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

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTEENTH CONGRESS

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

Wednesday, November 4, 2015

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

The committee met, pursuant to notice, at 10:01 a.m., in room 2128, Rayburn House Office Building, Hon. Jeb Hensarling [chairman of the committee] presiding.

Members present: Representatives Hensarling, Lucas, Garrett, Neugebauer, Pearce, Posey, Luetkemeyer, Huizenga, Duffy, Hurt, Stivers, Stutzman, Mulvaney, Hultgren, Ross, Pittenger, Wagner, Barr, Rothfus, Messer, Schweikert, Guinta, Tipton, Williams, Poliquin, Love, Hill, Emmer; Waters, Maloney, Velazquez, Sherman, Capuano, Hinojosa, Clay, Lynch, Scott, Green, Cleaver, Ellison, Himes, Carney, Sewell, Foster, Kildee, Murphy, Sinema, 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.

The Dodd-Frank Act requires the Federal Reserve's Vice Chair of Supervision to testify before our committee twice a year regarding the Fed's supervision and regulation of financial institutions. Regrettably, 5 years after the passage of Dodd-Frank, no such person exists. President Obama has been either unwilling or unable to follow the law and appoint a Vice Chair. We can no longer wait for the President to do his job so that we can be allowed to do ours. Thus, Chair Yellen appears before us today in substitution.

As we know, Dodd-Frank rewarded the Federal Reserve with vast, new, sweeping regulatory powers despite its contributions to the last financial crisis. Under Dodd-Frank, the Fed can now functionally control virtually every major corner of the financial services sector of our economy, separate and apart from its traditional monetary policy authority.

Disturbingly, the Fed does so as part of a shadow regulatory system that is neither transparent nor accountable to the American

people. Simply put, the Fed must not be allowed to shield its vast regulatory activities from the American people and congressional oversight by improperly cloaking them behind its traditional monetary policy independence. This is a vitally important point.

What is clear is that despite the largest monetary stimulus in our Nation's history and 7 years of near-zero real interest rates, middle-income families aren't getting ahead, and the poor and working class are falling further behind. Preliminary third-quarter GDP growth is coming in at an anemic 1.5 percent.

Our economy, for 7 years, has limped along at about half of the post-war average. That means every man, woman, and child is thousands of dollars poorer than they should be, and millions could be fully employed who are not. Trillions of dollars in capital that could fuel robust economic growth instead remains sidelined due to a regulatory tsunami, much of it dictated by Dodd-Frank and promulgated by the Federal Reserve.

Thus, serious questions must be asked. Why isn't the Fed subject to statutory cost-benefit analysis? Why has the Fed yet to find any connection between its Volcker Rule or any other rule in the precipitous drop in bond market liquidity? Why does the Fed's stress test resemble, in the words of Columbia University Professor Charles Calomiris, "a Kafkaesque Kabuki drama" in which regulators punish banks for failing to meet standards that are never stated, either in advance or after the fact.

Combining the Fed's lack of transparency with its all-encompassing new regulatory authority under Dodd-Frank is a dangerous mix. It is a threat to economic growth, not to mention the principles of due process, checks and balances, and the rule of law. If we are not careful, our central bankers will soon become our central planners.

Fortunately, the House will soon have the opportunity to reform the Fed and make it more transparent with the Federal Oversight Reform and Modernization Act, offered by our colleague, Mr. Huizenga, and approved by this committee.

I now yield 5 minutes to the ranking member for an opening statement.

Ms. WATERS. Thank you, Mr. Chairman, for holding this hearing. And thanks to Federal Reserve Chair Yellen for making herself available to testify.

The 2008 financial crisis inflicted staggering damage to our economy within the months before President Obama took office, with employers shedding more than 800,000 jobs a month, unemployment topping 10 percent, home foreclosures displacing millions of families, and entire industries 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 Act entrusted significant responsibility to the Federal Reserve and directed the Fed to improve its supervisory program so that another crisis of such scope and depth would never happen again.

Recognizing that the Federal Reserve failed to apply appropriate prudential standards to large banks, Congress directed the Fed to impose enhanced requirements for capital liquidity, resolution

planning, and other factors to ensure that no large bank or group of banks could again endanger our economy.

I am eager to hear from Chair Yellen on the progress of these reforms, along with a description of 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.

Congress specifically permitted the Fed to differentiate among companies on an individual basis or by category, considering their capital structure, riskiness, complexity, financial activities, size, and other factors. The Fed should use this authority.

Likewise, Dodd-Frank provided the Fed with new responsibility to collectively regulate the activities of systemically risky non-bank entities, such as the insurance company AIG, whose near failure imposed dire systemic consequences on our economy just 7 years ago. I very much would like to hear from Chair Yellen about how the Fed has bolstered its expertise to take on these new responsibilities.

And let me also express my deep concern about legislation this committee considered during a markup this week that would severely undermine efforts by the Fed to regulate both banks and non-banks. With regard to banks, the legislation would hamstring the Fed's ability to regulate all but the largest globally active banks, ignoring how the failure of many large, interconnected regional banks could have dire consequences for our economy. Similarly, other legislation would undermine the Financial Stability Oversight Council's (FSOC's) ability to identify supervisory gaps, designate non-bank firms for enhanced prudential regulation, and ensure that the Fed is regulating them on a comprehensive, consolidated basis.

Finally, as we just have passed the 5-year anniversary of Dodd-Frank, I think it is important to remind the committee and the public of the need to be ever-vigilant of the threat of another crisis. Among our supervisors, we must guard against complacency and regulatory capture. Among our law enforcement, we must hold institutions and individuals accountable, something that former Fed Chairman Ben Bernanke, in his recent book, said that we did not adequately do.

And here in Congress, we must be mindful of attempts to defund and defame Dodd-Frank. The American economy has made substantial progress since the depths of the crisis, but that progress will be threatened if we do not protect these reforms, both in statute and in practice.

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

Chairman HENSARLING. The gentlelady yields back.

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

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

And good morning, Chair Yellen.

Today marks the first time since the passage of Dodd-Frank that someone from the Federal Reserve has testified under the authorities bestowed upon the statutorily created Vice Chair of Super-

vision. Yet today, the person testifying was not appointed or confirmed for that position.

I remain baffled that the President has failed to put forth a single name to serve in this important role. I fear it is largely because Federal Reserve Governor Dan Tarullo, who serves as Chairman of the internal Committee on Bank Supervision, can already exercise many of the authorities in a de facto capacity, free from any meaningful checks and balances.

As you know, the Federal Reserve, in addition to its monetary policy operation, regulates and supervises financial institutions. Many of them are some of the largest in the world. Over the past few years, we have seen significant rulemakings, driven in large part by the Federal Reserve, that have significantly altered the bank capital structures and artificially manipulated liquidity.

Annual stress-testing under the CCAR process, arguably the most important exercise a bank must do each year, remains completely opaque and free from any meaningful oversight. Further, the Federal Reserve plays an integral role in the forums where international banking supervision and regulation standards are advocated and implemented.

Together, these important regulatory operations of the Federal Reserve deserve much of our needed attention and oversight.

Today, I hope Chair Yellen will address some of the more intricate points of bank regulation and supervision. Specifically, I look forward to getting a better understanding of how she sees each major capital and liquidity rulemaking working together.

Additionally, I look forward to learning how the Federal Reserve analyzes the market implications of institutional regulations. We have already seen unintended consequences in the bond market, where liquidity and volatility concerns have been raised as a result of institutional regulations like the liquidity coverage ratio.

Finally, I look forward to her thoughts on how to make CCAR more transparent. She also must address how major regulation factors into and is prioritized under the CCAR stress environment.

Thank you, Mr. Chairman, and I look forward to this important hearing.

Chairman HENSARLING. Today, we welcome the testimony of the Honorable Janet Yellen. Chair Yellen has previously testified before our committee, as all of you know, so I believe she needs no further introduction.

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

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 on the Federal Reserve's regulation and supervision of financial institutions.

One of our most fundamental goals is to promote a financial system that is strong, resilient, and able to serve a healthy and grow-

ing economy. We work to ensure the safety and soundness of the firms we supervise and also to ensure that they comply with applicable consumer protection laws so that they may, even when faced with stressful financial conditions, continue serving customers, businesses, and communities.

This morning, I would like to discuss how we have transformed our regulatory and supervisory approach in the wake of the financial crisis.

Before the crisis, our primary goal was to ensure the safety and soundness of individual financial institutions. A key shortcoming of that approach was that we did not focus sufficiently on shared vulnerabilities across firms or on the systemic consequences of the distress or failure of the largest, most complex firms.

In the fall of 2008, the failure or near failure of several of these firms, many of which we did not supervise at the time, sparked a panic that engulfed the financial system and much of the economy. Today, we aim to regulate and supervise financial firms in a manner that promotes the stability of the financial system as a whole.

This has led to a comprehensive change in our oversight of large financial institutions. As my written testimony describes in more detail, we have introduced a series of requirements for the largest and most complex banking organizations that reduce the risks to the system and our economy that could result from their failure or distress. In addition, we now supervise financial institutions on a more coordinated, forward-looking basis.

At the same time, we have been careful to make more measured changes in our approach to regulating and supervising firms at the other end of the spectrum. We are committed to ensuring that the supervision of smaller institutions is tailored to the business model and activities of individual institutions.

In supervising community banks, we are refining our risk-focused approach, which 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. Given the important role that community banks play in their communities, and the economic support they provide across the country, we recognize that supervision of community banks must be balanced and measured.

The regulatory reforms we have adopted since the crisis address the risks posed by large financial institutions in two ways. First, our reforms reduce the probability that large financial institutions will fail by requiring those institutions to make themselves more resilient to stress. However, we recognize we cannot eliminate the possibility of a large institution's failure. Therefore, a second aim of our post-crisis reforms has been to limit the systemic damage that would result if a large financial institution were to fail.

Again, my written testimony provides more detail, but I wish to highlight for you two examples of how we are addressing this "too-big-to-fail" challenge.

First, to limit the systemic effect of a large institutions's failure, the Board and the Federal Deposit Insurance Corporation have adopted a resolution plan rule that requires large banking organizations to show how they could be resolved in an orderly manner under the Bankruptcy Code.

Second, the Board just last week proposed a rule setting long-term debt and total loss-absorbing capacity requirements for the very largest banks in the United States. With the new requirements, if losses were to wipe out a firm's capital and push a firm into resolution, a sufficient amount of long-term unsecured debt would provide a mechanism for absorbing losses and recapitalizing the firm without generating contagion across the financial system and damaging the economy.

In addition to strengthening the regulation of the largest, most complex financial institutions, we have also transformed our supervision of these firms. Our work is now more forward-looking and multidisciplinary, drawing on a wide range of staff expertise.

We put this new approach into operation with the creation of the Large Institution Supervision Coordinating Committee, or LISCC, which is charged with the supervision of the firms that pose elevated risk to U.S. financial stability.

The LISCC program complements traditional firm-specific supervisory work with annual horizontal programs that examine the same firms at the same time on the same set of issues in order to promote better monitoring of trends and consistency of assessments across firms.

For example, our Comprehensive Capital Analysis and Review, or CCAR, ensures that large U.S. bank holding companies, including the LISCC firms, have rigorous, forward-looking capital planning processes and have sufficient levels of capital to operate through times of stress.

I would note that capital at the eight largest U.S. banks alone has more than doubled since 2008, an increase of almost $500 billion. Our new regulatory and supervisory approaches are aimed at helping ensure these firms remain strong.

While more work remains to be done, I hope you will take away from my testimony just how much has changed. Our supervisory approach is more comprehensive and forward-looking while also tailored to fit the level of oversight to the scope of the institution and the risks it poses. The Federal Reserve is committed to remaining vigilant as a regulator and supervisor of the financial institutions that serve our economy.

Thank you. I would be pleased to respond to your questions.

[The prepared statement of Chair Yellen can be found on page 56 of the appendix.]

Chairman HENSARLING. The Chair now yields himself 5 minutes for questions.

Chair Yellen, the first couple of questions I have deal with the concern, has the Fed crossed the line from being a regulator to being a manager?

We have had a number of individuals come to our committee and tell us that Fed officials have regularly attended corporate board meetings of the systemically important financial institutions (SIFIs) under the Fed's purview. Is that true?

Mrs. YELLEN. I am not sure if that is true. It is not—

Chairman HENSARLING. So you are unaware of any Fed officials attending board meetings?

Mrs. YELLEN. It is conceivable that might have occurred. I am not saying that it did not occur. I would have to get back to you.

Chairman HENSARLING. If it did occur, what legal authority would you cite for having employees of the Fed invite themselves into corporate boardrooms?

Mrs. YELLEN. I don't know what the circumstances are in question, but I can, for example, tell you that when I was president of the San Francisco Fed, I occasionally would attend a portion of a board meeting of one of the firms that we supervised to make a presentation to the board about our supervisory findings and the emphasis on—

Chairman HENSARLING. But you are unaware of any Fed officials attending these board meetings, you have no personal knowledge of this, and this is not a policy of the Fed?

Mrs. YELLEN. I really don't have details about what officials—

Chairman HENSARLING. We would appreciate it if you could look into this, Chair Yellen, and get back to the committee on this matter.

We have also heard from individuals with respect to the stress test, about which we have had both public dialogue and private conversation. Many of us on this committee consider that to be, again, a rather opaque process, and so this committee has a number of questions.

We have also questioned employees of the financial institutions who have been on the receiving end of these stress tests, and we have been informed by numerous individuals that they have been told by the Fed not to speak to Members of Congress about the stress tests.

Do you have any knowledge of this matter?

Mrs. YELLEN. I have no knowledge of that.

Chairman HENSARLING. Okay. Is it the policy of the Federal Reserve to instruct members of banks subject to the stress tests not to speak to Members of Congress?

Mrs. YELLEN. I strongly doubt that is our policy.

Chairman HENSARLING. Okay. You are unaware of that being a policy.

Would you object to these people speaking to Members of Congress? Can you let it be known to your employees that they should not be telling private citizens not to speak to Members of Congress about the stress tests?

Mrs. YELLEN. Private citizens can interact with Members of Congress—

Chairman HENSARLING. So you are willing to direct your employees to ensure that dialogue can take place?

Mrs. YELLEN. I will certainly look into that.

Chairman HENSARLING. With respect to the stress tests—and again, I have great concerns about how opaque and nontransparent they are—I guess my first question is: We don't doubt that you have many serious employees, very smart regulatory staff who handle these matters, but we still don't know much about this. How are market participants supposed to be convinced that we have less systemic risk when they have no insight into these tests, since Members of Congress have little to no insight into these tests? How are we supposed to reaffirm market confidence?

Mrs. YELLEN. We do a great deal, in my opinion, to explain the methodologies that we employ. We have published overviews of the

methodologies that we use, and we update those every year. They include detailed information about the scenarios, the analytic framework we use, and information on the models that we employ—

Chairman HENSARLING. I guess, Chair Yellen, detail may be in the eye of the beholder, because Members of Congress still don't understand this, and in our dialogue with banking organizations, they still don't understand the tests either.

In my remaining time, I have one last question, again with respect to these tests. The stress tests really have become, in many respects, your main tool, your main supervisory tool for the large banks. But my concern is, if you have one centralized view of risk and you are imposing that view on our large banking organizations, to some extent, isn't that exactly what Basel II did in telling banks that they essentially had to reserve little to no capital against sovereign debt and mortgage-backed securities? Think Greek bonds and Fannie Mae and Freddie Mac.

How can that lower systemic risk, if we only have one centralized view of risk and it may be wrong?

Mrs. YELLEN. I guess I would dispute the idea that we have one centralized view of risk. The purpose of this exercise is to help the firms develop their own analytic capability to model the impact of various stresses on their organizations and to develop a robust capital planning process, which is what we evaluate in our CCAR exercise—

Chairman HENSARLING. Well, Chair Yellen, I wish we could conclude the same thing, but we have insufficient information about your stress tests to be able to come to the same conclusion that you make.

I am over my time. The Chair now recognizes the ranking member for 5 minutes.

Ms. WATERS. Thank you very much.

I am pleased to see you, Chair Yellen.

And, unlike the chairman, along with many of my colleagues, we have heard from regional banks about the Comprehensive Capital Analysis and Review, or CCAR, stress test, and they have complained that they are not sufficiently calibrated to the unique profile of large bank holding companies that focus on traditional banking activities. We have also heard that the new filing of living wills is cumbersome for the banks and not particularly helpful to the Fed's supervisory process.

So I have no indication that they have been told not to talk to us. They talk to us plenty. And we are listening.

At the same time, Congress is considering legislation that would do severe damage to the new standards the Fed has implemented and their ability to identify and respond to risk in the future.

So can you discuss why H.R. 1309, a bill debated by this committee yesterday which addresses this topic, would be severely damaging to the Fed's ability to respond to systemic risk on an agile and comprehensive basis?

Secondly, will the Federal Reserve commit to doing further tailoring using the existing authority provided by Section 165 of the Dodd-Frank Act specifically on the two issues I cited earlier, the CCAR stress test and living wills?

Mrs. YELLEN. Congresswoman Waters, I am very much concerned about a process that would require, as I understand H.R. 1309 would require, the Board to use a statutorily defined set of factors or make findings based on factors to decide whether or not to subject firms to higher prudential standards. I would see such a process as inhibiting our ability to take timely and necessary supervisory actions to address a firm's risk.

We do a great deal of tailoring of our supervisory approach to make sure that it is appropriate to the size, complexity, and systemic risks posed by a particular firm. We are committed to doing that. And we are looking at further ways in which we can tailor our supervisory approach. In particular, the CCAR process that we were discussing, we have some ideas about how we might tailor it, particularly to apply to smaller firms.

We have indicated that there are some constraints on our ability to tailor our supervisory approach for the smaller firms subject to the 165 requirements. In particular, the Dodd-Frank Act requires that we administer stress tests and receive resolution plans. Our experience thus far is that the safety and soundness value of those requirements for the smaller of those firms probably is not sufficient to justify the costs imposed on them. And so we would value, for the firms on the smaller end of the spectrum, being able to relieve them of those requirements.

But I do want to make clear that we do tailor our supervisory approach according to the complexity of the firm and are committed to doing that.

Ms. WATERS. I am so pleased to hear that, because what we heard constantly yesterday was that you do not. They kept talking about "one-size-fits-all" and that you are not using your tailoring authority. So thank you for explaining that to us.

And we are absolutely supportive of your being able to do that. We think it makes good sense. And perhaps what we need to do is work with your staff a little bit more to understand whatever restraints there are involved in tailoring and whatever authority that you have and flexibility that you have.

But thank you for clearing that up. That is very important. You know you have the authority. You understand that Dodd-Frank gives it to you. You use it. And you welcome any questions from this committee about how you use it and how you can't use it. So thank you very much.

Mrs. YELLEN. Thank you.

Ms. WATERS. 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 5 minutes.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

Chair Yellen, it seems like there are many different new regulations, and they are all kind of trying to drive at the same thing. And as an outsider, it is hard to see how they actually are coordinated.

For example, just in one broad area, capital, we now have TLAC, we have the GSIB surcharge, the supplemental leverage ratio, the normal Basel risk-weighted capital regime, as well as the annual stress test known as CCAR.

Can you walk me through how all of these capital rules fit together and what each are trying to address?

Mrs. YELLEN. Certainly. We do see these rules as fitting together. Most of the requirements that you just mentioned are imposed only on U.S. GSIBs, the eight largest U.S. firms. We think, given the risks that the failure of one of these firms would pose to the financial system, that it is important that they be subject to more stringent capital requirements, liquidity requirements, and ability to survive a very stressed event. And we think the various things that you mentioned coordinate with one another.

In particular, we have put in place so-called GSIB surcharges that impose additional high-quality capital standards on the eight U.S. GSIBs. And it is based on our estimate of the impact that the failure of one of those firms would have on the overall financial system.

The supplementary leverage ratio is a backup tool that works in a coordinated way—this has long been the case—with the risk-based capital charges. And so we see those as working together.

Now, the stress tests that we impose on these institutions are a very robust, forward-looking approach to assessing whether or not firms could survive a very adverse stress scenario and continue to serve the credit needs of the U.S. economy.

And so, these are coordinated approaches. The so-called TLAC requirement that you mentioned is a requirement that we think is necessary so that if one of these firms were to fail in spite of all of the resilience that we expect of it, it would be possible, as the Dodd-Frank Act requires, to resolve that firm under the Bankruptcy Code or, alternatively, under orderly liquidation.

Mr. NEUGEBAUER. So what kind of comes to mind here is, at what point does the CCAR process kind of override all of the other requirements? Literally, they could be in compliance with these other requirements, but they could fail their CCAR.

So is CCAR driving the regulatory process, or are these standards that you are putting in place driving the regulatory process?

Mrs. YELLEN. I believe they are complementary.

And I think that CCAR is a particularly valuable process because what we expect these firms to do is not simply to be able to meet some standard, a minimum capital standard, but what we want them to have in place is the internal ability to analyze the risks that face that unique organization and to have a rigorous capital planning process that that firm is using to make sure—whatever our rules may say, we want that firm to make sure that they have adequate capital to survive a severe stress.

And the stress tests and the CCAR process are looking to make sure that they have governance and risk management standards in place that are designed for that organization and for its unique risk profiles, that they are managing their risk in the way we would expect a systemic firm to be able to do.

Mr. NEUGEBAUER. But each entity is different. And so, you are imposing many of these standards on all of them, I assume, somewhat on a consistent basis, but the CCAR for one entity—that that entity may go under because of their business model is going to be differently.

Do you need all of these others if the final test—is the big test here the CCAR?

Mrs. YELLEN. We believe it is a belt-and-suspenders approach and that they work together in a coordinated fashion.

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. Chair Yellen, I will get to questions about regulation in a moment, but, first, I would like to ask one question on monetary policy.

When you testified in July, you said in response to one of my questions that one of the advantages to raising rates a little bit earlier is that, "We might have a more gradual path of rate increases."

Of course, one of the downsides to starting to raise rates while inflation is still below target is that it could end up hurting the fragile economic recovery. Fed Governor Brainard recently said that raising rates too early could end up "prematurely taking away the support that has been so critical to the economy's vitality."

So my question is, do you think the risks of raising rates in December, which will very likely be before inflation reaches the Fed's 2-percent target, outweigh the benefits?

Mrs. YELLEN. Thank you for that question.

Let me say that at this point, I see the U.S. economy as performing well. Domestic spending has been growing at a solid pace. Net exports are soft, but the Committee judged in October that some of the downside risks relating to global economic and financial developments had diminished. I see underutilization of labor resources as having diminished significantly since earlier in the year, although recently we have seen some slowdown in the pace of job gains.

Inflation is, as you mentioned, running considerably below our 2 percent objective. Nevertheless, the Committee judges that an important reason for that relates to declines in energy prices and the prices of non-energy imports, and that, as those prices stabilize, inflation will move back up to our 2 percent target.

With that sort of economic backdrop in mind, the Committee indicated in our most recent statement that we thought it could be appropriate to adjust rates at our next meeting. Now, no decision at all has been made on that. That decision will depend on the Committee's assessment of the economic outlook at that time, and that assessment will be informed by all of the data that we receive between now and then. What the Committee has been expecting is that the economy will continue to grow at a pace that is sufficient to generate further improvements in the labor market and to return inflation to our 2 percent objective over the medium term. And if the incoming information supports that expectation, our statement indicates that December would be a live possibility, but importantly, that we have made no decision about it.

You asked about the timing of such a move. The Committee does feel that moving in a timely fashion, if the data and the outlook justify such a move, is a prudent thing to do, because we will be able to raise the Federal funds rate at a more gradual and measured pace. We fully expect that the economy will evolve in such a

way that we can move at a very gradual pace. And, of course, after we begin to raise the Federal funds rate, we will be watching very carefully whether our expectations are realized.

As my colleague, Governor Brainard, noted, inflation is currently low. If we were to move, say, in December, it would be based on an expectation, which I believe is justified, that with an improving labor market and transitory factors fading, inflation will move up to 2 percent over the medium term. Of course, if we were to move, we would need to verify over time that our expectation was being realized, and if not, to just adjust policy appropriately.

I think I would also like to emphasize that I know there is a great deal of focus on the initial move. Interest rates have been at zero for a long time. Markets and the public should be thinking about the entire path of policy rates over time, and the Committee's expectation is that they will be on a very gradual path. But of course, the path will depend very much on the actual performance of the economy.

Chairman HENSARLING. The time of the gentlelady has expired.

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

Mr. GARRETT. I thank the chairman. And I thank Chair Yellen.

So we heard the other day about all the benefits that came out of Dodd-Frank and all the work that the Fed is doing overall. I want to go back and look a little bit deeper at that, both individually and cumulatively.

Back in 1994, Congress passed, and now it is the law, something called the Riegle Community Development and Regulatory Improvement Act. As you are probably aware, it applies to all Federal agencies, including the Fed, and it says that you shall consider the cost and burdens that any regulations would place on depository institutions, and for small depositories, especially, you have to look at the costs of regulations and also the benefits.

Now, we do hear about the benefits. I asked Governor Tarullo this question, have you done those individual cost-benefit economic analyses, and I didn't get a really clear answer from him whatsoever.

So very briefly, in a sentence, do you believe that the Riegle Community Development Act applies to the Fed, and then, as such, you are required to do a basic cost-benefit analysis each time you do a regulation? That is a yes or no, I guess.

Mrs. YELLEN. We follow rules of the Administrative Procedure Act and always request public comment on costs of our rules.

Mr. GARRETT. Did you do an actual cost-benefit analysis, for example, on TLAC?

Mrs. YELLEN. We did do an actual cost-benefit on TLAC.

Mr. GARRETT. Do we have a copy of that?

Mrs. YELLEN. It is described in the proposal that we issued last week. So in some cases, we have done a cost-benefit analysis. In other cases—

Mr. GARRETT. In some cases? In other cases, you do not?

Mrs. YELLEN. Very often what we are doing is putting into effect a rule that Congress has directed us to write to implement changes that in Congress' view will be beneficial.

Mr. GARRETT. Right. But you are doing the rule, and under Riegle—

Mrs. YELLEN. And the question becomes, when Congress has directed us to write a rule, that it is judged to be beneficial.

Mr. GARRETT. That is not—

Mrs. YELLEN. What is the least costly way to proceed.

Mr. GARRETT. Let me just stop you there, if I may. The Riegle Act doesn't say that you can pick and choose as to when you do a cost-benefit analysis, it says you shall—not "may" but "shall"—consider, and then it lays out those parameters. So it sounds as though you are doing it in some cases, but you are not dong it in other cases, which may explain why Governor Tarullo couldn't give me a clear answer.

Let me just move on to the broader issue then, since you are apparently not doing it in all cases. The broader issue is—and I asked this of your predecessor, Chairman Bernanke, has anyone done an analysis of all the costs and the burdens to everything cumulative of Dodd-Frank, and his answer was the famous, "no." And Treasury Secretary Lew, we asked the same question, and his answer was basically, no, but if Congress wants to do it, we can do it.

So I will throw that question out to you as well, since everyone else says that you haven't done it. Have you done a cumulative cost-benefit analysis on the regulations as they go through and the burdens? Is your answer—

Mrs. YELLEN. I think the answer for the kind of analysis that you have in mind is probably no.

Mr. GARRETT. Okay.

Mrs. YELLEN. But we are carefully monitoring what the effects of these rules are.

Mr. GARRETT. So let me ask you this. If you have not done—and I appreciate your candor on that—a cost-benefit analysis cumulatively—yesterday, Mr. Himes from Connecticut said FSOC came out with a report, and there is nothing in this report which shows that regulatory burdens are a cause of the negative effect on the economy.

I just went through the executive summary. There are about a dozen different factors that the FSOC came up with, and he is right that regulatory burdens is not listed as a factor. But now I understand exactly why, because you just told us that FSOC and the Fed never even did a cost-benefit analysis cumulatively.

If you haven't looked at it, then of course it is not going to be in your summary as one of the impacts, because you are not even studying it. So I guess this report is a little bit useless, isn't it, because if you are not going to study the problem, then you really don't know what the problem is, do you?

Mrs. YELLEN. I think it is important to take a step back here and to recognize that we lived through a devastating—

Mr. GARRETT. I will give you that.

Mrs. YELLEN. —financial crisis.

Mr. GARRETT. I will give you that.

Mrs. YELLEN. And the cost of that crisis to households, to businesses—

Mr. GARRETT. I get that, but—

Mrs. YELLEN. —the U.S. economy was enormous.

Mr. GARRETT. Is this summary of any benefit to us at all if you are not going to do the—

Mrs. YELLEN. When we have—

Mr. GARRETT. —basic analysis?

Mrs. YELLEN. We have done basic analysis. When we put in effect the capital rules and liquidity requirements—

Mr. GARRETT. You just told me that you did not—

Mrs. YELLEN. —we have looked—

Mr. GARRETT. Excuse me.

Mrs. YELLEN. —at the costs and—

Mr. GARRETT. I appreciate that, but you just told us what everyone else has told us, that you have not done an individual analysis and you have not done a cumulative analysis. If you haven't done this study, if you haven't dug into the records, then your analysis of what is affecting the economy is basically useless.

Chairman HENSARLING. The time of the gentleman has expired.

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

Mr. SHERMAN. Let me give you some advice in the other direction. There are a host of titles and provisions in Dodd-Frank and there are a host of other laws that you carry out. The fact that they come to you in a political package called Dodd-Frank or they come in some other package is of great interest to politicians.

But those are different titles. Just because a provision was in Dodd-Frank doesn't link it with another provision of Dodd-Frank or delink it from provisions of laws that were passed earlier or later. So I would hope in carrying out your responsibilities, you would look functionally, since the purpose is to give us advice on how to improve derivatives regulation, how to improve depository institution regulation, and leave it to the politicians to second-guess bills named for politicians.

We do get one benefit from the fact that the Vice Chair for Supervision has yet to take office, and that is we get to spend another day with you. This is a great personal joy to me. And from your standpoint, we get to spend another day with our chairman, who is the most prominent American named Jeb who does not use an exclamation point to spell his name. So there are some real benefits from that.

I want to focus on interest rates. You came here in July, and I spent my 5 minutes laying out reasons why you should not then increase interest rates. My most gullible friends believe that I was successful in persuading you, and hence that is the reason why interest rates have not gone up. I have some gullible friends. But I want to keep doing it.

As I argued then back in the summer, God's plan is not for things to rise in the autumn. As a matter of fact, that is why we call it "fall." Nor is it God's plan for things to rise in the winter through the snow. God's plan is that things rise in the spring, and so if you want to be good with the Almighty, you might want to delay until May.

And I know there are a bunch of things you are aware of. Many economists say we shouldn't move forward now; the managing director of the IMF has been fairly candid. We have deflationary risk. We just had a bad growth report. And you are aware of it, but you

probably won't estimate it as highly as I will, because of my occupation, but don't underestimate the ability of politicians in both Europe and the United States to screw things up.

I mentioned last time you were here the psychological advantage to retirees of nominal interest rates of 4 to 5 percent so they can live on their retirement savings without a nominal invasion of principal. That psychological benefit is not in the GDP statistics. As a matter of fact, you reduced the GDP statistics, because they are not going to psychologists and spending money, which would be part of the GDP, but it does enhance.

And then finally, as I pointed out to you, and I do want to talk to you privately about this, how FASB is coming up with this new $2 trillion change that will hurt construction, depress the economy.

The other thing is that if you act too soon and you decide, oops, we acted too soon, you put yourself in a position first where you have a zigzag policy, and you will face criticism from that by some people I know, and second, if you then want to go in the other direction, you only have a quarter point to play with. So if you hit the brake too soon and to say, oops, I have to hit the accelerator, you don't have any gas.

With that in mind, I am concerned about the effect raising interest rates now would have on the real estate recovery, and I would ask you what you would think the impact would be of raising interest rates on the housing recovery, and would we squeeze creditworthy borrowers out of the housing market and create a negative feedback loop with prices going down?

Mrs. YELLEN. You have made a large number of very good points and referred to many relevant considerations that the Committee is trying to weigh and has been taking into account.

With respect to the housing market, the level of mortgage rates is of course relevant to housing, and we are very aware that, for example, a sharp rise in mortgage rates could have a very negative effect on housing. We do, however, have a recovering economy in which employment and income are rising, and individuals are in better shape to form households. To be sure, some are moving into rental properties; the millenials seem to have a strong preference for later house purchases. But we do envision gradual recovery in the economy and the housing sector.

Let me come back to the point that I made earlier, which is the Committee anticipates a very gradual increase in interest rates. We are not envisioning that when we begin to raise rates we are going to be looking at a very steep path of interest rates that would cause the kind of harm that you are worried about for the housing sector. The whole path matters, and we expect it to be a gradual path—

Chairman HENSARLING. The time of the gentleman 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.

It is always interesting to listen to the gentleman from California. He is a very bright guy with lots of interesting correlations. But I have never heard God's plan for the seasons correlated to the

Fed's plan to raise interest rates. I enjoyed the discussion this morning, gentlemen.

Welcome, Chair Yellen. This morning I want to talk a little about a SIFI designation of insurers. I am very concerned that FSOC and the Fed have become a rubber stamp for the Financial Stability Board (FSB). It is my understanding that the FSB made the designations for global systemically important insurers without extensive analysis or information from the companies other than what was publicly available.

So my question is, is that the case? And if you did not receive information from the companies, how did you reach the conclusion that they posed a risk to the global system?

Mrs. YELLEN. Congressman, in the case of the companies that were designated, in every case there was an extremely detailed evaluation that was done, and a summary of the evaluation is publicly available, that did involve interaction with the company.

Mr. LUETKEMEYER. Excuse me. Did the analysis, though, come from the FSB or was it your own analysis?

Mrs. YELLEN. This was the analysis of the FSOC.

Mr. LUETKEMEYER. The FSOC.

Mrs. YELLEN. The FSOC and its staff prepared very detailed assessments of what the consequences would be for the U.S. financial system of the failure of one of these firms.

Mr. LUETKEMEYER. It is interesting. That is not the answer that we get from the insurance side of this, from the company side of this. Did you solicit any of this information, anything from them, or did you just take FSB's information and take that and try and analyze that?

Mrs. YELLEN. We have detailed interactions with the companies.

Mr. LUETKEMEYER. You got information from them outside of what is publicly available?

Mrs. YELLEN. Absolutely. Part of the designation process, in stage 3 of the designation process, there have been detailed interactions with the companies. They have provided information, they have had every opportunity to weigh in and to offer their views of—

Mr. LUETKEMEYER. If I can interrupt just a second here, it is kind of interesting, though, that the one individual on FSOC who has an insurance background is the one who said, no, we don't need to designate them as systemically important, yet FSOC went ahead and did it. Can you enlighten us as to why that would occur? Why did the other folks who are not experts think that they need to be designated, where the expert said, no, we don't?

Mrs. YELLEN. We have a great deal of expertise in insurance on the FSOC and among the staff who look at this. And what I can assure you of is that very detailed analysis was done, firm-specific analysis of what the consequences of a failure would be, and the firms had ample opportunity to weigh in, and they very well understand what the logic was of why they were designated.

Mr. LUETKEMEYER. With all due respect, Chair Yellen, I am not sure they had plenty of time to respond, because now they are going to court to try and resolve the situation. So I think if they could have responded to this, surely there would have been an ongoing discussion that could have minimized this and they wouldn't

be going to court. They would have agreed with your analysis or agreed with your designation. But let me—

Mrs. YELLEN. They may disagree, but they have had a detailed opportunity to weigh in. And in the case of one firm—I was only involved myself in the designation of one firm, and that firm had an opportunity to meet with the entire FSOC.

Mr. LUETKEMEYER. Okay. I recently have had the opportunity to meet with some of the international folks who designate the G-SIFIs, and it was very concerning the way they went about it. And I think to take their analysis without our own analysis is very concerning.

Mrs. YELLEN. We have absolutely not taken international analysis to substitute for our own. We have done our own analysis in FSOC.

Mr. LUETKEMEYER. I will take you at your word.

With regard to one other issue here, yesterday we passed out of this committee a bill to deal with the SIFI designation for banks. And in the bill, we have guidelines that actually you use, the Fed uses in their own analysis, just recently, in the BB&T and Susquehanna merger. And I was kind of concerned at the way that the questioning went and the discussion went with the ranking member with regards to the guidelines that are provided in our bill as being the only ones that are considered. I am sure that you take those into consideration as well as other ones whenever you make that sort of decision. Do you not?

Mrs. YELLEN. We try to tailor a supervisory program that we think is appropriate given our full understanding of the risk—

Mr. LUETKEMEYER. The ones that I detail in my bill are significant ones that you believe that need to be used to provide the guidelines to make the designation.

Mrs. YELLEN. We look at those factors, but we tailor an entire program that is specific—

Mr. LUETKEMEYER. In your previous testimony before this committee, you have agreed that those are important criteria and you supported the bill. So I thank you for that.

Chairman HENSARLING. The time of the gentleman has expired.

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

Mr. CAPUANO. Thank you, Mr. Chairman.

Mr. Chairman, for the record, I want to clarify that some of us do use an exclamation point after your name. And as a matter of fact, some of us use hash tags, star marks, and a few other things are in there too. So I just want to be clear. Some may not, but some do.

Chairman HENSARLING. As long as you spell it right.

Mr. CAPUANO. Madam Chair, first of all, thank you for being here again. And as always, it is a pleasure to see you.

I have a few questions, and we are going to start on one that kind of has been a bit concerning to me, and I think for the most part most of us have been pretty quiet about it, and that the requirements of Section 956(b) of the Dodd-Frank Act that requires the Fed and others to take action relative to executive pay at banks.

And I want to be clear. I for one do not care how much anyone in this country makes. The "how much" is not my concern. The "how" is a concern. It is a concern in law, because of the incentives that may be involved. Some of us think that those incentives had a lot to do with the 2008 problem. And yet the law says 90 days. Fine, okay, 90 days, 180 days, 360 days. It is now 2015, 7 years—7 years—and we do not have a regulation on this issue. And I am just wondering, could you tell me when you think we might have one?

Mrs. YELLEN. If I might start by saying that from a supervisory perspective, many years ago we put into effect guidelines pertaining to incentive compensation, and our supervision is very attentive to aspects of incentive compensation that could lead to excessive risk-taking. It is not focused on the total overall level of pay, but on the potential adverse incentives that could be embodied in that pay.

Mr. CAPUANO. But that is not the regulation that is called for by law.

Mrs. YELLEN. It has been very challenging. There are many agencies involved in trying to come up with this compensation—

Mr. CAPUANO. So what is the holdup? How do we help? Who do I have to kick to get this done?

Mrs. YELLEN. I can't give you a good answer to that question.

Mr. CAPUANO. Have you done your job?

Mrs. YELLEN. As I said, we have been working with the institutions now for many years to ensure—

Mr. CAPUANO. Yes, I know, and the law says 90 days. At some point, regulators have to regulate. I am not complaining that it is 91 days; I am complaining that it is 365 days. And if it is not you, tell me who it is. If it is my friends at the SEC, first of all, I wouldn't be shocked, and second of all, maybe that is a pretty fair thing.

Have you done what you need to do to get this regulation, required by law, simply to allow us to know the incentives that are involved and to prohibit inappropriate incentives that did help lead to the 2008 debacle? Have you done your job?

Mrs. YELLEN. We have tried to work constructively with the other agencies and we have—

Mr. CAPUANO. I love when Fed Chairs never give answers.

Mrs. YELLEN. We have done—

Mr. CAPUANO. I think the Fed has done a pretty good job. I am not complaining about the Fed. But this one is long overdue, and each and every regulator that comes before me, I am going to start asking. Again, I am not suggesting you do a specific item. I don't care how much they make. I care that the incentives are appropriately placed so that the American taxpayer doesn't get put on the hook again on an item that we have already identified as a problem, that everybody agrees was a problem, and that should be relatively easy to fix.

Mrs. YELLEN. I agree with your assessment that it is an important problem, that it is essential to address it. And as I said, in our supervision we have addressed it and we do feel we have seen very meaningful changes.

Mr. CAPUANO. And I trust you do that, but I want the regulation that was required by law.

Mrs. YELLEN. I understand that.

Mr. CAPUANO. That is what I want. I want the regulation done so that the American people will feel comfortable.

Two other items, since my time is running out. One, I want to talk just basically, I am not pushing yet, but I am looking forward to the results of the current—the next iteration of living wills. Back a few years ago when we had them, they were all called—all of them were called not credible. And the living will provision in Dodd-Frank, as you know, was pretty important to many of us. We think it is a way to avoid too-big-to-fail. We think it is a way to allow these institutions to say, hey, we are this big, but don't worry, we can take care of ourselves, we don't need any more help. And when they are all called not credible, that is a problem.

I know that you are in the process now. Do you have any idea what the timeframe might be when you are into the second chance?

Mrs. YELLEN. Last year the Board, working jointly with the FDIC, sent very detailed evaluations of the living wills to the firms and directed the firms to take action to improve their resolvability that were quite specific, are quite specific.

Mr. CAPUANO. Timeframe?

Mrs. YELLEN. We have received those plans. We are evaluating them jointly with the FDIC.

Mr. CAPUANO. Thank you.

Mrs. YELLEN. And we will be making decisions in the coming months—

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.

I am happy, Chair Yellen, to rescue you from the hostile questioning of my Democrat friend over there. Don't take it personally. He is like that with everybody.

But I do actually want to kind of follow on on something that he had, which is a point of interest and frustration for a number of us, having to do with the speed or lack thereof where there have been some very specific things that were laid out for the Fed to do, and specifically I want to talk about Section 13(3). Dodd-Frank required the Fed to adopt regulations "as soon as practicable," and that was 5 years ago. There have not been final rules implemented to what Federal Reserve restrictions and guidelines you, yourself, were going to put as far as far as utilizing 13(3). And so I am very concerned that it has taken that long.

When is the Fed is going to issue those final rules?

Mrs. YELLEN. We expect to issue the final rule by the end of this month.

Mr. HUIZENGA. By the end of this month.

I will point out to my friend from Massachusetts, just talk nicely and she will give you a great answer.

My next follow-up question on that is, will the rules address the concerns that Senator Warren, Chairman Hensarling, and others

have put forward regarding whether your earlier proposal leaves the door open to future Wall Street bailouts?

Mrs. YELLEN. Let me just say that we regard our emergency lending powers as very crucial powers. It is very important if, God forbid, there should be a future financial crisis. We hope that won't occur. But if there is, that is why the Federal Reserve was created, to provide liquidity when there is a financial panic and lenders are worried about the state of financial institutions and markets generally, those powers we used during the crisis to keep credit flowing to the economy.

Mr. HUIZENGA. Sure.

Mrs. YELLEN. So we want to be very careful about what we do.

Mr. HUIZENGA. Sure. And the words used for that are "unusual and exigent circumstances," correct?

Mrs. YELLEN. Correct.

Mr. HUIZENGA. Okay.

Mrs. YELLEN. That is right.

Mr. HUIZENGA. In my format, we take that and we say—we add upon it, raise the bar marginally, I would argue, and we use the language, "Unusual and exigent circumstances exist that pose a threat to the financial stability of the United States."

You have come out, and some of the other Fed Governors have come out, opposed to that language. Why?

Mrs. YELLEN. I am not sure that we have been opposed to it. That is when we would use those powers, when there are unusual and exigent—

Mr. HUIZENGA. I understand—

Mrs. YELLEN. —it is understood to mean pose a risk to the financial system.

Mr. HUIZENGA. We have kind of added two things as a belt and suspenders, that it is a phrase you used earlier. One was to include the language, "that pose a threat to the financial stability of the United States." And certainly informally, that is the pushback we have gotten. I have met with some of the other Fed Governors, and they have pushed back saying we should not address 13(3).

The other one that we have is, in my bill, Section 11, we also mandate, in addition to the current requirement of 5 of the 7 Fed Board Governors to approve a 13(3) usage, that 9 of the 12 district Federal bank presidents must also approve. Any concern with the belt-and-suspenders approach that way?

Mrs. YELLEN. I think the approach that we have currently that is in Dodd-Frank is quite adequate.

Mr. HUIZENGA. So you do have a concern with adding the district Fed Bank presidents?

Mrs. YELLEN. I might have some concern with that.

Mr. HUIZENGA. What concern?

Mrs. YELLEN. This has always been a Board power to decide when to authorize particular Reserve Banks to engage in programs through the discount window, emergency lending programs through the discount window.

Mr. HUIZENGA. But you understand there is a bipartisan concern and bicameral concern about how that has been used in the past, and that there is too big of a door open yet for these massive Wall Street bailouts to happen, and that what we are trying to address

is, in addition to adequate collateral and solvent borrower definitions, we are trying to make sure that there is not just a check and there is just not a rush to find a solution here, but that we also have the Fed Bank presidents in there.

Mrs. YELLEN. Dodd-Frank clearly restricts the way in which this power can be used. And the rule that we finalize will address concerns about the definition of broad-based eligibility, insolvent borrowers, and penalty rates.

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.

And welcome, Madam Chair Yellen. Thank you for your appearance here today. Please accept my sincere gratitude for your steadfast leadership at the Federal Reserve.

The Dodd-Frank Act reforms paved the way for solid and steady economic growth by restoring confidence in our markets. It is one of the pillars of reform supporting the creating of 13 million private sector jobs for 67 consecutive months, extending the longest running growth streak in our history, and reducing the unemployment rate to 5.1 percent, the lowest since 2008.

My first question is as follows. You indicated in your testimony that the Fed has tailored its regulatory and supervisory requirements for regional and community banks. However, I continue to hear from banks of all sizes in Texas and in my congressional district that they are burdened by the regulation and the costly stress tests required. In fact, one regional bank, Amegy Bank of Texas, okay, one of the facilities that is in Houston, spent $20 million in its stress tests alone.

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. Congressman, my understanding is that stress tests are required of banks that are $10 billion and above, and the requirements for the smaller banking organizations are very different than those for the larger, above $50 billion organizations, that they are only required to do company-run stress tests. For the smallest organizations, there is no such requirement.

Now, I did say earlier that we don't have as much ability with respect to stress tests to tailor as I think would be ideal. There are smaller banking organizations where we do see costs of having to participate in the stress tests and benefits that are probably not commensurate. So that is an area that we are focused on where we are tailoring as best we can, but some legislative change to reduce the burden on the smaller institutions subject to it could be useful.

Mr. HINOJOSA. My next question: Last week the Fed finalized its Total Loss Absorbing Capacity Rule for the largest eight banks. Yesterday, I read in Bloomberg where they reported that Standard & Poor's, as well as the other credit rating agencies, may cut the rating of these banks based on the prospect that the United States Government is less likely to provide aid in the case of a financial crisis.

Can you elaborate for us how TLAC works and how it makes it less likely that a government bailout will be needed in case of a future failure of one of these very large banks?

Mrs. YELLEN. Thank you for that question. It is an important regulation that is intended precisely as you say, to mitigate too-big-to-fail. And to the extent that the ratings agencies recognize that, that a firm is more likely to be able to—allowed to fail, and they reduce—

Mr. HINOJOSA. It is my understanding that here in Congress there is no willingness to repeat what we did back in 2008 to save the banking system. So let me go to the next question.

Yesterday, we debated replacing the $50 billion threshold from mandated enhanced prudential standards with a Financial Stability Oversight Council designation process. What is your opinion on what the SIFI threshold should be?

Mrs. YELLEN. We would not like to see an FSOC process that tells us exactly how to tailor our supervision to firms of different sizes. We already have an elaborate program in which we do tailor the requirements within the confines of law to match the footprint and complexity of the firms, and there are only a few areas where we have concerns that we may be limited in our ability to do that.

Stress tests and resolution planning are two areas where I would say the smaller of the firms above that $50 billion threshold, we would like to be able to reduce the burden on them, but generally we have been able to tailor a different threshold.

Mr. HINOJOSA. Thank you for answering my questions.

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. Thank you, Mr. Chairman.

And good morning, Mrs. Yellen.

When you were here in October, we had an exchange about a lawful subpoena that we made to the Fed. You were unwilling to comply with that subpoena. However, 2 weeks ago you did comply with that lawful House subpoena, and we are grateful for your cooperation with the Oversight Subcommittee.

In your cover letter, when you provided those documents, you stated that, "As Chair, I have implemented the practice of immediately referring to the Inspector General all suspected material security breaches involving FOMC information." Why is that your personal practice and why isn't that the policy of the Fed?

Mrs. YELLEN. The policy of the Fed that was adopted back in 2011, I believe, stated that if the Chair was alerted to a breach, that the procedure would involve asking the FOMC's General Counsel and Secretary to review the matter and to decide whether or not it should be referred to the Inspector General.

Mr. DUFFY. No, no, I am aware of that, but every January don't you meet in regard to the leak policy on the program for security of FOMC information? And you set the policy every year. And since you have been Chair, you haven't made that the new policy, you have only made that your personal practice. You could this January change that rule and make it policy, not practice, right?

Mrs. YELLEN. If it seems appropriate to look at it, it is something that we could do.

Mr. DUFFY. So let's go—

Mrs. YELLEN. My understanding of that, of the existing policy, I am simply trying to say my understanding of the existing policy is that if there is a material breach, it should be referred to the Inspector General. And I have done that, that has been my practice, and I think that ought to be the understanding.

Mr. DUFFY. And you can change the policy, I think, this coming January. And I think with all that has happened, you should actually change it from personal practice to policy. But it brings me to a question about the policy. The way it currently is written, if there is a leak, you will have the FOMC Secretary and the General Counsel perform a review and then make a request potentially to the Inspector General.

But it is fair to say that the General Counsel, who would make the recommendation for referral, also is privy to sensitive information, which would mean that there could be a conflict of interest, that the General Counsel could actually be the leaker and he is also or she is also the one who is responsible for referring the matter to the IG.

Do you see the conflict there? And I think that this is ripe for some internal policy review at the Fed. I would encourage you to take that under consideration.

Mrs. YELLEN. Let me simply say that I think maintaining the confidentiality of sensitive information is to me a very high priority.

Mr. DUFFY. I know, but that is not my point. I think that you can see that there is an issue here on how the policy works internally and I think you could work on changing it. I only have a couple of minutes left.

The Wall Street Journal recently reported that the White House and Treasury were made aware of the 2012 leak. Is that true, before Congress was made aware in December of 2014?

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

Mr. DUFFY. But you are aware that they were doing a background check on Mr. Carpenter for a potential nomination from the Fed to Treasury, correct? You are aware of that process? You are not aware of that?

Mrs. YELLEN. I am—I know that he was—has been nominated to be assistant Secretary.

Mr. DUFFY. And as part of a background review, are you telling me that they did not reach out to the Fed and ask about his access to this information that was involved in the leak and you did not provide that to the White House?

Mrs. YELLEN. I don't have direct knowledge of that.

Mr. DUFFY. Do you have any indirect knowledge of that?

Mrs. YELLEN. That is a particular matter pertaining to an employee.

Mr. DUFFY. No, no, no, no.

Mrs. YELLEN. It has to do with the Treasury—

Mr. DUFFY. Listen, come on.

Mrs. YELLEN. —and I would—

Mr. DUFFY. Madam Chair, here is my concern: That we find out in Congress, who have the oversight over the Fed, and we find out in December of 2014. However, before the nomination, the White

House has this information about the leak. The White House and Treasury, that don't have any oversight over the Fed, are made privy to not just the internal investigation at the Fed, but also they received the IG investigation. And so it brings—

Mrs. YELLEN. I am not aware that that is correct. I think it would be maybe standard practice for an agency that is considering a nomination to do a background check, and that might involve asking—

Mr. DUFFY. For compliance.

Mrs. YELLEN. —asking the previous employer as part of the government about an individual.

Mr. DUFFY. I would agree with that. And also it is common practice for the Oversight Subcommittee to send subpoenas that are lawful to the agencies in which they oversee and that that agency actually comply with those subpoenas in a timely manner.

Mrs. YELLEN. I have done my best to do that—

Mr. DUFFY. Thank you.

Mrs. YELLEN. —and I believe we have now fully complied.

Mr. DUFFY. You have. Thank you.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Missouri, Mr. Clay, ranking member of our Financial Institutions Subcommittee.

Mr. CLAY. Thank you, Mr. Chairman.

And thank you, Chair Yellen, for your return visit.

H.R. 1309 would remove the Fed's ability to make safety and soundness decisions and place them with the FSOC. What impact would this dilution of your authority have on your ability to work with international regulators?

Mrs. YELLEN. It is important to the Fed to be able to put in place the supervision program that we regard as appropriate for a particular institution, and we would not like to see FSOC involved in determining exactly what that appropriate program would be once a firm is under our supervision. There is no real relationship. I am not sure when you say international negotiations, I am not sure what is involved there. Is there something—

Mr. CLAY. Let me elaborate for you. Under H.R. 1309, designation of banks for enhanced prudential standards can only be undertaken if the FSOC follows standards developed by the international Basel Committee made up of banking regulators from over two dozen countries.

Mrs. YELLEN. I see.

Mr. CLAY. Do you know of any major nation that defers their domestic bank safety and soundness regulations to a board of international regulators?

Mrs. YELLEN. No, I do not. That is a very useful committee. We participate actively. We want to make sure that other countries put in place tough safety and soundness regulations that will be good for our firms and for financial stability. But nothing is law in the United States or is adopted as a regulation unless we deem it to be appropriate for our firms, and I believe all countries behave in the same manner. These international bodies are coordinating bodies where consultation takes place, but that doesn't substitute for domestic rule-writing efforts here in the United States.

Mr. CLAY. Sure. And that would be a highly unusual arrangement.

Mrs. YELLEN. It would be extremely unusual.

Mr. CLAY. Let's shift, Chair Yellen, to insurance capital standards. Now that the Insurance Capital Standards Clarification Act, which gives the Federal Reserve flexibility in implementing capital standards for insurance companies subject to enhanced supervisor, has been signed into law, can you please provide an update on the Federal Reserve's implementation?

Mrs. YELLEN. We appreciated the flexibility that law provides to us to design an appropriate capital regime for insurance-centric companies that we supervise. We are taking our time to really understand the business models of these firms so that we can tailor the regulations in a way that is genuinely appropriate to their business models.

We are working on that. In the process, we are closely consulting with the National Association of Insurance Commissioners, with the Federal Insurance Office, with representatives of the industry and the firms. Again, to be clear, we really understand their business models. We want to get this right and we want to take the time we need to understand what will be appropriate.

Mr. CLAY. Right. And it sounds to me as though you are on the path to getting it correct.

Mrs. YELLEN. We are definitely on the path to implementing that.

Mr. CLAY. This week, the Federal Reserve Bank of New York is for the second year in a row hosting a conference to promote the importance of a strong culture of compliance within the banking industry. In light of the seemingly endless series of bank violations on everything from sanctions and mortgage fraud to LIBOR manipulation, the focus on improving bank culture certainly seems appropriate. Can you discuss what the Board's role has been in the effort to improve bank culture?

Mrs. YELLEN. We have been extremely disturbed by the pattern we have seen of violations in a whole variety of areas, such as LIBOR and foreign exchange. We have imposed exceptionally large fines and in a number of cases barred individuals from continuing to work at the supervised institutions or in the industry. And we do fully expect as part of our supervision that the boards of directors of these firms will put in place rules and attend to the culture so that we do not see a continued pattern of flagrant violations.

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 thanks, Madam Chair, for being here.

Kind of as a continuation of the questions that Mr. Capuano had, do you all ever sit around as a team and assess the things that were within your control leading up to 2008 that you all were doing sort of a bad job of regulating and say, "Hey, we had internal failures here. We were sitting in the room, we were allowing this. We saw long-term capital collapse, we saw the instability." I think Chairman Greenspan actually forced the banks to come in and buy the bad assets just because he could and because of trying to save

a system. Have you all sat around and kind of had that discussion internally as a team, that we need to do better?

Mrs. YELLEN. That is a set of discussions we have had over many years and lessons-learned exercises about how did this happen and what do we need to do differently so that it doesn't happen again. And I have tried to describe in some detail in the testimony how we have changed the process of supervision, as well as more broadly our monitoring of financial stability risks in the system outside, just the portion that we regulate, in order to avoid the problems that occurred.

Mr. PEARCE. Right. And if I could then follow that with you are saying the things in the system that provide a risk. So I understand that—I am kind of getting mixed signals whether or not you have released the standards on which you evaluate firms, so I am not quite sure.

But my question is, do you really look at the systems themselves? Your comments say that, "We aim to regulate and supervise financial firms in a manner that promotes the stability of the financial system as a whole." And it is that financial system as a whole that I think provides maybe the greatest risk to the largest firms, or all of us.

So are you really discussing that? Are you discussing the fact that the BRIC nations are forming the NDB or whatever they are forming, that other nations are trying to figure out how to avoid the U.S. currency because of our actions internally? Are you having that discussion?

Mrs. YELLEN. We are bringing together a diverse group of people to consider what the significant threats are that could affect not only individual firms, but a set of firms that are large and interconnected.

Mr. PEARCE. With respect, I don't—

Mrs. YELLEN. It could involve foreign threats. For example, when there were stresses pertaining to the euro area, a focus would have been how could those—

Mr. PEARCE. Could you share with me then the parts of the discussion that deal with China selling down its debt? With them selling their treasuries, they have decreased the percentage from 74 to 54 percent, which to me indicates a very strong reaction against our policies and against our dollar. And it is maybe the biggest threat. Forget the internal stresses of corporations. Think about the fact that the ground we are standing on literally is going to get insolvent and very quickly.

So can you share with me the concerns that have been expressed internally about China selling its treasuries?

Mrs. YELLEN. China has been selling Treasuries because its currency has been under downward pressure. And in the market, there is a demand—

Mr. PEARCE. I understand that. And I only have a little bit of time. I don't mean to interrupt.

So then, let's step aside from that if that says there is no concern there. Look at the fact that we are putting out $1.1 trillion of debt and you have $300 billion being purchased, and so that leaves a gap of $800 billion. Forget the Chinese, forget everybody else. You, the Fed, are going to have to fill the gap with printed money for

the $800 billion. $800 billion out of &1.1 trillion, you all should be saying, this is really outside the scope of what the stress tests are showing us on the banks. So tell me a little bit about that conversation.

Mrs. YELLEN. Congressman, we have no intention, given the economic outlook, of expanding. We are maintaining our holdings of securities that we acquired during the period that we use—

Mr. PEARCE. Let me just wrap up.

Mrs. YELLEN. —but we have no—

Mr. PEARCE. I only have 17—

Mrs. YELLEN. —intention of adding to those holdings.

Mr. PEARCE. This morning in Barron's, they compared the situation to Zimbabwe. This morning in Barron's, they said that the Federal Reserve is making itself the lender of last resort. These are huge warning signs to us, and we are sitting here talking about some relatively small stress tests inside different banks.

I appreciate the work you are doing, but I really think we ought to be looking at it a bit deeper.

Thank you. I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

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

Mr. SCOTT. Thank you, Mr. Chairman.

Mrs. Yellen, let me ask you first about Basel capital. How is it that the Basel capital requirements do not recognize the exposure-offsetting nature of segregated customer margins that are posted from a derivatives client? And then that goes to a bank. And at the bank, they then guarantee the client's transaction with the clearinghouse. And this is particularly when just 5 years ago we here in Congress through the Dodd-Frank Act actually encouraged more derivatives clearing as a means of reducing clients' counterparty risk.

So my question is, what sort of message are we sending these clients who post margin to offset this guarantee by not recognizing it as such?

Mrs. YELLEN. Congressman, I am not sure that I can respond properly to your question. I may need to get back to you on that. We certainly have required higher margin requirements, both initial and variation, on noncleared derivatives. Is your question about capital requirements on the assets that are being held? Is that—

Mr. SCOTT. Yes. And I think it is sending a conflicting message to the public, particularly when we on one hand are encouraging more derivatives action for risk management, but yet the Basel capital requirements do not recognize the exposure-offsetting nature of the segregated customers' margins.

So my point is that we need to send a clearer message to the public as to how Basel capital is interreacting with this margin requirement of posting.

Mrs. YELLEN. The important message we want to send is we have taken key steps to make the derivatives markets and transactions safer and less a source of risk. And I promise to get back to you with details about how that interacts with Basel.

Mr. SCOTT. Yes, this is very important, Madam Chair, because, as you well know, derivatives and swaps now, as far as using for risk management, is now an $822 trillion piece of the world's economy, and we need to take a little bit better care of making sure we send out nonconflicting information.

I want to go back to another question about the designated company. And as a member of FSOC, you are responsible for determining when a designated company no longer presents a risk to our financial system. So it would be important if you could tell us in a nutshell exactly when does a designated company no longer present a risk to the financial system and therefor should be de-designated?

And in your opinion, is it not important for FSOC to communicate clearly and publicly with designated companies as to what are those specific risks that they present so that we can have transparency in the process so that designated companies and the public will know exactly what a designated company is and what those issues are?

Mrs. YELLEN. FSOC explains very clearly to the company and to the public what the basis was for designation. So it is no mystery at all to the companies what aspects of their business model caused them to be designated. The firms have that information.

Every year, FSOC reconsiders whether or not designation is appropriate, and looks at the changes that have occurred in the business of those designated firms since it last reviewed them. If there are significant changes, then a firm can be de-designated. Now—

Mr. SCOTT. I want to get to this last bit of a question, because I want to know, if we here in Congress made a move to improve the transparency and due process designated companies received in the de-designation process, what would you recommend we do?

Mrs. YELLEN. I don't really think it is necessary to do anything, because these companies have every opportunity to provide information to FSOC, to tell us that their business model has changed, to ask the Council to consider de-designation. You probably know, for example, that GE Capital has significantly changed its business model. It has decided that it is in their interest to do that. They have not come to FSOC yet, to the best of my knowledge, to ask to be de-designated, but a company like GE Capital, of course, could present information to FSOC and when they ask, there would be an active discussion of whether that is appropriate.

Mr. SCOTT. Thank you, Chair Yellen.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Virginia, Mr. Hurt.

Mr. HURT. Thank you, Mr. Chairman. I want to thank Chair Yellen for appearing before us today, and I want to thank the chairman for holding this important hearing.

Madam Chair, we have discussed before sort of the dynamic. In my rural congressional district, the rural Fifth District of Virginia, where access to capital is absolutely critical for job growth across all those Main Streets, across all that farmland that I represent, it is important to our small businesses, it is important to our farmers, and it is important to families. And I think that those of us

who live in rural areas depend disproportionately on community banks.

I appreciate your testimony up front talking about the efforts that you have made to try to tailor the rulemaking, tailor the regulation and supervision to try to accommodate the difference in size and complexity of these institutions. But I think you—I hope you would agree that despite these efforts, community banks have been disproportionately affected.

UVA Law School Professor Dean Mahoney, who testified before our committee previously, testified that Dodd-Frank in significant part is designed to enhance the regulatory reach of bank regulators. Inevitably, that will mean increasing the size, market share, and political clout of the largest banks.

I think if you looked at the trend over the last 3 decades, you see that it has been brutal for community banks. Just in the 5 years since Dodd-Frank has been enacted, we have seen a drop in the number of community banks, from 7,700 to 6,300, a whopping 20-percent loss. The rate of consolidation has doubled.

This regulatory regime and the supervision has clearly impacted our smallest institutions. I hear from institutions across our district who say, you now, all I have time to do is do paperwork. I don't have any time to serve my customers or to go out and look for new business. In one instance, I have recently talked to a bank president who said, I realized I had a problem when we were up for an examination and we had more examiners, bank examiners, in our boardroom than we had bank employees." Those are the kind of stories that we hear as we travel across the district.

So I guess my first question really deals with why you are here. We know that the Dodd-Frank Act included one provision that would create a Vice Chair for Supervision. And I guess my question is—or let me just tell you what Paul Volcker said—you know what he said—after it was included. He said, "This new post might turn out to be one of the most important things in there. It focuses the responsibility on one person." And we know this is a Senate-confirmed position.

So I guess my first question is, would you agree that effective and balanced supervision is an important part of the role of the Federal Reserve?

Mrs. YELLEN. Absolutely. It is one of our most important responsibilities. And I spend a great deal of time on it, take it very seriously. There is—

Mr. HURT. I guess my next question would be, then, if there was, in fact, a Senate-confirmed person in that spot, how would that affect your ability to focus on what your other responsibilities are in the larger picture? Wouldn't it be good—in fact, as former Fed Chair Volcker said, wouldn't it be good to have that position filled?

Mrs. YELLEN. Congress created that position, and I would welcome having it filled.

I have to say that we now have a division of labor among the Governors on the Board. We operate through a committee system. We do have a committee—

Mr. HURT. But the Senate-confirmed position remains after 5 years unfilled.

Mrs. YELLEN. Yes. Governor Tarullo heads our Bank Supervision—

Mr. HURT. But he has not been confirmed for that position by the Senate.

Mrs. YELLEN. That is correct. But I would say that he has done an outstanding job of leading our work in this area. And all of us do need, including me, to be involved with that work.

Mr. HURT. Do you believe that the fact that this important role and Congress' important role in the appointment of that, does that reflect, do you think, the President's view of whether having a balanced and effective supervision, having somebody, as Chairman Volcker said, who is dedicated to this, striking this balance, does that reflect the President's priorities?

Mrs. YELLEN. You would really have to ask the White House why they have not yet—

Mr. HURT. Considering that this is the law, Dodd-Frank is the law of the land at this point, at this time, is it appropriate for you, as Chair of the Fed, to press the President to fill this position? Is it appropriate for you to do that?

Mrs. YELLEN. As I said, I think that we are carrying out our supervisory work in a very thorough and thoughtful fashion but would welcome a nomination to the position.

Mr. HURT. Great.

Thank you, Mr. Chairman.

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.

And thank you, Madam Chair, for your appearance today.

Madam Chair, Dr. King, MLK, reminded us that life is an inescapable network of mutuality tied to a single garment of destiny; whatever impacts one directly impacts all indirectly. We found this to be eminently true with Lehman and Bear Stearns. The failure of these mega-institutions had a direct impact on us, but indirectly they impacted the global economy, which is integrated to an extent that many of us can't even imagine.

I mention this to you, Madam Chair, because it is not just a failure of a bank in the United States that we have to concern ourselves with but the failure of one of these mega-banks in a foreign country because of the indirect impact that it can have on the United States and other banking institutions around the world.

I see some value in this living will for these mega-institutions and the lesser institutions, as well, simply because, when we had the failure in 2008, we had a crisis such that banks were reluctant to lend to each other. And when banks won't lend to each other, you don't have a lot of options left.

I mention all of this to you because I am getting to the $50 billion threshold. You have indicated a willingness to see that threshold lifted, but I believe you have also indicated that you would still prefer to have the opportunity, if necessary, to revisit those that are below the $50 billion threshold so as to ascertain whether or not they may become SIFIs by virtue of their activities.

So you have mentioned lifting it. I am not going to ask you to tell me at what point you would go to, in terms of lifting. But are you saying to us that you still prefer a trigger of some dollar amount? Currently, we have the $50 billion trigger. If you lift it, do you still want a trigger in there of a dollar amount, or are you amenable to going to a means by which only the activities will determine the SIFI designation?

Mrs. YELLEN. I certainly remain amenable to having a dollar threshold. And to the extent that I have discussed the possibility of raising the threshold, I would really only support a very modest increase in the threshold.

Once we get to a slightly higher threshold, we are dealing with institutions, even when we are looking at the large regional banking organizations, that are very important suppliers of credit to the country. Collectively, even the regional organizations have probably a trillion dollars or more of lending throughout the country. And while, conceivably, the failure of one of these organizations would not bring about the downfall of the financial system, it could impact a significant portion of the country and the borrowers who depend on these institutions for access to credit.

So I think a threshold is appropriate, especially in which banks over that threshold are designated for more intense supervision, especially if we have the ability to tailor our supervision.

And the only reason that I have said I would be supportive of some modest increase in the threshold is because Dodd-Frank does impose some requirements on the smaller institutions in the area of stress-testing and resolution plans where we have limited, insufficient flexibility to remove those requirements, and we really think the costs exceed the benefits.

Mr. GREEN. Thank you.

Moving quickly to the interest rates, you have a global economy that is weak and, by some standards, continuing to weaken. How much emphasis do you have to place on the global economy when setting the interest rates within our economy, given what I said about the inescapable network of mutuality?

Mrs. YELLEN. We are mutual and interconnected. We take global performance into account. And, at the moment, what we see is a domestic economy that is pretty strong and growing at a solid pace, offset by some weakening spilling over to us from the global economy.

On balance, as we have said, we still see risks to economic growth and the labor market as balanced, but the global economy has been a drag.

Mr. GREEN. Thank you, Mr. Chairman.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Ohio, Mr. Stivers.

Mr. STIVERS. Thank you, Mr. Chairman.

Chair Yellen, thank you for being here today.

The gentleman to my left, Mr. Hurt from Virginia, already talked about the fact that the reason for this hearing is statutorily mandated around your supervisory roles. Normally, it would be the Vice Chair of Supervision here, who is supposed to be Presidentially-appointed, and Senate-confirmed. That position is still only filled by an acting person.

Governor Tarullo is acting in that capacity. When was he appointed by you into that acting position?

Mrs. YELLEN. I guess I wouldn't call it an acting position. We have a committee system in which up to three Governors oversee particular functions that we carry out. Supervision is one of those functions. There are other areas—oversight of reserve banks and so forth.

This is a longstanding practice. And the Chair of the Committee on Banking Supervision, who is Governor Tarullo—

Mr. STIVERS. So—

Mrs. YELLEN. —that individual has long been the person.

Mr. STIVERS. —how long has he been doing that?

Mrs. YELLEN. He has been doing that—

Mr. STIVERS. Three years?

Mrs. YELLEN. —I think he did that under Chairman Bernanke—

Mr. STIVERS. Okay.

Mrs. YELLEN. —since he joined the Fed. I think that was 2009, if I am not mistaken.

Mr. STIVERS. Okay. So 5 years.

And so, not having him here, even though he is acting in that role, reduces the accountability. It reduces the interaction that the person in that supervisory role should have.

So my question for you is, will you commit to allowing him to accompany you to these hearings in the future, these semiannual hearings?

Mrs. YELLEN. Governor Tarullo has testified on many occasions to our oversight committees and usually stands ready to do so. I certainly have no concerns about having him come up and answer questions. And I am—

Mr. STIVERS. I hope you will bring him—

Mrs. YELLEN. —happy to do so, as well.

Mr. STIVERS. —with you next time because he is the one making a lot of the decisions. I know you are his boss and you are engaged, but we really need him here, because these are important.

The next area I would like to quickly talk about is the impact of regulation.

So, as you know, we don't live in a static world; we live in a dynamic world. And every time we take an action, there are responses to that action. And regulation has increased the compliance costs for many financial institutions, created barriers to entry. And, actually, the result has been a consolidation of assets in the too-big-to-fail banks. It has almost been the opposite of what we, as policymakers, would have liked to have seen.

And, on the Volcker Rule, the result has been a reduction in the number of market makers, which is a market utility function that provides important liquidity during a crisis.

And I guess I would just ask you, are you trying to look at these unintended consequences? Because in both of these cases, we are actually creating problems through unintended consequences.

Mrs. YELLEN. We certainly are looking at consequences. And, in particular, in the case of market liquidity that you mentioned, that is something we are looking into very carefully. We—

Mr. STIVERS. And I have asked the OFR to do a report. I hope you guys will do a report on it.

I think there are a lot of driving forces to it. There is basic business simplification; there is the Volcker Rule; there is the coming DOL standard. There are a lot of things driving it.

But I would like you to do an important analysis of it, because liquidity is so important to anybody, whether they are a small 401(k) person or a large corporate entity, because we all enter and exit through the capital markets. If there is no liquidity, the marketplace doesn't work.

Mrs. YELLEN. I completely agree.

Mr. STIVERS. Okay.

Mrs. YELLEN. And that is why we are looking at it. We—

Mr. STIVERS. And quick—

Mrs. YELLEN. —issued a report on October 15th—

Mr. STIVERS. Yes.

Mrs. YELLEN. —episode—

Mr. STIVERS. And I have one more thing—

Mrs. YELLEN. —and individual reports on—

Mr. STIVERS. —I want to get to, so—

Mrs. YELLEN. —corporate bond markets—

Mr. STIVERS. —please keep looking at it. And I hope you will look at the Volcker Rule as potentially—another way to look at Volcker is separately capitalize those activities. It takes away the whole argument and doesn't make it as complicated.

Yesterday, your IG issued a report that showed, with regard to stress tests, there were six problems that were found in the Fed's own stress test, and, if it had been a member bank, they would have required immediate attention.

I have only seen media records on this. I look forward to reading the report on it. But, in light of these highly critical things in the report, do you plan to undertake any changes that would create more transparency and accountability in the stress-testing and CCAR process with regard to the Fed?

Mrs. YELLEN. As I understand it, the IG's findings had to do with our model validation procedures. And those are matters that we certainly will look into and attempt to strengthen.

Mr. STIVERS. And I think we should probably request a more complete review by the IG on all of that.

Thank you, Mr. Chairman. I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Missouri, Mr. Cleaver, ranking member of our Housing and Insurance Subcommittee.

Mr. CLEAVER. Thank you, Mr. Chairman, and Ranking Member Waters.

And thank you, Chair Yellen.

Chair Yellen, I think it has been a little over a year ago since Congress gave you the authority to tailor standards for insurance companies, those who would qualify for enhanced supervision. There is, as you know, a great deal of angst, there is maybe even panic on the part of many of the insurance companies over the fact that they don't know what is going on and fear of what may come.

To the degree that you can speak about this publicly, I would present you with that opportunity, because it would also help us—

or help me, as I am asked questions over and over and over again from that industry.

Mrs. YELLEN. We know that this is a very important matter. We understand that insurance companies are different from banks in important ways. In particular, the nature of their liabilities is, in many cases, quite different from that of banking organizations.

We appreciate the flexibility that we were given to tailor appropriate rules, and we are working very hard to get it right, to understand the nature of the business, to consult with the firms, with the State insurance commissioners, with our colleagues in the Federal Insurance Office. We are consulting widely and thinking very carefully about what the appropriate regime is.

When we have made a set of initial decisions, we will go out with a notice of proposed rulemaking, likely, and ask for comments. And so we will go through an open and transparent process in deciding on what the appropriate supervision is and allow for comments that we will carefully respond to.

Mr. CLEAVER. I don't want to ask you to give me a date certain, but is the process moving along?

Mrs. YELLEN. Yes. People are working very hard. And I am sorry, I can't give you a date certain, but this is something that our staff is working on very hard. It is a high priority.

Mr. CLEAVER. Kind of similarly, the Fed is a member of the International Association of Insurance Supervisors (IAIS).

We have to do something about that with the Federal Government, especially this committee, Mr. Chairman. We need to do something.

But your mission is to promote effective, global, consistent supervision of the insurance industry.

And we are, I think, at a point now where—and maybe it is because of the 2008 collapse—everybody is nervous about everything, and everybody is afraid that there is a new regulation that is going to come in to cause the world to collapse and allow the Mets to win the World Series.

But there is no need for this hysteria, is there?

Mrs. YELLEN. There is no need for hysteria at all. We are, as I said, looking very carefully at our own firms to design an appropriate regime.

And, by participating in the IAIS, we are trying to make sure that we weigh in on how other countries set up their own regimes in a manner that will be good for U.S. firms and the U.S. market. It is an attempt to influence what other countries do and, thereby, to ensure a level playing field that is in our best interest.

Mr. CLEAVER. Their angst is based on the fact that they believe we might end up accepting standards from the international community that might create problems for them here at home.

Mrs. YELLEN. Nothing that is adopted internationally has any binding force in the United States. We go through our own rulemaking process and decisionmaking. It is our internal decision.

Now, of course, given our thoughts on what is appropriate, we are using that and collaborating, doing this collaboratively with other U.S. insurance regulators. We are presenting positions in Basel attempting to influence the international decisions. But we decide here what is the appropriate regime.

Mr. CLEAVER. Thank you, Madam Chair.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Illinois, Mr. Hultgren.

Mr. HULTGREN. Thank you, Mr. Chairman.

Chair Yellen, thank you so much for being here.

I have been closely following the work of the Fed and other regulators during the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA) process. In fact, I sent a letter to you just a couple of weeks ago when a public outreach meeting was held at the Chicago Fed. I am very supportive of the EGRPRA process, and I imagine you are hearing many of the same concerns that I am hearing from banks in my district.

In addition to the report that is mandated to be provided to Congress, what tangible regulatory relief can we expect as a result from this process?

Mrs. YELLEN. We are listening very carefully to the concerns that are raised in the hearings and in the course of taking comments in this process. And I am very hopeful that there will be things that we can address and look to change that will reduce regulatory burden.

An example of the kind of thing we are hearing, for example, has to do with appraisal requirements, that many community banks think the cutoffs are too low and make lending difficult, particularly in rural areas. I am sure that is something we will take a look at.

Mr. HULTGREN. Can I—

Mrs. YELLEN. Reporting and so forth.

Mr. HULTGREN. Can I jump in on that? Your written testimony notes the banking regulators have taken steps to reform the CAR report. As you are probably aware, it has grown from 18 pages back in 1986 to 29 pages in 2003 to nearly 80 pages today.

I wondered, would you support legislation requiring the banking agencies to issue regulations allowing for a reduced reporting requirement for the first and third quarter, assuming they are highly rated, specifically if they have a CAMELS composite rating of 1 or 2?

Mrs. YELLEN. I believe that this is a matter that the FFIEC is studying carefully. And I think there is a mutual desire among the supervisors to reduce burden on smaller institutions. I would suggest that you let that process play out, and we are all trying to do what we can to reduce burden.

Mr. HULTGREN. Good. We appreciate that. And we continue to hear, especially from our small and medium-sized institutions, of feeling the weight of this and growing burden.

As you know, the supplementary leverage ratio requires a banking organization to hold a minimum amount of capital against on-balance-sheet assets and off-balance-sheet exposures regardless of the riskiness of the individual exposures. These capital requirements yield an economic cost to financial institutions and are a major driver of what assets they are able to hold.

Why is the supplementary leverage ratio applicable to funds banks deposit at the Federal Reserve despite the low risk of these funds?

Mrs. YELLEN. The supplementary leverage ratio is meant as a kind of backup ratio that works as a backup to risk-based capital standards to make sure that the minimum amounts of capital held by banks are sufficient. And it is a requirement that is based on the size of the entire balance sheet of the organization, including low-risk assets, such as accounts held at the Federal Reserve. It is reflective of the overall scale and size of a firm's balance sheet.

For many organizations, that supplementary leverage ratio is unlikely to be the binding ratio. Particularly for the larger organizations that face SIFI surcharges, the risk-based capital requirements are likely to be what is binding going forward.

Mr. HULTGREN. Chair Yellen, do you share the concern that the minimum interest rate paid by the Fed on these deposits is far below the yield some banks would need to generate in order to offset the economic cost of the capital requirements and the supplementary leverage ratio?

And, along with that, with just less than a minute left, I wonder what advice you would give to banks which, as a core function of their business model, hold large cash deposits for their institutional customer base? And, also, what advice would you give to their customers?

Mrs. YELLEN. I am not positive I really understood the question. You were asking about the level of interest that we pay on reserve balances?

Mr. HULTGREN. Right. That was the first part of it, and then I was trying to sneak in the last question of advice, again, where banks have a core function of holding large cash deposits for their institutional customer base, and yet, because there is a cost with that and it impacts, again, the ratios that they need to hold, we are hearing concern from some important institutions, Northern Trust, and others, that are feeling pressure from this.

Mrs. YELLEN. I would say with respect to interest we pay on reserves, that is our key monetary policy tool. And we set that not to cover particular costs of banks but to establish a level of interest rates that is appropriate for the economy.

Mr. HULTGREN. My time has expired.

Mrs. YELLEN. Sorry.

Mr. HULTGREN. I yield back. Thank you.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentlelady from Wisconsin, Ms. Moore, ranking member of our Monetary Policy and Trade Subcommittee.

Ms. MOORE. Madam Chair, thank you so much for appearing. It is always good to see you.

I was wondering—and I hope that you haven't been asked this question over and over and over again, but I am curious about how going through another round of living wills has informed you and other regulators on implementing the orderly liquidation facility and the cross-border liquidation of large systemic banks and, of course, non-bank SIFIs.

Mrs. YELLEN. We have learned a lot from looking at and evaluating the living wills of the firms that we have reviewed. We have recognized that cross-border issues are among the most challenging.

We have made progress in working with those firms to encourage them or even require them to adopt changes in a set of financial contracts that would, under the existing rules, make it difficult to resolve a firm by triggering early-termination rights to derivatives contracts. So one of the things that we asked the firms to do in their most recent submissions is to work on that and to change the nature of those contracts.

But, more generally, over several years of reviewing living wills, we have been able to give very detailed guidance to the firms about what the shortcomings of those living wills are and what we wanted to see in the submissions this year.

We are working closely with the FDIC to evaluate this latest round of submissions. We are prepared to ask the firms for significant changes or, if need be, to determine that a living will is not credible.

Ms. MOORE. Thank you for that, Madam Chair.

Just as kind of a followup, there have been a lot of critics of the stress tests. And I was wondering, how has this criticism informed your regulation, and has it contributed to a better focus in your oversight?

Mrs. YELLEN. It has been 5 years now that we have conducted the stress tests. We have learned things in every round and worked with the institutions to try to improve what we do and their understanding and the public understanding of these stress tests.

I really want to say that this is one of the most significant innovations in how we conduct supervision. It is a truly forward-looking and comprehensive evaluation of how firms would fare under very stressful conditions of the type that we experienced in 2008 and 2009.

The firms themselves, I think, if you were to talk to their executives, they would tell you that they have learned a lot about the risks in their organizations and how to manage those risks because they have been required to engage in such rigorous analysis. And we see some marked improvement in the capital planning processes that are going on in these firms. They are asking themselves hard questions about what capital do they need to make sure they are sufficiently resilient.

So this is a very important exercise. It is a core, key part of our supervision of the largest firms. And we are reviewing our experience to see if there are some changes we can make to make this more effective and, where possible, to reduce burden, but this is a major innovation that I believe has resulted in much sounder supervision, especially of systemic firms.

Ms. MOORE. Thank you so much.

And, Mr. Chairman, I yield back the balance of my time.

Chairman HENSARLING. The gentlelady yields back.

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

Mr. EMMER. Thank you, Mr. Chairman.

And thank you, Madam Chair, for being here this morning.

Madam Chair, I am going to go a different route. I don't think anybody has asked you about this today. Will the Federal Open Market Committee ever rule out going to negative interest rates?

Mrs. YELLEN. Rule out is something we tend not to do.

I don't, at the moment, see a need for negative interest rates. The Committee is seeing a domestic economy that has been proceeding on a steady path of improvement. Our focus has been on the possibility that it will be appropriate to begin—

Mr. EMMER. To raise.

Mrs. YELLEN. —to raise interest rates. This is something we are actively considering, although no decisions have been made.

Of course if circumstances were to change, and the economic outlook were to deteriorate in a significant way so that we thought we needed to provide more support to the economy, then potentially anything, including negative interest rates, would be on the table. But I don't expect that to happen.

Mr. EMMER. Thank you.

Mrs. YELLEN. I should say that we would have to study carefully how negative interest rates would work here in the U.S. context.

Mr. EMMER. And let me ask you, because we have seen it in other countries when they have—

Mrs. YELLEN. That is what is new, yes.

Mr. EMMER. Yes. When they have had economic difficulties—

Mrs. YELLEN. Yes.

Mr. EMMER. —we have seen other countries use negative interest rates or go to negative interest rates.

Mrs. YELLEN. Right.

Mr. EMMER. What impact, Madam Chair, would negative interest rates have on lending and economic activity? What impact do you believe it would have?

Mrs. YELLEN. Most loans would not have negative interest rates. Even if a central bank pays negative interest rates the bank deposits with the Fed.

Mr. EMMER. I understand, but what impact would it have on lending?

Mrs. YELLEN. It would be intended to spur lending and, I believe, would have some at least modest favorable effect on banks' incentives to lend. And it would be undertaken as a measure to support the economy, to encourage additional lending, and to move down the yields on interest-bearing assets to stimulate risk-taking and investment spending.

Mr. EMMER. I want to change just a little bit. I would like to talk about this proposal, if you could clarify it for me, the TLAC proposal that was discussed last week. Was that finalized last week?

Mrs. YELLEN. No. It is a notice of proposed rulemaking. It is out for comment.

Mr. EMMER. Because it has been around for a while. You have been discussing it for a while.

Mrs. YELLEN. Members of the Fed, Governor Tarullo and others, have given speeches on this. It is something that is being discussed internationally in the FSB. In fact, the United States has been contemplating this. We are working jointly with the FDIC. It is an important step in ensuring that the FDIC's single-point-of-entry strategy would be workable in a Title II resolution or in a bankruptcy resolution.

We see it as very important. It has been under discussion for quite a long time—

Mr. EMMER. If I can interrupt you, because in the short time left, I have some specific things I would like to ask you about this TLAC proposal.

In fact, some of the analysis that I have been provided regarding the draft proposal suggests that it penalizes firms for what is broadly understood to be a desirable business model: gathering deposits and making loans. In fact, some have even suggested the effect of the new rule could be interpreted as a tax on deposit funding.

Would the Federal Reserve benefit? And have you done—because I know this question has been asked before—from a quantitative impact study being conducted by the FSB prior to implementing the new TLAC proposal?

Mrs. YELLEN. So I think that is, frankly, a mischaracterization of this proposal. The purpose of this proposal is to ensure that if a firm becomes insolvent that there is sufficient—

Mr. EMMER. Would you benefit—forgive me. I have 20 seconds left. Would you benefit from a quantitative impact study being done prior to implementation?

Mrs. YELLEN. We have carefully analyzed this proposal for cost and benefit.

Mr. EMMER. Have you done a quantitative impact study?

Mrs. YELLEN. We have done the quantitative analysis, and—

Mr. EMMER. Would you share that with us?

Mrs. YELLEN. There is information contained in the proposal that we published.

Mr. EMMER. All right. The analysts say—well, it looks like my time has expired.

Mrs. YELLEN. The point is the deposits are not a liability that is capable of absorbing losses when a firm is in trouble. We have seen that in financial crises. And the point of this—

Mr. EMMER. Thank you. My time has expired.

Mrs. YELLEN. —is to make sure there are enough assets at risk.

Chairman HENSARLING. The time of the gentleman has expired.

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

Mr. CARNEY. Thank you, Mr. Chairman.

Over here, Chair Yellen. And thank you for coming in today for a hearing that you wouldn't normally do. And thank you for filling in for that vacant position and for listening and responding to all of our questions.

There has been a lot of debate here on both sides of the aisle in the committee over the last several days about regulatory relief, mainly for midsized banks and smaller community banks. You addressed it a little bit in the answer to some of your questions from my colleagues. And I would like to ask some questions about that.

Mr. Hurt talked about these banks, particularly the community banks, as being the lifeblood of our local communities in most of our districts across the country, particularly rural districts. Not so much my State, the State of Delaware. We have fairly sophisticated financial services institutions, some of the biggest, and we are not talking about regulatory relief for those firms.

But there has been a lot of debate about what is the best way to do it. And one side of the argument is, well, the FSOC and the

regulators have the flexibility under Dodd-Frank to tailor these enhanced prudential regulations for the size of the bank.

I have a list of the bank holding companies that are $10 billion and above, and so subject to that CCAR process, which is the Comprehensive Capital Analysis and Review process that we have been talking about. This is what we hear from our banks, in terms of the expense that is involved in all of that.

Governor Tarullo said the $50 billion cutoff—these are $10 billion and above—$50 billion and above is a SIFI designation, and you have even additional regulations that you are subject to if you are at $50 billion or above. Mr. Tarullo has said publicly that that number is way too low. I talked to him directly in my office, and he said something very far north of $100 billion.

We considered a bill today in committee—I did not vote for it—that would have used a different approach, wouldn't have a size cutoff but would apply an activities-based approach. What is your view of that? Is there a better way to do it?

And part of that question is, do you have the authority? I heard you say earlier that you do not have the authority to appropriately tailor the CCAR process for some of these smaller and community banks.

Mrs. YELLEN. So, by and large, we have considerable ability to tailor what we do to fit the complexity and systemic footprint of an institution.

Mr. CARNEY. What did you mean when you said, we don't have the ability to tailor for smaller banks as necessary? I don't know if that is a direct quote, but I tried to write down the words that you said.

Mrs. YELLEN. So banks $50 billion and above are, under Dodd-Frank, subject to stress-testing requirements and resolution plan requirements that, while we can tailor to some extent, we can't completely remove. And what we found is that, for some of the smaller institutions, we think—

Mr. CARNEY. My time is running out. So I—

Mrs. YELLEN. —the costs exceed the benefits. And that is why—

Mr. CARNEY. —would certainly be interested in having a conversation about what is a better way to do that and to give you the flexibility and authority to enable you to provide the appropriate tailoring that is necessary.

If you look at this list of banks, JPMorgan Chase, which is a $2.5 billion—

Mrs. YELLEN. Trillion.

Mr. CARNEY. —trillion-dollar bank—excuse me—is a lot different than the Bank of Hawaii and some of these other—Nordstrom, Inc., which I didn't even know was a bank. And I suspect that some of those that are much smaller than the top five or six don't have any systemic risk associated with them and shouldn't be, then, subject to some of these more expensive—they could do what they do, right, is lend money so that people can build businesses and buy homes and the like.

Mrs. YELLEN. We have eight banks that have been designated as U.S. GSIBs. And those eight banks are subject to a heightened set of requirements with risk-based capital surcharges, an enhanced le-

verage ratio, and TLAC requirements that the banks below that, those eight, are not subject to. So, even among the largest banks—

Mr. CARNEY. Right.

Mrs. YELLEN. —we have been able to tailor our rules.

Mr. CARNEY. I would be interested in hearing more about how we would tailor for some of the smaller banks.

My time has run out. Thank you very much for being here.

Thank you, Mr. Chairman. I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Indiana, Mr. Stutzman.

Mr. STUTZMAN. Thank you, Mr. Chairman.

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

I would like to talk a little bit about a comment that you make in your written testimony regarding the lessons of the financial crisis that we have learned. You state, "... to supervise financial firms in a manner that promotes the stability of the financial system as a whole and limit the systemic damage that would result if a large financial institution does fail."

Obviously, we always want to learn lessons from different situations that we have experienced. Prior to the collapse in 2008, the Fed was focused on financial stability, but we still see about once per generation some support of collapse. How do you believe that what the Fed is doing now prevents us from another experience like we had in 2008?

Mrs. YELLEN. As I tried to describe in my testimony, I think the focus of supervision has changed and is now far more focused on financial stability than it ever was prior to the crisis.

We are trying to diminish the risks of another financial crisis in a number of ways. Most important, I would say, is to improve the resilience of all of those systemically important firms so that they have much a greater ability to survive adverse conditions and continue to meet the credit needs of the economy.

We have much more and higher-quality capital, higher liquidity requirements. Our stress-testing procedures, which I have discussed earlier this morning, are providing a much more robust way of attempting to detect weaknesses in these organizations.

Mr. STUTZMAN. Okay. Thank you.

Mrs. YELLEN. So we are doing that.

And, also, we are working very hard to address "too-big-to- fail" by making sure that if one of these firms was faced with insolvency, we could resolve that firm in a manner that would not create systemic risk, would guard the remainder of the financial system from systemic risk.

Mr. STUTZMAN. Thank you.

So can I ask you, what portion of your time each week is typically spent on regulatory matters relative to monetary policy?

Mrs. YELLEN. A good share of my time is spent on regulatory matters. I am not sure I can tell you exactly, and it certainly varies from week to week, but a substantial share of my time is devoted to regulatory matters.

Mr. STUTZMAN. Do you have any concern that if the focus is on regulatory matters that it becomes a politicized regulatory—the

focus becomes more political, at some point, when you are focused on the regulatory side rather than the monetary side?

Mrs. YELLEN. I have never seen the focus in regulation to be politicized at all.

Mr. STUTZMAN. All right.

As far as the frequency of financial crises, would you say that any of them were successful as far as the regulations that were in place that kept us from some other greater collapse?

Mrs. YELLEN. And you are talking about earlier crises?

Mr. STUTZMAN. Correct. Prior to 2008, the Fed was focused on—

Mrs. YELLEN. We were—

Mr. STUTZMAN. Go ahead.

Mrs. YELLEN. I think the United States was very fortunate that from the Great Depression until 2008 we never suffered a major financial crisis. And I think conditions developed prior to the crisis. It was a variety of things that came together that provoked a very, very serious crisis.

Mr. STUTZMAN. Let me ask you this quickly: Why do you expect Basel III to be more successful than Basel I or Basel II?

Mrs. YELLEN. I think that we have improved capital standards by raising the quantity and quality of capital we demand particularly of the most systemic organizations. And we have designed, kind of, backup leverage requirements that also serve to enhance safety and soundness.

Mr. STUTZMAN. Thank you.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Illinois, Mr. Foster.

Mr. FOSTER. Thank you, Mr. Chairman.

And thank you, Chair Yellen.

As you may be aware, there is a shared enthusiasm on the part of both the chairman and myself for contingent capital instruments as a way of stabilizing the banking system.

I have a copy of a staff memo describing the actions taken last week, the preliminary rule. And it seems to me—I haven't completely digested this, but it seems to me that you are implementing contingent capital requirements for the U.S. subsidiaries of foreign-owned IHCs. Is that correct?

Mrs. YELLEN. What we have put in place or what we are proposing is a long-term debt requirement. I don't think I would use—I am not sure precisely how you define "contingent capital."

Mr. FOSTER. It is defined in this memo as eligible internal LTD of foreign GSIBs.

Mrs. YELLEN. Oh, this is for foreign.

Mr. FOSTER. Foreign. Right.

Mrs. YELLEN. We do have—

Mr. FOSTER. But it is my reading of this that the Federal Reserve Board will be operating the trigger for the conversion of these. Is that correct?

Mrs. YELLEN. You are talking about for the foreign banking organizations?

Mr. FOSTER. For the foreign banks, yes.

Mrs. YELLEN. We are making sure that the U.S. subsidiaries of foreign banking organizations that will be required to set up an in-

termediate holding company have enough, essentially, debt that has been issued to them by their parents that it will make it easier for—

Mr. FOSTER. I understand.

Mrs. YELLEN. —them to be resolved—

Mr. FOSTER. Right. They accomplish very similar things. But the difference—

Mrs. YELLEN. They do.

Mr. FOSTER. —that I see between CoCos and just unsecured debt is that one triggers an insolvency so that there has to be a determination by the regulator that you are not a growing concern and you are going into resolution. Am—

Mrs. YELLEN. That is correct.

Mr. FOSTER. —I right? And that is the solution that appears to have been chosen for U.S. companies, whereas you appear to have allowed or chosen the CoCo mechanism, where the Federal Reserve Board would say, you are in violation of your capital requirements, you are not insolvent, you are in violation of capital requirements, therefore triggering the conversion to equity.

And so it seems like you have—my question is, do you have in place and will the Federal Reserve Board be operating that trigger mechanism, in the case of the foreign-owned subsidiaries?

Mrs. YELLEN. Clearly, in the case of the U.S. subsidiaries, what we want is in a Title II resolution with enough loss absorbency for the FDIC to be able to recapitalize—

Mr. FOSTER. What I am fishing for is, why didn't—

Mrs. YELLEN. —holding company.

Mr. FOSTER. Right. I view the European solution, the CoCo mechanism, as superior because it warns the banks when they are in danger of being—there is a market-based signal that warns the banks when they are likely to be in violation of their capital requirements, not that they are likely to become insolvent. Do you understand?

And that I view as a major difference. I think that the political nature of that decision will be much easier and less fraught if you are talking about triggering the conversion to equity rather than just sending the firm into resolution. And so, for that reason, I think it is likely to be less politicized, and, moreover, it is much more likely to yield a going firm at this end of this.

And so I was wondering why you had decided, then, to allow for foreign subsidiaries the mechanism of CoCos and yet not include it in the capital stack of U.S. firms and what the thinking was behind that?

Mrs. YELLEN. I am not sure if I am going to be able to explain this to your satisfaction. But we think, in the case of a foreign firm, many foreign regulators, if a firm got in trouble, would want to essentially engage in a single-point-of-entry type of recapitalization. And the structure that we have proposed, I think, would make that possible. We would end up cooperating with a foreign supervisor who was trying to resolve a firm.

Now, there will be problems—

Mr. FOSTER. The CoCos don't trigger when the firm needs resolution, right? As I understand it, the CoCos trigger when the firm

violates its capital requirements but is not yet insolvent. Is that correct?

Mrs. YELLEN. If a firm were, under our supervision in the United States, to violate that requirement, we would demand, I guess, that it be refilled so that, if the firm were to be in trouble and we needed to resolve it, it wouldn't operate in the manner you suggested.

Mr. FOSTER. All right. So it sounds like you have in place the trigger. When I have brought this up before, the response that I have gotten was, "Well, the trigger is really too complicated for us to set up," whereas, in fact, it seems like you plan to set up such a trigger.

Anyway, would it be possible to get me a briefing on this whole—

Mrs. YELLEN. Yes, certainly. We would be glad to do it.

Chairman HENSARLING. The time of the gentleman has expired.

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

Mr. MULVANEY. Thank you, Mr. Chairman.

Madam Chair, I know it is a relatively minor issue in the greater scheme of things, but since this is an oversight hearing more than it is a monetary policy hearing, I want to go back to Congressman Duffy from Wisconsin's line of questioning regarding the 2012 leak, generally, your policies on those sorts of things when we are dealing with what we call information security rules.

Mr. Duffy asked you a question; I don't know if we are able to get to the bottom of it. You said in your cover letter to him of about 2 weeks ago producing the documents, you wrote the following: "As Chair, I have implemented the practice of immediately referring to the Inspector General all suspected material security breaches involving FOMC information."

I believe that is from your letter. If it is not, please let me know, but I think that is a fairly accurate representation.

And his question was, why—and my question still is—you say you have implemented the practice. Why hasn't that become part of the formal policy of the Fed since you have been the Chair? Because a policy is different. A formal policy is very different from that, as a matter of fact. So help me reconcile your practice and the formal Fed policy.

Mrs. YELLEN. The formal Fed policy says that, in the case of a purported information security breach, there should be a review by the FOMC Secretary—

Mr. MULVANEY. Correct.

Mrs. YELLEN. —and General Counsel to determine what the next steps should be, including whether it should be referred to the Inspector General.

Now, my understanding of that policy, the way I understand that, is that if there is a material breach, it is appropriate to refer it to the Inspector General, and I have done so. If these rules need clarification, that is how the FOMC Chair is tasked with handling these investigations, and that is my understanding of the rules—

Mr. MULVANEY. Right.

Mrs. YELLEN. —and how I intend to proceed.

Mr. MULVANEY. Let me see if I can cut to the chase on this. I think what you are saying is that you believe that your practice is entirely consistent with the policy and that what your letter really

said was, after—without saying this—after the General Counsel did their investigation, I would immediately refer it to the Inspector General.

Mrs. YELLEN. I have taken the view of, as soon as we have determined that there is a material breach, I have asked the Inspector General to look at it right away.

Mr. MULVANEY. Right. And you wouldn't determine there is a material breach until after the General Counsel and the Secretary had done their—

Mrs. YELLEN. They need to do a review.

Mr. MULVANEY. Correct.

Mrs. YELLEN. Let me just give you a sense of the kind of thing that—

Mr. MULVANEY. I know this is a bit stunning, Mrs. Yellen, given our history, but I am actually agreeing with you. So if you want to just take "yes" for an answer, we can move on if you would like.

Mrs. YELLEN. The kind of thing that happens is sometimes somebody has a USB with a draft of something on it and it drops out of their pocket in a taxi or they lose their BlackBerry. Now, there are security procedures both in USBs and in BlackBerrys that just basically should disable them and protect the information. But—

Mr. MULVANEY. Right.

Mrs. YELLEN. —the FOMC Secretary receives reports of such things. In general, I wouldn't refer such things to the Inspector General. But something that is a material breach, I would do so, and have done so routinely.

Mr. MULVANEY. Fair enough.

Mrs. YELLEN. There have not been a lot of things, but I have—

Mr. MULVANEY. Before going back briefly to the 2012 leak, let me just simply ask you the question, have you ever actually activated this practice since you have been the Chair at the Fed?

Mrs. YELLEN. The practice of referring to the—yes, I have.

Mr. MULVANEY. Okay. And have you disclosed all of those referrals to Congress?

Mrs. YELLEN. I am not certain. For example, I think we did disclose publicly that a portion of the Fed staff's forecast was accidentally disclosed on a website or was included on a website, and—

Mr. MULVANEY. That is fine. And, again, I am—

Mrs. YELLEN. —that was referred.

Mr. MULVANEY. I am familiar with that example. I am asking if there are ones that we don't know about. Have there been referrals to the Inspector General that you have not notified Congress of, publicly or privately, since you have been the Chair?

Mrs. YELLEN. That we have not told Congress about it?

Mr. MULVANEY. Yes, ma'am.

Mrs. YELLEN. I need to check on that.

Mr. MULVANEY. Fair enough.

Let's go back—oh, by the way, one final change. And I know this is splitting hairs, but I used to be a lawyer in the real world a long time ago, so this is the type of stuff that catches my eye every now and then.

You all switched the policy on the security breaches somewhere about 2014–2015. You are shaking your head "no," but you did, right?

Mrs. YELLEN. We made a small change.

Mr. MULVANEY. Yes.

Mrs. YELLEN. And I know it has been alleged that that was a weakening of the requirements. It absolutely was not in any way a weakening of our requirements.

Mr. MULVANEY. So if I may, Mr. Chairman, very briefly, it is your testimony, ma'am, that the small changes in language, changing "an investigation" from "a full investigation," was not intended to change the scope of the rule at all?

Mrs. YELLEN. Absolutely not. And there was nothing, as far as I know, about "full investigation."

Mr. MULVANEY. Thank you, Madam Chair.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair wishes to inform Members that Chair Yellen will be departing at 1 o'clock. Presently, I think we can clear the queue in the room. Members who may be monitoring from their offices, you are out of luck.

The Chair now recognizes the gentleman from Washington, Mr. Heck.

Mr. HECK. Thank you, Mr. Chairman.

And, Madam Chair, thank you for being here. Indeed, thank you for your outstanding public service.

Mrs. YELLEN. Thank you. I appreciate that.

Mr. HECK. I think you have probably heard something closely resembling consensus here today from both sides of the aisle about concerns regarding regulatory relief. Many of us share your commitment to providing for both prudential protections as well as consumer protections, as well as enabling the free flow of credit, but with a belief on our part that could be done with a bit of a lighter touch.

I am hearing that somewhat from you today. Indeed, my perception is that the regulatory structure is, in fact, moving from what I would characterize as actively resistant to receptive.

Mrs. YELLEN. Very receptive. We are actively looking for ways that we can safely diminish burden, particularly on community banks but also smaller institutions that are, for example, subject to the 165 rules in Dodd-Frank, those over $50 billion. So we are very receptive and actively engaged.

Mr. HECK. So my encouragement would be that you would move it from receptive to being proactive. And in the spirit of that recommendation, I want to—and if this has been asked, I apologize—follow up with your testimony where on page 11 you indicate that the Reserve "is giving all of these suggestions careful consideration and will be working closely with other banking agencies in developing a report to Congress at the conclusion of the EGRPRA review," which is a deregulation exercise.

Mrs. YELLEN. Yes.

Mr. HECK. Approximately when can we expect the report?

Mrs. YELLEN. I am not sure. By the end of next year for sure.

Mr. HECK. By the end of?

Mrs. YELLEN. By the end of next year for sure.

Mr. HECK. By the end of 2016. Then I would encourage you to see if there is any distance between the pedal and the medal on the velocity of that effort, because I think it would play a very re-

constructive part to move from receptive to proactive. I think it is important that you all be a part of this. Because, frankly, otherwise what I observe here is you have those who legitimately believe that we can do a whole lot less, but that which many of us believe would compromise prudential considerations and consumer safety considerations, and so we react accordingly.

Mrs. YELLEN. Yes.

Mr. HECK. And the positive, constructive advancement on your part, I think, would be very helpful to—

Mrs. YELLEN. I think that is completely fair, and I pledge that we will try to be proactive in looking for—actively looking for ways that we can reduce burden.

Mr. HECK. I have another question. We tend to think about the Fed's monetary policy as its big lever to deal with the issue of price stability and the Fed funds rate that you set, but if I understand this thing correctly, and I may not, you also have the ability to set the interest rate that you pay on excess reserves that member institutions have with you, which seems to me to have potentially the same benefit as hiking the Fed funds rate, because if they are incentivized to leave more money with you, it is less money that they lend out, which is tapping the brakes on inflationary pressures.

Why would you do one over the other? What are the comparative benefits of doing just Fed funds rates versus looking at excess reserve rates?

Mrs. YELLEN. The interest we pay on excess reserves will be the key tool that we use in order to raise the Federal funds rate. The Federal funds rate is not something we can decree; it is a market-determined rate. And when we decide it is appropriate to raise that rate, we will accomplish it by raising what we pay on excess reserves. They are intimately connected, not two separate tools.

Interest on excess reserves is critical, and we expect by raising it that short-term interest rates generally, or money market instruments, will all rise across-the-board. And—

Mr. HECK. Can I see if I can get one more in, in 14 seconds?

Mrs. YELLEN. Yes.

Mr. HECK. One of the rating agencies recently indicated that the exercise of living wills is actually working, and they put it in writing. We are about to go through another round, I think, this winter. What is your forecast for what the impact will be?

Mrs. YELLEN. We have very detailed living wills. They are much more detailed than previous versions. They have responded to instructions that we carefully gave out. We are carefully evaluating them and we will be making decisions in the coming months.

Chairman HENSARLING. The time of the gentleman has expired.

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

Mr. PITTENGER. Thank you, Mr. Chairman.

And thank you, Chair Yellen. Chair Yellen, we will see if we can set some kind of record together and answer 5 questions in 5 minutes.

I am following up on Chairman Hensarling's questions regarding the role of the Fed in the boardroom. And I am going to read a quote from the Financial Times in August of 2014 that said, "Fed

officials are also involving themselves in the kinds of decisions that company management or board directors usually make, including whether employees should be fired or disciplined, which has been surprising."

Mrs. Yellen, do you support this type of activity? Notwithstanding that you said it is not the policy, but do you support this type of invasive participation by the Fed? Would you approve of it?

Mrs. YELLEN. When there is wrongdoing, as we have seen, for example, in the LIBOR ethics scandals, it is appropriate for us, in addition to leveling fines, to try to identify individuals who are guilty of wrongdoing.

Mr. PITTENGER. As an ongoing process, do you think it should be a matter that the Fed, for example, should be opining on human resource decisions and so forth inside the boardroom, as was quoted here in the Financial Times?

Mrs. YELLEN. I'm sorry. What exactly did they quote?

Mr. PITTENGER. They just said that they were including whether employees should be fired or disciplined. That was one of the comments that was made.

Mrs. YELLEN. I am not aware that we—

Mr. PITTENGER. But would you approve of that? Would you approve of them opining out on whether or not this should be done?

Mrs. YELLEN. We should not be managing firms. We should be making sure that firms have—

Mr. Pittenger. So do you all believe the Fed should—

Mrs. YELLEN. —the most appropriate systems.

Mr. PITTENGER. Should the Fed, then, be micromanaging these boardrooms and trying to dictate policy inside of the boardroom?

Mrs. YELLEN. We are not managing the firm, we shouldn't be managing the firm, but we need to make sure that the firm is managing itself properly.

Mr. PITTENGER. Chair Yellen, following up on Mr. Hurt and Mr. Hinojosa regarding community banks, what reforms, if you can give some clarity on this further, would you say that the Fed could do to reduce regulatory burdens on community banks? And, also, what would you recommend that we as a committee could recommend to do to provide some type of regulatory relief for community banks and to ensure that they can provide the best services and products for their consumers?

Mrs. YELLEN. There is a lot that we can do on our own and we have been doing it. We are trying to do more work offsite so that we have fewer examiners spending less time in actual banks doing exams. We are trying to tailor our exams to the areas that are really high risk, either in terms of consumer compliance or safety and soundness.

Mr. PITTENGER. Chair Yellen, pardon me. Have you had occasion to go out and visit some small community banks?

Mrs. YELLEN. Absolutely.

Mr. PITTENGER. How many have you seen?

Mrs. YELLEN. Many over the years that I have been involved with the Federal Reserve.

Mr. PITTENGER. In the last 2 years, have you been out to see any community banks?

Mrs. YELLEN. Since I have been at the Board, I haven't made trips to see community banks, but I meet with many community bankers. We have the so-called—the CDIAC, and, in fact, we are meeting with the CDIAC on Friday.

Mr. PITTENGER. If I could interrupt—I think the more in-depth awareness and understanding— I was on a community bank board for 10 years. And just to go visit these banks yourself, it would make a major statement of your own, the importance that you see for community banks. And I think you would get a sense from the staffing of what they are addressing, and you can hear from the CEO, the bank chairman. I would really encourage you to do that.

As you look at the imposition of the regulations on the financial industry, it is had really indirectly a major impact on industry that has left our country to move offshore. We have seen that occur too many times.

What do you think can be done to make sure that we can provide the financial resources available and not have the regulatory impediments on financial institutions that, frankly, impact our business growth and their environment? They are leaving here, and that is part of the problem.

Mrs. YELLEN. This is partly why we participate in international groups like the IAIS or the Basel Committee or the Financial Stability Board, to work with—

Mr. PITTENGER. And how do measure success in this approach? Do you think what you are doing is working now? Because we haven't seen the measured success that we would like to see in terms of being able to attract companies who want to stay onshore.

Mrs. YELLEN. I think we have seen success in that we have a much safer and sounder financial system. And other countries are also raising the standards that they apply to their large banking organizations.

Mr. PITTENGER. Thank you.

Chairman HENSARLING. The time of the gentleman has expired.

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

Mr. ELLISON. I thank the ranking member and the chairman.

Thank you for being here, Chair Yellen. I really appreciate it.

We had this big debate yesterday and the votes today on whether or not the $50 billion designation is the right metric for SIFI designation. And I have to tell you, I am sympathetic to changing it, but I didn't vote for either one of those proposals, because I feel that after there is a big crash, then we regulate, and then before the ink is dry, we are all trying to change it suddenly, and is it good or is it bad?

And so what I want to see when a proposal comes back to change it from—and so people may—there may be a growing consensus that $50 billion could be different, but we don't have a consensus on what it should be.

And I guess my point to you is, knowing that our constituents lean on us to do things that they want, our constituents aren't thinking about the system, they are thinking about their business, and that is a generalization, but I think it is generally true, I am looking for good guidance from people like you as to if it is not $50 billion, what should it be and why.

I am sure that this issue is not going away. And so I just want to make that point clear, because I definitely believe that the $50 billion designation, the truth is that it is an imprecise metric, I will agree with that, but there were some regional banks that caused some major damage in the last go-round. So I am not willing to just walk away without a really clear plan on what is going on forward.

Do you have any reaction to that?

Mrs. YELLEN. I agree with that. And we have said modest increase, not a large increase, a modest increase. And while I think there would be some benefits to the smaller banking organizations that are over that $50 billion threshold and would save us some supervisory resources, this isn't a must have.

Mr. ELLISON. Okay. On living wills, the very largest banks in the country are even larger today than they were during the financial crisis. The living wills provision of Dodd-Frank was created to make sure these banks never threaten the economy again by giving regulators additional powers if banks' living wills are found to be not credible.

The last time the Fed and the FDIC evaluated these banks' living wills, only the FDIC took the official position that the wills were not credible. The Fed's decision not to join the FDIC has slowed both regulators' ability to take additional action.

Why would the Fed voluntarily give up additional authorities to force changes at problem banks?

Mrs. YELLEN. We took the position that this was a completely new process, and we stated this when we put out guidance on the living will process, that we expected to have to work with firms for a few rounds in order to understand what we needed to see in the plan and to give firms reasonable guidance on our expectations. That is why we declined to join the FDIC last summer and did not vote to find the plans noncredible.

But we have worked closely and jointly with the FDIC over the last year to give very clear, very detailed, and we are asking for very substantial changes on the part of these firms. They have submitted a new round of living wills, we are evaluating them with the FDIC, and in the coming months we will make important decisions.

Mr. ELLISON. Thank you. With my last minute, I just want to know if you would be willing to offer your perspective on one of the observations of Ben Bernanke, whom, as you know, he came out with a memoir recently, and in there he said something like this: It would have been his preference to have more investigations of individuals' actions, as obviously everything that went wrong or was illegal was done by some individual, not by an abstract firm, and so in that respect, there should have been more accountability at the individual level.

And then, of course, Loretta Lynch and the DOJ just said about a month ago that they are going to look into white collar prosecution a little bit more.

Do you have any observation on Mr. Bernanke's observation? What about prosecuting some of these folks who engage in fraud?

Mrs. YELLEN. I completely agree with his assessment. Now, we can't engage in criminal prosecutions, but I would say, to the extent that we can identify individuals who have been responsible for

wrongdoing and significant breaches, we have leveled big civil money fines. We are trying to take action against individuals as well, and that means barring them from working for those organizations or potentially for the banking industry.

Chairman HENSARLING. The time of the gentleman has expired.

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

Mr. BARR. Thank you, Mr. Chairman.

Chair Yellen, welcome back to the committee.

We routinely hear from President Obama and Senator Warren and others that an absence of regulation was the principal cause of the financial crisis. I would like to explore with you today the threats to financial stability posed by too much regulation.

Let me take as an example the CLO market, collateralized loan obligations. This market provides more than $400 billion in financing for hundreds of American companies that employ more than 5 million people. They are a crucial source of funds for many companies that cannot issue bonds. CLOs also performed extraordinarily well during the last 20 years, with a negligible default rate, they performed better than high-grade corporate bonds over that same period of time.

Unfortunately, we are hearing from market participants that the risk retention rules promulgated by the Fed will cause a contraction in the CLO market and a credit crunch for American companies. Alternative sources of funds are available through hedge funds and the like, but they are not a stable source of funds and they will certainly demand a much higher interest rate.

Do you believe that American businesses are better served with expensive short-term financing from hedge funds as opposed to stable long-term financing options?

Mrs. YELLEN. We want to make sure that businesses have stable long-term financing sources, but we also want to make sure that when securitizations take place that the originators do have skin in the game so that we avoid the kinds of problems that happened previously, and that is what those QRM rules are designed to accomplish.

Mr. BARR. I appreciate it. I would make a distinction between securitized mortgages, which were at the epicenter of the financial crisis, as opposed to highly rated senior secured commercial and industrial loans that never defaulted in 20 years.

But I do appreciate the point about skin in the game, and I wanted to just ask you about a letter that we sent to regulators. I joined a bipartisan group of Members of Congress who wrote to you recommending that you support the concept of a qualified CLO, much like a qualified mortgage, a structure that would ensure the safety of these vehicles, but also ensure a continuation of financing to hundreds of companies that rely upon them.

Is that something that you would be open to?

Mrs. YELLEN. I think it is something we could have a look at. I would have to get back to you on it.

Mr. BARR. I appreciate that. I would love to have that discussion with you.

Let me move on to the issue of illiquidity in the market generally. Secretary Lew has denied that there is a liquidity issue or

that some of the post-crisis regulations are contributing to illiquidity in the market.

In your previous testimony before this committee, you said that you would not rule out the possibility that regulations are playing a role in decreased fixed-income liquidity. Certainly your colleague Lael Brainard acknowledged that regulations may be a factor in diminished fixed-income liquidity, and there has been a lot of research on this.

And I am quoting from one often cited piece of research: "Almost every institutional investor, in almost every market, seems worried about liquidity. Even if it is here today, they fear it will be gone tomorrow." They say that e-trading is contributing to volume, but little depth for these who need to trade in size. "The growing frequency of 'flash crashes' and 'air pockets,' often without cause, adds weight to the fears and the most frequently cited explanation is that increased regulation has driven up the cost of balance sheet and reduced the street's appetite for risk and hence their ability to act as a warehouser between buyers and sellers."

What would lead you to doubt that increased regulation is actually creating a destabilizing impact in terms of liquidity?

Mrs. YELLEN. There are just a bunch of different things going on in these markets, and we are trying to carefully study them. The Treasury market and the corporate bond market aren't the same. The conditions are quite different and the role of the broker-dealers is different. High frequency trading has become very prevalent in the Treasury market, and—

Mr. BARR. Let me—and I hear that explanation—just jump to one other potential theory here, and, again, the same piece of research. The more liquidity central banks add, the less there is in markets. In addition to regulation, central banks' distortion of the markets has reduced the heterogeneity of the investor base.

And so the question is, is central bank liquidity forcing investors to view fixed income and equities as expensive, making markets more prone to sudden corrections?

Mrs. YELLEN. We hold significantly more assets, the Federal Reserve and other central banks, than we did prior to the crisis, but we have very deep and liquid markets in the Treasury securities and mortgage-backed securities that we hold. So I am not aware that our behavior is significantly influencing market functioning. I am not aware of any evidence suggesting that.

Mr. BARR. Thank you for your testimony.

Chairman HENSARLING. The time of the gentleman has expired.

To accommodate the Chair's schedule, the gentleman from Maine will be the last Member recognized. The gentleman from Maine, Mr. Poliquin, is recognized for 5 minutes.

Mr. POLIQUIN. Thank you, Mr. Chairman.

And thank you, Chair Yellen, for being here. They always save the best for last here, that is what they say up in Maine, anyway. But I was thrilled to have a discussion with you in the lobby before we came into the hearing, Chair Yellen, where I had asked you specifically what your thought process is now, going forward, about FSOC and your involvement in FSOC as designating asset managers, pension fund managers, mutual funds as systemically important financial institutions. And if that happens, of course, they

have to succumb to smothering regulations with respect to Dodd-Frank, and that can stifle rates of return for small savers.

You mentioned something that was very interesting. You said that right now the Fed is not focused on designating asset managers as—

Mrs. YELLEN. The FSOC. I have said that—what I said was that the FSOC—

Mr. POLIQUIN. I stand corrected.

Mrs. YELLEN. —was focusing on—

Mr. POLIQUIN. I stand corrected.

Mrs. YELLEN. —activities and studying a set of activities involved in asset management, liquidity risks, redemption risks, potential risks that have—

Mr. POLIQUIN. Thank you. I stand corrected. And you, of course, sit on FSOC.

Mrs. YELLEN. That is right, but that is FSOC's focus at the moment, it is studying these areas. The SEC is actively involved in rulemaking in these areas.

Mr. POLIQUIN. Thank you.

Mrs. YELLEN. And that has been the focus recently in FSOC.

Mr. POLIQUIN. Thank you.

You know what would be really helpful, Chair Yellen, if I can make a suggestion, is if we had a written set of criteria that the industry, those folks who are in this space, can look at something on paper to say, if I had these various business practices that revolved around my business model, or I managed these sort of assets, then I know the probability of me being designated a SIFI is very high or low.

Does that make sense to do something like that, instead of saying, well, our focus on FSOC is not to look at asset managers as designated as SIFIs, but maybe down the road we will? Do you have a written set of guidelines so folks in this space can see—

Mrs. YELLEN. There were a set of criteria that FSOC initially issued to indicate firms—

Mr. POLIQUIN. And has that been updated?

Mrs. YELLEN. —that we might look at.

Mr. POLIQUIN. And has that been updated, Chair Yellen?

Mrs. YELLEN. I am not certain it has been, but there was—

Mr. POLIQUIN. Great. If you don't mind, we will reach out to your staff to see if there is any updated criteria on that. And do you also, Chair Yellen, have a set of criteria that deals with an off-ramp, such that if an institution, a nonbank financial institution is designated as a SIFI, and they know if they go down this path and derisk, in your eyes and the eyes of FSOC, there will be an off-ramp for them? Do you have that set of criteria?

Mrs. YELLEN. We evaluate each of these firms every single year to decide if it is no longer appropriate for them to be designated—

Mr. POLIQUIN. But do you have a set of written criteria, Chair Yellen? Because if you are running a business, it is really helpful if you have those guidelines.

Mrs. YELLEN. We are not trying to run these businesses, and we are not going to—I don't think it would be appropriate for us to say, you need to do X, Y, and Z, to be de-designated. These firms understand very well why they have been designated and they un-

derstand what kinds of changes in their business model would change that assessment.

Mr. POLIQUIN. As a Member, if I may—

Mrs. YELLEN. And these are firms that have decided they want to do this kind of business. And if they change that decision, of course it is possible—

Mr. POLIQUIN. Here is what I worry about, Chair Yellen. And I don't mean to be rude, but we have a little over a minute left. Here is what I worry about. You have probably seen the study that was conducted by Mr. Holtz-Eakin, who is the former Director of the nonpartisan CBO.

Mrs. YELLEN. Yes.

Mr. POLIQUIN. And when you have pension fund managers and mutual fund managers that are designated as SIFIs, he concludes that the long-term rate of return of these retirement nest eggs is likely to go down by up to 25 percent if they have to succumb to these Dodd-Frank regulations.

So it is my contention that when you have a trucker in Bangor, Maine, or a teacher in Lewiston, Maine, in the greatest district, in the greatest State in the country, and they are doing their best to put aside $50 or $100 a month to make sure they plan for retirement, but because of these Dodd-Frank regulations over an industry that poses no systemic risk to the economy, if that happens and these regulations prevail, then these folks will have to work longer, and will have less money in their nest egg, and that is not fair, and it is not compassionate.

So all I am asking of you is—as a Member of Congress, I represent 650,000 of the most honest, hard-working people you can find in this country. I just would like to see what written criteria you have such that these pension fund managers, these asset managers know how to be de-designated as a SIFI.

Mrs. YELLEN. None of them have been designated.

Mr. POLIQUIN. I know, but wouldn't it be great if they knew what would cause them to be designated and how they could get out of it?

Mrs. YELLEN. FSOC has not designated any asset manager.

Mr. POLIQUIN. And thank you for doing that, but it would be wonderful if we have criteria so going forward, we know what that will look like.

Chairman HENSARLING. The time of the gentleman—

Mr. POLIQUIN. Thank you, Chair Yellen.

Chairman HENSARLING. The time of the gentleman has expired.

And I want to thank Chair Yellen 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. 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 1:05 p.m., the hearing was adjourned.]

A P P E N D I X

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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

November 4, 2015

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 our most fundamental goals is to promote a financial system that is strong, resilient, and able to serve a healthy and growing economy. We work to ensure the safety and soundness of the firms we supervise and also to ensure that they comply with applicable consumer protection laws, so that they may, even when faced with stressful financial conditions, continue serving consumers, businesses, and communities.

At today's hearing, I would like to discuss the lessons of the financial crisis and how we have transformed our regulatory and supervisory approach. Before the crisis, our primary goal was to ensure the safety and soundness of individual financial institutions. A key shortcoming of that approach was that we did not focus sufficiently on shared vulnerabilities across firms or the systemic consequences of the distress or failure of the largest, most complex firms. In the fall of 2008, the failure or near-failure of several of these firms--many of which we did not supervise at the time--sparked a panic that engulfed the financial system and much of the economy.

Today we aim to regulate and supervise financial firms in a manner that promotes the stability of the financial system as a whole. This shift in focus has led to a comprehensive change in our regulation and supervision of large financial institutions. As I will discuss in more detail, we have introduced a series of requirements for large banking organizations that reduce the risks to the system and our economy that could result from the failure or distress of these institutions. In addition, we have made changes in our supervision that now allow us to supervise large financial institutions on a more coordinated, forward-looking basis.

At the same time, we have been careful to make more-measured changes in our approach to regulating and supervising firms at the other end of the spectrum. Smaller institutions did not

emerge from the financial crisis unscathed, and we have identified several areas in which the supervision of these institutions can be strengthened. At the same time, we are well aware that regulatory and compliance costs can impose a burden that is disproportionate to the risks these institutions pose to taxpayers and financial stability. We are committed to ensuring that the supervision of smaller institutions is tailored appropriately to their risk.

Strengthening the Regulation and Supervision of the Largest Financial Institutions

Regulatory Framework

The regulatory reforms we have adopted since the crisis have been designed to address the risks posed by large financial institutions in one of two ways. First, our reforms are designed to reduce the probability that large financial institutions will fail by requiring those institutions to make themselves more resilient to stress. However, we recognize that we cannot eliminate the possibility of a large financial institution's failure. Therefore, a second aim of our post-crisis reforms has been to limit the systemic damage that would result if a large financial institution does fail. This effort has involved taking steps to help ensure that authorities would have the ability to resolve a failed firm in an orderly manner while its critical operations continue to function.

To reduce the probability of a large financial institution's failure, we and the other federal banking agencies have implemented a series of reforms that strengthen the firms we regulate. We have implemented capital rules that require large banking organizations to hold substantially larger amounts of high-quality capital. Working with the other federal banking agencies, we also have adopted a liquidity coverage ratio (LCR) rule that requires large banking organizations to hold a buffer of high-quality liquid assets sufficient to meet net liquidity outflows during a period of severe stress. In addition, the Board has established a broader set of enhanced

prudential standards for large domestic and foreign banking organizations pursuant to section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), which includes risk-based and leverage capital requirements, liquidity standards, risk-management requirements, and stress testing.[1]

We have also adopted risk-based and leverage capital surcharges for the handful of U.S. firms that we have identified as global systemically important banking organizations (GSIBs), which require these firms to hold larger amounts of loss-absorbing capital than other firms.[2] The U.S. GSIBs are central intermediaries in U.S. financial markets, and their failure or distress would thus likely cause the most harm to the financial system. Under the framework that the Board adopted this summer, a GSIB's risk-based capital surcharge would reflect the effect that its failure would have on the financial system. In effect, the risk-based capital surcharge confronts each U.S. GSIB with a choice: It can hold more capital, or it can reduce its systemic footprint. Although similar to the international risk-based capital surcharge framework that we helped design, the rule adopted by the Board is calibrated at a level that requires U.S. GSIBs to hold significantly more capital than would be required under the international framework. A second important difference between the Board's rule and the international framework is that the Board's rule incorporates a measure of each GSIB's use of short-term wholesale funding, which is a key determinant of a GSIB's systemic footprint.

To limit the systemic effect of a large financial institution's failure, the Board and the Federal Deposit Insurance Corporation (FDIC) have adopted a resolution plan rule that requires

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[1] The enhanced prudential standards we have established require foreign banking organizations with large U.S. operations to organize their U.S. subsidiaries under an intermediate holding company. This intermediate holding company requirement provides a basis for regulating and supervising the U.S. operations of foreign banking organizations on a more robust and consistent basis.

[2] The firms currently identified as U.S. GSIBs are Bank of America Corporation; The Bank of New York Mellon Corporation; Citigroup, Inc.; The Goldman Sachs Group, Inc.; JPMorgan Chase & Co.; Morgan Stanley; State Street Corporation; and Wells Fargo & Company.

large banking organizations to show how they could be resolved in an orderly manner under the bankruptcy code.

Last week the Board proposed another reform that would establish long-term debt and total loss-absorbing capacity (TLAC) requirements for U.S. GSIBs. We see these requirements as critical to avoiding the choice that authorities faced in the most recent crisis between bailing out large financial firms and allowing those firms to fail in a manner that would impose large costs on the broader economy. With the new requirements, if losses were to wipe out a firm's capital and push a firm into resolution, a sufficient amount of long-term unsecured debt would provide a mechanism for absorbing additional losses and recapitalizing the firm without generating contagion across the financial system and damaging the economy. In effect, this requirement provides a means for "bailing in" a firm's long-term debt holders so that a taxpayer bailout will be unnecessary. These requirements also should improve market discipline by ensuring that each GSIB has a class of creditors with clear incentive to monitor the firm's risk-taking.

Supervisory Approach

In addition to strengthening the regulation of the largest, most complex financial institutions, we have also transformed our supervision of these firms. Our work is now more forward looking and multidisciplinary, drawing on a wide range of staff expertise. We put this new approach into operation with the creation of the Large Institution Supervision Coordinating Committee (LISCC). The LISCC is charged with the supervision of the firms that pose elevated risk to U.S. financial stability. Those firms include the eight U.S. banking organizations that have been identified as GSIBs, four foreign banking organizations with large and complex U.S. operations, and the four nonbank financial institutions that have been designated as systemically

important by the Financial Stability Oversight Council (FSOC).[3] The supervisory approach embodied in the LISCC differs from our more traditional approach to supervision in that it is oriented toward both the safety and soundness of the individual firms, and the stability of the financial system as a whole.[4]

The LISCC program is distinguished by several characteristics. First, the LISCC, led by the Board's director of the Division of Banking Supervision and Regulation, has implemented a more centralized, multidisciplinary supervisory approach by bringing together experts from around the Federal Reserve System in the areas of supervision, research, legal counsel, financial markets, and payments systems. Second, the LISCC takes a forward-looking approach by focusing on capital and liquidity resiliency under normal and potentially adverse conditions in the future as well as governance and recovery and resolution preparedness. And, third, the LISCC complements traditional, firm-specific supervisory work with annual "horizontal" programs that examine the same 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. The Federal Reserve conducts three major horizontal reviews of the LISCC banking firms each year that are focused on capital adequacy, liquidity resiliency, and preparedness for recovery and resolution.

With regard to capital adequacy, the Federal Reserve's Comprehensive Capital Analysis and Review (CCAR) is designed to ensure that large U.S. bank holding companies, including the LISCC firms, have rigorous, forward-looking capital planning processes and have sufficient

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[3] The foreign banking organizations whose U.S. operations are currently supervised as part of the LISCC program are Barclays PLC, Credit Suisse Group AG, Deutsche Bank AG, and UBS AG. The firms designated by the FSOC for supervision by the Federal Reserve are American International Group, Inc.; General Electric Capital Corporation, Inc.; MetLife, Inc.; and Prudential Financial, Inc.

[4] Further information on the LISCC, including a full list of the supervised firms, is available on the Board's website at www.federalreserve.gov/bankinforeg/large-institution-supervision.htm.

levels of capital to operate through times of stress, as defined by the Federal Reserve's supervisory stress scenario. The program enables us to make a quantitative and qualitative assessment of the resilience and capital planning abilities of the largest banking firms on an annual basis and to limit capital distributions for firms that exhibit weaknesses.

With regard to liquidity resiliency, under the Federal Reserve's Comprehensive Liquidity Analysis and Review (CLAR), LISCC firms are subject to a comprehensive review of their liquidity positions and liquidity risk management, including internal stress-testing practices. Firms with weak liquidity positions or practices are directed to improve those practices and augment their liquidity positions as needed. Similar to CCAR, CLAR is designed to ensure that LISCC firms have rigorous, forward-looking liquidity stress testing and risk-management practices that account for unique risks, and that the LISCC firms maintain sufficient liquidity to continue to operate through a period of acute stress. The program allows the Federal Reserve to compare the range of practices across firms and form a view on liquidity vulnerabilities and funding concentrations in the system as a whole. Unlike CCAR, which currently applies to all firms with $50 billion or more in total assets, only firms within the LISCC portfolio are required to participate in CLAR.

LISCC firms are also subject to an annual review of their recovery and resolution preparedness. The program evaluates progress in implementing operational capabilities and legal entity rationalization that would facilitate recovery or resolution under a range of scenarios and provides the Federal Reserve with the ability to compare progress on recovery and resolution planning across firms. We are working with the FDIC to evaluate the GSIBs' most recent resolution plans, which were submitted in July.

As I noted, the LISCC is also responsible for the supervision of nonbank financial companies that have been designated by the FSOC. The Federal Reserve currently conducts active, on-site supervision of all four of the designated firms. We are tailoring our supervisory framework to the specific business lines, risk profiles, and systemic footprints of these firms. Our supervisory efforts to date have focused on strengthening the firms' risk identification, measurement, and management; internal controls; and corporate governance. Our objectives for the designated holding companies are to ensure that the consolidated firms operate safely and soundly and to mitigate risks to financial stability. We coordinate our consolidated supervision of the three designated insurance companies, as well as the other insurance holding companies we supervise, with state insurance regulators, who continue their established oversight of insurance legal entities within the consolidated firms. We do not regulate the manner in which insurance is provided by these companies or the types of insurance they provide. Those important aspects of the firms' activities are the province of state insurance supervisors.

Regulation and Supervision of Large and Regional Companies

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 financial stability 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

internationally active banking organizations.[5] We also scale our examination procedures to reflect the lower level of systemic risk presented by non-LISCC companies.

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 recently implemented changes that strengthened the risk-based 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 and evaluate their safety and soundness based on each company's individual circumstances. 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 our regulatory colleagues 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 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 responsible for 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

[5] An "internationally active banking organization" is defined as a banking organization with more than $250 billion in total assets or $10 billion in on-balance-sheet foreign exposure.

and supervision, one size does not fit all. To effectively promote safety and soundness and ensure consumer compliance 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 830 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 these institutions, 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 are taking 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 be more forward looking in addressing emerging risks and to ensure that community bank examiners with specialized expertise and experience are allocated to the institutions exhibiting the highest risks. We have also implemented a new risk-focused consumer compliance examination framework 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. And we continue to improve our examiner commissioning training program to ensure that it fully reflects the lessons of the recent crisis.

With the Congress's support, we have also taken action to relieve small holding companies of certain requirements by raising the asset threshold for the Board's Small Bank Holding Company Policy Statement from $500 million to $1 billion, and by applying this statement to small savings and loan holding companies. The Small Bank Holding Company Policy Statement promotes local control of community banking organizations by acknowledging that smaller companies have less access to the capital markets and allowing them to fund

acquisitions with a higher level of debt than would otherwise be allowed. We also relieved small holding companies of requirements to comply with consolidated capital requirements, recognizing that their bank subsidiaries make up most of their assets and are already subject to capital rules. In addition, in conjunction with this change, we eliminated quarterly and more detailed consolidated financial reporting requirements for holding companies with less than $1 billion in assets, and instead require parent-only financial statements on a semiannual basis. [6]

Consistent with the Economic Growth and Regulatory Paperwork Reduction Act (EGRPRA), the Board is also working with the other federal banking agencies to identify banking regulations that are outdated, unnecessary, or unduly burdensome. As part of the EGRPRA review, the agencies have held several public outreach meetings with bankers, consumer groups, and other stakeholders.[7] Several themes have emerged during the discussions. For example, community bankers in rural areas have noted that it can be difficult to find an appraiser with knowledge about the local housing market at a reasonable fee. Bankers have asked the agencies to consider increasing the dollar threshold for requiring appraisals, which could allow them to use a less formal valuation of collateral for a larger number of mortgage loans. In addition, bankers have raised concerns about the extent of the financial reporting requirements established by the banking agencies. In response, the banking agencies have already taken steps under the auspices of the Federal Financial Institutions Examination Council to consider options to eliminate or revise Call Report data items and to develop a streamlined reporting form for community banks.[8]

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[6] See Board of Governors of the Federal Reserve System (2015), "Federal Reserve Board Issues Final Rule to Expand Applicability of Small Bank Holding Company Policy Statement and Apply It to Certain Savings and Loan Holding Companies," press release, April 9, www.federalreserve.gov/newsevents/press/bcreg/20150409a.htm.
[7] An additional EGRPRA outreach meeting is scheduled to be held in Washington, D.C., on December 2, 2015.
[8] See Federal Financial Institutions Examination Council (2015), "FFIEC Announces Initiative to Streamline Reporting Requirements for Community Banks," press release, September 8, www.ffiec.gov/press/pr090815.htm.

Bankers have also asked whether the agencies could review the statutorily mandated safety-and-soundness examination frequency for banks, which varies based on a bank's asset size and condition, as a way to ease the burden of frequent on-site examinations. Other bankers have commented on the burden associated with recently implemented changes to the capital guidelines and have encouraged the agencies to consider simplifying requirements for community banking organizations.

The Federal Reserve is giving all of these suggestions careful consideration and will be working closely with the other banking agencies in developing a report to the Congress at the conclusion of the EGRPRA review. Given the important role that community banks play in their communities and the economic support they provide across the country, we recognize that our supervision of community banks must be balanced and avoid unnecessarily constraining their activities.

Current Conditions

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

The financial condition of the firms in the LISCC portfolio 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 of almost $500 billion. Moreover, these firms generally have much more stable funding positions: The amount of high-quality liquid assets held by the eight U.S. GSIBs has increased by roughly two-thirds since 2012, and their reliance on short-term wholesale funding has dropped considerably. Our new regulatory and supervisory approaches are aimed at helping ensure these firms remain strong. Requiring these firms to plan

for an orderly resolution has forced them to think more carefully about the sustainability of their business models and corporate structures.

Nevertheless, while we have seen some evidence of improved risk management, internal controls, and governance at the LISCC firms, they continue to have substantial compliance and risk-management issues. Compliance breakdowns in recent years have undermined confidence in the LISCC firms' risk management and controls and could have implications for financial stability, given the firms' size, complexity, and interconnectedness. The LISCC firms must address these issues directly and comprehensively.

Our examinations have found large and regional banks to be well capitalized. Both large and regional banking organizations experienced dramatic improvements in profitability since the financial crisis, although these banks have also faced challenges in recent years due to weak growth in interest and noninterest income. Both large and regional institutions have seen robust growth in commercial and industrial lending.

Finally, community banks are significantly healthier. More than 95 percent are now profitable, and capital lost during the crisis has been largely replenished. Loan growth is picking up, and problem loans are now at levels last seen early in the financial crisis.

Conclusion

While more work remains to be done, I hope you will take away from my testimony just how much has changed. Taken as a whole, the reforms we have adopted since the crisis, including those mandated by the Dodd-Frank Act, represent a substantial strengthening of the regulatory framework for the largest financial institutions and should help ensure that the U.S. financial system remains able to fulfill its vital role of supporting the economy. Our supervisory

approach is more comprehensive and forward looking while also tailored to fit the level of oversight to the risks and scope of the institution.

We know our work is not complete. In the coming year we anticipate moving forward on other rulemaking initiatives that will complement the steps we have already taken. The Federal Reserve is committed to remaining vigilant, diligent, and forward looking as a regulator and supervisor of the financial institutions that serve our economy. We will do everything we can to fulfill the responsibility that has been entrusted to us by the Congress and the American public.

Thank you. I would be pleased to respond to your questions.

Congress of the United States
Washington, DC 20515
July 31, 2014

The Honorable Janet L. Yellen
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave, NW
Washington, DC 20551

The Honorable Martin J. Gruenberg
Director
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 200429

The Honorable Mary Jo White
Chair
The Securities and Exchange Commission
100 F Street, NE, Room 10700
Washington, DC 20549

The Honorable Thomas J. Curry
Comptroller of the Currency
Administrator of National Banks
250 E Street, SE
Washington, DC 20219

Dear Sirs and Madams:

We are writing in regards to your joint rulemaking designed to implement the risk retention requirements of Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. While the joint order setting forth further proposed rules issued on August 28, 2013, is an earnest effort to improve upon the initial proposal of rules issued in March 2011, the provisions regarding open market collateralized loan obligations (CLOs), and in particular the potential adverse effect on credit availability, continue to concern us.

CLOs are a vital source of corporate finance in the United States. They provide more than $300 billion of loans to American companies — almost one-quarter of all outstanding funded corporate loans. Understanding the significant role CLOs play, we want to ensure that the risk retention requirements are properly tailored to the unique structure of open market CLOs. Open market CLOs do not engage in "originate to distribute" securitizations, so simply applying the standard risk retention rules designed for such securitizations to open market CLOs does not necessarily make sense. As you acknowledge in your re-proposal, "the standard form of risk retention in the original proposal could, if applied to open market CLO managers, result in fewer open market CLO issuances and less competition in the sector." Specifically, we are concerned that the approach outlined in the August re-proposal that requires CLO managers to retain 5% of the CLO's fair value could impede the issuance of new CLOs. With very limited balance sheets, very few CLO managers could retain a 5% share of a CLO.

One approach to risk retention that we believe merits consideration is a proposal to create "qualified" open market CLOs ("QCLOs") that would have to meet a series of strict criteria designed to protect investors, ensure that a CLO's portfolio is conservatively invested, and align the interests of the CLO manager and the investors in the CLO. We believe this approach could provide a workable solution for most managers of open market CLOs and ensure the continued flow of credit to companies across the country. We hope you will seriously evaluate this proposal as you work towards the final rules implementing Section 941.

The QCLO approach requires managers of open market CLOs to retain 5% of the equity of a QCLO rather than 5% of fair value. This level of retention would still be a significant commitment for thinly capitalized CLO managers, and would still likely force some managers out of the market. However, this approach would permit most CLO managers to continue to participate in this important market, avoiding a dramatic reduction in CLO financing and resulting harms to the public interest that could otherwise result from the agencies' proposed rules.

Importantly, this modified risk retention requirement would apply only to CLOs that meet certain criteria across six categories. First, the portfolio would have to consist almost entirely of U.S. dollar denominated senior secured commercial loans and could contain no re-securitizations or derivatives other than basic interest rate or FX hedges. The portfolio would also have to be diversified such that no more than 3.5% of a CLO's assets could relate to any single borrower, and no more than 15% of its assets could relate to any single industry — thereby reducing the chance that a few individual defaults could cause significant losses for a CLO investor. The borrowing companies would have to be overwhelmingly based in the United States. The CLO's equity would have to equal at least 8% of the value of its assets, which would provide a substantial cushion for CLO debt investors.

Significantly, the QCLO proposal would advance the core policy goals of the risk retention requirement by ensuring an alignment of interests between the CLO manager and the investors. Specifically, the CLO manager's interests would have to be aligned with those of the CLO's investors through the subordination of the majority of the manager's fees — in addition to the manager satisfying the risk retention requirement — and the CLO documents would have to provide that the manager could be removed by the CLO investors. The QCLO designation would be available only if the CLO manager is an SEC-registered investment adviser and, as such, has a fiduciary duty to the CLO investors. Finally, investors in a qualifying CLO would be provided with extensive information, including a monthly report that would, among other things, specifically identify all CLO assets and benchmark the CLO's compliance with its various performance covenants.

We urge you to consider the QCLO proposal as an alternative approach to credit risk retention. We believe this proposal could achieve the important goals of Section 941 while enabling the continuation of the vibrant CLO market that is so important to economic growth.

Sincerely,

JIM HIMES
Member of Congress

ANDY BARR
Member of Congress

GWEN MOORE
Member of Congress

SCOTT GARRETT
Member of Congress

GARY PETERS
Member of Congress

PATRICK MCHENRY
Member of Congress

JOHN CARNEY
Member of Congress

PETER KING
Member of Congress

TERRI SEWELL
Member of Congress

BILL POSEY
Member of Congress

BILL FOSTER
Member of Congress

BLAINE LUETKEMEYER
Member of Congress

JOHN DELANEY
Member of Congress

STEVE STIVERS
Member of Congress

PATRICK MURPHY
Member of Congress

STEPHEN FINCHER
Member of Congress

GREGORY W. MEEKS
Member of Congress

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

1. CLOs provide more than $400 billion in financing for hundreds of American companies that employ more than 5 million people. They are a crucial source of funds for many companies that cannot issue bonds. CLOs also performed extraordinarily well during the past 20 years, with a negligible default rate; they performed better than high- grade corporate bonds over that time. I joined a bipartisan group of Congressmen who wrote you recommending that you support the concept of a "Qualified CLO," a structure that would ensure the safety of these vehicles and ensure a continuation of financing to the hundreds of companies that rely upon them. Do you support the concept of a Qualified CLO as expressed in this bipartisan letter? Would you consider such a concept as you examine liquidity in the market, and is the Federal Reserve planning to promulgate any rules or regulations that would include the Qualified CLO concept?

In recent years, the Federal Reserve Board (Board) has received numerous inquiries and comments regarding the impact of regulations on collateralized loan obligations (CLOs). Comments received have included information related to the "Qualified CLO" concept that you have referenced, which involves structuring CLOs with certain characteristics designed to strengthen the quality of assets selected by CLO managers and better align the interests of CLO managers with investors. Such characteristics would include requirements for diversification of assets by industry and borrower, and a subordinated compensation structure for CLO managers.

The Board has taken all the comments received, including yours, very seriously and devoted considerable effort and staff resources to examining the issues that such comments have raised. These efforts have included meetings with industry representatives, consultations with staffs of other agencies, and review and monitoring of market data and information.

The Board recognizes that certain structural features of Qualified CLOs may contribute in some degree to aligning the interests of CLO managers with investors with respect to the quality of securitized loans. In this regard, an increase in the availability of CLOs that reflect strengthened underwriting and compensation standards, among other features, could be considered a positive development in the market.

Board staff has been closely monitoring developments in the CLO and commercial loan markets. Data indicates that CLO issuance has been robust in recent quarters. While the Board does not have any current plans to promulgate regulations regarding the Qualified CLO concept, we will continue to monitor developments in the market to ensure that lending to commercial borrowers, on appropriate terms, continues at a healthy rate.

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

1. If other financial regulators like the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Consumer Financial Protection Bureau publically disclose the salaries of their employees and are still able to perform their regulatory duties, I think the Federal Reserve should be required to do the same. Do you support making salaries of all Federal Reserve employees public?

The Federal Reserve Board (Board) has publicly disclosed the amount spent on salaries of Board employees in its Annual Report. You may find the Annual Report on the Board's public website at the following link: http://www.federalreserve.gov/publications/annual-report/files/2014-annual-report.pdf.

The Board also publishes its salary structure for non-officer employees on its public website. That information can be found at the following link: http://www.federalreserve.gov/careers/salary.htm. The Board also discloses, upon request, the salary structure for its officer employees. I have enclosed a copy of that salary structure for your information.

The Board has also publicly disclosed information about its top earners, which are defined as individuals who are paid a salary of $225,000 or more. This information includes the name, title, and division of each employee who earns a salary of $225,000 or more. A copy of this list is also enclosed for your information.

2. The Consumer Financial Protection Bureau (CFPB) is funded by the Federal Reserve, not Congress. Thus, Congress has little opportunity to provide oversight of the CFPB. As the head of the institution that provides funding to the CFPB, a) what oversight do you provide over the CFPB; b) how do you ensure that the CFPB is properly staffed and is appropriately funds that could have been remitted to the Treasury; c) in the event that the CFPB has misused funds or, in any way, how do you notify congress, the Administration and the American people?

As you know, the Consumer Financial Protection Bureau (CFPB) was established as an entity that is independent of the Board and the Board is required by statute to provide the CFPB with annual funding at a level that is determined by the Director of the CFPB, up to a cap established by Congress.[1] While Congress directed the Board to provide funding to the CFPB, up to a statutory cap, the Dodd-Frank Wall Street Reform and Consumer Protection Act, which established the CFPB, specifically prohibits the Board from intervening in any matter before the CFPB, including the appointment, direction of, or removal of any officer or employee of the CFPB.[2] The statute also directs the Comptroller General, not the Board, to audit the financial transactions of the CFPB. The CFPB is subject to review by an inspector general who may investigate any concerns regarding the misuse of funds.

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[1] 12 U.S.C. § 5497.
[2] 12 U.S.C. § 5492(c).

3. Bankers are concerned about their shrinking margin and would therefore like to see a higher rate environment. However, they are equally concerned about the effect of higher interest rates on commercial - especially agricultural - borrowers. Has the Federal Reserve quantified, however approximately, the effect of an increase in interest rates would have on agriculture and affiliated businesses?

Economists generally think that higher interest rates reduce investment by commercial businesses by increasing their borrowing costs. However, quantifying the magnitude of such effects is difficult because the statistical relationship between interest rates and business investment is confounded by the fact that both investment prospects and interest rates depend simultaneously on the level of economic activity. In addition, a substantial fraction of nonfinancial firms do not borrow from outside markets to finance new investment projects, relying instead on internally generated funds.

With regard to the agricultural sector as a whole, the modest increases in interest rates currently anticipated by the Federal Open Market Committee will probably have only modest effects on agricultural businesses for two reasons. First, total interest expenses, including both real estate and non-real estate debt, currently account for only a small share (about 5 percent) of total farm sector production expenses. Second, the continued low level of longer-term interest rates, which are particularly important for farm real estate financing and valuation, have allowed borrowers to lock in low rates for relatively long time periods. As a result, survey evidence indicates that declines in farm income associated with recent declines in agricultural commodity prices far outweigh most producers' concerns about the potential for modest increases in borrowing costs.

That said, producers with high-cost operations, significant leverage, and who lack off-farm income sources may face greater financial strains in a higher interest rate environment, especially if this relatively small group of higher-risk producers experience difficulties accessing credit. Farm equipment dealers and manufacturers, in particular, may be more vulnerable in a higher interest rate environment as sales of farm equipment have plummeted by more than 50 percent over the past two years. The Federal Reserve will remain attuned to the potential for financial strains resulting from the effects of interest rate increases on borrowing costs and land values.

(Effective for pay period starting on December 27, 2015)

Officers

Level	Minimum	Administrative Base Pay Cap	MidPoint
00/3	$173,100	$247,500	$218,800
00/2	$201,700	$260,000	$241,600
00/1	$217,500	$267,500	$253,600
D3	$230,200	$267,500	$263,200
D2	$230,200	$270,000	$263,200
D1	$230,200	$275,000	$263,200

Name	Division	Job Title	Comp Rate
Bialek,Mark	IG	Inspector General	313000.000000
Hammond,Donald V	COO	Chief Operating Officer	272500.000000
Alvarez,Scott G	Legal	General Counsel	272500.000000
English,William B	BDM	Sr Special Adviser to the Brd	272500.000000
Wilcox,David W	R&S	Director	272500.000000
Kamin,Steven B	IF	Director	272500.000000
Gibson,Michael S	BS&R	Director	272500.000000
Liang,Jean Nellie	OFS	Director	270375.000000
Laubach,Heinrich T	MA	Director	270000.000000
Roseman,Louise L	RBOPS	Director	267500.000000
Mitchell,William L	DFM	Director and CFO	267500.000000
Hunter,Maryann F	BS&R	Deputy Director	265000.000000
Van Der Weide,Mark Eugene	BS&R	Deputy Director	265000.000000
Meyer,Stephen A	MA	Deputy Director	265000.000000
Connors,Thomas A	IF	Deputy Director	265000.000000
Leahy,Michael P	IF	Deputy Director	265000.000000
Belsky,Eric	C&CA	Director	265000.000000
Eichner,Matthew J	RBOPS	Deputy Director	265000.000000
Wascher III,William L	R&S	Deputy Director	265000.000000
Covitz,Daniel M	R&S	Deputy Director	265000.000000
Marquardt,Jeffrey C	RBOPS	Deputy Director	265000.000000
Nelson,William	MA	Deputy Director	265000.000000
Clouse,James A	MA	Deputy Director	265000.000000
Madigan,Brian F	MA	Deputy Director	265000.000000
Lehnert,Andreas W	OFS	Deputy Director	264966.000000
Frierson,Robert Devere	SECY	Secretary of the Board	262500.000000
Smith,Elizabeth Michelle A	BDM	Assistant to the Board	262500.000000
Clark,Michell C	MGT	Director	262500.000000
Mowry,Sharon L	IT	Director	262500.000000
Ashton,Richard M	Legal	Deputy Gen Coun Lit/System Ops	261620.000000
O'Day,Kathleen M	Legal	Deputy Gen Coun Banking Sup&Re	259560.000000
Edmondson,Wayne A	IT	Deputy Director	257890.000000
Reeve,Trevor A	BDM	Special Adviser to the Chair	257500.000000
Natalucci,Fabio Massimo	MA	Associate Director	257500.000000
Spaniel,William G	BS&R	Senior Associate Director	257500.000000
Lindo,Arthur W	BS&R	Senior Associate Director	257500.000000
Jennings,Jack P	BS&R	Senior Associate Director	257500.000000
Erceg,Christopher	IF	Senior Associate Director	257500.000000
Bouchard,Barbara J	BS&R	Senior Associate Director	257500.000000
Shanks,Margaret M	SECY	Deputy Secretary	257500.000000
Wilson,Beth Anne	IF	Senior Associate Director	257500.000000
Clark,Timothy P	BS&R	Senior Associate Director	257500.000000

Palumbo,Michael G	R&S	Senior Associate Director	257500.000000
Kiley,Michael T	OFS	Senior Associate Director	257500.000000
Vermilyea,Todd A	BS&R	Senior Associate Director	257500.000000
Engen,Eric M	R&S	Senior Associate Director	257500.000000
Hancock,Diana	R&S	Senior Associate Director	257500.000000
Lebow,David E	R&S	Senior Associate Director	257500.000000
Jones,David S	BS&R	Senior Adviser	257210.000000
Barger,Norah M	BS&R	Senior Adviser	257130.000000
Weinbach,Gretchen C	MA	Associate Director	256989.000000
Zakrajsek,Egon	MA	Associate Director	256978.000000
Passmore,Stuart Wayne	R&S	Senior Adviser	256880.000000
Zickler,Joyce K	MA	Senior Adviser	256259.000000
Solomon,Michael D	BS&R	Associate Director	254940.000000
Robertson,Linda L	BDM	Assistant to the Board	254672.000000
Misback,Ann	BS&R	Associate Director	254360.000000
Prager,Robin A	R&S	Senior Adviser	253990.000000
Foley,Susan V	RBOPS	Senior Associate Director	253872.000000
Capp,David J	MGT	Deputy Director	253770.000000
Ogden,James A	IG	Deputy Inspector General	252522.000000
Wheatley,Katherine H	Legal	Assoc Gen Coun Lit/Legal Svcs	252391.000000
Schaffer,Laurie S	Legal	Assoc Gen Coun Legislation&SP	252144.000000
Campbell,Sean D	BS&R	Associate Director	252000.000000
Evans,Gregory L	RBOPS	Senior Associate Director	250000.000000
Gallin,Joshua H	R&S	Associate Director	250000.000000
Sidari,David	RBOPS	Deputy Director	250000.000000
Casey,Micheline M	COO	Chief Data Officer	249919.000000
Martin,Stephanie	Legal	Assoc Gen Coun Mon & Cons Aff	249312.000000
Purcell,Peter J	BS&R	Senior Associate Director	249180.000000
Naylor II,Richard A	BS&R	Associate Director	249060.000000
Bowman,David H	IF	Associate Director	247800.000000
Bertsch,Kevin M	BS&R	Associate Director	247490.000000
McClanahan,Patrick J	DFM	Deputy Director/Controller	247200.000000
Ryu,Lisa H	BS&R	Associate Director	245000.000000
Sapong,Kofi A	IT	Senior Associate Director	245000.000000
Bell,Lisa M	IT	Senior Associate Director	245000.000000
Romero,Raymond	IT	Senior Associate Director	245000.000000
Clark,Sheila	COO	Program Director, ODI	244604.000000
Tevlin,Stacey M	R&S	Deputy Associate Director	243330.000000
Carey,Mark S	IF	Associate Director	243281.000000
Thomas,Charles P	IF	Associate Director	243281.000000
Lopez-Salido,Jose David	MA	Deputy Associate Director	243061.000000
Campione,Jeffrey C	R&S	Senior Associate Director	242000.000000
Sullivan,Thomas R	BS&R	Associate Director	241810.000000

Doyle,Brian M	IF	Senior Adviser	240573.000000
Gruber,Joseph W	IF	Deputy Associate Director	240056.000000
Ahmed,Shaghil	IF	Deputy Associate Director	240056.000000
Sexton,Michael J	BS&R	Associate Director	240000.000000
Edge,Rochelle M	OFS	Deputy Associate Director	239990.000000
Lambert,Michael J	RBOPS	Associate Director	239772.000000
Hewko,Anna L	BS&R	Deputy Associate Director	239000.000000
DeBoer,Margaret Gillis	MA	Deputy Associate Director	238797.000000
Ihrig,Jane E	MA	Deputy Associate Director	238797.000000
Boyd,Anna Alvarez	C&CA	Senior Associate Director	238703.000000
Williams,Cary K	Legal	Assistant General Counsel	238600.000000
Anderson,Jean C	Legal	Asst Gen Counsel HR&SP	238486.000000
Thro,Alison M	Legal	Asst Gen Coun Banking Sup & Re	238486.000000
Kennickell,Arthur Barry	R&S	Adviser	237710.000000
Glissman,Todd A	MGT	Senior Adviser	237553.000000
Killian,Suzanne G	C&CA	Senior Associate Director	237425.000000
Fields,Christine M	DFM	Associate Director	235355.000000
Bassett,William F	MA	Deputy Associate Director	235339.000000
Michaels,James A	C&CA	Associate Director	235252.000000
Finger,Christopher	BS&R	Associate Director	235000.000000
Claessens,Constantijn A	IF	Senior Adviser	235000.000000
Mills,David C	RBOPS	Assistant Director	234873.000000
Oakes,Nancy	BS&R	Special Counsel (Manager)	234840.000000
Yelisetty,Rajasekhar R	IT	Associate Director	234000.000000
Eskow,Glenn S	IT	Associate Director	234000.000000
Gilbert,Charles E	R&S	Sr Economist	233632.000000
Davis,Nida	BS&R	Associate Director	233620.000000
Sabelhaus,John E	R&S	Assistant Director	233500.000000
Skidmore,David	BDM	Assistant to the Board	233495.000000
Pelitere,Tara Tinsley	MGT	Associate Director & CTO	233040.000000
Lucier,Jennifer A	RBOPS	Deputy Associate Director	232650.000000
Wei,Min	MA	Deputy Associate Director	232000.000000
Kiser,Elizabeth K	R&S	Deputy Associate Director	231750.000000
Stevens,John J	R&S	Deputy Associate Director	231750.000000
Fishbein,Allen J	C&CA	Associate Director	231029.000000
Roberts,John M	R&S	Assistant Director	230720.000000
Hambley,Winthrop P	BDM	Senior Adviser	230644.000000
Hsu,Michael J	BS&R	Deputy Associate Director	230000.000000
Perkins,Nancy J	BS&R	Deputy Associate Director	230000.000000
Paul,Bajinder N	RBOPS	Associate Director	230000.000000
Aiken,Mary L	BS&R	Deputy Associate Director	229000.000000
Bryan,Patrick M	Legal	Asst Gen Coun Enforcement	229000.000000
Sherlund,Shane M	R&S	Assistant Director	228660.000000

Merriett,Steven P	BS&R	Deputy Associate Director	228380.000000
Rogers,John	IF	Senior Adviser	227904.000000
Mize,Lawrence E	RBOPS	Deputy Associate Director	227500.000000
Sperry,Stuart E	RBOPS	Deputy Associate Director	227480.000000
Savoy,Marie S	MGT	Sr Assoc Director,Facility Svc	227423.000000
Clubb,Christopher W	Legal	Special Counsel	227400.000000
Morin,Norman J	R&S	Chief, Economic Section	227400.000000
Bettge,Paul W	RBOPS	Associate Director	227045.000000
Pope,Tameika L	BS&R	Deputy Associate Director	227000.000000
Watkins,Richard C	BS&R	Deputy Associate Director	227000.000000
Crossen,Janet S	Legal	Special Counsel	226882.000000
Rudd,Jeremy	R&S	Senior Adviser	226830.000000
Luecke,Matthew M	MA	Assistant Director	226004.000000
Schindler,John W	OFS	Assistant Director	225858.000000
Davies,Sally M	IF	Senior Adviser	225830.000000
Haltmaier,Jane	IF	Senior Adviser	225830.000000
Duygan-Bump,Burcu	MA	Adviser	225000.000000
Quimby,Kassandra Arana	IT	Associate Director	225000.000000
Warren,Sheryl Lynn	IT	Associate Director	225000.000000

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

1. Custody banks are reportedly finding it increasingly difficult to provide core custody services, particularly accepting large cash deposits. This has been attributed to recent regulatory reforms such as the Supplementary Leverage Ratio. Custody banks typically place certain types of cash received from clients on deposit with the Federal Reserve, due to the high liquidity and essentially riskless nature of Fed deposits. The Federal Reserve's Supplementary Leverage Ratio, however, does not recognize the riskless nature of Fed deposits. The inclusion of central reserve deposits in the Supplementary Leverage Ratio, and the attendant cost, appears to be leading custody banks to push away customer deposits.

What evaluations has the Federal Reserve Board conducted on the impact of emerging limitations on custody banks' ability to accept cash deposits on markets, financial stability, and investors, especially during times of financial stress?

Beginning in 2018, the Federal Reserve Board's (Board) regulatory capital rules require internationally-active banking organizations to hold at least 3 percent of total leverage exposure in tier 1 capital Supplementary Leverage Ratio (SLR) requirement. Total leverage exposure is calculated under the SLR requirement as the sum of certain off-balance sheet items and all on-balance sheet assets.[1] Under the SLR requirement, a banking organization must hold a minimum amount of capital against on-balance sheet assets, including cash, and off-balance sheet exposures, regardless of the risk associated with the individual exposures. By requiring large banking organizations to hold more capital based on their size, the SLR increases their resiliency. Thus, the SLR requirement is designed under the principle 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 items, such as cash, from a banking organization's total leverage exposure would be inconsistent with this principle.

In addition, the Board issued in April 2014, a final rule that imposed enhanced SLR requirements on U.S. banking organizations identified as global systemically important banking organizations (GSIBs). As indicated in the preamble to the final rule, the enhanced SLR requirements serve important safety and soundness goals. The requirements would reduce the likelihood of bank failures by requiring the banking organizations subject to the rule to hold additional capital.[2] In addition, "[by] further enhancing the capital strength of covered organizations, the enhanced [SLR requirements] could counterbalance possible funding cost advantages that these organizations may enjoy as a result of being perceived as 'too big to fail.'"[3]

The enhanced SLR requirements in the final rule will require U.S. top-tier bank holding companies identified as GSIBs to maintain an SLR of more than 5 percent to avoid

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[1] See 79 FR 57725 (September 26, 2014), available at http://www.gpo.gov/fdsys/pkg/FR-2014-09-26/pdf/2014-22083.pdf.
[2] See 79 FR 24528, 24530 (May 1, 2015).
[3] See id.

restrictions on capital distributions and discretionary bonus payments to executive officers.[4] Insured depository institution subsidiaries of these bank holding companies must maintain at least a 6 percent SLR to be "well-capitalized" under the federal banking agencies' prompt corrective action framework.

In connection with the final rule, Board staff estimated the impact of the rule on GSIBs, including on the two largest custody banks. Board staff estimated a tier 1 capital shortfall across U.S. GSIBs of approximately $68 billion to meet a 5 percent SLR, but all internationally-active banking organizations firms were estimated to already meet the minimum 3 percent SLR requirement.[5] At that time, Board staff also estimated the amount of capital required to meet a 3 percent SLR under stressed conditions (on a post-stress basis) and found it to be roughly equivalent to the amount of capital required to meet the 5 percent SLR on a pre-stress basis.

As noted above, the SLR requirement and the enhanced SLR requirements do not become effective until January 1, 2018. According to public disclosures of firms subject to these requirements, the GSIBs have made significant progress in complying with the enhanced SLR requirements.

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[4] See 79 FR 24528 (May 1, 2014), available at http://www.gpo.gov/fdsys/pkg/FR-2014-05-01/pdf/2014-09367.pdf.

[5] See Staff memo to the Board 'Draft final rule on enhanced supplementary leverage ratio (SLR) standards'; p.2, available at http://www.federalreserve.gov/aboutthefed/boardmeetings/20140408openmaterials.htm.

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

1. In your testimony, you indicated that banks within the Large Institution Supervision Coordinating Committee (LISCC) portfolio are those that pose elevated risk to U.S. financial stability and, for this reason, those firms are subject to the Fed's heightened liquidity risk management and stress testing requirements. I agree that supervisory requirements should be tied to actual risk posed to the financial system. Yet, you also indicate that any firm with more than $250 billion in assets is subject to the "full" version of the Liquidity Coverage Ratio (LCR), even if the firm is not a LISCC bank. Why does it make sense to impose LCR on a bank simply because of its asset size even if the bank does not pose elevated risk to the U.S. financial system?

The Federal Reserve is committed to ensuring that our regulations, including the liquidity coverage ratio (LCR), are appropriately tailored to the size and risk profile of regulated firms. The LCR is designed to promote the short-term resilience of the liquidity risk profile of large and internationally active banking organizations, thereby improving the banking sector's ability to absorb shocks arising from financial and economic stress, and to further improve the measurement and management of liquidity risk. The LCR is a minimum liquidity requirement that ensures covered firms maintain a sufficient amount of high-quality liquid assets (HQLA) to meet net cash outflows under a standardized 30-day stress scenario. The net cash outflows are measured based on the activities of a covered firm, so the HQLA requirements in the LCR adjust to the risk profile of the particular firm. For example, a covered firm primarily funded with insured retail deposits would incur a substantially lower measure of net cash outflows compared to a covered firm primarily funded with short-term wholesale funding. Large Institution Supervision Coordinating Committee (LISCC) firms, which are the largest and most complex financial institutions, are subject to additional liquidity reporting, risk management, and stress testing requirements, as compared to other banking organizations.

2. Chair Yellen, in your testimony, you note that several heightened regulatory requirements, like LCR and the Basel Accords, apply to banks that are "internationally active." Yet, your testimony states that a bank is considered "internationally active" simply because it has $250 billion or more in assets--even if it has no or limited foreign activities. Can you explain why a bank should be considered "internationally active" even if it has no or very limited foreign activities?

The full version of the LCR applies to large, as well as internationally active, banking organizations in the United States, which generally have more complex liquidity risk profiles based on their size and breadth of activities. The LCR focuses on these large and internationally active banking organizations to promote the short-term resilience of their liquidity risk profiles, thereby improving their ability to absorb shocks arising from financial and economic stress, and to further improve their measurement and management of liquidity risk. Large and internationally active banking organizations are

those that have $250 billion or more in total assets or $10 billion or more in on balance sheet foreign exposure.

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

3. I am pleased that the International Association of Insurance Supervisors (IAIS) and the Financial Stability Board have acknowledged that they have more work to do on the Higher Loss Absorbency (HLA) requirement. HLA includes features that, by the Board's own admission, unfairly target products offered in the U.S. insurance market. I am particularly concerned that the IAIS principles used to identify Non-Traditional, Non-Insurance (NTNI) activities are inappropriate and would be harmful to guaranteed lifetime products commonly available in the U.S. Do you share those concerns? How will you ensure that any final HLA protects the interests of U.S. insurance companies and consumers and preserves a level playing field?

With regards to your comments on the Higher Loss Absorbency (HLA) requirement and the definition of Non-traditional and Non-insurance activities and products (NTNI) as they are presently set out by the International Association of Insurance Supervisors (IAIS), the HLA requirement remains under development, as noted in the HLA Document. Moreover, work currently underway at the IAIS to further develop the NTNI definition will lead to changes in the HLA requirement. The recently published NTNI Public Consultation Document highlights the evolving nature of the IAIS's NTNI definition. One of the IAIS's goals with this project will be to ensure consistency of the application of NTNI across jurisdictions. This has been advocated for by the Federal Reserve Board (Board) as well as the Federal Insurance Office, state insurance commissioners, and National Association of Insurance Commissioners as part of our Team USA approach to IAIS deliberations. The Board continues to advocate for the development of international standards at the IAIS that best meet the needs of the U.S. insurance market.

It is also important to keep in mind that the international insurance standards currently under development at the IAIS are not self-executing or binding on the U.S., neither at the state nor federal levels, and cannot be imposed on U.S. firms by an international body. Rather, these standards apply in the United States only if adopted by the appropriate U.S. regulators in accordance with applicable rulemaking procedures. Additionally, none of the standards are intended to replace the existing legal entity requirements that are already in place. Therefore, regardless of the HLA and NTNI standards developed at the IAIS, the standards applicable to insurers supervised by the Board will reflect the Board's evaluation of the standards' appropriateness for the U.S. market, U.S. insurers, and consumers.

4. You and other Federal Reserve officials have often responded to questions on the international insurance capital negotiations by stating that the Board will go through its own rule making process, including notice and public comment. Under Dodd-Frank, the Board is separately charged with rulemaking to adopt a capital framework for insurance savings and loan holding companies and insurance SIFIs. How will these rule makings converge? Will the Board propose one set of rules that works for both purposes, or implement Dodd-Frank and the Insurance Capital

Standards Act, and then propose a second, separate rule implementing any international agreement applicable to federally supervised insurers? What assurances can you give this Committee that the Board will not agree to anything internationally that could interfere with a robust rulemaking process in the United States?

As you note, under the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Board assumed responsibility as the consolidated supervisor of insurance holding companies that own thrifts, as well as insurance companies designated by the Financial Stability Oversight Council. Our principal supervisory objectives for the insurance holding companies that we oversee are protecting the safety and soundness of the consolidated firms and their subsidiary depository institutions, and mitigating financial stability risk. The Board continues to focus on constructing a domestic regulatory capital framework for our supervised insurance holding companies that is well tailored to the business of insurance.

The Board is exploring possible approaches to a capital standard for insurers who are also savings and loan holding companies and insurance systemically important financial institutions (SIFIs). A specific approach has not been determined as of this date. The Board is committed to a capital approach that is tailored to the unique risks of insurers and one that is appropriate for the U.S. market, insurers and consumers. We are committed to following a transparent rulemaking processes to develop our insurance capital framework, which will allow for a period of open public comment on a concrete proposal.

International regulatory standards cannot be imposed on U.S. firms by an international body; rather, these standards apply in the United States only if adopted by the appropriate U.S. regulators in accordance with applicable rulemaking procedures conducted here.

5. Can you provide to this Committee information on the staff resources at the Fed assigned to the development of insurance capital standards and the supervision of insurance companies? Please provide to the Committee an organizational chart with information on the number of staff assigned to these insurance functions, including the number of insurance actuaries. Please include an organizational chart and information on staff responsibilities, job titles, and lines of reporting.

The Federal Reserve has invested significant time and effort into enhancing our understanding of the insurance industry and firms we supervise, and we are committed to tailoring our supervisory framework to their specific business lines, risk profiles, and systemic footprints. Our insurance company supervisory teams are a combination of experienced Board staff as well as staff with insurance expertise. Across our system, we currently employ approximately 90 full-time equivalents for the supervision of insurance firms. Many of our supervisors are individuals with substantial prior experience in state insurance departments or the insurance industry, including individuals with experience and credentials in actuarial science, accounting, and financial analysis. Staff responsibilities include development of insurance capital standards as well as other fulfillment of statutory mandates for the Board's regulation of insurers, policy

coordination and rulemaking, and supervision and examination of insurers. We plan to continue to add staff, as appropriate, at both the Board and the Reserve Banks, to ensure we have the proper depth and experience to carry out our mandate.

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