Written Testimony of
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Before the House Financial Services Subcommittee on Oversight and Investigations
March 14, 2013

Chairman McHenry, Ranking Member Green, and members of the Committee, thank you for the opportunity to appear here today to discuss the Financial Stability Oversight Council's (Council) role in implementing key reforms of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

This month marks the five-year anniversary of the failure of Bear Stearns and the start of the financial crisis and the biggest recession our country had experienced since the Great Depression. Those events in turn led to the passage of the Dodd-Frank Act that President Obama signed into law in the summer of 2010 – the most comprehensive set of reforms to our financial system in 80 years.

The Dodd-Frank Act was a comprehensive response to a financial regulatory system that was too weak to prevent or effectively monitor risks in the financial system and that lacked the tools to respond effectively to a financial crisis that inflicted devastating damage on the U.S. economy and American families.

One of the key failures that contributed to the financial crisis was a lack of accountability for the overall stability of the financial system. The Dodd-Frank Act addresses this gap in the financial regulatory framework by creating the Financial Stability Oversight Council, which is the first federal entity vested with clear responsibility for comprehensive monitoring of the stability of our nation's financial system. The Council's three statutory missions are to identify risks to the financial stability of the United States, to promote market discipline, and to respond to emerging threats to the stability of the U.S. financial system. To support the activities of the Council and its member agencies, the Dodd-Frank Act also created the Office of Financial Research (OFR), within the Treasury Department, to collect and improve the quality of financial data and develop tools to evaluate risks to the financial system.

These complementary statutory mandates of the Council and the OFR facilitate a comprehensive approach to monitoring and analyzing emerging risks to, and trends in, the U.S. financial system. The two organizations work closely toward their common goals while minimizing duplication of efforts. OFR leadership and Council staff meet on a weekly basis to coordinate their activities and discuss current priorities.

Since the enactment of the Dodd-Frank Act, the Council has moved quickly to achieve its statutory mission while also promoting collaboration and coordination among its members. To that end, one of the Council's first activities was to build an open operational framework that included the creation of standing committees composed of staff of all of the Council members. The participation on these committees draws upon the collective policy and supervisory expertise of the Council members and institutionalizes opportunities for open and frank discussion, collaboration, and coordination. The Council's Deputies Committee, which meets bi-weekly, coordinates the activities of the Council and monitors for overlap and opportunities for collaboration among Council member agencies. Additionally, the Council has developed protocols for statutorily required consultations regarding certain Dodd-Frank Act rulemakings.

The Council is also firmly committed to operating in an open and transparent manner. At its first meeting, the Council adopted a transparency policy which states that Council meetings will be open to the public whenever possible and not less than twice each year. In fact, the Council has held nine open sessions in its first two and a half years. Council member agencies, including Treasury, have also voluntarily disclosed meetings with the public related to Council activities. For example, Treasury has disclosed on its public website hundreds of meetings related to the implementation of the Dodd-Frank Act.

The Council's annual report, which summarizes the Council's activities over the previous year and provides a forward-looking assessment of its future priorities, is a key accountability document that provides transparency to the public and to Congress. Additionally, the Council has demonstrated its commitment to transparency by actively seeking public comment on a number of key issues under the Council's consideration, including the Council's study on effective implementation of the Volcker Rule, its proposed recommendations for money market mutual fund reform, and its rule and interpretive guidance related to the designation of nonbank financial companies. In particular, the Council's rules and guidance on nonbank financial company designations and on the designation of financial market utilities were not statutorily required, but the Council believed it was important to provide the public with insight into how the Council intended to evaluate these firms for potential designation. Finally, Council members have also informed both the Congress and the public of Council activities through a large number of public testimonies, briefings, and speeches.

Although the Council is a relatively young organization, it has quickly assumed a central role in financial regulatory reform and in addressing risks to the financial system. Since its establishment, the Council has convened 28 times, has published two annual reports and six additional studies or reports on matters including concentration limits on financial companies and contingent capital, and has designated eight financial market utilities as systemically important.

In 2012 alone, the Council convened 12 times to conduct its regular business and respond to specific market developments including issues such as the sovereign fiscal developments in Europe and the United States, the trading losses of JPMorgan's Chief Investment Office, and the state of mortgage foreclosures in the United States. When superstorm Sandy ravaged the East Coast, the Council convened twice in two days to monitor market conditions and closures, discuss the effects on financial infrastructure, assess operational challenges facing banks, thrifts, and credit unions, and receive information on preliminary state and federal insurance loss estimates as a result of the storm.

The Council is also in the final stages of evaluating an initial set of nonbank financial companies for potential designation, which will subject them to enhanced prudential standards and supervision by the Federal Reserve, closing an important regulatory gap. Over the last year, Council member staff has participated on interagency teams to review public data, engage with an initial set of companies to gather additional information, and coordinate with the companies' regulators to develop thorough assessments. Moreover, the Council has laid out a process in its final rule and guidance to reevaluate any designated companies each year, consistent with the statutory standards, to determine if the company continues to meet those standards.

During the past two-and-a-half years, the Council staff has also been pleased to work with a number of teams from the Government Accountability Office (GAO) as they have conducted multiple reviews of the Council's activities. In particular, we have worked closely with Nicole Clowers and her staff and appreciate their important suggestions for the continued improvement of the Council's effectiveness.

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The Committee's letter asked me to address a GAO report issued in September 2012 that examined the progress of the Council and the OFR in achieving each organization's mission. This report reinforced that the work of the Council and the OFR is critical to safeguarding the stability of our financial system and highlighted examples of how both organizations have demonstrated transparency and accountability while carrying out their respective missions. The report also made a number of recommendations to further enhance the progress that each organization has made in these important areas.

Enhanced Transparency

As Treasury emphasized in its comment letter included as an appendix to the GAO's report, the Council is firmly committed to promoting transparency and accountability in connection with its activities. In November 2012, the Council and the OFR jointly provided a response to Congress and the GAO with a description of the actions planned and taken in response to each of the recommendations in the report.

Specifically, the report made a number of constructive recommendations on ways in which the Council could further enhance its transparency, including improving the Council's website. Subsequently, the Council's website was reintroduced, in December 2012, to improve transparency and usability, to improve access to Council documents, and to allow users to receive e-mail updates when new content is added. Continued enhancements to promote further transparency are expected over time. We also expect the Council's Deputies Committee to review whether to recommend any further changes to the Council's transparency policy.

The Council is firmly committed to holding open meetings and closes its meetings only when necessary. However, the Council must continue to find the appropriate balance between its responsibility to be transparent and its central mission to monitor emerging threats to the financial system. Council members frequently discuss supervisory and other market-sensitive data during Council meetings, including information about individual firms, transactions, and markets that require confidentiality. In many instances, regulators or firms themselves provide nonpublic information that is discussed by the Council. Continued protection of this information, even after a period of time, is often necessary to prevent destabilizing market speculation or other adverse consequences that could occur if that information were to be disclosed.

Enhanced Collaboration

The Council and its committees are key forums for coordination among regulators.

The Council has developed protocols for the statutorily required consultations regarding certain Dodd-Frank Act rulemakings. Collaboration and coordination beyond these statutory consultation requirements are inherent in the work of the Council, and occur routinely through the work of the Council members, Council committees, and member agency staff. For example, the Council has engaged in extensive consultation with the Federal Reserve Board on its proposed enhanced prudential standards, and Council members have frequently engaged in discussions on key regulatory issues, such as the international coordination of derivatives rules. Additionally, this collaborative approach is evidenced by the Council's ongoing work related to short-term funding markets, including working with the Federal Reserve Board on reforms to strengthen the tri-party repo markets, as well as the Council's recently proposed recommendations regarding money market mutual funds reforms.

The Council's framework for regulatory coordination has supported a broader and more collaborative approach than existed before the Dodd-Frank Act, and it illustrates that a more rigid approach to interagency coordination could constrain the open and collaborative environment that exists today. Additionally, Congress did not provide the Council or its Chairperson with authority to require the independent member agencies to coordinate in all cases, nor did the Dodd-Frank Act change the statutory independence of the Council's member agencies. Nevertheless, the Council will continue to seek to identify ways to further enhance collaboration through the Council's committees and working groups.

Enhanced Accountability

The Council's annual reports serve as key accountability documents. Two of the GAO's recommendations relate to ways in which the Council can improve the content of these reports. Work on the Council's 2013 annual report is underway, and we will consider the GAO's recommendations as the Council works to refine its approach to communicating key recommendations regarding financial stability in the report.

As with the Council's 2012 annual report, future annual reports will continue to articulate any intent by the Council to indicate when a particular member agency is responsible for addressing an identified risk, such as the Council's 2012 recommendation that the SEC and CFTC consider error control and risk-management standards for exchanges, clearing firms, and other market participants that are relevant for a high-speed trading environment. Appropriate timeframes will also be included, where applicable. At the same time, the Council's annual reports may contain recommendations that are directed to market participants or other entities. The GAO also recommended that the Council adopt a more formal and quantitative approach to identifying risks to financial stability. The Council's Systemic Risk Committee has worked with the OFR to develop a monitor of key financial and economic data and to highlight areas of potential concern. This information is now presented every month by OFR staff to the Council's Systemic Risk Committee and assists the Council and member staff in identifying potential risks.

Enhanced Public Outreach

Since the GAO issued its report in September, the Council and the OFR have leveraged outside expertise in several ways. In December 2012, the OFR and the Council co-hosted a second annual conference on key analytical and data needs regarding financial stability, bringing together industry experts, academics, advocacy groups, Congressional staff, and staff of Council members. In November 2012, Treasury announced the members of a new Financial Research Advisory Committee, which will work with the OFR to recommend ways to develop and employ best practices for data management, data standards, and research methodologies. The Committee is made up of 30 distinguished professionals in economics, finance, financial services, data management, risk management, and information technology. In addition, we continue to actively seek engagement with a wide range of experts outside of government. Further, in November the Council issued proposed recommendations regarding money market mutual fund reform in order to solicit feedback from market participants, academics, and others on this important issue.

The Council members and its committees also continue to help the Council benefit from the expertise of, and facilitate coordination with, outside parties. For example, the Council's state banking, insurance, and securities members were instrumental in coordinating outreach to state authorities during superstorm Sandy and have facilitated valuable information sharing with state regulators.

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We strongly support GAO's important oversight function, and we appreciate the constructive input and feedback received during our interactions. I also appreciate the Committee inviting me here to provide this update on the Council's responses to the GAO report, and I look forward to working with the GAO in the future.

Thank you.