Open Board Meeting Transcript **June 7, 2012**

Discussion Agenda:

1. Proposed interagency rulemakings: strengthening and harmonizing the regulatory capital framework for banking organizations, including proposed rules for implementing Basel III for banking organizations and proposed consolidated capital requirements for savings and loan holding companies.

2. Final interagency rulemaking: market risk capital rule.

[Background noise]

CHAIRMAN BEN BERNANKE: Good afternoon. I’d like to begin by welcoming our guests to the Federal Reserve.

The proposed rule-making we're considering today is a further step toward putting in place the integrated and comprehensive regulatory capital framework, known as Basel III, that the Board has been developing for some time in consultation with our domestic and international colleagues. Critically, this framework would require banking organizations to hold more and higher quality capital. We would also finalize the market risk requirements thus implementing what is known as Basel 2.5. Reduced compliance costs and minimized effects of higher capital on lending, the proposed rule-making would phase in the new requirements over a period of time.

Capital is important to banking organizations and the financial system because it acts as a finish cushion to absorb firm losses, while reducing the incentive for firms to take excessive risks. With these proposed revisions to our capital rules, banking organization's capital requirements should better reflect their risk profiles, leading to improved resilience in the U.S. banking system in times of stress, and thus contributing to the overall health of the US economy.

So I welcome the staff as well, and I look forward to today's discussion of this important initiative. Let me turn the meeting over to Governor Tarullo.

GOVERNOR DANIEL K. TARULLO: Thank you, Mr. Chairman. While numerous capital requirements are not a sufficient condition for a strong, resilient financial system, they're surely a necessary one. Banks with a strong capital position can absorb losses from unexpected sources, whether an external shock to the economy, the insolvent inventories of important counter parties, or a failure of risk management within the firm. Strong capital buffers help ensure that losses are borne by shareholders of the bank, not by taxpayers, either directly through some form of bail out, or indirectly, through a major negative effect on the economy resulting from a bank's failure.

Uncertainty about the capital positions of large financial firms was a major factor in the turmoil that beset the country in the fall of 2008. The subsequent increases in capital at our major banks, along with the information provided by the stress tests in 2009 were important factors in stabilizing the system. Pre-crisis capital requirements had been too low in general; had risk weights that were especially inadequate for certain securitized and other traded instruments; were too easily met through capital instruments lacking the loss absorption capacity of common equity; and were focused almost exclusively on firm-specific rather than economy-wide risk.

The one final and three proposed rules before us this afternoon mark an important milestone on the road to a set of strong, complimentary capital standards for banking organizations. We have already promulgated a rule for annual capital reviews of large bank holding companies, which are conducted against the backdrop of our annual stress tests. Last year the three federal banking agencies adopted a rule to implement the so-called Collins amendment of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which provides that banks using the Basel II advanced approach must also meet capital requirements as calculated using the standardized method applicable to all banks.

As staff will shortly explain, the final rule before us today would address inadequacies in trading book capital requirements as agreed in the so-called Basel 2.5 revisions to the international market risk capital framework. The three proposed rules would increase both the quantity and quality of required capital, focusing squarely on common equity, as well as update both the standardized and advanced methods for calculating capital requirements.

While approval of today's proposals will mark major progress on the way to overhauling capital requirements, it does not signal the end of that effort. Clearly, of course, we will need to finalize the three proposed rules. Next, once refinements of the Basel framework on capital surcharges have been completed, we will need a regulation to apply surcharges to U.S. institutions with the largest systemic footprints.

Looking beyond these measures already in train, I hope that we and other regulators will also consider two ideas for further capital reforms. First, depending on the results of the fundamental review of the trading book currently underway in the Basel committee, we may want to return to the market risk capital requirements at a later date. I, for one, am particularly interested in exploring possible standardized capital requirements for market risk as a backup for model-derived risk weights, just as we do now for credit risk. Second, we may want to consider changes in capital requirements to ensure that there would be adequate subordinated debt for similar liabilities on the balance sheets of the largest banking firms to help ensure they could be successfully resolved under title II of Dodd-Frank through the conversion of debt to equity.

The reason for the multiplicity of capital requirements, which also include a new leverage ratio, is that every individual capital measure has limitations and is subject to regulatory arbitrage. However, it is important to note that the full set of these requirements would be applicable only to the largest institutions. Smaller banks are not covered at all by the stress testing, capital review, and surcharge requirements; nor will they be subject to the new Basel III leverage ratio or counter cyclical buffer; nor are they likely to be effected by most of what is in the market risk requirements or of course to the changes in the advanced approaches risk weights. For smaller banks, there will still be only two capital requirements: the traditional leverage ratio and the standardized risk weight approach that is being updated in one of today's proposed rules.

All four of the rules before us today are the product of joint rule-making with the FDIC and OCC. Most of the content of those rules was also the subject of the Basel 2.5 and Basel III international capital frameworks. I should note that Board staff provided significant leadership in the Basel discussions over the last several years. They also spent many hours drafting the rules before us today as interagency negotiations eventually yielded agreement or compromise on individual points. Anna Lee Hewko in particular, has been indefatigable in bringing this work to a conclusion. I mention this not to just give kudos to Anna Lee to Mike Gibson, Nora Barger, Pat Parkinson and others, deserved as they are, but also to underscore the fact that these are consensus rules, the product of extended negotiating and collective drafting efforts. Left to my own devices, I would not have written everything the way it is in these rules. Indeed, I doubt that anyone, staff or principal, at any of the three banking agencies would have done so. We will, of course, have ample opportunity to consider the comments on the proposed rules with respect to items that the agencies have added to international standards and to consider alternatives.

All of that being said, I want to reiterate, unqualifiedly, that the package as a whole will be a major contribution to achieving a strong financial system. And with that, Mr. Chairman, I turn to Governor Duke.

GOVERNOR ELIZABETH A. DUKE: Thank you. I'll confine my opening remarks to the aspects of the rule that seem most applicable to community banks. I want to begin by declaring my support for strong levels of high-quality capital in banks of all sizes. The recent experience in the financial crisis demonstrated that the level and quality of a bank's capital was a primary factor in its ability to withstand adverse conditions and continue lending to households and businesses. This is just as true for small banks as it is for large ones. Not only will stronger capital add resilience to individual institutions, but all banks, including community banks, also benefit from the strengthening of the entire financial system. Aggregate additional capital held by all banks should reduce volatility in financial markets and collateral evaluations. Furthermore, under Dodd-Frank and in this proposal, larger banks using the advanced approach to determine their required capital will not be able to reduce their required capital to levels lower than that required of community banks. This would remove the concern expressed by community banks about Basel II that larger banks could gain a competitive pricing advantage through lower capital requirements for some banks.

I would especially like to applaud the staff for an exemplary effort that not only incorporates the provisions of Dodd-Frank and Basel III, but also restructures the capital rules into a harmonized, integrated regulatory framework. The product of this effort runs hundreds of pages, so I want to thank and commend the staff for the breakthrough practice of including a shorter summary for the provisions that apply to community banks. The summaries, which are included as addenda to the two proposals that effect community banks, reduce this much required reading to 34 pages. And I would note that each of the summaries contain references back to the sections of the full rule for those who want to drill down further into the details.

I think this is an especially available innovation for regulatory proposals. It's very important that we hear comments from banks of all sizes. Yet I know from personal experience how daunting it is to wade through hundreds of pages of sometimes complicated provisions to try to understand which provisions are applicable to a small community bank. Perhaps by offering the summaries, we will receive more specific comments from community banks, and comments from banks that otherwise would be deterred by the sheer volume of the proposals. I really like the summaries, and I think they might be helpful beyond their usefulness for community banks. But since they're included as an addendum, they don't appear until late in the documents. I confess I don't know the issues you face in the legal framework, but I hope we’ll continue to use summaries in future rule-makings, and find a way to alert readers very early in the document about the existence and the location of the summaries.

And finally, I'd like to stress the importance of understanding the trade-offs between the costs of significant changes to bank accounting and reporting systems against the benefits of more granular calibration of risk. Some parts of the proposal seem to me likely to require significant reprogramming by smaller banks. Before we impose such burdens it's important that we understand the costs involved with each data element and weigh it against the expected improvement of the resiliency of the financial system. So I will be especially interested in commentary on the operational burdens that these rules might impose. And now I'll turn it over to Mike Gibson.

MICHAEL GIBSON, DIVISION DIRECTOR, BANKING SUPERVISION & REGULATION: Thank you. In our staff presentation today, I will begin with a brief discussion of how the capital reforms we are discussing today fit into the larger package of reforms that are underway in the wake of the financial crisis. Mike Kiley will discuss the macroeconomic impact of higher capital requirements. Anna Lee Hewko will describe the proposed and final rules in more detail.

Stronger capital standards are an important part of the regulatory reform practice that is being put in place in response to the financial crisis. In addition to the package of rules we are discussing today, there are other complimentary efforts underway to strengthen capital, particularly at the largest financial firms. The Federal Reserve has adopted a capital plan rule in which the largest banking organizations must annually stress test their capital positions against an adverse economic scenario. The capital plan rule is the basis of the Federal Reserve's enhanced prudential standards proposed under Section 115 of Dodd-Frank. We intend to supplement that proposal with a subsequent proposal to implement a risk-based capital surcharge based on the Basel committee's surcharge for globally systemic banking organizations.

Outside of capital, reforms are underway to make large banking organizations more resolvable. In the United States, large banking organizations will soon be submitting resolution plans or living wills to the FDIC and Federal Reserve to help ensure that they can be resolved without causing a systemic risk. If a systemically important financial firm does get into severe financial difficulty and its failure to pose a threat to financial stability, orderly liquidation authority under title II of the Dodd-Frank Act can now be used by the FDIC to resolve such a firm. In addition, the Federal Reserve has strengthened its supervision of the largest bank holding companies through the creation of the LISCC, the Large Institution Supervision Coordinating Committee. And important reforms are underway to reduce the potential for systemic risk from OTC derivatives, including an emphasis on central clearing of derivatives.

All of these elements of the reform practice taken together are intended to increase the resiliency of the financial sector and ensure that the banking system can support a return to strong and stable growth for the U.S. economy. And I'll now turn it over to Mike Kiley.

MICHAEL KILEY, ASSOCIATE DIRECTOR, RESEARCH & STATISTICS: Thank you. In my remarks, I will summarize the staff's assessment of the benefits and potential costs to the macroeconomy that may stem from higher capital requirements for the banking sector. In order to assess the effects on the macroeconomy of higher capital requirements, staff investigated a range of possible channels and impacts, used a variety of approaches, and consulted with experts from academia and from the private sector. This analysis involved consultations with staff from central banks and regulators around the world, which were coordinated by the Basel committee. Much of this work was performed over the course of 2010 and the initial Basel proposals were being formed.

In macroeconomic terms, the main benefit of stronger capital requirements stem from a lowering in the probability of a banking crisis and the associated output losses. In addition, higher capital buffers are likely to reduce the amplitude of fluctuations in economic activity outside crisis periods. A variety of approaches were used to examine these possible effects. In general, these analyses found significant economic benefits from higher capital requirements for two reasons. First, historical experience suggests that the cumulative loss of economic activity from a banking crisis is sizeable. And second, experience also demonstrates that higher levels of capital reduce the probability of a crisis.

Analyses were also careful to consider the macroeconomic costs that could accompany higher capital requirements. Using a range of models and approaches, staff considered the possible impact of higher capital requirements on banks' cost of funds as well as banking institutions reactions to such changes. Overall, our analyses considered cases in which the impact of higher capital on bank costs were significant, and could potentially affect their willingness to lend. Nonetheless, such long run adverse consequences were estimated to be modest relative to the benefits.

Finally, our assessment considered the impact of higher capital requirements over the transition period that is part of the proposed standards. Using a range of macroeconomic models, the possible short-run costs in terms of economic activity that could stem from higher borrowing costs charged by banks or decreased willingness to lend were estimated to be moderate. Indeed, the potential adverse impacts on economic growth estimated by most of our approaches on a per year basis were low, quite low relative to the year-to-year fluctuations in growth that typically characterized economic recoveries. The modest drag on economic growth in the short run estimated in our analysis owed partly to the transition period, which ensures that banking organizations have sufficient time to adjust to the new standards in a forward-looking manner, thereby facilitating continued access to credit for borrowers, as these important new standards are implemented.

That concludes my prepared remarks. Anna Lee will follow up with more detail.

ANNA LEE HEWKO, ASSISTANT DIRECTOR, BANKING SUPERVISION & REGULATION: Thank you. The final rule and proposals before the Board today are the product of a tremendous team effort across divisions here at the Board, and they represent the culmination of a major policy initiative to address weaknesses in the regulatory capital framework highlighted by the financial crisis. I will provide an overview of the rule-makings this afternoon, and my colleagues, including Connie Horsley, Tom Boemio, April Snyder, and Ben McDonough can help answer questions about the details of the rule-makings.

As several governors have mentioned, in considering how to implement the Basel agreements in the United States, staff considered which aspects of the agreements were most appropriate for which banking organizations. Some parts of the proposal before you today would apply to all banking organizations; whereas others would apply to a subset, based on their size, foreign exposure, or trading activities. In particular, a number of aspects of Basel 2.5 and Basel III that would significantly raise capital requirements for trading and derivatives activities would apply only to a small number of banking organizations subject to either the market risk rule or the Basel II advanced approaches rule, less than 35 bank holding companies in all. And for internationally active banking organizations, the proposals combined with the final market risk rule would fully implement the Basel 2.5 and Basel III agreements to the extent permissible in the United States.

Today's proposals also reflect a domestic response to weaknesses revealed by the financial crisis, especially insufficient risk sensitivity regarding real estate-related exposures and statutory requirements of the Dodd-Frank Act. Taken together, staff believes that the proposals would result in capital requirements that better reflect banking organizations' risk profiles and enhance their ability to continue functioning as financial intermediaries, including during periods of financial stress.

The agencies’ capital rules have been created and updated in a somewhat piecemeal fashion over the last two decades. Given the scope of changes being proposed, the agencies took the opportunity to integrate the various capital rules into a comprehensive framework that removes inconsistencies that exist across the agencies’ current capital standards. This complete restatement of the capital rules is a key reason for the length of the proposals before you today. There's a lot of repetition of what we're keeping as well as introduction of new material.

So the agencies have taken several steps to make the proposed comprehensive framework for digestible for commenters. First, we are proposing it in three separate NPRs to help make clear which proposals apply to which banking organizations, and help interested parties focus their comments on particular areas of interest. The first two NPRs apply to all banking organizations, including state member banks, bank holding companies not subject to the Board's small bank holding company policy statement, and consolidated savings and loan holding companies. In contrast, the third NPR applies only to banking organizations subject to the market risk capital rule or the Basel II advanced purchase rule. In addition, as Governor Duke mentioned, the first two NPRs contain addendum to the preamble that highlight the differences between the current capital rules and the proposed framework that are most relevant for community banking organizations.

Turning to the substance of the proposals, the first NPR would raise the quantity and quality of regulatory capital. Consistent with Basel III, it will establish a new common equity tier 1 capital requirement of 4.5 percent of risk-weighted assets. It would raise the tier 1 capital requirement from 4 percent to 6 percent of risk-weighted assets, and would leave the minimum total capital ratio requirement unchanged at 8 percent.

On top of these minimums, the proposal would also establish a capital conservation buffer, comprised of common equity tier 1 capital, equal to 2.5 percent of risk-weighted assets. The buffer is designed to provide incentives for banking organizations to hold sufficient capital to with stand a severe systemic stress event and still remain above the minimum capital levels. The proposal emphasizes common equity tier 1 capital, which is the highest quality, most loss absorbing type of capital, and it's the measure that the Federal Reserve has been using in its Comprehensive Capital Analysis and Review, or CCAR, as well as the capital plan rule.

Also consistent with Basel 3, the proposal introduces more strict criteria for allowing instruments to be included in regulatory capital, as well as more stringent deductions from capital. Most capital instruments traditionally issued by depository institutions already meet these criteria. So the main impact would be that cumulative preferred securities and trust-preferred securities would no longer qualify as capital for bank holding companies with transition provisions. The approximately 20 bank holding companies and their subsidiary depository constitutions that are subject to the advanced [Inaudible] rule would be subject to an additional capital requirement, a supplementary leverage requirement of 3 percent. This requirement is consistent with the leverage ratio developed by the Basel committee as part of the Basel III package. And the most important difference from our current leverage ratio is that it includes off-balance sheet exposures in its measure of exposure.

So turning to impact, most community banks would meet the new minimum capital requirements plus the capital conservation buffer if they were imposed in full today. In looking at the impact of the entire proposal on bank holding companies under $10 billion that meet our current regulatory capital requirements, our pro forma analysis indicates that more than 90 percent would meet the 4.5 percent minimum common equity tier 1 ratio today. And more than 80 percent would meet the 7 percent common equity tier 1 ratio, plus buffer level. The aggregate shortfall for these banking companies not meeting the 7 percent plus buffer would be about $3.6 billion. As Mike mentioned, the proposals contain an extended transition period that would allow banking organizations that don't meet the minimums or the buffers today to accrete capital through the retention of earnings, in particular the buffer is proposed to be phased in from 2016 until 2019.

During the CCAR process in 2012, supervisors assess whether each of the largest 19 bank holding companies was making steady process to meet the Basel regulatory capital standards, including Basel III, 2.5, and III. The assessments indicated that these firms generally are on the path to meet the proposed capital requirements over the proposed transition period with an aggregate tier 1 common shortfall of approximately $50 billion. The new minimum capital requirements under the proposals would have additional implications for large banking organizations subject to the capital plan rule or to the Basel II advanced approaches rule. Governors Tarullo and Duke have already mentioned that they would serve as a floor for banking organizations subject to the advanced approaches. And in addition, the higher minimum capital requirements would flow through to the capital plan rule, which requires bank holding companies with $50 billion or more in consolidated assets to demonstrate that they can maintain capital above their minimum capital requirements over nine quarters of stress conditions. So those minimums would be raised.

Turning now to the denominator of the risk-based capital ratios, the proposal contains a standardized approach for calculating risk-weighted assets that is similar to the approach in our current capital rules, but contains some more risk-sensitive elements and options. For most banking organizations, the most important changes are in the treatment of residential mortgages and certain land development loans, and reflect lessons learned from the financial crisis about the risk of these types of exposures.

The proposed approach for residential mortgages is more risk-sensitive and granular than the current approach, which assigns almost all first lien mortgages a preferential 50 percent risk weight. Instead under the proposed approach residential mortgages would be divided into two categories based on whether they meet certainly credential, underwriting, and product characteristics. Mortgages in both categories would be assigned a risk weight based on their loan-to-value ratio at time of origination. The risk weights would range between 35 [percent] and 200 percent.

Land acquisition, construction, and development loans have significantly higher delinquency and charge-off rates than other commercial real estate loans and have contributed significantly to a number of recent bank failures. Thus, the proposal would increase the risk weight on most acquisition, construction, and development loans to 150 percent.

Turning to the market risk rule, it would significantly strengthen capital requirements for the trading activities of approximately 25 bank holding companies, capturing risk beyond those captured in the current rule and reducing capital arbitrage opportunities. The calibration of the final market risk rules capital requirements would reflect appropriate periods of market distress and better reflect the tail risk of positions. And in addition, the final rule would significantly increase capital requirements for structured credit products, whose risks were previously not adequately captured.

In addition to this rather granular, micro-prudential risk sensitivity, the proposals and the final rule contain a number of macro-prudential elements designed to mitigate risk and cyclicality in the financial system as a whole, as well as promote the safety and soundness of the individual banking organizations. For example, in addition to the capital conservation buffer, all banking organizations would be subject to capital requirements that are calibrated to reinforce the migration of derivative transactions to central counterparties. They would also be subject to capital deductions designed to incent reduce inter-- reduced interconnectedness amongst financial firms.

The advanced approaches rule would also layer on a number of macro prudential features to which smaller banking organizations would not be subject. These include a countercyclical capital buffer that allows regulators to increase the capital conservation buffer, and thus loss-absorption capacity in the system in times of excessive credit growth. Counterparty credit risk capital requirements on derivatives that reflect the heightened systemic risk associated with the interconnectedness of large derivatives dealers and increased capital requirements for credit exposures to large financial firms. The market risk rule also contains macro-prudential elements designed to reduce procyclicality and mitigate other weaknesses associated with bar-based measures.

The proposal in the final rule implements a number of requirements of the Dodd-Frank act. For example, the proposal incorporates consolidated capital requirements for savings and loan holding companies; it establishes generally applicable depository institution capital requirements that serve as a floor for other capital requirements; and it narrows the current definition of capital bank holding companies.

Consistent with Section 939A of the Dodd-Frank Act, the proposal and the final rule do not include any references to credit ratings, and the greatest impact of this provision is on the treatment of securitization exposures. Last December the agencies proposed alternative measures of credit-worthiness in the context of the market risk rule. The agencies have modified the proposed approaches based on comments received and aspects of the modified approaches are in today's standardized and advanced NPRs and in the final market risk rule.

Finalizing the market risk rule would significantly strengthen capital requirements for trading activities and would be a significant step forward in addressing weaknesses in our capital rules, highlighted by the financial crisis. The proposed comprehensive capital framework would build on that progress, increasing the quality and quantity of capital held by all banking organizations and targeting specific risk areas where the current capital rules have proven insufficient. Together, the rule-makings before the Board today would better position U.S. banking organizations to continue to function as financial intermediaries during times of stress and enhance the resiliency of the system as a whole.

So that concludes my prepared remarks, and my colleagues and I would be pleased to answer your questions.

CHAIRMAN BERNANKE: Thank you very much. This is the culmination of a very long process that's involved international negotiations as well as coordination with other agencies here in the United States. And I would also like to extend my appreciation to the staff for their persistence as well as their good work. Could you explain a little better--you were talking about the shortfalls that banks current have relative to these capital requirements. Over the period in which these requirements are phased in, would you expect to see banks having to issue new equity? Or can they meet these requirements through earnings? What is our general sense of what they have to raise?

HEWKO: Our general sense is they could meet it through retained earnings, both on the small bank side and the large bank side. Banks have done significant capital rises already, and that's positioned them well to meet the requirements as they phase in.

CHAIRMAN BERNANKE: Thank you. Could you talk a little bit about--you did mention the phrase prompt, corrective action in your presentation. Could you talk a little bit about how that is imported? How that works in the--in the context of this proposal?

HEWKO: Sure. I'll actually turn it over to my legal colleagues for that.

APRIL SNYDER, SENIOR COUNSEL, LEGAL: So the prompt corrective action framework would be revised to will you the new minimum requirements that would be established by the proposals. It would not include the counter--the capital conservation buffer, as that buffer has a different intention, which is to encourage banking organizations to maintain a cushion above their minimum requirements in order to absorb losses under times of stress. And that is accomplished by placing an increasing--increasingly stringent limits on capital distributions and bonus payments as the buffer starts to fall and get closer to the minimum ratios. Under the PCA framework, if a banking organization falls below the minimum ratios, as is the case today, then other supervisory actions would automatically take effect. So the two frameworks have different purposes.

CHAIRMAN BERNANKE: Thank you. This is kind of a technical question, but this has to do with the unrealized gains and losses on available for sale debt securities, which now under this proposal are going to feed through into tier 1 common equity. I understand the benefits of having a certain mark-to-market approach to capital. But on the other hand, this will increase volatility in measured capital, perhaps make it more difficult to plan. Could you discuss the benefits and costs of making this change?

HEWKO: Sure. Art’s going to talk about that.

ART LINDO, SENIOR ASSOCIATE DIRECTOR, BANKING SUPERVISION & REGULATION: Certainly. A guiding principle throughout this discussion has been loss absorbency of capital. When we looked at some of the volatility that existed in the current capital, some of that was constrained because we reversed certain types of losses, the ones you reference in particular, the unrealized holding losses on available sale equity securities. At the same time, we realized during the crisis if we were to have a liquidity or other problem, those securities, properly valued, could not be, in essence, increased in value by the reversal of these losses. Excuse me. So during our deliberations, we weighed whether that was a benefit longer term. We looked at the individual impact. There was some volatility over a period of time.

We ran the numbers as recently as this past March, our most recent [Inaudible] data. And we found in those cases, we looked at the introduction of unrealized holding gains and losses to the capital regime actually added it. It increased the amount of capital that firms had available to meet the requirements. So in times of an economic downturn or changes in interest rate, that may be reversed. But what we did factor in is over a period of time whether or not those costs could be absorbed. And that's in large part because we thought that modeling that would be of importance. We did look at a period of time, and a most recent period, again, it looked to be very additive. In this case, gains were being incorporated rather than just losses. That was true for particularly banks under $10 billion, and we also looked at banks over $10 billion. And it was slightly negative, only about 10 basis points, if I think of our most recent [Inaudible]. So the costs were measured in current terms of the reduction in capital. And then we looked at a period of time when losses should be added back, and we couldn't come up with a good justification for sustaining that model.

CHAIRMAN BERNANKE: Thank you. Vice Chair?

VICE CHAIR JANET L. YELLEN: Thank you. I wonder if you could say a little bit about the countercyclical buffer, and what kind of thinking went into the determination of its size? And how you contemplate it being used? What can be the decisions they can process, for example, that will bring this into play?

HEWKO: Sure. So the countercyclical buffer is designed to be a macro-potential tool available to regulators and policy-makers. It's designed so that when it's turned on, it increases loss absorption capacity in the system. It may also act something as a break to further lending by increasing--not exactly capital requirements but effectively putting penalties on banks that don't meet the higher buffer. The proposal is not very specific about exactly how it would work. It outlines mechanics that we could expect it to be a joint interagency decision, and it outlines some of the factors that we expect might be considered by the policymakers. But I think we think that's an area we still need to do some thinking about how the exact decision would be made.

GOVERNOR TARULLO: And, Anna, you might want to tell the Vice Chair the range of banks to which the countercyclical buffer would apply.

HEWKO: So yes, we did make the decision to apply the countercyclical buffer only to the largest banking organizations, the advanced purchase banking organizations. There were a couple of reasons for that. One is the complexity of having to manage to a potentially moving buffer for smaller banking organizations, who don't have much access to capital markets, that didn't seem particularly reasonable. And also the biggest banks are the most interconnected. And so we got the biggest bang for the buck, say, for imposing the buffer on them.

VICE CHAIR YELLEN: Thanks. That makes a lot of sense. Now I know one of the challenges you faced in writing these rules was that Dodd-Frank prohibited the use of credit ratings. I wonder if you could just talk a little bit about the alternatives you've used in whether or not you've--you feel satisfied that you have found workable alternatives.

HEWKO: I'll actually turn that over to Tom to address.

TOM BOEMIO, MANAGER, RISK POLICY & GUIDANCE, BANKING SUPERVISION & REGULATION: So during the proposal last December, when we actually made these proposals in the market risk rule, we came up with a number of alternatives. We had been working on this for a number of months with the other agencies, and it was a bit challenging. We have developed for sovereigns and basically foreign sovereigns and for public sector entities in sovereign countries and for foreign banks the use of what we call country risk classifications, which is somewhat different from the current approach where we look at OECD. It's a little more risk-sensitive in that it gives ratings to a broader group of countries. It's not as risk-sensitive, necessarily, as we would like. And clearly we're not going to look at individual banks and assess their credit quality when we look at the rating of a country, because we would have a rating for the country and then we'd step up the capital charge for the banks one step higher in the risk [Inaudible].

With respect to corporate--corporate exposures in the trading book, we have drawn a line that we say investment grade, but it's not relying on that rating. But it's looking at a number of different aspects. A bank would have to look at a number of different aspects and determine whether or not the counterparty is able to pay its bills, whether it's able to pay the obligation that is extended. And this is similar to the definition that the OCC is going to be finalizing soon with respect to the suitability requirements for purchasing assets at national banks, to which we're also subject to.

With respect to securitization, as Anna Lee mentioned earlier, that was a little bit trickier. And we developed what we call the simplified supervisory formula, which is a supervisory formula, something we currently have in Basel II, which we have in our advanced approaches rule. But this is a simpler approach, and we're going to import that from the market risk, and we’re proposing that in the credit rating rules as well, so that it can be used by smaller institutions. We tied it to the capital requirements on the underlying securitized assets. So for residential mortgages, we would look at the underlying exposures and whatever that capital charge is for that pool, that will be our starting point. And then we charged lesser--lower and lower capital amounts as we get more and more senior in the security trenchant.

So we are relatively happy with that. It's not quite as risk-sensitive as possibly where we were. But as we know, ratings blew up. We're much more comfortable in terms of where we are. It comes up with higher amounts of capital.

VICE CHAIR YELLEN: Thank you very much.

CHAIRMAN BERNANKE: Governor Duke.

GOVERNOR DUKE: Thank you. I appreciate your estimate of the number of banks that would meet the higher capital requirements today. It seems in coming up with that estimate, though, you had to make assumptions for data that just doesn't exist today. So I wonder if you could identify the data that might be particularly difficult for smaller banks to locate and to track that doesn't exist today.

BOEMIO: Sure. So with respect to the numerator, we had to make some assumptions with respect to how we would allocate deferred tax assets that would be deducted over the proposal versus those that would be subject to the capital limitations. In addition, we also had to make an assumption, and the small banks are going to have to be able to track the investments in unconsolidated financial subsidiaries that they may have some investment in, so that they can also be subject to the capital limitations as well.

With respect to minority interest, which tends to be in tier 1 capital today, the banks are going to have to be able to track which part of minority interest would be allocable to common equity and which part would be allocable to tier 1 capital.

With respect to the denominator, we had to make a number of assumptions, in particular we had to--we had to make an estimate of high volatility commercial real estate, and we had a line item on the call report where we could pull this information. But because of the definition of HVCRE in the proposal, which is more of a subset of what we currently collect on the call, we're going to have to probably collect some additional information, the banks will have to track a subset of the current HVCRE, the construction loans.

We also, with respect to residential mortgages, institutions will have to look at and track the loan-to-value ratios on their particular mortgage products, and then we're going to have to look at types of mortgages. Is a negative M? Is it an I/O? Is it a typical fixed-rate amortizing loan? So that's going to be some additional requirements for them there.

With securitization, we're going to be changing the way we look at securitizations for purposes of capital. And as a result, the banks are going to have to have a better understanding of the structure, the--of the position that they hold and the secure of the securitization in which this tranche is a part of. They're also going to have to look more at the underlying assets, depending upon the risk weighting option that they take for securitizations to get a better sense of the performance of the underlying portfolios.

In addition, as you've mentioned earlier in your opening remarks, there's going to be an effect on these institutions with respect to their systems. They're going to have to change their systems to collect the information that they're now going to need to risk-weight their exposures under the standardized approached. Now many of the smaller institutions use vendors, and we--we fully expect to be working with the vendors as we change the call reports and as we move forward so they can actually report accurately and actually ask for the appropriate data so it can be risk-weighted.

So that pretty much wraps it up. We do believe there's ample time for us to make these changes because the standardized approach actually comes into play in 2015. The people have the ability to early adopt if they like, but there is a little bit of a transition there as well.

GOVERNOR DUKE: Thank you. And just one other question, and I guess this one goes to you, Mike. I know that you've studied the expected overall effect of higher capital, but I wonder if you've studied the effect of the granular risk rating on mortgages, and particularly the risk weighting on HELOCs and home equity lending, and that impact both on housing as well as consumer lending and small business lending, which relies quite a bit on home equity.

KILEY: So in our macro assessment, we didn't go into that degree of detail. We would look at how the broad shifts in required capital might affect bank's [Inaudible] and their willingness to lend. Staff certainly have been thinking about how different requirements might affect different aspects of lending. And obviously, it is the case that mortgage credit is one of those areas, current, that's--where availability is tough for many households, but that degree of detail didn't figure into our macro assessment.

GOVERNOR DUKE: Thank you.

CHAIRMAN BERNANKE: Governor Tarullo?

GOVERNOR TARULLO: I don't have any questions.

CHAIRMAN BERNANKE: Governor Raskin?

GOVERNOR SARAH BLOOM RASKIN: Thank you, Mr. Chairman. I do have a question, and it has a bit of a wind-up here. I want to start by saying that the three proposed rule-makings before us today, I think, do represent significant progress towards addressing regulatory shortcomings that did become apparent during the recent financial crisis. Together, the texts of these proposed rule-makings underscore the importance of capital as a regulatory mechanism for absorbing the inevitable losses that financial institutions experience.

I don't want to detract in any way from this good work that by noting that from a regulatory and supervisory perspective, we cannot declare with these proposed rules mission accomplished. While the imposition of these capital rules and buffers are an important and necessary step towards strengthening the regulatory framework that large, complex banks operate within, they are not sufficient. In particular, these proposed capital rules are designed to focus on risk that is created by particular types of assets. If risk is developing outside these assets, for example, operational risks, representational risks, or unaccounted for market risks, then the proposed capital rules should not be understood as having limited or constrained or controlled in any way these particular risks. In these cases, the overall sufficiency of the capital cushion must be relied upon to cover the risk that may be developing outside these asset classes.

In short, the proposed capital rules provide a guide, a road map, so to speak, about certain parts of the balance sheet where risk may be lurking. But this is an imperfect guide, because as we all know, risk can develop and lurk in spaces that no one outside the bank, or sometimes even inside the bank, sees or can expect. In the run up to the financial crisis, mortgage-related assets were weighted the same at low risk, and yet the losses that emerged from them were significantly destabilizing. Fraud risk is also almost impossible to detect, and risk-based capital rules should not be understood as being able to address the various massive fraud-related trading scandals that have rocked various financial institutions. In other words, capital requirements do not compensate for good governance and appropriate risk management by the institution.

In addition to strong capital requirements there is continuing need for exacting risk management controls and appropriate supervision of those controls. From this perspective, I look forward--I continue to look forward to now the Federal Reserve System's regulatory and supervisory and examination staffs elaborate upon and build out their expectations for the internal governance and risk management controls that our country's largest and most complex institutions are expected to design and implement to capture the risks that develop outside the confines of formal capital rules. The need for supervision is all the more critical, given that full compliance with most aspects of the rules won't be required until January 1, 2019, which is more than six years from now.

So let me turn to a second dimension that strikes me, is a currently unavoidable deficiency in these proposed rules. In particular, I note that under the proposed rules we are permitting large, complex banks to rely on their internal models to ensure proper liquidity. We are proposing placing additional prudential requirements on these internal models, and these revisions, as I understand them, include requiring banks to take into account stressful conditions when modeling market risk capital requirements.

I applaud the intent of the staff to address some of the shortcomings inherent in a reliance on the internal models of banks, but I do remain skeptical. I think we should proceed with such a reliance cautiously. Or in other words, trust but verify. As a supervisory matter, I would like to see our examiners make sure that these internal risk models are keeping pace with the complexity that certain business lines or trades are presenting. If the internal risk models fall short then the activities must be flatly and out right prohibited. End of story.

My sense, by the way, is that our large and complex financial institutions have struggled with their ability to keep their internal risk models closely approximating and mirroring the risks that these institutions are embracing. Instead, we need assurances that the internal risk models are being updated regularly by the institution's chief risk officer and then examined regularly by the institution's examiners. To do this exercise correctly, the institution needs to assure that revenues and the risks generated by these revenues in various business lines are transparent so that stakeholders can provide input necessary to revise the internal risk models and assure their credibility.

So this is now the question. Here it is. Do we current feel comfortable from a supervisory perspective permitting banks to rely on their internal models for capital purposes? And to what extent will the proposed enhancements to these internal models address or not address our perception of any shortcomings in the bank's modeling processes?

GIBSON: So in the supervisory process already, since the introduction of modeled capital requirements for market risk, we have insisted on reviewing and approving internal risk models before the bank is allowed to use them for regulatory capital purposes. So in the past, it's already our current practice to do that, and we expect that we will continue to do that in the future.

It's challenging. We can't detect every nuance of everything through our examination process, but we devote significant resources to it, and it is a high priority. One aspect of the current proposal is that, as Anna Lee mentioned, the capital requirements for trading activities are being increased substantially. I think our estimate is around three times what we were pre-crisis, by, for example, the institution of the stress VAR requirement, which requires that the evaluated risk model be run under stressed market conditions.

So that partially moves things in the direction that we think is the right direction. Whether it's completely sufficient is certainly something we continue to work on. And as Governor Tarullo mentioned, we have a process underway within the Basel committee, a fundamental review of the trading book capital requirements, which is asking a lot of these questions about our reliance on models, and in particular are there simpler back-stop approaches we could use to give us more comfort that the models are not leading us astray.

So we share the concern. The proposal moves us in the right direction, and it's definitely going to continue to be a supervisory focus.

GOVERNOR RASKIN: Thank you.

CHAIRMAN BERNANKE: Governor Stein?

GOVERNOR JEREMY C. STEIN: OK, thanks very much. Anna Lee, you mentioned that one of the important components of this is to use capital to create incentives for over-the-counter derivatives to migrate the centralized clearly, as opposed to remaining over the counter, I suppose. Can you elaborate just a little bit on the precise mechanisms by which that's going to work?

HEWKO: I'll actually turn that over to April.

SYNDER: So under the proposals consistent with the Basel standards, clear transactions would get a lower risk weight than other transactions if they were made through a qualifying central counter party. And under the proposal, the qualifying central counter party has to meet certain standards, and this reflects the intention of the Basel standard setters, that lower risk weight should only be applied to clear transactions with parties that beat prudent risk management and governance standards. So the proposed definition of qualified central counter party recognizes that many rules related to central counterparties that are either proposed or soon to be finalized in the U.S. would already encompass some of these standards, and U.S. entities that already comply with these standards should meet the definition of qualified central counterparty. And foreign central counterparties that are regulated and supervised in a similar manner, would also likely be considered a qualified central counterparty.

GOVERNOR STEIN: Thanks.

CHAIRMAN BERNANKE: Governor Powell.

GOVERNOR JEROME H. POWELL: Thank you. I know that we all share a concern that, well, we need to implement better and higher capital requirements on all of our financial institutions, that it be done in a way that minimizes the effect on economic activity. And I think a big part of the answer of why we all believe that these rules comply with that desire is that the long transition periods are quite significant. So the question I have is do you have any concerns that out in the field banking organizations are going to be pressured to comply earlier than the transition requirements would suggest.

HEWKO: So that was a concern when the international Basel proposal was announced, and what we have seen in practice is that banking organizations were not immediately held to the higher standards. They are continuing to raise capital as we would -- you would expect. But there was not an immediate upfronting and as I mentioned for the smaller institutions, the capital gap is not very big, the aggregate gap. So again, we think that they could meet it through retaining earnings and not be pressured to shorten the transition period, in effect.

GOVERNOR POWELL: Thank you.

GIBSON: I would also add that was an important consideration, but not the most important consideration effecting the macroeconomic cost. So when we looked in our models at a faster transition period, it did as you expected, that if banks felt the pressure to pull things forward we would estimate a larger impact but the impacts were still quite modest relative to the types of benefits we expect to occur.

GOVERNOR POWELL: Another question on just following up on the securities that were available for sale. One also hears, in addition to the volatility point that was made by the Chairman, one also hears that competitiveness point that this is going to affect American banks more than non-American banks. Do you have -- how do you think about that?

LINDO: We monitor both what happens domestically in terms of accounting standards, as well as what goes on nationally. This point had been raised early in our process, both the U.S. financial accounting standards board and the international accounting standards boards are aware of the difference. And last month during their normal deliberations the two boards agreed to implement an approach where available for sale securities that are classified in the U.S. would be likely classified in the same way abroad. So we saw that as an indication of this leveling of the playing field on this one point. What we remain vigilant in is to make sure that both boards do reach a converged solution for financial enrichments that result in comparable accounting treatment. Since both the U.S.--our U.S. proposed rules today and the Basel committee's framework flow through unrealized gains and losses to tier one and common equity capital ratios, we'd anticipate that simply by the actions taken by the ISB to make the rules consistent with the U.S. rules, they would in fact throw through to all the regimes subject to Basel III, so we think that problem has been addressed.

GOVERNOR STEIN: That's great. Thank you.

And then finally I would think -- I gather from reading the rules and the summaries why which I also express my appreciation for that, echoing Governor Duke, but that taking -- the business of taking references to credit ratings out of the rules had to be one of the hardest things that you did, and I complement you on it. When you talk about the use of CRC's for sovereign debt and financial institutions and other government entities. You talk in there about using -- you evaluated using market-based measures instead, decided not to do it because more work was needed. Is that something that is really ongoing, and could possibly come into play over time?

BOEMIO: Well, we had gotten some comments when we put the proposal out in December. And a lot of industry participants were also concerned about liquidity in the markets, whether someone could gain the markets if we did use some of the market-based measures. It's been -- we've reproposed it again in the Basel 3 package and we'll get additional comments on it. We have looked at it, it's not -- and I think that we'll continue to look at it, but I don't think it's going to be the highest priority.

CHAIRMAN BERNANKE: Thank you, thank you very much. I'm now going to go around the table and ask each governor to state their position. After we do that, we will take two votes. The first vote is for the notice of proposed rule makings, the three elements that were described by Anna Lee. And the second vote will be for the final rule on the market risk rule. Vice chair?

VICE CHAIR YELLEN: I support the proposal to put out for comment the three notices of proposed rule-making to revise and enhance the Board's capital requirements and I also support finalizing the market risk capital rule. I consider the publication of the proposed rule on regulatory capital standards a major accomplishment, I want to congratulate the staff and my colleagues for the excellent work that they've done. The crisis showed the need for robust capital requirements to improve the safety and soundness of the financial system, and these rules do take a major step to significantly improve both the quantity and quality of capital that banks will be expected to hold. Importantly, the proposed rules also strengthen the capital requirements for counterparty credit exposures arising from bank's derivatives, repo and securities financing transactions. I think the inclusion of a counter cyclical buffer may also prove very helpful in providing a macro prudential tool that may prove useful in leaning against excessive credit growth that could threaten financial stability. As Governor Tarullo and many others have emphasized, capital isn't the only critical element of a strong regulatory regime, but it is certainly a key requirement, and I think it's very important that this rule-making is taking place in the context of an internationally-agreed set of standards to create a global playing field.

CHAIRMAN BERNANKE: Thank you. Governor Duke?

GOVERNOR DUKE: Thank you. I also support the issuance of these notices of proposed rule-making and the finalization of the market risk rule. I believe that strengthening the capital requirements including the addition of a common equity requirement, is an important element of a more stable, resilient financial system. I view the capital conservation buffer with its graduated limits on capital payouts as a prudent safeguard for banks approaching regulatory minimums. I have thought a lot about the inclusion of unrealized gains and losses on securities, that is the other comprehensive income in the capital requirement, and I'm in favor of including it. With interest rates at historic lows and loan demand weak, I worry the banks will begin to take on more interest rate risk to improve earnings, and as rates return to normal longer maturity securities will decline in value, and this decline will represent a very real reduction in bank's ability to absorb losses. Including unrealized gains and losses, we'll have the effect of incorporating interest rate risk on instruments that otherwise would have zero or low rates for credit risk. And I support higher risk rates for construction and land development lending. I would in fact include one to four family residential construction loans in this category. Construction and development lending resulted in especially high loss rates and led to the majority of bank failures in both the most recent financial crisis and in the savings and loan crisis.

I am, however, less sure about the appropriateness of using specific mortgage underwriting characteristics to differentiate among mortgage loans for risk weighting purposes. Given the magnitude of the financial crisis and the role of mortgage loans in that crisis, I can certainly understand the concern about risk-weighting for mortgage loans. And the risk weights in the proposal are well supported by loss data from the past several years, but this approach may not come--this approach may not come without cost. We do not have any similar methodology in other loan types such as credit cards or C and I lending, so as we parse the risk in mortgages more finely, we run the risk of distorting bank's willingness to make certain loans and even, it seems to me, potentially creating some counter intuitive results. For example, an unsecured loan to a small business would have a risk weight of 100 percent, while the same loan if secured by a second lien on the owner's residence with a loan to the value of 85 percent would have a risk weight of 150 percent. In another odd twist, 95 percent loan to value HELOC would have twice the risk weight of a one to four family residential construction loan. So I will be interested in reviewing any alternative suggestions for risk-weighting mortgages. Along the same lines, I look forward to receiving comments about the potential effect of the risk-weighting scheme on mortgage lending, consumer lending, and small business lending. I want to be sure that banks can still underwrite responsibly and meet the credit needs of their customers. Balance sheet lending might be the last alternative for sound mortgage loans that do not fit standardized underwriting boxes. I'm afraid the narrower we make the boxes through regulatory action, the more important it will be to have an outlet for loan by loan underwriting that takes advantage of banker's knowledge of their customers' experiences and circumstances. Also a concern that we could make it more difficult or more expensive to tap home equity for home improvement, educational expenses, major purchases, or investments in small businesses. If this happens, it might have the effect of either discouraging such purchases or investments, or it might make investment in a home less liquid, and thus more risky and less desirable for households. I also look forward to comments on the potential outcome -- on this potential outcome of the proposal.

And I believe it's important to weigh the precision of our risk definitions against the complexity of the overall regulatory structure. The qualifications for mortgages that receive lower risk weights are defined along a number of dimensions, including the loan to value, the structure of the loan, the priority of a lean and the borrowers ability to repay, these are the same elements that will be used in definitions of qualified mortgages, QM, or qualified residential mortgages, QRM, in other regulations that govern mortgage lending specifically. We should think about the difficulty of maintaining consistency across numerous rules that are the responsibility of different agencies. If the elements result in capital -- if the elements result in capital requirements that don't line up well with the requirements of other regulatory mechanisms for restraining the risk in mortgage lending, it could further fracture and potentially restrict the mortgage market. So I'm interested in comments about the complexity of the mortgage risk definitions, the interaction and overlap with other rules, and the difficulty of collecting data to assign mortgage loans to different risk buckets, especially with respect to existing loans and purchase loans.

Along the same lines, I'm interested in comments about any data elements required to calculate capital minimums and the cost or difficulty involved in locating or tracking them. Finally, even though the overwhelming majority of community banks already meet the common equity standards and despite my strong support for high quality loss-absorbing capital, I'm still mindful of the cost and difficulties smaller banks face in accessing capital markets. I understand the problems that were revealed with respect to trust-preferred securities, but I also know that they were an important source of capital, especially pooled capital, for smaller banks. So I would be very interested to hear about alternative forms of capital or structures that would meet the qualification criteria described in the rule and thus could be more loss absorbing than trust-preferred, but also more accessible than common equity for smaller banks. In particular, I would be interested in other forms that capital that could enhance the strength of institutions that face self-imposed limitations on their common stockholders, such as sub S banks, banks trying to remain below FCC registration thresholds, and minority banks. I commend Anna Lee and her colleagues, as well as Governor Tarullo, for the difficult but thorough job in considering these many difficult issues, and I look forward to receiving comments on this proposal.

CHAIRMAN BERNANKE: Thank you. Governor Tarullo?

GOVERNOR TARULLO: Thank you, Mr. Chairman. For the reasons I stated at the beginning of the meeting, I'm for all of these packages, conditional only on Anna Lee's agreement to take tomorrow off.

[Laughter]

CHAIRMAN BERNANKE: Thank you, Governor Raskin.

GOVERNOR RASKIN: Thank you Mr. Chairman. I too support moving forward with the three proposed rule-makings and finalizing the market-based rule.

CHAIRMAN BERNANKE: Governor Stein?

GOVERNOR STEIN: Thank you very much, Mr. Chairman. I also support both the proposal to put out the three NPRs for comment as well as to finalize the market risk rule. I just want to add my congratulations both to Governor Tarullo and to the staff, I think it's worth stepping back and just sort of recognizing the accomplishment here. You know, there's always more to do on financial reform, there's a lot of important stuff left to be done. But on the simplest metric we have, which is common equity capital, we're moving from a world where 2 percent was the norm to a world where 7 percent is the norm. And that alone is I think one of the most important steps we can take to safeguard the financial system. I want to emphasize again this qualify point, that is to say that it's common stock is a very, very powerful tool. People have used, repeatedly, the idea of loss absorption. And I agree with that, but I think that that in some sense understates the importance. To me, the most important thing about common stock is what you might call its dynamic properties, the fact that it makes it easier to recapitalize once the bad thing has happened, because you don't have a very small sliver of common equity sitting behind an overhang of preferred, which would make things difficult. And this embodies what I actually consider to be one of the central macroprudential principles, which is of course protecting the tax payer is paramount. And that's one of the goals. But as Governor Tarullo alluded to, it's not the only goal. One of the very important things we want to have is a financial system that once a loss has been realized is able to recapitalize itself and doesn't contract lending but is able to sustain lending. And I think this thing is highly complimentary, the use of common stock is highly complimentary to efforts at prompt corrective action. And again, there's a lot of detail, but this one central feature is, again, I think a very, very major accomplishment.

CHAIRMAN BERNANKE: Thank you. Governor Powell.

GOVERNOR POWELL: Thank you, Mr. Chairman. As for the three Basel proposals, first I think they send a strong message that the United States will live up to its obligation to implement international capital standards and that's obviously a positive. Secondly, we saw in the crisis a need for both substantial improvement in both the quality -- the quality of the capital in our banks, and I think the proposed rules accomplish that in a way that is faithful to the Basel agreements, and also to Dodd-Frank. The rules will make for a stronger, more resilient banking system, and I strongly support them. I also think that these are complex matters, and I know that all the responsible agencies will look forward to receiving comments and carefully consider them, and in the end implement our obligations under Basel and Dodd-Frank in a way that is faithful to those rules, but that minimizes burden and economic cost to the institutions are far more important to their customers, that ultimately bear much of the burden. As far as the market risk rule is concerned, we saw in the crisis that the existing capital regime was inadequate to deal with the reality of the capital trading exposures, we needed a much better match between capital standards and the risks, and also focus on assuring that the market risk rules were really only applying to trading risks and not really to what should be credit risks. I think the proposed rule really accomplishes that, and I would add that I think the drafters were very thoughtfully responsive to the comments, and appropriately so. So I strongly support the final rule as well.

CHAIRMAN BERNANKE: Thank you. I support the components as well, I think it's a very attractive package. It meets the standard of providing more and better capital, which is the most essential element. It's appealing to have an integrated framework that puts together everything in a consistent package so that we don't have legacy rules that are damaging the logic of the framework. Appropriately, it focuses on the largest and most complex banks. That's important both because they are the ones who are the most complex and have the -- pose the greatest risk to financial stability, but also because they're best able to bear the regulatory costs and burdens associated with the rules. The macroprudential aspect I think deserves considerable note, the entire philosophy of the supervision here at the Federal Reserve has been changed so that we know routinely consider macroprudential aspects of our rules and our supervision, and this package certainly does that. And as Governor Powell noted, this is consistent with the global agreements that were made, in fact, I think this may well be the standard against which other capital regimes around the world may be measured going forward, and I hope that other countries, other jurisdictions, will meet this standard. As Governor Duke said, the devil is in the details here, there are many specific questions about appropriate weights, about regulatory costs and so on. And that's what the comment period is for. And we will certainly look -- take very seriously the comments we receive and other input that we receive and try to make this product even better after the comment period is closed. But again, I do support this, and I thank the staff, Governor Tarullo, as well as Governor Duke who's also on this committee, Governor Raskin who worked frequently with the supervisory efforts, and then of course the staff. So with that, we have two votes, the first one will be to approve the three proposed rules, regulatory capital proposals, to be put out for comment. And may I have a motion, please?

VICE CHAIR YELLEN: Moved.

CHAIRMAN BERNANKE: Second? All right. All in favor of approving the proposed rules?

GROUP: Aye.

CHAIRMAN BERNANKE: Any opposed? Thank you, the second vote is on the finalization of the market risk capital rule.

VICE CHAIR YELLEN: Moved.

CHAIRMAN BERNANKE: Second? All in favor?

GROUP: Aye.

CHAIRMAN BERNANKE: Any opposed? All right, the two motions have carried, again, I thank everyone very much, I thank our guests, and the meeting is adjourned.

[Background noise]