

TESTIMONY OF GARY GENSLER
CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION
BEFORE THE
U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
WASHINGTON, DC
April 14, 2011

Good afternoon Chairman Neugebauer, Ranking Member Capuano and members of the Subcommittee. I thank you for inviting me to today's hearing on the Financial Services Oversight Council (FSOC). I am pleased to testify alongside my fellow regulators.

Before I begin, I'd like to thank the hardworking staff of the CFTC for their continued efforts to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act and to support the mission of the FSOC.

The Financial Stability Oversight Council

In 2008, the financial system failed, and the regulatory system failed. As a result, a lot of Americans are still suffering. The crisis left them with an uncertain future. Many now own homes that are worth less than their mortgages. Many are still seeking employment.

As one response to that crisis, the Dodd-Frank Act established the FSOC to ensure protections for the American public. The Council is an opportunity for regulators – now and in the future – to ensure that the financial system works better for all Americans. The financial system should be a place where investors and savers can get a return on their money. It should provide transparent and efficient markets where borrowers and people with good ideas and business plans can raise needed capital.

The financial system also should allow people who want to hedge their risk to do so without concentrating risk in the hands of only a few financial firms. One of the challenges for the Council and for the American public is that like so many other industries, the financial industry has gotten very concentrated around a small number of very large firms. As it is unlikely that we could ever ensure that no financial institution will fail – because surely, some will in the future – we must do our utmost to ensure that when those challenges arise, the taxpayers are not forced to stand behind those institutions and that these institutions are free to fail.

There are important decisions that the Council will make, such as determinations about systemically important nonbank financial companies and systemically important financial market utilities and clearinghouses, resolving disputes between agencies and completing important studies as dictated by the Dodd-Frank Act. Though these specific decisions are important, to me it is essential that the Council make sure that the American public doesn't bear the risk of the financial system and that the system works for the American public, for investors, for small businesses, for retirees and for homeowners.

The Council's eight current voting members have coordinated closely. Treasury's leadership has been invaluable. To support the FSOC, the CFTC is providing both data and expertise relating to a variety of systemic risks, how those risks can spread through the financial system and the economy and potential ways to mitigate those risks. We also have had the opportunity to coordinate with Treasury and the Council on each of the studies and proposed rules issued by the FSOC.

I will spend my time this morning discussing a number of matters that have been on the FSOC's agenda. In particular, I will focus on the FSOC's work thus far on its authority to designate financial market utilities, including clearinghouses, as systemically important and on the Volcker Rule, as the CFTC has additional responsibilities in those areas. I also will touch on the FSOC's concentration limits study and supervision of certain nonbank financial companies.

Clearinghouses

Comprehensive and robust regulatory oversight of clearinghouses is essential to our country's financial stability. This is particularly important since, under the Dodd-Frank Act, standardized swaps between financial entities must be brought to clearinghouses.

The CFTC has overseen clearinghouses for decades. Title VII of the Dodd-Frank Act provides for enhanced oversight of these clearinghouses. In close consultation with our fellow domestic and international regulators, and particularly with the Federal Reserve and the SEC, the

CFTC proposed rulemakings on risk management for clearinghouses. These rulemakings take account of relevant international standards, particularly those developed by the Committee on Payment and Settlement Systems and the International Organization of Securities Commissions.

Title VIII of the Dodd-Frank Act gives the FSOC important roles in clearinghouse oversight by authorizing the Council to designate certain clearinghouses as systemically important. Title VIII also permits the Federal Reserve to join in the examination of such clearinghouses and to recommend heightened prudential standards in certain circumstances.

The FSOC's notice of proposed rulemaking on designating systemically important financial market utilities complements the CFTC's rulemaking efforts. Public input will be valuable in determining how the Council should apply statutory criteria to determine which clearinghouses qualify for designation as systemically important.

Volcker Rule Study

Section 619 of the Dodd-Frank Act provides that, other than certain permitted activities, “a banking entity shall not engage in proprietary trading, including trading in futures, options on futures and swaps.” The CFTC is directed to adopt rules to carry out this requirement with respect to any entity “for which the CFTC is the primary financial regulatory agency.”

As part of the Volcker rule's coordinated rulemaking requirement, CFTC staff has been meeting at least twice a week with other agencies, including the FDIC, Federal Reserve, Office

of the Comptroller of the Currency, SEC and Treasury Department. The goal of these meetings is to ensure, to the extent possible, that our rules on section 619 are comparable and provide for consistent application.

The FSOC's Study & Recommendations on Prohibitions on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds, also known as the Volcker Rule study, provides thoughtful recommendations to carry out Congress's intent to separate proprietary trading from otherwise permitted activities of banking entities. The study also provides a basis upon which each of our agencies can move forward with the required rule-writing to carry out Congress's mandate.

In particular, the study covers financial instruments both in the cash market and in the derivatives and swaps markets. This is significant, as any risk that a banking entity could take on in the cash markets also could be expressed through swaps and derivatives. The inclusion of both prevents regulatory arbitrage. In addition, the study indicates that the books of banking entities, including swap dealers, would not be precluded from the definition of a trading account regardless of whether those accounts held illiquid financial instruments, such as swaps, and regardless of whether those positions are short-term or long-term.

Supervision of Certain Nonbank Financial Companies and Concentration Limits

Title I of the Dodd-Frank Act authorizes the FSOC to determine whether certain activities of nonbank financial companies could pose a threat to the financial stability of the

United States. Those companies would be supervised by the Federal Reserve and subject to specific prudential standards. The FSOC's proposed rulemaking on Authority to Require Supervision of Certain Nonbank Financial Companies lays out a set of designation criteria that the Council would use to determine whether nonbank financial companies are systemically significant. Effective regulation of systemically important nonbank financial entities is essential to preventing the next AIG from threatening the financial system. I look forward to seeing the staff's summary of the comments received in response to the Council's proposed rulemaking and considering the public's recommendations before moving forward to any final rulemaking in this area.

The Dodd-Frank Act also includes a provision that no financial company be permitted to grow through either merger or acquisition if the resulting companies' consolidated liabilities would exceed 10 percent of all the aggregate consolidated liabilities of all financial companies. The FSOC's Study & Recommendations Regarding Concentration Limits on Large Financial Companies is an important step in implementing Congress's direction. These limits are designed to promote financial stability by preventing the liabilities of the financial sector from becoming too concentrated in any given financial entity. The 2008 financial crisis demonstrated the potential repercussions to the American public of concentration within our financial sector.

Annual FSOC Report to Congress

Under section 112 of the Dodd-Frank Act, the FSOC is to report annually to Congress. Staff of the CFTC, including people from our Chief Economist's office, Division of Market

Oversight, and Division of Clearing and Intermediary Oversight, have been contributing to that effort. I believe this annual report can serve as an important means for the Council to communicate to Congress on the stability of the financial system and make recommendations to enhance the U.S. financial markets and protect the public.

Coordination with FSOC Member Agencies

The CFTC is consulting heavily with the member agencies of the FSOC to implement the Dodd-Frank Act. We are working very closely with the SEC, Federal Reserve, FDIC, OCC and other prudential regulators, which includes sharing many of our memos, term sheets and draft work product. We also are working closely with the Treasury Department and the new Office of Financial Research. As of Friday, CFTC staff has had 598 meetings with other regulators on implementation of the Act. This close coordination has benefited the rulemaking process and will strengthen the markets. The CFTC will consider final rules only after we have the opportunity to consult with our fellow regulators.

Conclusion

Thank you for the opportunity to testify. I'd be happy to take questions.