far less than adequate during periods of stress. For this reason, consistent with the stress-testing mandate in the Dodd-Frank Act, the Federal Reserve conducts supervisory stress tests each year on banking organizations with $50 billion or more in total assets to determine whether they have sufficient capital to continue operations through periods of economic stress and market turbulence, and whether their capital planning frameworks are adequate to their risk profiles. The expectation embodied in our stress testing program that large

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[1] The firms currently in the LISCC portfolio are American International Group, Inc.; Bank of America Corporation; The Bank of New York Mellon Corporation; Barclays PLC; Citigroup Inc.; Credit Suisse Group AG; Deutsche Bank AG; The Goldman Sachs Group, Inc.; JPMorgan Chase & Co.; Morgan Stanley; Prudential Financial, Inc.; State Street Corporation; UBS AG; and Wells Fargo & Company. Further information on the LISCC is available on the Board's website at www.federalreserve.gov/bankinforeg/large-institution-supervision.htm.

banking organizations should maintain sufficient capital buffers to withstand a period of significant stress promotes the resilience of those firms and of the financial system more generally.

While our stress testing program has been successful since it was first introduced in 2009, the crisis reinforced the need for regulators and supervisors to continually revisit the effectiveness of their tools and adjust as needed over time. We therefore launched a review of the Comprehensive Capital Analysis and Review (CCAR) program last year with the aim of re-assessing our stress testing practices on a comprehensive basis. As part of this process, we met with a wide range of stakeholders, including academics, analysts, bankers, public interest groups, and others. We are now considering making several changes to our stress testing methodology and process.

The leading idea that has emerged from our comprehensive CCAR review is to integrate CCAR with our regulatory capital framework. More specifically, the regulatory capital rules now include a firm-specific, risk-based capital surcharge for each global systemically important bank (GSIB) and a uniform capital conservation buffer requirement above the regulatory capital minimum for all firms. Under the approach we are considering, the existing capital conservation buffer would be replaced with a risk-sensitive, firm-specific buffer that is sized based on stress test results. Each firm's buffer requirement would be set equal to the decline in its common equity tier 1 capital ratio in the supervisory stress test. The buffer requirement would be floored at 2.5 percent of risk-weighted assets, the current level of the capital conservation buffer, to avoid any reduction in the stringency of the regulatory capital rules. We call this idea the "stress capital buffer," and it would effectively move the stress test to the center of our regulatory capital framework.

For the eight U.S. GSIBs, the move to the stress loss buffer--which would be similar in effect to including the GSIB capital surcharge in the CCAR post-stress minimum--would result in a significant aggregate increase in capital requirements. Thus, in addition to simplifying the capital framework by integrating CCAR with our regulatory capital rules, the stress loss buffer would advance our macroprudential goal of making GSIBs more resilient. In contrast, the move to the stress loss buffer approach generally would not entail a toughening of our requirements for the 25 large banking firms that are subject to CCAR but are not GSIBs. Nor would the move have any impact on community banks or other firms with less than $50 billion in assets.

We are also considering making certain changes to the stress test assumptions used in CCAR. For example, under the current CCAR program, a firm's capital adequacy is assessed by assuming that the firm continues to make its baseline capital distributions over the stress test's two-year planning horizon. We are considering changing this conservative assumption, in significant part because of the advent of the capital conservation buffer in the regulatory capital rules, which limits the ability of a firm to make capital distributions when its capital ratios are lower than the buffer requirement. Instead, we are proposing that firms simply add one year of planned dividends to their stress capital buffer requirement in recognition of the fact that firms generally are more reluctant to reduce dividends than share buybacks. On this and other changes to CCAR that we are considering, we will of course seek public input before moving to adopt them.

Resolvability

During the crisis, fears about the systemic consequences that would result from the bankruptcies of systemically important firms motivated extraordinary government actions. The fears proved well-founded: The bankruptcy of Lehman Brothers significantly exacerbated the crisis. To reduce the potential that resolution of a large financial firm in bankruptcy will be disorderly, section 165(d) of the Dodd-Frank Act requires large banking organizations to produce living wills that help these firms prepare to be resolved in an orderly way under the Bankruptcy Code. Although the Bankruptcy Code provides the default legal framework for resolving a failed bank holding company, the Dodd-Frank Act also creates a backup resolution authority that can be used if the resolution of a failed financial company under the Bankruptcy Code would have serious adverse effects on U.S. financial stability. The orderly liquidation authority in Title II of the Dodd-Frank Act has several features that could reduce the systemic impact of a firm's resolution, including an orderly liquidation fund and provisions to prevent the chaotic unwinding of a firm's derivatives, securities financing transactions, and other qualified financial contracts. In the unlikely event that the orderly liquidation fund does incur losses, these losses would be covered by assessments on major financial firms and would not be passed on to taxpayers.

The Federal Reserve has recently proposed important new rules to increase the prospects for the orderly resolution of a GSIB. Last October, the Board proposed to require the eight U.S. GSIBs to meet total loss-absorbing capacity (TLAC) and long-term debt requirements. The proposal would require these systemically important firms to maintain outstanding a large quantity of long-term debt that could be used to absorb losses and recapitalize the firm in resolution. Because, by definition, the actual equity of a bank will have been substantially depleted--if not totally eliminated--by the time it fails, a separate long-term debt requirement is essential to ensure that the resolution authority has the raw material from which to manufacture new equity in resolution to recapitalize and stabilize the failed firm. For this reason, the proposed long-term debt requirement would more assuredly enhance the prospects for successful resolution--and thereby contribute to solving the too-big-to-fail problem--than would a TLAC requirement on its own. The proposal would also restrict the operations of GSIB holding companies, so that those legal entities could go through resolution without setting off short-term wholesale funding runs or otherwise jeopardizing financial stability.

In May this year, the Board issued another proposal to make GSIBs more resolvable. This second proposed rule would impose restrictions on GSIBs' qualified financial contracts--including derivatives and repurchase agreements (repos)--to guard against the rapid, mass unwinding of those contracts during the resolution of a GSIB. The proposed restrictions are a key step toward GSIB resolvability because rapidly unwinding these contracts could destabilize the financial system by causing asset fire sales and toppling other firms.

Acting in conjunction with the FDIC, the Board has also sought to increase GSIB resolvability through the living wills process. In April this year, the Board and the FDIC announced the results of their review of the eight U.S. GSIBs' 2015 resolution plans. During this review, the agencies evaluated the plans based on the firms' capital, liquidity, governance mechanisms, operational capabilities, legal entity rationalization, derivatives and trading activities, and responsiveness to prior agency feedback. The agencies found that five of the GSIBs' plans fell short of the resolvability standard set by the Dodd-Frank Act and required those firms to fix deficiencies in their plans by October of this year or potentially face more stringent prudential requirements. If the agencies jointly determine that a firm has failed to adequately remedy the noted deficiencies, the agencies may jointly determine that the company or its subsidiaries will be subject to more stringent capital, leverage, or liquidity requirements or to restrictions on the growth, activities, or operations of the firm. The agencies also identified less-severe shortcomings in the plans of all eight U.S. GSIBs, which are expected to be addressed in the next round of resolution plan submissions, due in July 2017.

The resolution planning process requires firms to demonstrate that they have adequately assessed the challenges that their structure and business activities would pose during resolution and that they have taken action to address those issues. Firms must also confront the resolution consequences of their day-to-day management decisions on a continual basis, particularly those related to structure, business activities, capital and liquidity allocation, and governance. Firms are also expected to create a meaningful set of options for selling operations and business lines to generate resources and to allow for restructuring under stress, including through the sale or wind-down of discrete businesses that could further minimize the direct impact of the firm's distress or failure on the broader financial system. The deficiencies and shortcomings issued in the most recent plan review focus on steps necessary to ensure these objectives are met at each GSIB on an ongoing basis.

In addition to providing the firms with our feedback on their resolution plans, the agencies took several steps in April to improve the transparency of the resolution planning exercise. These steps included publicly releasing the firm feedback letters, a paper outlining the resolution plan assessment framework and firm determinations, and a document detailing the expectations of the agencies regarding the firms' 2017 resolution plan submissions. The expectations articulated for the 2017 plan contents build on detailed guidance previously provided to the GSIBs in 2014 and 2015.

While the five firms that received joint deficiencies are required to fix those deficiencies by October 2016, all of the firms that received agency feedback in April are required to submit a full resolution plan by July 1, 2017. In these plans, firms will be required to address all identified shortcomings, follow all guidance provided by the agencies, and meet all statutory and regulatory requirements for their resolution plans. In meeting these expectations, the actions that firms need to take should be substantially complete by July 2017, as previously communicated by the agencies.

Regulation and Supervision of Large and Regional Banking Organizations

In supervising banking organizations with more than $50 billion in assets but outside the LISCC program, the Board focuses on ensuring that companies are well managed, appropriately capitalized, and prepared to withstand potential adverse developments in the business environment. However, because the distress or failure of a non-LISCC firm is unlikely to have the same effect on the financial system and broader economy as that of a LISCC firm, we do not apply the full range of rules that we apply to those in the LISCC portfolio. For example, the Board's risk-based and leverage capital surcharges, as well as the recently proposed long-term debt and TLAC requirements, only apply to GSIBs. Similarly, the advanced approaches capital rules, countercyclical capital buffer, supplementary leverage ratio, and full LCR only apply to the largest and most internationally active banking organizations. We also scale our examination procedures to reflect the lower level of systemic risk presented by banks with more than $50 billion in assets that are not LISCC companies.

As a result of the comprehensive CCAR review I described earlier, we are also considering exempting from the qualitative portions of CCAR any bank that has less than $250 billion in total assets and that does not have significant international or nonbank activity. While we strongly believe the CCAR qualitative review produces significant safety and soundness benefits for the largest firms, we can achieve our supervisory goals at most medium-sized banking firms using our normal supervisory program combined with targeted horizontal assessments of particular aspects of capital planning, as many of these firms are now meeting or close to meeting our supervisory expectations for capital planning processes. As required by statute, these firms would still be subject to the quantitative portion of our stress testing program. But even with respect to the quantitative portions of CCAR, we are considering reducing the amount of data that these firms are required to submit for stress testing purposes.

Regulatory and supervisory requirements are further tailored for regional banking organizations, defined as those with total assets between $10 billion and $50 billion. For example, while regional banking organizations must comply with capital rules, they are not subject to a supervisory stress test or CCAR. Rather, as required by the Dodd-Frank Act, regional banking organizations perform their own stress tests. Similarly, these companies are not subject to enhanced prudential standards established under section 165 of the Dodd-Frank Act, the LCR, or other related requirements. Instead, we conduct regular inspections of regional banking organizations and evaluate their safety and soundness based on each company's individual circumstances, in addition to horizontal exams we conduct of regional banking organizations. Because many regional banking organizations concentrate their assets and activities in banking subsidiaries that are supervised by other federal banking agencies, we coordinate supervisory activities closely with the other U.S. banking agencies and rely significantly on the results of their examinations, focusing our own inspections on the parent company and its ability to serve as a source of strength to the subsidiary banks.

Community Bank Supervision

I know that community banks play a vital role in many of your districts. Let me say that the experiences and challenges of community banking are not new to me. Before I became Chair of the Board of Governors and Vice Chair before that, I spent six years as president of the

Federal Reserve Bank of San Francisco. In that role, I was involved in the supervision of a substantial number of community banking organizations in the nine states of the San Francisco District. Among the lessons that experience reinforced is that when it comes to bank regulation and supervision, one size does not fit all. To effectively promote safety and soundness and to ensure that institutions comply with applicable consumer protection laws without creating undue regulatory burden, rules and supervisory approaches should be tailored to different types of institutions such as community banks.

The Federal Reserve supervises more than 800 community banks and more than 4,000 holding companies that control small depository institutions. These are banking organizations with total assets of $10 billion or less. In supervising community banks, we follow a risk-focused approach that aims to target examination resources to higher-risk areas of each bank's operations and to ensure that banks maintain risk-management capabilities appropriate to their size and complexity. In the wake of the crisis, we have taken steps to refine this process by using the financial data we collect from banks to calibrate our examination procedures based on risk. We believe this will help us to identify and address emerging risks and to ensure that community bank examiners with specialized expertise are allocated to the institutions exhibiting the highest risks. We also implemented a risk-focused consumer compliance examination framework for community banks in 2014 that is intended to allow examiners to spend less time on low-risk compliance issues so that issues more likely to result in harm to consumers get more attention.

The Federal Reserve and the other banking agencies are currently in the process of completing the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA) review. Under EGRPRA, the federal banking agencies are required to conduct a joint review of their regulations every 10 years to identify provisions that are outdated, unnecessary, or unduly burdensome. The Federal Reserve views this review as a timely opportunity to step back and identify ways to reduce regulatory burden, particularly for smaller or less complex banks that pose less risk to the U.S. financial system. In carrying out this review, the agencies sought public comment on their regulations and held several roundtable discussions with bankers and interested parties to gather additional feedback on sources of burden. Themes emerging from these comments include streamlining the Call Report, reducing examination frequency, raising long-standing dollar-based thresholds for appraisals, and reducing the complexity of capital requirements for smaller banks. In response to public comments on examination frequency, the agencies have already approved interim rules to implement a provision of the Fixing America's Surface Transportation Act (FAST Act), which raises the asset threshold for insured depository institutions that are eligible for an 18-month examination cycle from $500 million to $1 billion. As a result of raising the threshold, eligible institutions will be subject to fewer safety and soundness and Bank Secrecy Act exams. The agencies are also exploring potential options for alleviating some burdens of appraisal requirements and are actively considering proposals to simplify regulatory capital requirements for community banks.

In addition, the banking agencies, under the auspices of the Federal Financial Institutions Examination Council, recently issued a proposal for a new and streamlined Call Report for community banks. The proposal would eliminate certain data items and reduce the reporting frequency of many other data items. As a result, banks with less than $1 billion in total assets would submit a Call Report with about 40 percent fewer data items than the existing Call Report. The proposal incorporates comments the banking agencies received from community banks during several outreach events used to gather information on the challenges faced by community banks in preparing Call Reports.

Congress may also wish to consider carving out community banks from two sets of Dodd-Frank Act requirements: the Volcker rule and the incentive compensation limits in section 956. The risks addressed by these statutory provisions are far more significant at larger institutions than they are at community banks. In the event that a community bank engages in practices in either of these areas that raise heightened concerns, we would be able to address these concerns as part of the normal safety-and-soundness supervisory process. While the banking agencies have tailored the Volcker rule and have proposed significant tailoring of incentive compensation rules, community banks and supervisors would benefit from not having to focus on regulatory compliance for matters that are unlikely to pose problems at smaller banks.

Current Conditions

Having reviewed some of the major elements of our regulatory and supervisory programs, let me offer a few brief remarks about the current state of the firms we regulate.

In response to regulatory and supervisory pressures, the financial condition of the U.S. GSIBs has strengthened considerably since the crisis. Common equity capital at the eight U.S. GSIBs alone has more than doubled since 2008, representing an increase to almost $800 billion. Moreover, these firms generally have developed much more stable funding positions. The largest banking organizations have increased their holdings of high-quality liquid assets by over $1 trillion over the past five years, at the same time as they have substantially reduced their reliance on run-prone sources of funding. Reducing run-risk is a central goal of post-crisis regulation and supervision.

Questions for The Honorable Janet L. Yellen, Chair, Board of Governors of the Federal Reserve System from Representative Hultgren:

1. Under leverage requirements implemented by prudential regulators to implement the Basel III regulatory framework, deposits at the Federal Reserve are subject to enhanced capital requirements despite the very low risk that these funds will not be available on demand. There is concern that the minimal interest rate paid on these deposits is far below the yield needed to offset the costs of the capital requirement, which may make it prohibitively costly for certain financial institutions to accept customer deposits.

a. Do you agree that current regulatory focus on this essentially risk-less activity, possibly impeding custody bank's ability to provide traditional custody services, could have an adverse impact on financial stability by preventing custody banks from being able to accept cash deposits from their clients during a crisis, denying those clients a safe haven to preserve their capital?

Regulatory requirements established by the Federal Reserve Board (Board) and the other banking agencies (Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation) since the financial crisis are meant to address risks to which banking organizations are exposed, including the risks associated with funding in the form of cash deposits. The supplementary leverage ratio (SLR) rule requires internationally active banking organizations to hold a minimum amount of capital against all on-balance sheet assets and certain off-balance sheet exposures. This leverage requirement is designed to recognize that the risk a banking organization poses to the financial system is a factor of its size as well as the composition of its assets. Excluding select categories of on-balance sheet assets, such as cash deposits, from the calculation of a banking organization's SLR generally would be inconsistent with the purpose of the requirement.

Certain banking organizations, particularly custody banks that act as intermediaries in high-volume, low-risk, low-return financial activities, may experience increases in deposits during periods of financial market stress.[1] Because the SLR reflects size as a primary measure of risk, it is possible that banking organizations' costs of holding low-risk, low-return assets, such as cash, could increase if this ratio were to become the binding regulatory capital constraint. However, regulatory capital requirements generally are not the only basis for these decisions. Banking organizations take many considerations into account when choosing their asset profile, such as available yields, preservation of flexibility and liquidity, generation of revenue, market share and overall business relationships, and credit risk.

Board staff has held meetings with and reviewed materials prepared by banking organizations in connection with the implementation of the SLR. The Board continuously considers potential improvements to its regulations based on feedback from affected parties and the general public but is not actively considering making any modifications to the SLR at this time. According to public disclosures of firms subject to this requirement, banking organizations have made significant progress in complying with the SLR requirements.

[1] The Board has reserved authority under the capital rule to require a banking organization to use a different asset amount for an exposure included in the SLR to address extraordinary situations. See 12 CFR 3.l(d)(4) (OCC); 12 CFR 217.l(d)(4) (Federal Reserve); 12 CFR 324.l(d)(4) (FDIC).

b. What communication have you had with the Bank of England regarding its decision, announced August 4, 2016, to exclude central bank reserves from the exposure measure in the current U.K. leverage ratio framework? Doesn't the Bank of England's decision make U.S. custody-based banks less competitive than those based in the U.K.?

Federal Reserve staff regularly communicate with Bank of England staff and have discussed the United Kingdom's announcement regarding its decision to exclude central bank reserves from the U.K. leverage ratio's exposure measure. The Bank of England has stated that it intends to recalibrate the U.K. leverage ratio requirement to offset the decrease in the required notional amount of capital due to the central bank reserve exclusion.[2] Board staff is monitoring the Bank of England's plans to recalibrate the requirement and the potential impact. It should be noted that the Basel leverage ratio exposure measure currently includes central bank deposits.

2. I am also concerned the U.S. implementation of the Basel leverage ratios does not properly consider the exposure-reducing effect of segregated customer margin provided to a banking organization for the limited purpose of facilitating derivatives clearing services on behalf of customers. By its very nature, the customer margin received by the bank-affiliated clearing agent lessens the bank's exposure. Furthermore, under the Commodity Exchange Act, this highly liquid margin must be legally segregated form the bank's assets so that it is always available to pay any debt owed by the customer to the clearinghouse *before* the bank must make good on its guarantee.

a. Do you agree that segregated customer margin reduces the bank's exposure to credit risk?

As noted in response to questions 1a, the risk a banking organization poses to the financial system is a factor of the banking organization's size as well as the composition of its assets. In this regard, the SLR rule requires a banking organization to hold a minimum amount of capital against on-balance sheet assets and off-balance sheet exposures, including with respect to segregated customer margin, regardless of the risk associated with the individual exposure. The denominator of the SLR, total leverage exposure, generally includes all on-balance sheet assets as determined by U.S. generally accepted accounting principles, as well as certain off-balance sheet items. Whether cash initial margin is recorded on the balance sheet depends on the provisions of each margin agreement. Excluding select categories of on-balance sheet assets, such as customer margin, on the basis of risk from the calculation of a banking organization's SLR generally would be inconsistent with the purpose of the SLR.

b. I am concerned fewer financial institutions will engage in clearing activities after being subjected to higher capital surcharges under the Basel Leverage Ratios, despite their inherent low-risk nature. What has the Federal Reserve, and the rest of the FSOC, done to assess resulting concentration risk, especially during times of market stress?

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[2] See "Financial Policy Committee statement and record from its policy meeting 25 July 2016" available at http://www.bankofengland.co.uk/publications/Pages/news/2016/062.aspx.

As discussed, certain banking organizations that engage in high-volume, low-risk, low-return financial activities, may face increased costs related to holding low-risk, low-return assets, such as cash margin, if the SLR were to become the binding regulatory capital constraint. The SLR requirement is designed to address the risk a banking organization poses to the financial system due to its size as well as the composition of its assets. However, as discussed above, regulatory capital requirements generally are not the only basis for these decisions. Banking organizations take many considerations into account when choosing their asset profile, such as available yields, preservation of flexibility and liquidity, generation of revenue, market share and overall business relationships, and credit risk.

According to public disclosures of firms subject to this requirement, the firms have made significant progress in complying with the SLR requirements. In addition, the swap margin rule, issued in October 2015, incentivizes firms to clear through central counterparties.[3]

[3] See https://www.federalreserve.gov/newsevents/press/bcreg/20151030b.htm.

<u>Questions for The Honorable Janet L. Yellen, Chair, Board of Governors of the Federal Reserve System from Representative Love</u>:

1. Chair Yellen, your written testimony states on page 13:

"Congress may also wish to consider carving out community banks from two sets of Dodd-Frank Act requirements: the Volcker rule and the incentive compensation limits in section 956. The risks addressed by these statutory provisions are far more significant at larger institutions than they are at community banks. In the event that a community bank engages in practices in either of these areas that raise heightened concerns, we would be able to address these concerns as part of the normal safety-and-soundness supervisory process. While the banking agencies have tailored the Volcker rule and have proposed significant tailoring of incentive compensation rules, community banks and supervisors would benefit from not having to focus on regulatory compliance for matters that are unlikely to pose problems at smaller banks."

We know from OCC data that the four largest banks account for over 90 percent of derivatives trading activity, while the 25 largest banks account for nearly 100 percent of derivatives activity. America's community banks -- the banks that most American households and businesses rely on for credit and mortgages -- don't make money by trading.

Could you elaborate on how you think we could go about determining which banks should be exempt from regulatory compliance with the Volcker Rule?

Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the statutory provision known as the "Volcker Rule"),[1] which added a new section 13 to the Bank Holding Company Act of 1956, generally prohibits any banking entity from engaging in proprietary trading, and from acquiring or retaining an ownership interest in, sponsoring, or having certain relationships with a covered fund, subject to certain exemptions. Under the terms of the statute, the Volcker Rule applies to any banking entity, regardless of its size. As a result, the Volcker Rule and the implementing rules issued by the Federal Reserve, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Securities and Exchange Commission, and the Commodity Futures Trading Commission (the "Agencies") apply to community banks.

Generally, the Federal Reserve makes substantial efforts to tailor supervisory practice to the size of the institution supervised. Requirements are lowest for smaller, local institutions and increase with the size, complexity, and geographic reach of firms. The tiered approach allows us to account for differences in business models and risk levels among different types of institutions.

As part of the rules implementing the Volcker Rule, the Agencies endeavored to minimize the compliance burden on banking entities by reducing the compliance program and reporting requirements applicable to banking entities with $10 billion or less in total consolidated assets. This was based in part on information that indicated that banking entities of this size generally

[1] 12 U.S.C. § 1851.

have little or no involvement in prohibited proprietary trading or investment activities in covered funds.[2] Exempting banking entities of this size from the Volcker Rule would provide relief for thousands of community banks that face ongoing compliance costs incurred simply to confirm that their activities and investments are indeed exempt from the statute. At the same time, an exemption at this level would not be likely to increase risk to the financial system. The vast majority of activity and investment that the Volcker Rule is intended to address takes place at the largest and most complex financial firms whose failure would have a significant effect on the stability of the financial system. Moreover, even with an exemption, the Federal banking agencies could continue to use existing prudential authority to address unsafe and unsound practices at a community bank that engaged in imprudent investment activities.

2. Chair Yellen, pursuant to section 620 of the Dodd–Frank Act, the Fed, in conjunction with the FDIC and OCC, recently released a report to Congress regarding Banking Activities and Investments. The report states that "the ILC [industrial loan company] exemption creates special supervisory risks because an ILC's parent company and nonbank affiliates are not subject to consolidated supervision" and that "a commercial firm . . . may acquire and operate an ILC without complying with the standards that Congress has established for Bank Holding Companies to maintain the separation of banking and commerce and to protect insured banks, the federal safety net and, ultimately, the taxpayer."

The implications of the report are that ILCs present heightened risk in our banking system. Can you provide any data demonstrating that heightened risk?

As noted in the 620 report, the industrial loan company (ILC) exemption creates special supervisory risks because an ILC's parent company and nonbank affiliates are not subject to consolidated supervision. Lack of consolidated supervision is problematic because the organization may operate and manage its business on an integrated basis, and, in the Federal Reserve's experience, risks that cross legal entities and that are managed on a consolidated basis cannot be monitored properly through supervision directed at one or even several of the legal entity subdivisions within the overall organization. Moreover, history demonstrates that financial distress in one part of the business organization can spread, sometimes rapidly, to other parts of the organization.

3. The report also recommends repealing the exemption that permits corporate ownership of ILCs in the current form. ILCs, however, have access to the resources of the corporate parent which is a significant source of capital for the bank. Often the corporate parent could recapitalize the bank overnight. Given this structure, which protects taxpayer dollars and increases the safety and soundness of the banking entity, why do the Board of Governors of the Federal Reserve, the FDIC, and the OCC recommend removing the exemption?

ILC holding companies are not subject to consolidated supervision and regulation, which helps to ensure that they are able to serve as a source of financial strength to subsidiary insured

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[2] See The Volcker Rule: Community Bank Applicability (Dec. 10, 2013), available at: http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20131210a4.pdf.

depository institutions in times of stress. It is the policy of the Board that in serving as a source of strength to its subsidiary banks, a bank holding company should stand ready to use available resources to provide adequate capital funds to its subsidiary banks during periods of financial stress or adversity, and should maintain the financial flexibility and capital-raising capacity to obtain additional resources for assisting its subsidiary banks. To this end, the Federal Reserve has established consolidated capital requirements for bank and savings and loan holding companies. The parent companies of ILCs, however, are not subject to the consolidated capital requirements established for bank holding companies. Indeed, among the factors contributing to the failure of a federally insured ILC in 1999 were the unregulated borrowing and weakened capital position of the corporate owner of the ILC and the inability of any federal supervisor to ensure that the parent holding company remained financially strong.

4. Further, on page 32 of the report, it is noted that "[t]he continuation of the ILC and GUSLHC exemptions undermines several fundamental policies that Congress has established and reaffirmed governing the structure, supervision, and regulation of the financial system," but the report does not further describe those "fundamental policies." Can you please identify the policies to which the report refers and how repealing the ILC exemption would further those policies?

Separation of Banking and Commerce. For many years, Congress has sought to maintain the general separation of banking and commerce in the United States and has acted affirmatively to close loopholes that create significant breaches in the wall between banking and commerce. For example, one of the primary reasons for enactment of the Bank Holding Company Act (BHC Act) in 1956, and its expansion in 1970 to cover companies that control only a single bank, was to help prevent and restrain combinations of banks and commercial firms under the auspices of a single holding company. Mixing of banking and commerce presents several concerns, including that the federal safety net might, in effect, be extended to commercial affiliates and that banks associated with commercial firms may be less willing to provide credit to the competitors of their commercial affiliates or may provide credit to their commercial affiliates at preferential rates or on favorable terms. The ILC exception undermines this separation by allowing commercial firms to evade these general restrictions and acquire an FDIC-insured bank with broad deposit-taking and lending powers.

Bank Affiliations with Financial Firms. Besides restricting the mixing of banking and commerce, Congress also has placed preconditions on the ability of firms that are purely financial to affiliate with banks. Bank holding companies and savings and loan holding companies may engage in a broad range of financial activities, such as securities underwriting, only if the holding company and its subsidiary insured depository institutions meet enhanced capital and managerial standards. Corporate owners of ILCs, on the other hand, may engage in this broader range of financial activities without meeting enhanced capital and managerial standards.

Consolidated Supervision. As discussed above, the ILC exception undermines the consolidated supervisory framework that Congress has established for the corporate owners of insured banks, as well as for foreign banks that seek to enter the banking business in the United States. Consolidated supervision of the corporate parents of insured depository institutions began with the enactment of the Bank Holding Company Act. This framework is intended to help protect the safety and soundness of corporately controlled banks that have access to the federal safety net, ultimately backed by the taxpayer, and to maintain the general separation of banking and commerce in the United States.

Competitive equality. The ILC exception creates an unlevel playing field among organizations that control a bank because it allows the corporate owners of ILCs to operate under a substantially different framework than the owners of other insured banks. These advantages provide incentives for firms to continue to exploit the exception and create the opportunity for firms to engage in "regulatory arbitrage."

Questions for The Honorable Janet L. Yellen, Chair, Board of Governors of the Federal Reserve System from Representative Luetkemeyer:

1. In June, the Board put out an advanced notice of proposed rulemaking (ANPR) on capital rules for federally supervised insurers. In 2014, Congress passed legislation to clarify that the Board can and should tailor capital rules for the insurance business model and complement, rather than disrupt, the state system of insurance regulation. I appreciate the thoughtful process that went into the ANPR. However, I believe the best way to tailor rules to insurers and reflect the will of Congress is to fully incorporate the state risk-based capital system into your rules. The building blocks approach, or BBA, in your proposal does that, while the consolidated approach, the CA, does not. Would you consider adopting the BBA for both categories of insurers?

As you note, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) was amended to allow the Federal Reserve Board (Board) to tailor its minimum capital requirements as they would apply to persons regulated by state or foreign insurance regulators. The Board has flexibility to develop risk-based capital requirements that are tailored to appropriately reflect the risks of supervised institutions significantly engaged in insurance activities. Moreover, our supervisory program, complementary to and in coordination with the states, continues to be tailored to consider the unique characteristics of insurance operations and rely on the work of the state regulator(s) to the greatest extent possible.

The Board's advance notice of proposed rulemaking (ANPR) requests input from the public on two possible options for capital standards for supervised insurers. The Board has not reached decisions on approaches to be used to build a capital standard for supervised insurers. As stated in the ANPR, the Board's initial review of the relative strengths and weaknesses of the consolidated approach indicates that this approach may be an appropriate regulatory capital framework for the systemically important insurance companies. As a consolidated capital framework, this approach would cover all material risks of the systemically important insurance companies, reduce the opportunity for regulatory arbitrage and risk of double-leverage, and more easily enable supervisory stress testing and other macroprudential measures for these companies. The advantages of the consolidated approach are most salient for the systemically important insurance companies, which tend to be large, internally and externally complex institutions. It would be premature for me to comment on this framework before staff has finished its research vetting potential options. As indicated by the questions included in the ANPR, the Board welcomes comment on the considerations that should guide the development of its insurance regulatory capital framework for the two populations of supervised institutions significantly engaged in insurance activities, as well as whether the consolidated approach is appropriate to apply to systemically important insurance companies and key challenges in this application.

2. The Board, along with several other financial regulators, put out a notice of proposed rulemaking (NPR) on incentive-based compensation earlier this year. Insurance savings and loan holding companies are subject to this rule. Congress has consistently stated the importance of tailoring your rules for insurers, but the NPR does not tailor the rules in any way for insurers, despite the differences in their business model. Will you undertake a specific, separate Board analysis of the compensation practices and risks at insurers, like

you did for banks, before the NPR? How will you ensure that the final rule is appropriately tailored for insurance savings and loan holding companies?

Consistent with the statutory requirements of section 956 of Dodd-Frank Act, the Agencies[1] joint notice of proposed rule-making[2] covers all depository institution holding companies, including all savings and loan holding companies.[3] As described in the preamble, the proposed rule does not establish a rigid, one-size-fits-all approach. Rather, the Agencies have tailored the requirements of the proposed rule to the size and complexity of covered institutions. In addition, the proposed rule would allow firms to tailor the incentive-based compensation arrangements to the nature of a particular institution's business and risks, as long as those incentive-based compensation arrangements appropriately balance risk and reward. The Agencies have encouraged institutions to provide feedback on the potential impact of the proposed rule on covered institutions through the comment process.[4] The Agencies have included numerous questions, touching on all aspects of the rule. The comment process is intended to help us assess and address the impact of the rule on all types of covered institutions, including insurance savings and loan holding companies. At the request of certain insurance companies, we have met with those companies, and will include summaries of these meetings in the rulemaking record. Through these meetings, we will be able to obtain a deeper understanding of how their compensation practices work to inform the final rule. Similarly, the Agencies will consider your comments, and all other comments received, as a final rule is developed.

3. We appreciate that the pending capital rule reflects that difference and the intent of Congress regarding federal regulations for insurers. As the Board developed incentive compensation proposals, can you tell me which studies and reports you used to specifically evaluate the risks that needed to be addressed in the business of insurance? Did you do insurance-specific studies, as you did for banks through the Horizontal Banking Reviews? If not, will you commit to doing a Horizontal Review for insurance SLHCs before the rule is made final for those companies?

Please see the response to question 2.

5. Governor Tarullo recently announced that the Board plans to incorporate the GSIB surcharge in the annual CCAR process based on the idea that *"financial regulation should*

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[1] Office of the Comptroller of the Currency; Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; Federal Housing Finance Agency; National Credit Union Administration; and U.S. Securities and Exchange Commission.

[2] 81 FR 37670 (July 10, 2016).

[3] Section 956 of the Dodd-Frank Act defines "covered financial institution" to include any of the following types of institutions that have $1 billion or more in assets: (A) a depository institution or depository institution holding company, as such terms are defined in section 3 of the Federal Deposit Insurance Act ("FDIA") (12 U.S.C. 1813); (B) a broker-dealer registered under section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o); (C) a credit union, as described in section 19(b)(1)(A)(iv) of the Federal Reserve Act; (D) an investment adviser, as such term is defined in section 202(a)(11) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(11)); (E) the Federal National Mortgage Association (Fannie Mae); (F) the Federal Home Loan Mortgage Corporation (Freddie Mac); and (G) any other financial institution that the appropriate federal regulators, jointly, by rule, determine should be treated as a covered financial institution for these purposes.

[4] As of the preparation of this response, the Agencies have already received multiple comments letters regarding the application of the proposal to insurance SLHCs and have met with insurance industry representatives.

***be progressively more stringent for firms of greater importance, and thus potential risk, to the financial system".* Do you agree that this move demonstrates that that a significant number of regional banks pose very minimal risk?**

Section 165 of the Dodd-Frank Act requires the Board to establish prudential standards for bank holding companies with total consolidated assets of $50 billion or more.[5] The law further provides that the standards should increase in stringency based on a number of risk-related factors, including firm's leverage, funding structure, and nonfinancial activities of the company. In implementing this requirement, the Board has assessed a range of factors to identify the potential risks posed by these bank holding companies, including their size, the complexity of their operations, and their interconnections with other financial institutions.[6]

The most systemically important firm--those that are identified as global systemically important bank holding companies (GSIBs)--are subject to the most stringent standards, including the Board's GSIB surcharge rule and an enhanced supplementary leverage ratio.[7]

Large and complex firms--those that are not GSIBs, but meet certain criteria, such as $250 billion in total assets or $10 billion in total foreign exposure--are subject to elevated standards relative to other firms with total consolidated assets of $50 billion or more. These firms generally have significant credit, market, and liquidity risk, but do not present the same level of systemic risk as the GSIBs. The elevated standards that apply to large and complex firms include the supplementary leverage ratio, countercyclical capital buffer, and liquidity coverage ratio requirement.[8]

In keeping with this tiered approach to prudential regulation, the speech by Governor Tarullo described a notice of proposed rulemaking that the Board issued on September 26, 2016, to tailor the stringency of the Board's capital planning assessments for large bank holding companies.[9] Under the proposal, large and noncomplex firms,[10] which would include certain regional banks, would no longer be subject to the Comprehensive Capital Analysis and Review's qualitative assessment or possible qualitative objection to their capital plans. However, in recognition that the material distress or failure of any large financial institution, including a regional bank, could create economic disruption, large and noncomplex firms would still be subject to requirements that reflect their importance to the financial system. These firms would still be required, for example, to submit an annual capital plan to the Board, which would be evaluated in the normal course of supervision. This reflects the view that all large financial institutions, regardless of complexity, should maintain capital planning practices that are commensurate with their risks. Further, large and noncomplex firms would continue to be subject the Federal Reserve's

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[5] 12 U.S.C. 5365.

[6] 79 FR 17240 (March 27, 2014), 80 FR 49082 (August 14, 2015).

[7] 12 CFR 217.11, 79 FR 24540 (May 1, 2014).

[8] 12 CFR 217.10-11, 12 CFR part 249.

[9] See Next Steps in the Evolution of Stress Testing (September 26, 2016), available at: https://www.federalreserve.gov/newsevents/speech/tarullo20160926a.htm; 81 FR 67239 (September 30, 2016).

[10] Large and noncomplex firms are defined in the proposal as bank holding companies with more than $50 billion but less than $250 billion in total consolidated assets, less than $10 billion in on-balance sheet foreign exposure, and less than $75 billion in total nonbank assets.

supervisory stress test requirements and to a possible objection to their capital plans on quantitative grounds.

6. If the GSIB assessment methodology is good enough to show what firms are risky and deserving of more regulation, doesn't it also accurately show where risk is not present and highlight the firms that should not be included in the SIFI regulation regime?

As explained in the response to question 5, the Board has developed regulatory requirements based on considerations of size and complexity to ensure the regulations and supervisory programs appropriately address both safety and soundness and financial stability concerns. Regional banks are subject to relatively less stringent regulation than larger firms and GSIBs, reflecting their smaller systemic footprint. While regional banks may not pose the same level of risk to the financial system as GSIBs and other large and complex financial companies, the material distress or failure of any large financial institution could create disruptions in a regional economy. Further, the Dodd-Frank Act requires the Board to develop certain enhanced standards for all bank holding companies with $50 billion or more in total consolidated assets. This helps to ensure that these companies operate in a safe and sound manner and subject to standards that are enhanced relative to smaller firms.

The Federal Reserve also has tailored its supervisory program to the size, complexity, and riskiness of supervised firms. The Federal Reserve has established the Large Institution Supervision Coordinating Committee (LISCC) framework to supervise the GSIBs and foreign firms that may pose elevated risks to U.S. financial stability. The LISCC framework includes rigorous supervision of individual firms, and comprehensive horizontal reviews and analyses of activities and risks across the portfolio, focusing on how macroeconomic and financial risks could affect individual firms and the financial system collectively. Bank holding companies with total consolidated assets of $50 billion or more that are not subject to the LISCC framework are subject to a supervisory process that includes firm-specific supervision and periodic targeted horizontal reviews.

7. What new information do you get from a bank stress test that is not otherwise available through supervisory information, examinations or other reports?

The Federal Reserve, Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency first conducted the stress test of large and complex banking institutions in 2009 in the midst of the financial crisis. The crisis highlighted a need to have a consistent framework that provides a forward-looking assessment of capital adequacy of large and complex banking institutions under stress, in addition to a need to enhance other aspects of supervision of those institutions.

Stress testing is a key supervisory tool that helps both bank supervisors and a banking organization measure the sufficiency of capital available to support the banking organization's operations throughout periods of stress. In addition, stress testing provides a risk-sensitive measure of a firm's capital needs under stress by evaluating the impact of a macroeconomic scenario on a firm's balance sheet and risk exposures. As required by the Dodd-Frank Act, the Federal Reserve conducts an annual stress test (supervisory stress test) of banking institutions with consolidated assets of $50 billion or more, and also requires institutions with more than

$10 billion in consolidated assets to conduct their own stress tests (company-run stress tests) at least annually. The supervisory stress test provides an independent, forward-looking assessment of firms' capital adequacy under stress. The supervisory stress test relies on the detailed data each firm provides, but uses a consistent set of scenarios, assumptions, and models for firms, making the results comparable across institutions.

Institutions with assets between $10 and $50 billion are subject to annual company-run stress test requirements, using the scenarios the Federal Reserve provides annually. This stress test provides the Federal Reserve with a forward-looking quantitative evaluation of the impact of stressful economic conditions on firm's capital, rather than a point-in-time assessment of capital under current economic conditions. As there is no supervisory stress test, the company-run stress test is the sole forward-looking assessment of a firm's capital under the same set of stressful operating scenarios. As such, the Dodd-Frank Act stress tests provides valuable information for the Federal Reserve, the firms, and the public regarding the $10-50 billion firms' potential vulnerabilities to stress.

As required by the Dodd-Frank Act, institutions with $50 billion or more in assets must undergo an annual supervisory stress test and conduct semi-annual company-run stress tests. Together, the supervisory stress tests and the company-run stress tests are intended to provide supervisors with forward-looking information to help identify downside risks and the potential effect of adverse conditions on capital adequacy of these institutions. The Federal Reserve uses the results of the supervisory stress tests and company-run stress tests in its supervisory evaluation of a firm's capital adequacy and capital planning practices. In addition, the stress tests also provide a means to assess capital adequacy across companies more fully and support the Board's financial stability efforts.

Additionally, to gain a deeper understanding of a firm's unique vulnerabilities, the capital plan rule requires each firm to design an internal stress scenario that is appropriate to the firm's business activities and exposures, including any expected material changes therein over the nine-quarter horizon. The requirement to create an internal stress scenario and execute a stress test under the scenario allows the Federal Reserve to assess large firm's internal practices and policies to determine their capital needs, given each firm's unique risk exposures and business activities.

In addition to the information that the Federal Reserve gains from bank stress tests, the company-run stress tests ensure that firms undertake robust forward-looking capital planning under baseline and stress conditions.

Finally, the disclosure of stress test results by the Federal Reserve and the firms provide valuable information to market participants and reduces uncertainty about the financial condition of the participating bank holding companies.

<u>**Questions for The Honorable Janet L. Yellen, Chair, Board of Governors of the Federal Reserve System from Representative Luetkemeyer:**</u>

4. Section 956 of The Dodd Frank Act (DFA) relies on Title V of the Gramm-Leach Bliley Act (GLBA) section 505 to assign enforcement responsibilities for incentive pay restrictions. Section 505 of GLBA explicitly places the authority to bring enforcement actions with the State insurance authority of the State where the company is domiciled. Consequently, it appears that only state insurance authorities are given authority have the legal authority to enforce section 956 of DFA and any implementing regulations for insurers and there is no statutory basis for the Fed enforcement authority in the area of insurance SLHC compensation. Furthermore, it would appear that imposing such enforcement requirements upon the states may be an unconstitutional commandeering of state resources. I'm concerned that DFA renders section 956 inoperable as applied to insurers. Can you explain the Board's view as to how this works as a matter of law?

Section 956 specified the enforcement authority of section 505 of the Gramm-Leach-Bliley Act, which assigns enforcement authority for "persons providing insurance" to the "applicable State insurance authority." Because savings and loan holding companies are not enumerated under paragraphs (1) through (6) of subsection (a) of section 505, savings and loan holding companies and their subsidiaries would fall under the enforcement jurisdiction of the Federal Trade Commission under paragraph (7). Savings and loan holding companies are depository institution holding companies, as such term is defined in section 3 of the Federal Deposit Insurance Act.[1] Section 956 requires the rule apply to all depository institution holding companies and does not grant the Agencies[2] exemptive authority.

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[1] 12 U.S.C. 1813.

[2] Office of the Comptroller of the Currency (OCC); Board of Governors of the Federal Reserve System (Board); Federal Deposit Insurance Corporation (FDIC); Federal Housing Finance Agency (FHFA); National Credit Union Administration (NCUA); and U.S. Securities and Exchange Commission (SEC).

Questions for The Honorable Janet L. Yellen, Chair, Board of Governors of the Federal Reserve System from Representative Luetkemeyer:

8. The Federal Reserve's recommendations made pursuant to the Section 620 Study rest upon an assumption that an environmental risk's costs will exceed a subsidiary's capitalization, and that claims will then be made against a financial holding company by "piercing the corporate veil." However, the Federal Reserve notes in its recent notice of proposed rulemaking that such instances are an "exception to the general rule in corporate law that a parent company is not liable for the acts of its subsidiaries, and may be applied when the affiliated entity exercises a high degree of control over the liable company." Did the Federal Reserve conduct an analysis as to whether corporate "veil piercing" is more likely to occur in the context of merchant banking?

In recommending the repeal of merchant banking authority, the Federal Reserve Board (Board) considered the risks of the activity and whether the activity could have a negative effect on safety and soundness, as well as the appropriateness of the activity. As part of its review of merchant banking, the Board considered the risk that a financial holding company could be held liable for the acts of a portfolio company through a veil piercing action. The Board considered whether the factors that contribute to a court's decision to pierce the corporate veil may also be present in merchant banking. See also response to question 9.

These factors, many of which are described in response to question 9 below, are not prohibited under the Gramm-Leach-Bliley Act. Therefore, a financial holding company (FHC) may engage in activities under merchant banking authority that increase the likelihood that the corporate veil between the FHC and a company it holds under merchant banking authority would be pierced. For example, involvement in the day-to-day operations of a portfolio company increases the risk that a financial holding company will be held liable for the acts of a portfolio company. Under the Gramm-Leach-Bliley Act, a financial holding company may routinely manage or operate a portfolio company as may be necessary or required to obtain a reasonable return on the resale or disposition of the investment.

9. Can you provide specific examples of when claimants against a financial holding company affiliate have pierced the corporate veil in the merchant banking context? Please cite the specific factors that you believe would need to be present for such veil piercing to occur.

Staff is not aware of a successful veil piercing claim against a financial holding company for the actions of a company held under merchant banking authority.

The tests and various factors courts consider in an action to pierce the corporate veil vary from state to state. One key factor courts consider is the level of control evidenced by a dominant shareholder over the corporation. Such domination may be evidenced by control over finances, policy and business practice of the corporation, including whether (1) the shareholder sought to be charged owns all or most of the stock of the corporation, (2) the corporation is inadequately capitalized, (3) the shareholder uses the property of the corporation as its own, (4) the directors or executives of the corporation act independently in the interest of the corporation or simply take their orders from the dominant shareholder or act in the latter's interest, and (5) the formal legal requirements of the corporation are observed.[1]

[1] See Fletcher Cyclopedia of the Law of Corporations 41:10-30 (rev. ed. 2006).

Questions for The Honorable Janet L. Yellen, Chair, Board of Governors of the Federal Reserve System from Representative Luetkemeyer:

10. The Federal Reserve's impact analysis of proposed capital requirements estimated an increase of risk-weighted assets of $34 billion, meaning that the amount of capital that would need to be raised would be approximately $4.1 billion in the aggregate. What range of activities was covered in this impact analysis? Did the Federal Reserve conduct an analysis of whether increased costs would be passed down to end users that use commodity-linked derivatives (in accordance with the Riegle Community Development and Regulatory Improvement Act)?

In conducting the impact analysis, the Federal Reserve Board (Board) evaluated the permissible physical commodity activities that would be subject to the proposed rule. Specifically, with regard to physical commodities trading and settlement activities conducted by financial holding companies (FHCs) pursuant to section 4(k)(1)(B) (complementary authority) and section 4(o) (grandfather authority) of the Bank Holding Company (BHC) Act, the Board analyzed the commodity-linked derivative activities (which included estimates of a number of derivative transactions and frequency of physical settlement of commodity-linked derivatives) and spot-market trading activities of FHCs. In addition, the Board reviewed the extent of commodity infrastructure assets (such as oil refineries and oil and natural gas pipelines) held pursuant to the grandfather authority. With respect to merchant banking activity, staff reviewed the merchant banking data the Board receives from top-tier domestic holding companies.

As described in the proposal, the Board considered the potential impact of the proposal on the physical commodity markets. If FHCs choose to terminate the physical commodities subject to the proposal, it is unlikely that their exit would have a material impact on end users. Board estimates indicate that FHC market share in the physical commodity markets is quite low. Moreover, the activities subject to the proposal only represent certain physical commodities activities (e.g., physical trading of oil), and not the full panoply of commodities (such as metals and agriculture).

Section 302(a) of the Riegle Community Development and Regulatory Improvement Act requires that, in determining the effective date and administrative compliance requirements for new regulations that impose additional requirements on insured depository institutions (IDIs), the appropriate federal banking agency consider the administrative burdens that the regulation would place on IDIs and the benefits of the regulation. The proposed rulemaking, however, applies only to those FHCs that engage in physical commodity activities pursuant to complementary authority or grandfather authority or that engage in merchant banking activities pursuant to section 4(k)(4)(H) of the BHC Act.

11. What type of analysis was conducted to consider the impact on nonfinancial end-users of the proposed rule, outside of an assessment of how much capital a financial holding company would be required to raise? Did the Federal Reserve consider how this notice of proposed rulemaking interacted with other rules – particularly the net stable funding ratio – and how this rule would potentially add even further costs to the hedging and risk mitigation activities of nonfinancial end users?

The Board reviewed publicly available data, analyzed comments solicited through an advance notice of proposed rulemaking issued in January 2014, and collected information from certain FHCs regarding the extent of FHC activity in the physical commodity markets. Board estimates indicate that FHC market share in the physical commodity markets is quite low. If FHCs choose to exit the physical commodity markets, it is unlikely that their exit would have a material impact on end users. Further, a material impact is even less likely after taking into account that only certain physical commodities (e.g., oil), and not the full panoply of commodities (such as metals and agriculture), would be covered under the rulemaking.

The potential impact of the proposal is limited in a number of other respects as well. First, the proposal would not impose additional liquidity requirements or requirements on activities of FHCs that are not subject to the proposed rule such as physical commodities cash-settled derivatives and lending. Second, the proposal would not prohibit FHCs from continuing their physical commodity activities subject to the proposal if they determine that the activities are important to their overall strategy; rather, the proposal is intended to require FHCs to hold capital commensurate with the riskiness of the activity. Third, FHCs that choose to discontinue their physical commodity activities subject to the proposal would be able to continue other financial activities related to commodities, including cash-settled commodity-linked derivatives. For example, in the past few years a number of FHCs have ceased or significantly decreased their activities related to the buying, selling, and holding of physical commodities while continuing to engage in financial activities, such as cash-settled derivatives, related to physical commodities. Fourth, the proposal includes an exception to the merchant banking capital requirement for certain investments in commodity end users to maintain the availability of investment capital for such firms. The Board invited comment on the impact of the proposal, including any additional considerations and data that should be used. As part of the rulemaking process, the Board will consider comments on these and all other aspects of the proposal.

12. The Federal Reserve has noted that "information on physical commodity markets, in particular those covered by this proposal, is relatively scarce," but then states that this rulemaking will impact a small share of the market because "information available to the Board supports this view, with market participants asserting that, in general, FHCs' market shares in physical commodity markets are quite low and typically represent less than 1 percent of the market." How did the Federal Reserve obtain this information and on what basis? Please disclose, in particular, market participants that provided this information.

The Federal Reserve collected information regarding the type and extent of the physical commodities activities from the six domestic FHCs that engage in physical commodities activities under complementary or grandfather authority. Those firms are Bank of America Corporation, JPMorgan Chase & Co., Citigroup Inc., The Goldman Sachs Group, Inc., Morgan Stanley, and Wells Fargo & Company. Staff also reviewed the merchant banking data the Board receives in the FR Y-12 reporting form filed by top-tier domestic holding companies and the Bank Participation and Commitments of Traders Reports of the Commodity Futures Trading Commission.

13. The Federal Reserve also states that, with respect to commodities derivatives trading, U.S. bank market share is between 2 to 15 percent, and derivatives activities of non-bank

subsidiaries of financial holding companies is estimated to be similar or slightly larger. (81 Fed Reg. 67220 at 67229-67230). However, the Federal Reserve still believes that a reduction in activity relating to financial contracts would not materially impact the overall market. Is this correct – that the Federal Reserve believes that a reduction in activity for potentially 30% of the commodities derivatives market would not be "material"?

The U.S. bank market share range quoted above reflects the range of market share of derivatives activity on a product-by-product basis for commodities proposed to be covered under the proposal and does not reflect total market share across all commodities derivatives. Further, this market share range reflects a conservative upper limit on the amount of derivatives activity that would be impacted by this rule. The potential reduction of activity in the commodities derivatives market suggested in your question appears to be based on the assumption that FHCs cease all engagement in commodity derivatives activity. However, as noted in the proposal, FHCs are likely to continue holding, buying, or selling physical commodities covered under the proposal if they determine that such activities are important to their overall business strategy. Moreover, FHCs are likely to continue to engage in cash-settled derivative activities. In addition, FHCs may engage in market-making activities in the commodity derivatives market without relying on any physical commodity inventory. Finally, FHCs are unlikely as a result of the proposal to materially reduce their physical commodity trading activities relating to commodities that would not be subject to an additional capital requirement under the proposal.

Moreover, the proposal also notes that several FHCs have significantly reduced or fully divested their physical commodity business lines and assets related to these business lines. These same FHCs remain active in derivative markets and continue to conduct financial activity related to commodities.

Questions for The Honorable Janet L. Yellen, Chair, Board of Governors of the Federal Reserve System from Representative Mulvaney:

1. Chair Yellen, I appreciate the initial dialogue we had during the hearing concerning the Federal Reserve's authority to purchase equities. I appreciated your candor and agree with you that under current law, the Federal Reserve is not permitted to purchase equities and it would require a change in the law to do so. I also appreciated you sharing your perspective that the Fed may face longer term issues and difficulties with accommodative monetary policy, and while you are not asking for the authority to purchase equities, it may be something that Congress consider.

I also understand the day after our discussion, you spoke via videoconference on this topic with a group of bankers in Kansas City. Referring to the asset purchase stimulus programs, you said: "If we found, I think as other countries did, that they could reach the limits in terms of purchasing safe assets like longer-term government bonds, it could be useful to be able to intervene directly in assets where the prices have a more direct link to spending decisions," adding that buying equities and corporate bonds could have costs and benefits.

As a follow up, I would be appreciative if you could share some additional information about the Fed's review and analysis of equities purchases as a monetary policy tool.

When did you, other members of the Board, or Federal Reserve staff first begin internally discussing equities purchases as a monetary policy tool?

Have you and your staff been monitoring the purchases of equities by the Bank of Japan, the Bank of England, and the European Central Bank? What conclusions have you drawn?

What risks do you think buying equities entails? For the economies referenced above? For their impact on the international markets? For the U.S., if it were to adopt such a policy?

Similar to above, please detail the "costs and benefits" you referred to in your conversation with the Kansas City banking community.

Do you believe the risks associated with equities purchases include moral hazard? If so, I would appreciate your detailed thoughts on how to address these risks. And if not, why not?

Do you believe these risks involve the appearance of impropriety, politicization of markets, "playing favorites" for certain companies or industries, or result in the Fed casting proxy votes in corporate governance decisions? If so, I would appreciate your detailed thoughts on how to address these risks. And if not, why not?

How would the purchase of equities help the real economy? How would this mechanism function favorably, given that household wealth in the U.S. is around $89 trillion and relative to disposable income it is close to the highs in 2007? Does pushing it up even

higher have an effect on the real economy? If you believe so, please describe how you perceive that to happen.

In my remarks at this year's Economic Symposium in Jackson Hole, I noted the challenges for monetary policy posed by the effective lower bound on interest rates and the possibility that we may face these challenges more frequently in the future given the apparent decline in the so-called equilibrium real interest rate. To address such challenges, I noted that monetary policymakers may again need to rely upon unconventional tools such as forward guidance and asset purchases to promote statutory goals such as maximum employment and stable prices.

On the subject of asset purchases, it is important to note that the Federal Reserve Act provides authority for the Federal Reserve to purchase only a relatively narrow range of low-risk assets such as Treasury and agency securities. The Federal Reserve does not have the statutory authority to purchase a broad range of private sector obligations such as corporate bonds, equities, asset-backed securities, or household debt.

In contrast, other central banks such as the European Central Bank, the Bank of England, the Bank of Japan, and the Swiss National Bank have the authority to purchase a relatively wide range of financial assets. Moreover, these central banks have utilized their authority in recent years in different ways to address severe economic shocks that have depressed economic activity and generated disinflationary pressures.

There appear to be a number of advantages and disadvantages associated with the different approaches followed across countries regarding the authority for central bank purchases of financial assets. Factors that might favor establishing a fairly limited authority for central bank asset purchases include many of the types of considerations noted in the questions above—a desire to minimize the exposure of the central bank to financial risks, a desire to limit the scope for political pressures or other special interests to influence central bank decisions regarding asset purchases, a desire to avoid situations in which central bank asset purchases may adversely affect credit allocation or financial market functioning, and a desire to avoid creating adverse incentives for private investors. A factor that might support providing authority for a central bank to purchase a relatively broad range of assets is the potential to provide the central bank with tools to more effectively address adverse shocks and thus better promote macroeconomic objectives such as maximum employment and price stability. This type of authority might be particularly useful, for example, at a time of financial crisis when so-called "fire sales" of financial assets during a panic may have very negative and long-lasting consequences for the macroeconomy.

Regarding the specific issue of purchases of equity securities, I am not aware of any research, analysis, or discussions among members of the Board or Federal Reserve staff about the benefits and costs of purchasing equity securities as a monetary policy tool for the Federal Reserve. The absence of analysis of this issue no doubt owes importantly to the fact that the Federal Reserve does not have the statutory authority to purchase equity securities. Some other central banks, notably including the Swiss National Bank (SNB) and the Bank of Japan (BoJ), have purchased equity securities over recent years. In the case of the SNB, the purchase of equity securities has been seen as a way of diversifying investments of foreign exchange acquired in the SNB's efforts to manage the exchange value of the swiss franc. In the case of the BoJ, the purchase of equities through exchange traded funds has been described as a way of supporting business investment and helping to achieve the BoJ's inflation objective.

2. One of the roles of the Federal Reserve Board is to promote the integrity and efficiency of the payments system, and it has been exploring ways to make that system faster and more efficient using 21st century technology. Decentralized digital currency technology, like that found in Bitcoin, is at the cutting edge of payments systems. For example, Spanish banking giant Santander is working to issue tokens representing fiat cash on the public Ethereum blockchain. Do you find this technological avenue promising? And what obstacles do you see to great adoption of it?

The Federal Reserve views developments in financial technology, including digital currencies, through the lens of our long-standing public policy goals of safety and soundness of financial institutions, safety and efficiency for the payment system, financial stability more broadly, and an innovative financial system that provides widely shared benefits to the public over time. As such, fostering long-run innovation while continuing to safeguard the public interest is a key factor in how the Federal Reserve approaches payment system innovations such as digital currency.

The Federal Reserve has been actively monitoring developments in digital currencies and the technologies behind them, including blockchain technologies and distributed ledger technologies more generally. Some industry proponents of digital currency view it as having the potential to reduce transaction costs and provide faster processing speeds compared to current payment alternatives. Although this suggests that digital currency may have potential to improve payment system efficiency in the long run, the use of digital currencies raises a host of important legal, policy, security, and technical questions for a wide range of stakeholders, that could potentially present barriers to adoption.

For example, some digital currency implementations provide a degree of anonymity for their participants. In these instances, financial institutions may face difficulties with obtaining personally identifiable information, which could affect entities' ability to comply with Bank Secrecy Act/anti-money laundering and Office of Foreign Assets Control sanctions requirements. However, there may also be opportunities to use distributed ledger technology, which enables the transfer of value from one party to another party, to enhance efforts to combat money laundering and the financing of terrorism by its potential to provide regulators with transparent and complete transaction records. In order to provide such benefits, however, any distributed ledger technology must provide personally identifiable information, transactional information such as country of origin, and allow regulators and law enforcement to understand the transactions.

In addition, it remains to be seen whether digital currencies will evolve to efficiently process significantly more transactions than they do today. There exist hundreds of digital currency implementations, each with limited scale and acceptance. And similar to current payment methods, network and scale effects will be significant in determining the degree to which digital currencies are adopted by both households and businesses.

It is important to note that digital currencies are only the latest of many innovations in payment systems. At this stage of development, it is difficult to predict how digital currency and its associated distributed ledger technology will figure into the future of payments as the industry continues to explore a range of possible uses. For example, the industry is exploring the use of distributed ledger technology for cross-border payments, financial inclusion, and post-trade processing of securities, commodities, and derivatives. While there are several areas where digital currency and distributed ledger technology may hold promise, the extent to which they are adopted remains to be seen. The Federal Reserve will continue to monitor developments in this area.

<u>Questions for The Honorable Janet L. Yellen, Chair, Board of Governors of the Federal Reserve System from Representative Pittenger:</u>

1. Chair Yellen, we have long established that the business of insurance is different than the business of banking. As the Board developed incentive compensation proposals, can you tell me which studies and reports you used to specifically evaluate the risks that needed to be addressed regarding incentive compensation practices in the business of insurance?

Consistent with the statutory requirements of section 956 of Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the Agencies[1] joint notice of proposed rule-making[2] covers all depository institution holding companies, including all savings and loan holding companies.[3] As described in the preamble, the proposed rule does not establish a rigid, one-size-fits-all approach. Rather, the Agencies have tailored the requirements of the proposed rule to the size and complexity of covered institutions. In addition, the proposed rule would allow firms to tailor the incentive-based compensation arrangements to the nature of a particular institution's business and risks, as long as those incentive-based compensation arrangements appropriately balance risk and reward. The Agencies have encouraged institutions to provide feedback on the potential impact of the proposed rule on covered institutions through the comment process.[4] The Agencies have included numerous questions, touching on all aspects of the rule. The comment process is intended to help us assess and address the impact of the rule on all types of covered institutions, including insurance savings and loan holding companies. At the request of certain insurance companies, we have met with those companies, and will include summaries of these meetings in the rulemaking record. Through these meetings, we will be able to obtain a deeper understanding of how their compensation practices work to inform the final rule. Similarly, the Agencies will consider your comments, and all other comments received, as a final rule is developed.

[1] Office of the Comptroller of the Currency; Board of Governors of the Federal Reserve System; Federal Deposit Insurance Corporation; Federal Housing Finance Agency; National Credit Union Administration; and U.S. Securities and Exchange Commission.

[2] 81 FR 37670 (July 10, 2016).

[3] Section 956 of the Dodd-Frank Act defines "covered financial institution" to include any of the following types of institutions that have $1 billion or more in assets: (A) a depository institution or depository institution holding company, as such terms are defined in section 3 of the Federal Deposit Insurance Act (FDIA) (12 U.S.C. 1813); (B) a broker-dealer registered under section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o); (C) a credit union, as described in section 19(b)(1)(A)(iv) of the Federal Reserve Act; (D) an investment adviser, as such term is defined in section 202(a)(11) of the Investment Advisers Act of 1940 (15 U.S.C. 80b-2(a)(11)); (E) the Federal National Mortgage Association (Fannie Mae); (F) the Federal Home Loan Mortgage Corporation (Freddie Mac); and (G) any other financial institution that the appropriate federal regulators, jointly, by rule, determine should be treated as a covered financial institution for these purposes.

[4] As of the preparation of this response, the Agencies have already received multiple comments letters regarding the application of the proposal to insurance SLHCs and have met with insurance industry representatives.

<u>Questions for The Honorable Janet L. Yellen, Chair, Board of Governors of the Federal Reserve System from Ranking Member Waters:</u>

1. To conduct the search for candidates to serve as president of each Federal Reserve Bank, the Federal Reserve Board's website states that each Reserve Bank board of directors forms a search committee composed of Class B and Class C directors, which in turn hires an executive search firm to help identify a broad, diverse, highly-qualified candidate pool.[1] The website further states that the chair of the Board of Governors' Committee on Federal Reserve Bank Affairs meets regularly with the search committee chair throughout the search process. Finalist candidates are forwarded to the Board of Governors, all of whom are interviewed by the Governors. Each Federal Reserve Banks' Class B and C directors then formally appoint a candidate, subject to the approval of the Board of Governors.

- **Please discuss how such executive search firms are identified by the Federal Reserve Banks to assist in the selection of presidents.**
- **What, if any, specific criteria must executive search firms adhere to in identifying the most qualified candidates? What is the Board of Governors role in establishing such minimum criteria? To what extent is the Board of Governors involved in ensuring that minimum search criteria are consistently employed across each of the 12 Federal Reserve Districts?**
- **Please provide the names of each of the executive search firms used to assist in the selection of candidates to serve as presidents of the Federal Reserve Banks.**
- **I understand that the executive search firm Spencer Stuart has repeatedly been selected to help identify candidates to serve as presidents of the Federal Reserve Banks. To your knowledge, what steps has Spencer Stuart undertaken to ensure a broad and diverse recruitment pool? To what extent has the performance of Spencer Stuart been evaluated based on its ability to identify diverse candidates, including finalist candidates who are invited to be interviewed by the Board of Governors?**
- **What processes are in place to ensure that racially, ethnic, and gender diverse candidates are afforded due consideration?**
- **Historically, how many candidates to serve as Federal Reserve Bank presidents are typically submitted to and interviewed by the Board of Governors?**
- **Do all members of the Board of Governors interview each of the finalist candidates?**
- **What are the specific criteria that the Board of Governors use in determining whether a Federal Reserve Bank presidential candidate is best qualified?**
- **In approving presidents submitted by the Federal Reserve Banks, does the Board of Governors consider the collective diversity of presidents across each of the 12 Federal Reserve Bank districts?**
- **What is the process that the Board of Governors undertakes in approving the presidents of each of the Federal Reserve Banks? Is a recorded vote taken? Is consensus required**

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[1] See: http://www.federalreserve.gov/faqs/how-is-a-federal-reserve-bank-president-selected.htm.

- **Has the Board of Governors ever rejected a final candidate put forth by one of the Federal Reserve Banks, and if so, what was the basis for the decision?**

Executive search firms are retained by the relevant Reserve Bank's search committee, which is composed of Class B Bank directors who are not affiliated with a depository institution and Class C Bank directors. The Federal Reserve Board (Board) has supplied the Banks with a list of executive search firms that have provided services for Reserve Bank president and first vice president searches; a number of them specialize in identifying demographically and professionally diverse candidates. A copy of that list is attached. However, Reserve Banks are not limited to using the search firms on the Board's list. The search committee typically shares with the search firm a set of key dimensions provided by Board staff that outlines the primary roles and responsibilities of the president position. The current version of that document is attached. This general description of roles and responsibilities is also considered by the search committee as it drafts a detailed position description. As noted in the description, expectations of an individual Bank president may vary significantly from Bank to Bank.

The number of candidates that will ultimately be interviewed by the Board members varies, depending on the circumstances of the particular search. The Board members generally prefer to meet with more rather than fewer candidates. All Board members are invited to participate in the interview process. In general, each Board member interviews every finalist candidate for Bank president, because these individuals will serve not only as a Bank CEO, but also as a future colleague on the Federal Open Market Committee with whom each Governor will work closely. Interviews are held in person or in a few instances via telephone if schedules prevent every sitting Board member from participating in the interviews in Washington.

As a formal matter, executive search firms are solely accountable to the search committees that have retained them. The search committee oversees and assesses the search firm's work, including its process to identify a broad and diverse candidate pool. That said, the Board's Committee on Federal Reserve Bank Affairs and, in particular, its Chair exercise a high degree of engagement throughout the search process. This engagement includes regular interactions with both the search committee and the executive search firm. The focus of this engagement is not just on the broad process, but also on the composition and evolution of the specific pool of candidates, with an emphasis on diversity in a variety of dimensions.

The Board's Committee on Federal Reserve Bank Affairs reviews the pool of candidates with a view to ensuring diversity and discusses the issue with the search committee of the Reserve Bank. Ultimately, the Board votes as a whole on whether to approve the appointment of a Reserve Bank president. These decisions, like any other Board action, require a majority vote of the Board, and are recorded in the Board's minutes or records of notation voting.

2. Will you commit to using your authority to disapprove of candidates that have been recommended to serve as Federal Reserve Bank presidents by the Federal Reserve Banks' Class B and Class C directors, if such candidates fail to exhibit a deep personal commitment to diversity and inclusion?

Any candidate who is considered for a Reserve Bank president position is expected to display, as part of their previous work experience, a high level of leadership and personal integrity, including a commitment to diversity and inclusion. As I have noted before, we are dedicated to ensuring that diversity and inclusion is a priority at all levels of the Federal Reserve System.

The Board's Committee on Federal Reserve Bank Affairs and its Chair exercise a high degree of engagement with the search committee, composed of Class B and Class C directors, throughout the search process. Therefore, any concerns relating to potential candidates would likely be considered and addressed at stages of the search process prior to formal consideration of an appointment by the full Board of Governors.

3. What role do the Offices of Women and Minority Inclusion at the Board of Governors and each of the Federal Reserve Banks play in the process of recruiting, interviewing, and approving final candidates to serve as presidents of the Federal Reserve Banks?

The formal governance process around the selection of Federal Reserve Bank presidents, given the Banks' legal corporate existence, is the province of the Class B and Class C directors, with their appointment of a president subject to the approval of the Board of Governors. That said, the Chair of the Board's Committee on Federal Reserve Bank Affairs expects the search committee to consult with the Bank's Office of Minority and Women Inclusion (OMWI) officer and the Board officer responsible for overseeing Reserve Banks' EEO/diversity activities as part of the search process.

4. In remarks delivered on September 29, 2016, you stated that "improving diversity requires effort and constant focus" and noted that such diversity is vital to the Federal Reserve. What specific steps are you taking as Chair of the Board of Governors to overcome the historical lack of diversity among Federal Reserve Bank presidents? To what extent is your commitment to improving diversity in the Federal Reserve System shared by the Federal Reserve Banks and has been demonstrated by the Federal Reserve Banks through measurable outcomes?

I have been very clear in my public remarks that improving the representation of diverse backgrounds and viewpoints among the senior leadership of the Federal Reserve System (System), including among the presidents, is an important objective in our efforts to fully meet our responsibilities under the Federal Reserve Act. I have been equally clear that my Board colleagues and I are not satisfied by the present situation in this regard. We have indeed brought great effort and constant focus to the goal of improving diversity. We have strengthened our process over the past two years with such objectives in mind including in ways that are generally not visible outside the System, for example in providing greater resources and guidance to search committees, and in ways that are highly visible, such as strongly encouraging and working with Banks to provide greater transparency into the process, including via outreach through new channels such as social media. We continue to work with our colleagues across the System and at the Board to think even more creatively about the challenges of bringing greater diversity along many dimensions to the senior leadership of the System.

5. The Board of Governors' website states that the chair of the Board of Governors' Committee on Federal Reserve Bank Affairs meets regularly with the search committee chair throughout the search process. What is the purpose of these regular interactions throughout the search process?

As noted previously, the Chair of the Board's Committee on Federal Reserve Bank Affairs exercises a high degree of engagement throughout the search process. This engagement includes regular interactions with both the search committee, notably its chair who is drawn from among the Bank's Class C directors, and the executive search firm. The focus of this engagement is not just on the broad process, but also on the composition and evolution of the specific pool of candidates.

6. What guidance has the Board of Governors provided to the Atlanta Federal Reserve Bank's search committee to promote robust public awareness of the opportunity to express interest, recommend a candidate for consideration, or offer suggestions on other characteristics for consideration?

The Board provided to the Atlanta Federal Reserve Bank's search committee all of the formal guidance described above, which among other things sets out broad expectations regarding the open and inclusive nature of the search and the importance of identifying a broad and diverse pool of highly-qualified candidates. In addition, however, there was great enthusiasm both in Atlanta and at the Board of Governors to build on some of the innovative approaches that were utilized during the search last year for the president of the Reserve Bank of Minneapolis. These included outreach through social media to explain the nature of the president's responsibilities and the search process, and to solicit both specific nominations and more general suggestions regarding the desirable characteristics that a successful candidate should exhibit. The Atlanta search committee not only incorporated these innovations into its process, but also introduced some further enhancements, notably a webinar that provided a channel for the chair of the search committee and the representatives of the executive search firm to explain the process and answer questions from the public. In fact, the level of interest in this event was so high that the Bank subsequently prepared written answers to questions that were not addressed during the webinar due to time constraints and posted them on its web site. Details concerning the outreach undertaken by the Atlanta search committee can be seen at:
https://www.frbatlanta.org/about/atlantafed/officers/executive_office/atlanta-fed-presidential-search.aspx?d=1&s=qp

7. What assurances can you provide that candidates submitted by the public will receive due consideration by the Atlanta Federal Reserve Bank and the Board of Governors prior to the final selection of a Reserve Bank President?

I am fully confident that all input from the public, whether specific nominations or general suggestions regarding the characteristics that a successful candidate should exhibit, has been and will continue to be carefully taken into consideration by the Atlanta search committee and, ultimately, by the Board of Governors. As noted above, the Chair of the Board's Committee on Federal Reserve Bank Affairs has been closely involved in the search process from the announcement of President Lockhart's retirement. Our commitment to the objectives of a

System leadership that fully reflects the diversity of the United States and the Sixth District, the region that is the direct responsibility of the Federal Reserve Bank of Atlanta, is absolute and unbending.

SEARCH FIRMS USED FOR FRB PRESIDENT AND FIRST VICE PRESIDENT CANDIDATES

The following search firms have been used in recruiting president and first vice president candidates for the Reserve Banks.

Search Firm

Bridge Partners

Spencer Stuart

EFL Associates

Heidrick & Struggles

Korn Ferry

**KEY DIMENSIONS OF
THE FEDERAL RESERVE BANK PRESIDENT POSITION**

The position of the Federal Reserve Bank President reflects the unique nature of the Federal Reserve System itself, which by its very design, has assigned the Reserve Banks a range of very significant responsibilities and incorporates both public and private sector characteristics. A Fed President's responsibilities fall into three broad areas. The first is that of a public policymaker. The second is acting as Chief Executive Officer (CEO) of his/her organization. The third involves contributing to System leadership. All of these distinct roles include an important and sensitive requirement for communicating with the Federal Reserve's various constituents.

While there is a common core of key dimensions associated with a President's job, expectations of an individual Bank President may vary significantly from Bank to Bank, reflecting differences in the background and expertise of an incumbent President, the scale and scope of a particular Bank's work, special responsibilities assigned to a Reserve Bank or its President, and priorities established by the Bank's Board of Directors. The following paragraphs elaborate on key dimensions of a Fed President's primary responsibilities:

Policymaker

Monetary Policy

A Federal Reserve Bank President participates with the other 11 Reserve Bank Presidents and the 7 members of the Board of Governors in the process of debating and deciding U.S. monetary policy. The work of a President in Monetary policymaking includes:

Economic Research. Guides the focus of Bank-level economic research, often in collaboration with other researchers inside and outside the Fed, to inform the policy debate and the general understanding of important economic issues.

Regional Economic Intelligence. Gathers insightful, anecdotal economic intelligence through interactions with the District Board(s) of Directors and other business and community contacts. Provides strong support to the Board of Directors in developing the Directors' discount rate recommendations.

Policy Debate and Decision-making. Participates in FOMC policy debates, bringing both regional insights and independent views on national and international economic issues.

Policy Communication. Is actively involved in the process of informing the Fed's various constituents about monetary policy issues and actions.

Policy Advisor

Supervisory Policy

Pursuant to Section 11(k) of the Federal Reserve Act, the Board of Governors has exclusive authority to establish policies for the supervision and regulation of depository institution holding companies and other financial firms subject to its supervision. A President's involvement in the supervision of financial institutions will vary by the types and sizes of the institutions located in the President's District and their financial condition. The President is responsible for ensuring that the Bank's supervisory staff carries out their responsibilities as set forth by the Board of Governors. The President plays an important contact role, especially in times of financial problems. While bank supervision and regulatory decisions are made by the Board of Governors, the President may provide valuable input into the regulatory process through participation on joint Bank/Board committees and providing comments on regulatory proposals.

Payments Policy and Related Matters

Depending on the role of a President's Reserve Bank in payments operations and/or a President's System committee responsibilities, Presidents may contribute to setting the strategic direction for the Federal Reserve System payments services and efforts to influence national payments system evolution. In this regard, Presidents' contributions may be informed through their association with financial institutions in their Districts. During times of crisis, Presidents may play a more direct and visible leadership role in System payments issues.

Chief Executive Officer

A Federal Reserve Bank President serves as CEO of his/her bank, an organization with complex, challenging, and sensitive responsibilities. That work includes:

Strategic Vision and Leadership. In consultation with other senior officers at the Bank and with the Board of Directors, develops a broad vision for the organization subject to the statutory authority prescribed for the Reserve Banks. Communicates the corporate vision throughout the organization and develops effective strategies and goals to accomplish the vision. Models the integrity, intellect, character, executive disposition, personal leadership, and communication skills required of an effective top executive.

Business Performance and Stewardship. Fosters a culture of strong business performance and achieves strategic financial and operational goals. Provides good stewardship of public resources and is accountable for budget and financial performance for the Bank, including the oversight of System payments operations in their Districts, Discount Window lending, and shared financial goals of the System.

Risk Identification and Mitigation. Creates and participates actively in a process for identifying strategic risks facing the organization and leads the development of strategies and initiatives to mitigate those risks.

Director relations. Assists in the ongoing process of identifying and recruiting strong and diverse potential Directors for election by shareholder banks and appointment by the Board of Governors. Advises and consults with the Bank's Board of Directors regarding issues of strategic direction and policy and keeps the Board informed regarding ongoing operations and progress on business goals and objectives. Ensures that individual Directors are well prepared and supported to fully contribute to Board discussions.

Development of Leadership Talent and Teamwork. Identifies, recruits, and develops a strong and diverse cadre of leaders for the organization. Builds teamwork across functional areas and with other colleagues throughout the Fed System. Fosters a culture of openness, and provides an environment for personal growth and advancement. Develops senior management succession plans.

Community and Civic Involvement. Represents the Reserve Bank and the Federal Reserve System to the community within the Federal Reserve District. Educates community leaders and the public about the Fed's roles and responsibilities. Promotes the Federal Reserve as an involved and supportive organization within the cities where the Bank has a presence. Builds good will and respect for the Federal Reserve among the Bank's constituencies.

System Leadership

While each Reserve Bank operates as a distinct legal entity, the success of a Reserve Bank and the overall Federal Reserve System depends upon the effective collaboration and cooperation among the Reserve Banks. That intellectual and operational partnership among Reserve Banks has several dimensions:

Personal System Contributions. Contributes to the Conference of Presidents' debate and decision-making on issues that transcend individual Reserve Bank authority, recognizing the duty to ensure that decisions on such matters need to reflect the broad interests and strategies of the Federal Reserve System. Leads or contributes to individual System committees, projects, or other efforts to ensure that the best ideas and thinking from across the System are identified. Follows through in leadership assignments to build consensus, get decisions, implement decisions, and assess results.

Support for Coordinated System Direction. Ensures that the local Reserve Bank supports coordinated System objectives by contributing strong performance and quality on its local System responsibilities and by fulfilling its performance agreement obligations to the other Reserve Banks.

Staff Contributions. Identifies staff from his/her Reserve Bank with the experience, interest, and ability to take roles in System subcommittees, task forces, and project work. Makes such staff available and provides appropriate support for such System assignments.

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