JEB HENSARLING, TX , CHAIRMAN

United States House of Representatives
Committee on Financial Services
Washington, D.C. 20515

MAXINE WATERS, CA, RANKING MEMBER

M E M O R A N D U M

To: Members of the Committee on Financial Services

From: FSC Majority Committee Staff

Date: March 8, 2013

Subject: Subcommittee on Oversight and Investigations Hearing on the Financial Stability Oversight Council and the Office of Financial Research

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The Oversight and Investigations Subcommittee will hold a hearing titled "Who is Too Big to Fail? GAO's Assessment of the Financial Stability Oversight Council and the Office of Financial Research" at 10:00 a.m. on Thursday, March 14, 2013, in Room 2128 of the Rayburn House Office Building. This hearing will examine the operations and activities of the Financial Stability Oversight Council ("FSOC") and the Office of Financial Research ("OFR") in light of a recent report by the Government Accountability Office ("GAO").

This will be a one panel hearing with the following witnesses:

- Richard Berner, Director, OFR
- Amias Gerety, Deputy Assistant Secretary for FSOC, Department of the Treasury
- A. Nicole Clowers, Director, Financial Markets and Community Investment, GAO.

The FSOC and the OFR

Title I of the Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203) established the FSOC and charged it with (1) identifying "risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected bank holding companies or nonbank financial companies, or that could arise outside the financial services marketplace"; (2) eliminating expectations that the federal government will bail out such companies in the event of failure; and (3) responding to emerging threats to the stability of the financial system of the United States.

To carry out its mandate, the Dodd-Frank Act confers duties and powers upon the FSOC, including the following:

- Section 112(a)(2) of the Dodd-Frank Act requires the Council to monitor "domestic and international financial regulatory proposals and developments, including insurance and accounting issues," and to advise Congress and to make recommendations in these areas "that will enhance the integrity, efficiency, competitiveness, and stability of the U.S. financial markets." Section 112(a)(2) requires the FSOC to facilitate information-sharing and coordination among federal and state agencies that are developing domestic financial services policy, to recommend general supervisory priorities and principles to member regulatory agencies that reflect the outcome of discussions among those agencies, and to identify gaps in regulation that could pose risks to the financial stability of the United States.

- Section 113 authorizes the FSOC to identify U.S. and foreign nonbank financial institutions whose failure or activities "could pose a threat to the financial stability of the United States" and requires these institutions to be supervised by the Federal Reserve upon designation by the FSOC.

- Section 120 authorizes the FSOC to recommend that financial regulatory agencies apply new or heightened standards for a financial activity or practice conducted by bank holding companies or nonbank financial companies under their jurisdictions. The FSOC must first determine that the activity or practice could create or increase the risk of significant liquidity, credit, or other problems spreading among (1) bank holding companies and nonbank financial markets of the United States or (2) low-income, minority, or underserved communities. If the FSOC recommends a new or heightened standard after providing notice and opportunity for comment, the primary financial regulatory agency must impose the standard (or a substantially similar one acceptable to the FSOC) or explain in writing within 90 days why the agency will not follow the recommendation.

The FSOC comprises ten voting members and five nonvoting members. The ten voting members are the heads of nine federal financial regulatory agencies[1] and an independent member with insurance expertise; the five nonvoting members are the directors of the OFR and the Federal Insurance Office, a state insurance commissioner, a state banking supervisor, and a state securities commissioner. The Secretary of the Treasury chairs the FSOC. The FSOC must meet at least on a quarterly basis but generally meets more often, subject to the call of the Chairperson, and is governed by publicly available by-laws.

The OFR is an agency within the Department of the Treasury whose purpose is to support the FSOC in fulfilling the FSOC's duties of identifying and responding to risks and emerging threats to the financial stability of the United States. The Dodd-Frank Act requires the OFR to collect information for the FSOC and its member agencies; to standardize the types and formats of data reported and collected by those agencies; to perform applied research and long-term research; to develop tools for risk measurement and monitoring; to make the results of its activities available to financial regulatory agencies; and to assist the FSOC's member agencies in determining the types and formats of data that the Dodd-Frank Act authorizes them to collect.

[1] These agencies are the Department of the Treasury, the Federal Reserve, the Office of the Comptroller of the Currency, the Consumer Financial Protection Bureau, the Securities and Exchange Commission, the Federal Deposit Insurance Corporation, the Commodity Futures Trading Commission, the Federal Housing Finance Agency, and the National Credit Union Administration.

The OFR carries out its responsibilities through a "Data Center" and a "Research and Analysis Center."[2] The Data Center collects information from financial companies (including hedge funds, insurance companies and banks, among others) and maintains that information. The Data Center's broad authority to collect "all data necessary" to carry out its duties is enforceable by the Director's subpoena power.[3] The Director must "ensure that data collected and maintained by the Data Center are kept secure and protected against unauthorized disclosure."[4]

The OFR's Research and Analysis Center is the OFR's analytical and computing arm, and it is charged with developing metrics, analytic capacity, and research to identify failures in financial markets and providing advice on the effect of policies on systemic risk.[5]

The OFR is led by a Director, appointed by the President and confirmed by the Senate, who serves a 6-year term.[6] In January 2013, the Senate confirmed Richard Berner as the OFR's first director. The Director has authority over the OFR's budget, number of employees, employee salaries, and hiring of employees.[7] The Dodd-Frank Act grants the Director the discretion to establish technical or professional advisory committees.[8] The Director is required to consult with the FSOC's Chairperson before taking certain actions, such as setting the OFR's budget or promulgating rules. However, the Director is granted sole discretion in exercising his authority.[9]

The FSOC and the OFR are funded through assessments levied on financial institutions subject to heightened prudential supervision by the Federal Reserve. The FSOC and OFR are thus outside the congressional appropriations process.[10]

Actions by the FSOC and OFR

The FSOC

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[2] Section 154.

[3] Section 154(b)(1)(A). The OFR's Director may issue a subpoena upon the Director's written finding that the data is necessary to carry out the OFR's functions and that the OFR has coordinated with the relevant primary financial regulator. Section 153(f).

[4] Section 154(b)(3).

[5] Section 154(c)(1).

[6] Section 152(b).

[7] *See generally* section 152(b)-(d).

[8] Section 152(h).

[9] Section 152(b)(5).

[10] The Dodd-Frank Act requires the Treasury Secretary, with the FSOC's approval, to adopt a rule for collecting these assessments. Section 155(d). The Treasury Department adopted such a rule in May 2012. Assessment of Fees on Large Bank Holding Companies and Nonbank Financial Companies Supervised by the Federal Reserve Board To Cover the Expenses of the Financial Research Fund, 77 FR 29884 (May 21, 2012).

The FSOC has adopted rules to implement its authority under the Dodd-Frank Act and has considered whether it can and should undertake discretionary action under other provisions of the law. In July 2011, the FSOC published a rule for designating Financial Market Utilities ("FMUs") for enhanced supervision under Title VIII of the Dodd-Frank Act; the following year, it designated eight FMUs for enhanced supervision.[11] In April 2012, the FSOC adopted a rule for designating nonbank financial companies for supervision by the Federal Reserve, but it has not yet designated any. Currently, the FSOC is considering whether it will recommend that the Securities and Exchange Commission adopt certain rules to regulate money-market mutual funds. As required by the Dodd-Frank Act, the FSOC has issued a notice of its proposed recommendation and has solicited public comments.

Since October 2010, the FSOC has met approximately 25 times and has opened portions of nine of those meetings to the public.[12] The FSOC has published two annual reports, and it has completed six statutorily-required studies, including a study on the treatment of secured creditors under the Dodd-Frank Act's Orderly Liquidation Authority and bankruptcy law and a study on the implementation of the Volcker Rule's prohibition on proprietary trading activities and private fund investments.[13] The FSOC has established several committees and subcommittees to help meet its statutory duties, and it has adopted a transparency policy governing the public release of information about its meetings.[14]

The OFR

As directed by the Dodd-Frank Act, the OFR has begun collecting data and performing research. The OFR has established a Financial Research Advisory Committee to provide advice on developing the OFR's research and data priority. The OFR has issued statutorily-required annual reports to Congress, and it has published five studies as part of a working paper series. In conjunction with the FSOC, the OFR has organized two conferences attended by academics, government officials, interest groups, and industry representatives. The OFR has also worked towards developing a Legal Entity Identifier, which is intended to facilitate the identification of counterparties in complex transactions and aid in understanding systemic risk in the financial system. The OFR has published a strategic framework for FY 2012-2014.

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[11] An FMU is "any person that manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the person." Section 803(6)(A). Upon an FMU's designation for enhanced supervision, the Federal Reserve must establish risk management standards for the FMU's operations, in consultation with the federal regulatory agency that has primary jurisdiction over the FMU.

[12] *See* FSOC Meeting Minutes, available at http://www.treasury.gov/initiatives/fsoc/council-meetings/Pages/meeting-minutes.aspx.

[13] *See* FSOC Studies and Reports, available at http://www.treasury.gov/initiatives/fsoc/studies-reports/Pages/default.aspx.

[14] *See* Financial Stability Oversight Council Structure, available at: http://www.treasury.gov/initiatives/Documents/X%20-%20Committee%20Structure%20111910.pdf.

The OFR has also established policies and procedures to govern its workforce.[15] In July 2011, it adopted a compensation system based on that used by the Office of the Comptroller of the Currency, consistent with the Dodd-Frank Act's mandate that its pay structure be comparable to those of other financial regulatory agencies without regard to the General Schedule pay rates or classification system.[16] As a result, as of August 2012, the OFR paid its Data Center workers an average salary of $125,753 per year (the median salary was $115,250); its Research and Analysis Center employees $119,673 on average (the median salary was $93,495); and its support staff an average of $126,988 (the median was $114,744).[17]

The OFR anticipates a staffing level of 275 to 300 full-time equivalent employees by FY 2014 to 2015, with approximately 60% working in the Data Center and 20% in the Research and Analysis Center. As of September 30, 2012, 120 employees were employed by the OFR, with 63 working in the Data Center, 26 in the Research and Analysis Center, and the balance in support offices.[18]

Overview of the GAO Report

In June 2011, Financial Services Committee Chairman Spencer Bachus and Oversight and Investigations Subcommittee Chairman Randy Neugebauer requested that the GAO audit the operations of the FSOC and the OFR. In September 2012, the GAO published the results of its nine-month audit. The GAO's report, "New Council and Research Office Should Strengthen the Accountability and Transparency of Their Decisions," examined (1) challenges faced by the FSOC and OFR in fulfilling their missions; (2) the FSOC's and OFR's efforts to establish management structures and mechanisms to carry out their missions; (3) the FSOC's and OFR's activities for supporting collaboration among their members and external stakeholders; and (4) the FSOC's process for issuing rules and reports.[19]

The GAO found that the FSOC's and OFR's "management mechanisms to carry out their missions could be enhanced to provide greater accountability and transparency," although the

[15] In addition, as required by the Dodd-Frank Act, the Treasury Department completed an interim rule in September 2011, with the concurrence of the Director of the Office of Government Ethics, which places post-employment restrictions on OFR employees who have access to sensitive data.

[16] Specifically, the Director must seek to set salaries and compensation policies that are comparable to those paid by the Federal Deposit Insurance Corporation, the Comptroller of the Currency, the National Credit Union Administration Board, the Federal Housing Finance Agency, the Bureau of Consumer Financial Protection, and the Farm Credit Administration. Section 152(d)(3).

[17] Documentation provided by the OFR and on file with majority oversight staff, "All Offices—Onboard Employee Salary as of August 20, 2012." These data do not include salary information for external detailees, reimbursable Treasury support staff, and unpaid interns.

[18] Annual Report to Congress on Human Capital Planning, OFR, December 2012, http://www.treasury.gov/initiatives/ofr/about/Documents/OFR_HR_Report_Web_final.pdf.

[19] GAO-12-886, September 11, 2012, available at http://www.gao.gov/assets/650/648064.pdf.

GAO noted that the agencies had previously taken steps to establish such mechanisms.[20] The GAO also found that the FSOC "has not developed plans for comprehensively evaluating whether designations [of nonbank financial institutions] are . . . reducing threats to financial stability" and that the FSOC "does not have processes for consistently identifying such threats, separating them from more current threats, or prioritizing them."[21] Finally, the GAO found that a strategic framework that the OFR issued in March 2012 was an "important first step in adopting a strategic planning and performance management system," but that the plan "lacked some leading practices such as linking activities to strategic goals and performance measurement systems."[22]

The GAO made ten recommendations to improve the operations of the FSOC and the OFR. The GAO recommended that the FSOC keep more detailed records of its meetings and make them available to the public to the extent consistent with protecting market-sensitive information, and that the FSOC develop "a collaborative and comprehensive framework for assessing the impact of its decisions for designating FMUs and nonbank financial companies."[23] The report also recommended that the OFR further incorporate best practices into its strategic planning process.[24]

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[20] For example, the GAO concluded that the FSOC limited public information about its decision-making and activities even for subjects that did not involve sensitive financial information. *See id.* at "Highlights—What GAO Found."

[21] *Id*.

[22] *Id.*

[23] *Id*. at 54-56.

[24] *Id*.