Transcript of Open Board Meeting
April 8, 2014

CHAIR YELLEN. Good afternoon, everyone. I'd like to welcome our guests to the Federal Reserve today as we consider another important component of the Board's regulatory reform effort to mitigate the threat that systemically important financial companies pose to financial stability and our economy. The financial crisis showed that some financial companies had grown so large, leveraged, and interconnected that their failure could pose a threat to overall financial stability. Today's action is another step in the Federal Reserve's efforts to address those risks.

The final rule that the Board is considering today would implement enhanced supplementary leverage ratio standards for the largest and most systemic U.S. banking organizations. Under this framework, these banking organizations would have to hold substantially increased levels of high-quality capital as a percentage of their total on- and off-balance sheet exposures to avoid restrictions on capital distributions and discretionary bonus payments. Thus, the framework provides incentives to such firms to maintain capital well above regulatory minimums. The final rule is an important part of the Board's package of enhanced prudential standards for the most systemic U.S. banking firms--a package that is designed to materially reduce the probability of failure of these firms and to materially reduce the damage that would be done to our financial system if one of these firms were to fail.

The Board will also consider a proposal to revise the definition and calculation of the supplementary leverage ratio, which applies to all internationally active banking organizations. The proposed revisions are consistent with the amendments made by the Basel Committee on Banking Supervision in January to strengthen the international leverage ratio measure.

In addition, we will consider a proposed rule to address a technical matter under the advanced approaches risk-based capital rule.

I look forward to today's discussion of these important issues. Let me now turn to Governor Tarullo for introductory remarks.

GOVERNOR TARULLO. Thank you, Madam Chair.

the final rule on enhanced supplementary leverage ratio standards for the largest, most systemically important banking organizations in the United States is part of our program to establish, consistently with Section 165 of the Dodd-Frank Act, a set of enhanced prudential standards for firms whose failure or material distress would pose the greatest risk to the stability of the financial system. The final rule would strengthen our multi-pronged capital framework of complementary requirements and standards that focus on different vulnerabilities and therefore compensate for potential shortcomings in any single capital measure.

With our adoption of the Basel III capital reforms and our intention to implement risk-based capital surcharges for globally systemic firms, we must raise the required leverage ratio for these firms if we are to maintain the traditional relationship between the risk-based capital and leverage ratios. The leverage ratio serves as a critical backstop to the risk-based capital requirements--particularly for the most systemic banking firms--and moderates some of the pro-cyclicality in the risk-based capital regime. It helps compensate for the possibility that risk-weighted measures understate the risk that large holdings of assets that are very safe in normal times may, as we observed during the financial crisis, become considerably less so in periods of serious financial market stress.

Numerous commenters have noted the potential for skewing the incentives of the largest financial firms if the leverage ratio becomes the binding capital requirement in ordinary times.

Board staff estimates do suggest that this rule would make the leverage ratio more binding, relative to the risk-based capital ratios, for certain U.S. systemic banking organizations. However, the impact would vary substantially among firms, depending on their business models, and analysis suggests that these organizations could manage their capital structures to help meet the standards through certain low-cost, systemic-risk-reducing actions. It is also worth noting that, if we increase the risk-based capital surcharge for U.S. systemically important firms to a higher level than the minimum agreed to internationally, such as by reference to dependence on runnable short-term wholesale funding, the supplemental leverage ratio would be less likely to bind in normal times.

The proposed rule before us would revise the definition of total leverage exposure in the supplementary leverage ratio--that is, the denominator of the ratio. This proposal would implement the recent international agreement on this definition. To help ensure global financial stability, it is important that all internationally active banking organizations meet a minimum leverage requirement. I should note that staff estimates that the aggregate amount of tier 1 capital needed to meet the supplementary leverage ratio would increase modestly as a result of the proposal, though again with potentially different impacts on different firms.

With that, I turn to Connie Horsley, who will provide a more detailed explanation of both the final and the proposed rules.

CONNIE HORSLEY. Thank you, Governor Tarullo. The rulemakings the Board is considering today are the result of a team effort across divisions here at the Board and across the federal banking agencies. They represent another element of our post-crisis efforts to increase the safety and soundness of the financial system. As noted, the supplementary leverage ratio changes are expected to complement and reinforce the revised capital rule that the Board finalized in July 2013.

I will discuss the key provisions of the proposed rule that would affect the calculation of the supplementary leverage ratio and the final rule that would impose enhanced leverage ratio standards on the largest most interconnected banking organizations. My colleague, Beth Klee, will then discuss the monetary policy perspective in connection with these rulemakings, then staff will answer any questions that you may have.

The rulemakings under consideration apply only to internationally-active banking organizations and do not apply--do not affect smaller community banking organizations. More specifically, the supplementary leverage ratio is a non-risk-based measure that applies only to advanced approaches banking organization, which are generally those with at least $250 billion in total consolidated assets or at least $10 billion of on-balance sheet foreign exposure. The enhanced standards would apply only to a subset of the advanced firms.

To begin with the proposal, the July 2013 revised capital rule requires advanced approaches banking organizations to maintain a 3 percent minimum supplementary leverage ratio. The numerator of this ratio was tier-1 capital, and the denominator is total leverage exposure, which is--includes both on- and off-balance sheet items. The proposed changes more appropriately measure leverage capital requirements and are consistent with the January 2014 changes made by the Basel Committee on banking supervision to the international leverage ratio. The proposed rule includes revisions to the leverage ratio denominator. The two most significant proposed changes to the denominator are: one, the inclusion of the notional amount of sold credit protection with some hedge recognition of certain conditions are met; and two, the use of standardized credit conversion factors for lines of credit, letters of credit and other off -balance sheet items, instead of a uniform, 100 percent conversion factor.

Other changes in the proposal include more specific criteria for the treatment of derivatives and repo-style transactions. These changes are not expected to have a significant impact on U.S. banking organizations because the 2013 rule and the U.S.--and U.S. accounting conventions already reflect most of these criteria. The proposal would also require banking organizations to calculate their total leverage exposure using daily averages as opposed to month-end balances. This revision would address some commenters' concerns about substantial and sudden fluctuations at the end of the month or during times of financial stress. The proposed rule also includes a common public disclosure template for the supplementary leverage ratio. This common template is intended to increase transparency regarding the calculation of the leverage ratio across jurisdictions. Advanced approaches banking organizations would begin reporting using the common template as of January 2015, but the 3 percent minimum supplementary leverage ratio would not come in to affect until January 2018.

Turning now to the enhanced supplementary leverage ratio standards, in July 2013, the agencies proposed an enhanced leverage ratio standard that would apply to the eight U.S. top tier bank holding companies identified as global systemically important banks, or G-SIBs, as well as to their insured depository institution subsidiaries. The revised standards would be finalized substantially as proposed. Under the final rule, the eight U.S. G-SIBs would need to maintain a leverage buffer of 2 percent on top of the 3 percent minimum requirement in order to avoid limitations on their capital distributions and discretionary bonus payments. A G-SIB with a leverage buffer of 2 percent or less would face increasingly strict limitations on its capital distributions and discretionary bonus payments as it approaches the 3 percent minimum requirement. For the insured depository institution subsidiaries of the eight G-SIBs, the enhanced supplementary leverage ratio standard would be a 6 percent well-capitalized threshold under the agency's prompt corrective action framework. Like the 3 percent minimum supplementary leverage ratio, the enhanced leverage ratio standards for the US G-SIBs and their insured depository institution subsidiaries would become effective in 2018.

The enhanced leverage ratio standards were designed with several objectives in mind, including mitigating the threat to financial stability posed by the largest, most systemically important banking organizations, and maintaining an effective complementary relationship between the supplementary leverage ratio and the risk-based capital ratios, which were significantly strengthened under the July 2013 rule.

In terms of quantitative impacts, staff is estimated that the proposed rule would increase the leverage ratio denominator across the eight G-SIBs by around 8 percent. Thus, the ratio would generally be stricter than under the 2013 rule, primarily as a result of the proposed treatment of sold credit protection that I mentioned earlier. Staff estimates that all eight G-SIBs would meet the 3 percent minimum supplementary leverage ratio under the proposed revisions. The aggregate tier-1 capital shortfall across these firms to meet a 5 percent supplementary leverage ratio would be approximately $68 billion, which amounts to about 8-1/2 percent of total tier-1 capital across these firms. Staff believes that firms will be able to meet the standards by 2018 through a combination of retaining earnings, effectively managing their capital structures, and taking certain systemic risk-reducing actions with relatively low economic cost.

Most of the eight G-SIBs as currently structured would need more tier-1 capital to meet a 5 percent supplementary leverage ratio than to meet the minimum tier-1 risk-based capital ratio plus applicable buffers. For these firms, the leverage ratio would be binding today, if it were in effect. Several commenters raise concerns that a binding supplementary leverage ratio may induce firms to increase the risk profile. We believe, however, that the 2013 rules risk-based capital framework, the Federal Reserve's stress test regime, as well as other supervisory and regulatory tools available should mitigate such concerns.

It is worth noting that under the Board's capital plan rule, subject bank holding companies must meet minimum capital requirements but not regulatory buffers on a post-stress basis. Staff estimates that the amount of tier-1 capital required for G-SIBs to meet the 3 percent leverage minimum on a post-stress basis and the amount required to meet the 5 percent supplementary leverage ratio on a pre-stress basis is roughly comparable.

That concludes my formal remarks with respect to the supplementary leverage ratio rulemakings. I would note that staff is also seeking the Board’s approval to issue a proposed rule that would make a technical fix to the definition of eligible guarantee under the 2013 capital rules. And with that, I'll turn it over to Beth Klee for the monetary policy perspective.

BETH KLEE. Thank you, Connie.

The staff have evaluated the effects of the supplementary leverage ratio on the ability of the Federal Reserve to implement monetary policy, and we have concluded that any effects would be limited and readily offset. As Connie described, today's proposed and final rules will raise the leverage ratio standard for the largest U.S. banks in 2018 sufficiently that the leverage ratio may become relatively more binding on some of them than the risk-based capital ratio. Moreover, many of the largest foreign institutions will face the leverage ratio requirement for the first time in 2018 as part of the Basel III capital reforms. These changes could have two consequences that are relevant for monetary policy and monetary policy implementation.

First, the changes could increase the amount of capital that these banks have to hold against their deposits at Federal Reserve banks, also known as reserve balances, which will reduce the demand for those balances for any given constellation of rates. As you know, reserve balances are a liability of the Federal Reserve System that goes up and down when the Federal Reserve purchases or sell securities. In normal circumstances, the primary means by which the Federal Reserve conducts monetary policy is by increasing or decreasing reserve balances to keep the federal funds rate near the FOMC target. In the future, after the Federal Reserve's balance sheet has been normalized and interest rates are no longer at the zero lower bound, if demand for reserve balances was reduced by a more binding leverage ratio, the FOMC could hit any particular target for the federal funds rate by either providing a somewhat smaller amount of reserve balances, or paying a somewhat higher interest rate on reserve balances, or both. Moreover, the impact on reserve demand in the longer run is likely to be modest because the higher leverage ratio standard would apply only to the largest U.S. banks. The level of reserve balances will be lower in the future as the size of the Federal Reserve's balance sheet is reduced, and banks will adjust their balance sheets to the new standard. Of course, the level of reserve balances currently is very high as a result of the large-scale asset purchases and the federal funds rate is at its effective lower bound. Holding constant the amount of reserve balances and the rate of interest paid on those balances, a shift to a more binding leverage ratio, should tend to reduce short-term money market rates somewhat but would have little implication for monetary policy.

The second possible consequence of the changes is that they could increase the amount of capital that banks have to hold against the purchase agreements involving Treasury and agency securities, which could make large banking organizations less willing to engage in such transactions. The result could be reduced liquidity in the repo market, a key market for monetary policy implementation and transmission. However, staff judges that repo market should remain sufficiently liquid for the purposes of monetary policy implementation. Repo intermediation is a vital component of the dealer-client relationship that supports more profitable business activities, such as hedging, inventory financing, and prime brokerage services. Thus, dealers have incentives to remain actively engaged in repo markets despite potential of higher regulatory costs. Thank you. That concludes my prepared remarks.

CHAIR YELLEN. Thank you.

Question, you mentioned the potential impact of this rule on willingness of banking organizations to engage in repo intermediation. I wondered more generally--maybe this is a question to Constance--if you could talk about the activities and transactions types and the business lines that you think would most likely be changed by banking organization to the consequence of this rule.

CONNIE HORSLEY. [Inaudible] or some of the comments that we got on the proposed rule with the enhanced leverage ratio standards, commenters raised concern on certain business activity in particularly in relation to the off-balance sheet items. And so, we made some changes in the--under the proposal that would actually treat short-term and long-term commitments with credit conversion factors that are less than 100 percent, so I think that addresses part of the concern.

I think some other things that we expect in reaction to the proposed rule with the inclusion of the sold credit protection--the notional amount of sold credit protection in the denominator--we do think that firms could undertake some activity to either do more trade compression of their OTC derivatives, or that they could do more maturity matching with purchase credit protection where you do get some offset.

So I think that's kind of what we think the reactions might be for the leverage ratio in particular. I think Beth may have other comments on sort of the repo market from her remarks but--

BETH KLEE. Yeah. And as I said at the end, you know, like any low-risk, low-return asset and leverage ratio, a binding leverage ratio with all else equal reduced demand for those assets. Our feeling though is that something like repo supports other markets, and so we'd still continue.

CHAIR YELLEN. One other question: I wonder if you could sort of walk me through when it comes to the stress tests and CCAR just how this new supplementary leverage--enhanced leverage ratio will factor in. Will that be included in the stress tests, or--?

CONNIE HORSLEY. So the stress tests right now are really focused on firms meeting the minimums on a post-stress basis. So they'd have to meet the 3 percent minimum supplementary leverage ratio requirement, but we wouldn't require them to meet the leverage buffer. So it would be 3 percent, not the five, and that's where I think when we were analyzing, we looked at the post-stress of the 3 percent on the capital required for that under the new definition, and the pre-stress 5 percent and the amount of tier-1 capital required for each of those was roughly comparable.

CHAIR YELLEN. Thank you. Governor.

GOVERNOR TARULLO. Thank you, Madam Chair.

So, Connie, as I think was apparent from the Chair's first question and also from the comments that you received, the question of the incentives is obviously one that a lot of people have raised and as we think about what the incentives will be, I'm assuming first that staff continues to have the view that a preferred state of the world is that in general and normal times, risk-weighted asset requirements are the binding constraint and that leverage ratio is a backup constraint. That's still correct, right?

CONNIE HORSLEY. Yes.

GOVERNOR TARULLO. And as you and your colleagues have described the ability to manage--of the firms to manage to these new requirements, are you contemplating that as this management takes this set of adjustments, to which I alluded quoting you in my opening remarks, as these adjustments are made that in fact the binding ratio will tend to be the risk-weighted capital ratio? Or will we still be in--are we likely to be in a world in which sometimes a leverage ratio is binding, sometimes the risk-weighted requirement is binding?

MICHALE GIBSON. So I think if you just do a static analysis on current data, which is what we've done as part of studying the impact of the rule, looking at risk-weighted assets and leverage exposure at eight U.S. G-SIBs, which shows that overall, the leverage ratio that we're proposing and finalizing today would be a tight backstop, and for some banks and some business lines, it could be the binding capital requirement.

If you try to do more of a dynamic analysis that takes into account how banks may respond to some of the incentives that are embedded in the rule, it makes me less concerned that the leverage ratio will wind up being overly binding, because there are some risk-reducing steps that banks can take to reduce their leverage exposure at relatively low cost, and I can give one example from Barclays Bank in the U.K.

They've--everything I'm going to tell you is public information, no confidential supervisory information; Barclays has disclosed this to the market. Their regulator told them last June that their Basel III leverage ratio was 2.2 percent, and they needed to raise it to 3 percent within 12 months by this coming June. So they had an 80 basis point gap, and they published a plan to close the gap 10 basis points of which referred to reducing leverage exposure, and the rest was--the rest of their plan is to agreed capital. So by the end of last year, after only six months of their plan, they had closed their entire 80 basis point gap in their leverage ratio and 40 basis point of that had come from reductions in leverage exposure of the sort that we've been alluding to, so let me be more specific. The biggest piece of their reduction in leverage exposure came from reducing the contribution of derivatives and this came from things like trade compressions, meaning two banks get together and look at offsetting trades that they have within their derivatives books and agree to eliminate those trades, which reduces their notional amount and the number of trades by keeping their exposures relatively the same, tearing up derivatives trades, or improve netting. So we understand that U.S. banks have already started to look at some of these ways to reduce their derivatives portfolios with tear-ups and trade compressions in anticipation of the leverage ratio, and we would say this is a good thing because it reduces the systemic risk from derivatives by reducing the total size of derivatives, and it will also reduce the binding-ness of the leverage ratio at a relatively low cost.

So when we think through a more dynamic analysis of how banks might respond to the leverage ratio and the incentives, that suggests that over time it'll be less binding than the static analysis looking just today's data that would suggest. But I would say that if it's going to be a meaningful backstop, there will be times when the leverage--or if it's to be a meaningful backstop, it has to be tight enough to affect banks’ behavior, which means that they have to expect that there are some circumstances where it will be binding. So we shouldn't expect that it will have no binding-ness ever, and we should also expect, given the nature of the leverage ratio, it will be more binding for more some banks than for others. But over time, we would expect the binding-ness to adjust.

GOVERNOR TARULLO. Thank you, Madam Chair.

CHAIR YELLEN. Thank you. Governor Stein.

GOVERNOR STEIN. Thank you, Madam Chair.

So just to pursue this same line of questions, so it sounds likely from what you--there'll be some adjustment, but when we settle down, it will be more binding for some banks than for others. So have you guys thought about what the incentives are that that will create in terms of asset reallocations? In other words, if I'm a bank that's bound by the leverage ratio, one thing I'd kind of want to do is go out and acquire some risk-based assets. So, you know, if I'm a broker-dealer, I might want to buy a credit bank or something 'cause that will give me slack on the leverage ratio, or vice versa from a bank that has mostly risk-weighted assets, I'd be in a comparative advantage of taking on a repo book. So should we be concerned, I guess, about what would be sort of arbitrage via MNA or via people changing lines of business in response to this?

MICAHEL GIBSON. So I think we can expect to see banks thinking along those lines. But as in the example that I just mentioned, there are actually a lot of low-risk assets that have low-risk weights, but have high leverage exposure that are now being added to the leverage ratio, because at now--the Basel III leverage ratio includes off-balance sheet exposures, which the traditional U.S. leverage ratio never did. So I think there would actually be a number of low-risk weight, high leverage exposure assets or business lines that would be the natural things for banks to adjust first. So the sort of more dramatic adjustments that you're asking about could go in the direction that the incentives would be pointing if the leverage ratio were binding, but I don't think they would be the first things that banks would turn to. And as I said in my intro to the previous question, I think our expectation is that there's enough slack in some of the lower risk, high leverage exposure activities to substantially facilitate banks adjusting.

GOVERNOR STEIN. One other question: [inaudible] some of the issues that Beth was discussing. Thoughts given to whether or not reserves with the central bank should be included in the leverage ratio denominator? I guess for monetary policy proposes or just for purposes of not having it bind as tightly, one could have imagined an alternative world where we kept the reserved balances out of the calculations. I just want to kind of hear a little bit about the thought process on that.

MICHAEL GIBSON. So I think the thought process was that the leverage ratio is intended to be a non-risk-based measure, so it's traditionally been based--the traditional U.S. leverage ratio has been based on the whole balance sheet. So we're comfortable staying with the traditional way we viewed it. Certainly, if we were going to look at particular assets and try to decide some that should be weighted lower in the leverage ratio, reserve balances at the central bank would be the first place to start because they’re the safest. But that's then the start down a path of what's the next asset that we should give more favorable risk weights to within the leverage ratio, and it gets in the way from the concept of a non-risk-based backstop. And remember, the whole--one of the arguments in favor of the leverage ratio is it’s a different way of looking at risk than the risk-weighted assets, and it's a useful complement to have a non-risk-based measure as a backstop to the risk-based measure. So I don't disagree with your point, but those are the sorts of considerations that we discussed.

[Inaudible Remark]

CHAIR YELLEN. Governor Powell.

GOVERNOR POWELL. Thank you, Madam Chair.

Beth, I got a follow-up to something you've addressed, which is: So we set the volume of reserves in the system, which is now at $2.6 trillion, and we now raised the cost of holding them for, particularly for the G-SIBs. So that suggests that they--the quantity is fixed but the location of them will probably change. So do you agree with that, and if it changes significantly, does that have implications for the way we would deploy our tools to manage monetary policy?

BETH KLEE. I think one thing to keep in mind is right now there's a very large balance sheet. These eight institutions only hold somewhere around--it's still a lot, but it's about 30 to 40 percent of reserve balances, so they could conceivably migrate elsewhere. In addition, when the final rule comes in in 2018, reserve balances should decline, adjusting the maturity of securities. And so-- the level of reserve balances of those projected would be lower. In terms of in the future, how the Fed wanted its balance sheet to look, this would not be a constraint in terms of the choice of the size of the balance sheet is pretty much what the staff has determined.

GOVERNOR POWELL. And one other question really for Connie or Mike. So we're creating incentives for the holding of liquid assets, of high-quality liquid assets with the leverage liquidity coverage ratio. At the same time, we're taxing that. And I just--can you talk about how sure we are that there's room to achieve both of these things, 'cause we are creating in effect counterincentives?

MARK VAN DER WEIDE. [Inaudible] on that one, I guess. I guess in our view I don't think there's any contradiction or negative synergy between having both a strong leverage ratio and also having bank liquidity requirement, like the LCR, that makes firms hold some amount of--some minimum amount of high quality liquid assets against net stress cash outflows over a short-term horizon. I think it is true that a binding leverage ratio does create some incentives for firms to reduce the amount of high-quality liquid assets that they hold on their balance sheet, as we've been discussing today. And I think in a pre-Basel III world, where we didn't have bank liquidity regulations, I think one of the best arguments against the leverage ratio was that it provided that incentive to banking firms. Now we've always had a risk-based capital requirement that would prevent them from taking advantages of those incentives and putting on high-credit risk assets and shedding the low-credit risk assets. In a pre-Basel III world with no bank liquidity regulation, we didn't have such a liquidity regulatory constraint to prevent them from shedding their liquid assets in response to the leverage ratio incentives. But now we're in a Basel III world, where we will have bank liquidity regulation. We will have an LCR that does put a constraint on how much banks can follow those national incentives traded by the leverage ratio to shed liquid assets. So I think from our perspective, having an LCR, having an NSFR, having a Basel III liquidity regulatory framework in place makes us more comfortable, having a strong leverage ratio.

ANNA LEE HEWKO. I think another way they're complementary is if the bank wanted to hold more high-quality liquid assets, one thing it could do is change its funding profile, which would change the amount of short-term, or high-quality liquid assets that we'd need to meet the LCR so I think they're complementary in that respect, both risk-reducing.

GOVENOR POWELL. Thank you very much.

CHAIR YELLEN. Great, if there are no further questions, I would like to go around and ask people to state their positions. There are actually three separate proposals before us. Maybe, Governor Tarullo, I can start with you and I could [inaudible].

GOVERNOR TARULLO. Sure. Thank you, Madam Chair.

I support all three of the proposals as I think apparent from all of our questions, the issue that is commanded most of our attention here is on the incentive effect. As Mike Gibson said, one does want to have a leverage ratio that has a meaning. Otherwise, it's not serving the backup purpose, and getting that balances has obviously been the task, and I think we've struck about the right balance. I will say that for me at least, this reinforces the importance of going forward as we will with the proposal to impose the surcharge--the capital surcharges on the G-SIBs and I think it also provides a little bit of reinforcement to a potential agenda item, which I've mentioned before, and that is the possibility of an additional capital charge addressed to the vulnerability of firms to runnable wholesale short-term funding. The way in which we're sequencing, having both the final rule and the proposed rule that would harmonize the denominator to the Basel standards, is maybe potentially a little confusing to the public. But I think it does make some sense to get that supplemental leverage ratio in place and then to harmonize their denominator for all of the firms that have the Basel capital ratio--Basel leverage ratio applicable to them, and that I think we were reasonably pleased with the outcome of the international discussions and, as I think Connie said, the changes both with respect to credit default swaps and to contingent liabilities. So, there are obviously issues, and I think staff has done a good job of trying to balance them. And as I say, that relationship between risk-weighted capital ratios and leverage ratios needs to be in a little bit of tension, so that each is playing a role, and I do think that some of this--if people fear there's an excessive tension there, I think we can relieve a bit of that with the additional changes that we're looking forward to making on risk-based ratios.

GOVERNOR STEIN. Thank you. Governor Stein?

GOVERNOR STEIN. Thank you, Madam Chair.

So I'm going to support all three proposals, but I will confess to some misgivings. I do think it's possible to go too far with the simple leverage ratio if it gets raised to the point where it's binding or near-binding, rather than being a backstop. So, in making this qualification, let me be clear: I absolutely share three of the premises that I take to be sort of the primary motivations for a more stringent leverage ratio. First and most importantly, I'd like to see more capital in the largest firms. Second, I agree that there are some important classes of exposures that are missed or underweighted by our risk-weighting schemes, one example being matched-book repo. Third, wherever possible, I think it's a good thing to minimize the dependents on internal models that are susceptible to gaming. So again, I'm totally on board, enthusiastically on board with all three of these.

But to my mind, there are--first and foremost, there are good arguments to improve on the existing risk-based regime. So for example, with respect to the first two, you know, I’m just going to echo something that Dan said, they're the motivation in my mind why capital surcharges based on some measure of short-term wholesale funding or something that's missed in the standard risk-based metric are so some important for us to consider. Similarly, one can and should work to make the risk-based regime less sensitive to internal models. So again, I'm totally on board with that.

There are a couple issues associated with trying to solve these problems by being more aggressive with the leverage ratio, and we've talked about these. One, if the leverage ratio binds or binds even in a probabilistic sense, we're going to be in a situation where all assets from Treasuries to the central bank reserves to leverage loans get the same risk weights, and that not only represents an increase in the risk weights on the safe assets, at the same time critically, it represents a decrease in the risk weights on the leverage loans in this example. So, at the margin, we're going to get less of the former and more of the latter, and, you know, on the leverage loan case, it works a little bit counter just some of our other efforts to reign in risky lending. So that's one concern.

The other concern is something I mentioned in the questioning, the idea that this by its nature creates a different capital regime for every firm to the extent that the degree of binding-ness differs across firms and that in turn creates incentives for assets to be moved around across firms. All else equal, I think one is better of with the same tough regime kind of applying equally to all firms, which doesn't create those sorts of arbitrage incentives. Now, at the end of the day, I think I'm in somewhat the same camp as Dan. I take comfort from the staff analysis that suggests that some of these concerns will be mitigated, if not eliminated by relatively easy actions that the firms can take to reduce the binding-ness of the leverage ratio: trade compressions tear-ups and things like that. So that gets me to the point where I feel like I can support this, but at the same I think, you know, one has to reasonably admit to someone's certainty and our predictions about all of this. So, I'd like to say, I think there's still some lingering concerns about there being unintended consequences and I just--I hope we'll remain attentive to these and be prepared to adjust if we see something really getting distorted in the way that doesn't make sense. Thank you, Madam Chair.

CHAIR YELLEN. Thank you. Governor Powell.

GOVENOR POWELL. Thank you, Madam Chair.

So as others have noted, both the leverage ratio and the risk-based capital standards can be gamed. The leverage ratio creates incentive at the margin from more risk-taking, and the risk-based standards can be very complex and nontransparent and sometimes produce very low levels of leverage capital, hence, the need for both requirements. And with the increase in risk-based capital standards, there has been a clear need to raise the leverage requirements to catch up, and it is my--my strong prior is that the risk-based standards should be binding in the end for the reasons that Governor Stein and others have mentioned. And under today's proposal, it is my hope and expectation that the rule that we finalize today and the NPR revising the definition of total leverage exposure when combined with future rulemakings will over time leave us in the right place, which in my view is a binding risk-based capital rule with a fairly tight leverage backstop. And I'll support all three of the measures as well.

CHAIR YELLEN. Thank you.

And I support all three proposals before us today as well. With respect to the supplementary leverage requirement for the eight U.S. G-SIBS, I strongly support higher capital requirements for systemically important financial institutions. I see robust capital standards to improve the loss absorbing capacity of these highly complex and interconnected institutions as essential to reduce systemic risk and mitigate the distortions imposed by institutions deemed too big to fail. We've already increased risk-based capital requirements and, as Dan and others have noted, are likely to impose further capital charges--fee surcharges, for example--on the largest institutions. And in that context, I consider raising the leverage requirement in tandem so it can serve as a meaningful backstop to be an appropriate complementary measure. That said, I think we should watch carefully the consequences for the reasons that Governor Stein has indicated.

O.K. With that, I think we need to vote on these measures separately. And in fact, I'm going to ask for four separate votes.

So first, I need a motion to approve the final rule implementing enhanced supplementary leverage ratio standards for large interconnected U.S. banking organizations.

GOVENOR TARULLO. So moved.

GOVERNOR STEIN. Second.

CHAIR YELLEN. All in favor?

ALL. Aye.

CHAIR YELLEN. Second, I need a motion to approve the notice of proposed rulemaking that would modify the definition of total leverage exposure in the bank regulatory agencies 2013 revised capital rule.

GOVERNOR TARULLO. So moved.

GOVERNOR STEIN. Second.

CHAIR YELLEN. All in favor?

ALL. Aye.

CHAIR YELLEN. Third, I need a motion to approve the notice of proposed rulemaking that would revise the definition of eligible guarantee under the agency's advanced approaches risk-based capital rule.

GOVERNOR TARULLO. So moved.

GOVERNOR STEIN. Second.

CHAIR YELLEN. All in favor?

ALL. Aye.

CHAIR YELLEN. And finally, I need a motion to authorize staff to make technical, nonsubstantive changes prior to publication in the Federal Register.

GOVERNOR TARULLO. So moved.

GOVERNOR STEIN. Second.

CHAIR YELLEN. All in favor?

ALL. Aye.

CHAIR YELLEN. I think all the motions have been approved. I thank the staff for the excellent presentations and hard work, and consider the meeting concluded and now adjourned. Thank you.