Board of Governors of the Federal Reserve System

Opening Statement by Governor Daniel K. Tarullo

Thank you, Mr. Chairman.

Adoption of the capital rules before us today will be a milestone in our post-crisis efforts to make the financial system safer. While strong capital requirements alone cannot ensure the safety and soundness of our financial system, they are central to good financial regulation, precisely because they are available to absorb all kinds of losses, no matter how unanticipated. Along with the stress testing and capital review measures we have already implemented, and the additional rules for large institutions that are on the way, these new rules will be an essential component of a set of mutually reinforcing capital requirements.

The rules would have several important consequences.

First, they would consolidate the progress that has been made by banks and regulators over the last four years in improving the quality and quantity of capital held by banking organizations. Adoption of these rules assures that, as memories of the crisis fade, efforts to build and maintain higher capital levels will not be allowed to wane.

Second, they would remedy shortcomings in our existing, generally applicable risk-weighted assets calculations that became apparent during the financial crisis. In so doing, they would also enhance the effectiveness of the Collins Amendment, which we have strengthened in this final rule by making it applicable to capital buffer, as well as minimum, requirements.

Third, adoption of these rules means that we will have met international expectations for U.S. implementation of the Basel III capital framework. This gives us a firm position from which to press our expectations that other countries implement Basel III fully and faithfully, thereby promoting global financial stability.

In characterizing this rule as a milestone in financial regulatory reform, I should note that this marker has quite different meanings for banking organizations of systemic importance, on the one hand, and the thousands of smaller banks, on the other. For the vast majority of banks, the rule we adopt today will mark the end of major modifications we plan to capital rules. In fact, as Governor Duke will explain in a moment, most of the significant changes we made to the final rule from the proposed rules we issued last year are intended to reduce the number of, and simplify, those modifications from current standards that apply to smaller banks.

With respect to larger banking organizations, we have a number of capital-related initiatives remaining. Before turning to those initiatives, I note that work continues in the Basel Committee on simplifying some of the more complex provisions in capital requirements applicable to larger institutions. Of particular interest is work on standardized capital requirements for market risk that would provide a sound back-up for model-derived risk weights.

As to what remains, beginning in the fall we will extend full stress testing requirements and capital plan reviews to the dozen or so banking organizations with greater than $50 billion in assets that have not been fully covered in the exercises we have undertaken since 2009. We also have, in various stages of development, four rulemakings that will enhance capital requirements for the eight U.S. banking organizations already identified as of global systemic importance.

First, we are very close to completion of a notice of proposed rulemaking that will establish a leverage ratio threshold for these firms above the Basel III required minimum. Despite its innovativeness in taking account of

off-balance-sheet assets, the Basel III leverage ratio seems to have been set too low to be an effective counterpart to the combination of risk-weighted capital measures that have been agreed internationally.

Second, we should be ready in the next few months to issue a notice of proposed rulemaking concerning the combined amount of equity and long-term debt these firms should maintain in order to facilitate orderly resolution in appropriate circumstances.

Third, after the Basel Committee has completed final methodological refinements to its framework for capital surcharges on banking organizations of global systemic importance, we will issue a notice of proposed rulemaking to implement this framework in the United States. Given the current state of Basel Committee work, we may be looking at such a notice late this year.

Fourth, and finally, staff is currently working on a recommendation for an advance notice of proposed rulemaking to seek comment on possible approaches to requiring additional measures that would directly address risks related to short-term wholesale funding, including a requirement that large firms substantially dependent on such funding hold additional capital.

Once final, these measures would round out a capital regime of complementary requirements that focus on different vulnerabilities and together compensate for the inevitable shortcomings in any single capital measure. This regime would conform to the mandate given us by Congress to apply to large banking organizations more exacting regulatory and supervisory requirements that become progressively stricter as the systemic importance of a firm increases.

The capital rule we consider today is a key element of this broader regime--in itself, as a foundation for the forward-looking requirements embedded in stress testing, and as a base on which to add additional requirements such as capital surcharges for banks of global systemic importance.

With that, I turn to Governor Duke for her introductory comments.