

## **Embargoed Until Delivery**

**Testimony of Jeffrey A. Goldstein**  
**House Financial Services Committee**  
**Subcommittee on Oversight and Investigations**  
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Mr. Chairman, Ranking Member Capuano, and members of the Subcommittee, thank you for inviting me to testify today.

In July 2010, Congress passed, and the President signed into law, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). A central piece of this legislation was the creation of the Financial Stability Oversight Council (the “Council”), which corrected a core deficiency in our country’s financial regulatory structure by making a single organization accountable for monitoring and addressing risks to financial stability.

After passage of the Dodd-Frank Act, Secretary Geithner asked me to act as his deputy on the Council. In that capacity, I chair the Council’s Deputies Committee as well as its Systemic Risk Committee and am working with my Council colleagues to build and execute the mandate of this new organization.

The Council’s statutory mandate is to identify risks to financial stability, respond to any emerging threats in the system, and promote market discipline. The Council also has specific responsibilities to implement several key features of the Dodd-Frank Act. In particular, the Council has the authority to designate nonbank financial companies for consolidated supervision by the Board of Governors of the Federal Reserve System, and to designate financial market utilities for heightened standards. It also is required to report annually to Congress on risks to financial stability and to conduct several key studies, including studies on implementation of the Dodd-Frank Act’s Volcker Rule and the Dodd-Frank Act’s limits on the concentration of large financial companies. As Chair of the Council, the Secretary of the Treasury has additional statutory responsibilities, including coordination of rulemakings on credit risk retention and the Volcker Rule.

These responsibilities are substantial, but the Council has made significant progress in the short time since the Dodd-Frank Act was signed into law. Since enactment, the Council has: (1) built its basic organizational framework; (2) laid the groundwork for the designation of nonbank financial companies and financial market utilities; (3) initiated monitoring for potential risks to U.S. financial stability; (4) carried out the explicit statutory requirements of the Council, including the completion of several studies; and (5) served as a forum for discussion and coordination among the agencies implementing Dodd-Frank.

### *Council structure and operations*

We have built a structure for the Council that is designed to promote accountability and action. Every two weeks, a Deputies Committee comprised of senior officials from each of the member agencies meets to set the Council’s agenda, and to direct the work of the Council’s Systemic Risk Committee and five functional committees. The functional committees are organized around the Council’s ongoing statutory responsibilities: designations of nonbank financial

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companies, designations of financial market utilities, heightened prudential standards, orderly liquidation and resolution plans, and data.

The Council's principals have met four times in the organization's first eight months, significantly more often than the statutorily required quarterly meetings. This pace has been driven by the substantive agenda outlined in the Dodd-Frank Act, and by the consideration of emerging issues affecting the financial system and the economy.

In addition to establishing an institutional framework, including adopting rules of operation and a budget, the first eight months of the Council's work has focused on completing statutorily required studies and beginning a transparent, rules-based process for designations of nonbank financial companies and financial market utilities.

At each meeting to date, the Council has held a public session. This exemplifies a commitment to conduct its work in as open and transparent a manner as practicable given the confidential supervisory and sensitive information that is at the heart of the Council's work. The Council also has released proposed rules to implement its Freedom of Information Act regulations, which represent a straightforward approach to implementing the requirements of the law.

### *Designations*

Two of the Council's most important tools are its ability to designate nonbank financial companies for consolidated supervision and financial market utilities for heightened standards. The Council is engaging in two parallel rulemakings to establish a process and define criteria for these designations that are robust and transparent.

For the first time, Dodd-Frank calls for consolidated supervision of and heightened prudential standards for the largest, most interconnected nonbank financial companies. Prior to the crisis, a large financial firm could escape consolidated supervision based on its corporate form. Through the designation authority, the Council will help ensure that large, interconnected financial companies, whose material financial distress could pose a threat to U.S. financial stability, will not be permitted to avoid adequate supervision and prudential standards.

The Council also has the ongoing authority to designate financial market utilities for heightened standards. Financial market utilities are a critical part of the nation's financial infrastructure, facilitating clearing, settlements, and payments for domestic and foreign financial institutions. These elements of the financial infrastructure are highly interconnected and thus, if an important market utility fails to perform as expected or fails to manage risk appropriately, it could pose significant risk to the financial system as a whole. The Council's work will help ensure these entities do not jeopardize the broader financial system.

While the statute carefully outlines the considerations and process requirements for making these designations, the Council is conducting rulemakings to ensure transparency and to obtain input from all interested parties.

For its nonbank designations work, the Council issued an Advanced Notice of Proposed Rule or "ANPR" in October 2010 and a Notice of Proposed Rulemaking or "NPRM" in January 2011

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providing guidance on the statutorily mandated criteria and defining the procedures that the Council will follow in considering the designation of nonbank financial companies. For designations of financial market utilities, public comments from last November's ANPR informed an NPRM released in March. The comment period for that NPRM is 60 days and remains open. The Council's member agencies continue to work in close collaboration, having received significant input from market participants, non-profits, academics, and members of the public to develop an analytical framework for designations that will provide a consistent approach and will incorporate the need for both quantitative and qualitative judgments.

The Council's commitment to a robust designations process goes beyond transparency during the rulemaking process. Every designation decision will be firm-specific and is subject to judicial review. Moreover, even before the Council votes on a proposed designation, a company under consideration will have the opportunity to submit written materials to the Council on whether, in the company's view, it meets the standard for designation. Only after Council members have reviewed that information will they vote on a proposed designation, which requires the support of two-thirds of the Council (including the affirmative vote of the Chair) and, if challenged, is subject to review through a formal hearing process and a two-thirds final vote. Upon the final vote, the Council must then submit a report to Congress detailing its final decision.

The Dodd-Frank Act requires Council members to evaluate a statutorily mandated set of qualitative and quantitative factors when designating a nonbank firm or a financial market utility. Since a firm's comprehensive risk profile is the result of a combination of these factors, the Council must exercise judgment during the process. Congress recognized that financial markets are dynamic and that this designations process must take into account changes in firms, markets, and risks. That is one of the key reasons that the statute mandates an annual reevaluation of any designation made by the Council.

### *Monitoring Threats to Financial Stability*

The Council established a Systemic Risk Committee to be accountable for identifying, analyzing, and monitoring risks to financial stability and for providing regular assessments of risks to deputies and principals.

The Council has focused on significant market developments that could affect the financial system both domestically and internationally. For example, as part of its ongoing efforts, the Council and its members monitor emerging issues such as the state of mortgage foreclosures in the United States, sovereign debt developments in Europe, and the recent earthquake and tsunami tragedy in Japan. The Council also has reviewed structural issues within the financial system, such as options for reform of the money market mutual fund industry. We will continue to monitor potential threats to stability, whether from external shocks or structural areas of concern.

The Dodd-Frank Act calls for a public report to Congress each year describing the activities of the Council and the health of the financial system. Staff at each of the member agencies are already hard at work drafting the Council's first annual report. As stated in the statute, this report will: outline the activities of the Council, including any designations or recommendations made with respect to activities that could threaten financial stability; detail significant financial

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market and regulatory developments; and identify potential emerging threats to the financial stability of the United States. The Council also will consider recommendations to enhance the integrity, efficiency, competitiveness, and stability of United States financial markets; promote market discipline; and maintain investor confidence.

### *Studies*

On January 18, the Council released a study and recommendations on the implementation of the Dodd-Frank Act's "Volcker Rule". The Volcker Rule will strengthen the financial system and constrain risk by prohibiting proprietary trading and limiting relationships with hedge funds and private equity funds for banking entities that benefit directly from the government's safety net. The Council sought input from the public in advance of the study and received more than 8,000 comments. The study recommends principles for implementing the Volcker Rule and suggests a comprehensive framework for identifying activities prohibited by the Rule. That framework includes an internal compliance regime, quantitative analysis and reporting, and supervisory review.

As requested, the Council also conducted a study of the effects of the Dodd-Frank Act's limits on the concentration of large companies on financial stability. The Council's study found that the concentration limit will reduce moral hazard, increase financial stability, and improve efficiency and competition within the U.S. financial system. The study also made largely technical recommendations to mitigate practical difficulties likely to arise in the administration and enforcement of the concentration limit, without undermining its effectiveness in limiting excessive concentration among financial companies. The Council approved the study at its January meeting and released the recommendations for public comment. The Council received six comments and is currently reviewing those comments to determine whether any of the recommendations should be modified.

The Council continues to have specific responsibilities to study key issues outlined in Dodd-Frank. For instance, the Council must complete a study regarding "haircuts" to secured creditors by July and a study regarding contingent capital instruments by July 2012.

### *Interagency Regulatory Coordination*

The Council also has served as a forum for discussion and coordination among the agencies implementing the Dodd-Frank Act.

For the Council's first meeting in October 2010, the staff of member agencies developed a detailed, public road map for implementation of the legislation. This integrated roadmap outlined a coordinated timeline of goals, both for the Council and its independent member agencies, to fully implement the Dodd-Frank Act.

As Chair of the Council, the Treasury Secretary is required to coordinate several major rulemakings under the Dodd-Frank Act. For example, to facilitate the joint rulemaking on credit risk retention, Treasury staff held frequent interagency discussions beginning shortly after the Dodd-Frank Act was passed to develop the rule text and preamble. This joint rulemaking

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required reaching consensus among six rulemaking agencies. The proposed rule, released on March 31, demonstrates our ability to promote effective collaboration, and it is a significant step towards strengthening securitization markets. Treasury staff is currently engaged in a similar process with the staff of member agencies tasked with drafting the Volcker Rule.

The Council's regulatory coordination role is greater than the specific statutory instances where coordination is required. Deputies meetings have served as a forum for sharing information about significant regulatory developments, particularly those that impact the work of more than one member agency and relate to financial stability. For example, the Federal Reserve recently briefed deputies on the results of its Comprehensive Capital Analysis and Review. Treasury has provided updates on housing finance reform.

### *Conclusion*

The work of the Council is critical to building a more effective financial regulatory system and to creating accountability over the long-term for the health of the financial system as a whole. I look forward to continuing to share our progress with you over the coming months and years.