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STATEMENT OF

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on

OVERSIGHT OF THE FINANCIAL STABILITY OVERSIGHT COUNCIL

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Chairman Neugebauer, Ranking Member Capuano, and members of the Subcommittee, thank you for the opportunity to testify today on behalf of the Federal Deposit Insurance Corporation on issues related to the Financial Stability Oversight Council (FSOC).

The recent financial crisis exposed shortcomings in our regulatory framework for monitoring risk and supervising the financial system. Insufficient capital at many financial institutions, misaligned incentives in securitization markets and the rise of a largely unregulated shadow banking system permitted excess and instability to build up in the U.S. financial system. These conditions led directly to the liquidity crisis of September 2008 that froze our system of intercompany finance and contributed to the most severe economic downturn since the Great Depression.

At the same time, the pre-2010 regulatory framework focused regulators narrowly on individual institutions and markets within their jurisdiction. No one had a firm grasp of the big picture of overall risk in the financial system. This allowed supervisory gaps to grow and created an incentive for companies to engage in regulatory arbitrage to find the weakest oversight or, worse, move to parts of the system that were virtually unregulated. In addition to these regulatory gaps, the absence of a resolution process for systemically important non-bank financial companies left financial regulators with limited options for addressing problems facing such firms, creating a no-win dilemma for policy-makers: bail out these companies or expose the financial system to destabilizing liquidations through the normal bankruptcy process.

The landmark Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) creates a comprehensive new regulatory and resolution regime that is designed to avoid the severe economic consequences of economic instability. The Dodd-Frank Act gives regulators new tools to limit risk in individual financial institutions and transactions, enhances the supervision of large non-bank financial companies, and facilitates the orderly closing and liquidation of large banking organizations and non-bank financial companies in the event of failure.

The FSOC is one of the most important new tools created by the Dodd-Frank Act and is designed to fill the gaps in regulatory oversight. For the first time, one entity has the collective accountability for identifying and constraining risks to the financial system as a whole. My testimony will review the FDIC's participation on the FSOC, identify FSOC-related issues that are of particular importance to the FDIC, and discuss actions of the FSOC to date.

Background and FDIC's Participation in the FSOC

Among other things, the Dodd-Frank Act directs the FSOC to facilitate regulatory coordination and information sharing among its members regarding policy development, rulemaking, supervisory information, and reporting requirements. The FSOC is also responsible for determining whether a nonbank financial company should be supervised by the Board of Governors of the Federal Reserve System (Federal Reserve) and subject to prudential standards, and for designating financial market utilities (FMUs) and payment, clearing, or settlement activities that are, or are likely to become, systemically

important.[1] The term systemically important financial institution, or SIFI, is used to describe nonbank financial companies that the Council has determined should be supervised by the Federal Reserve and subject to prudential standards. The FSOC has the authority to recommend more stringent risk management standards for SIFIs and large, interconnected bank holding companies, and can ultimately determine to break up firms that pose a "grave threat" to financial stability. The Dodd-Frank Act also directs the FSOC to issue specialized reports and conduct various studies.

In order to complete its day-to-day work, the FSOC has established a committee structure. The Deputies Committee, which is comprised of senior officials from each member agency, coordinates and oversees staff assigned to FSOC-related issues. Among other things, the Deputies Committee is responsible for sharing information on proposed policies and rules among member agencies.

Since the FSOC's main responsibilities revolve around systemic risk monitoring and mitigation, the FSOC created a Systemic Risk Committee and two subcommittees on which the FDIC and other members serve – "Financial Institutions" and "Financial Markets." The Systemic Risk Committee is primarily responsible for making recommendations to the FSOC regarding significant financial market and regulatory developments and potential emerging threats to the financial stability of the U.S. The Systemic Risk Committee also will help the FSOC carry out its responsibilities to report on its progress to Congress. The Dodd-Frank Act requires that the FSOC produce annual

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[1] Bank holding companies with total consolidated assets of $50 billion or more are automatically subject to enhanced prudential standards established by the Federal Reserve Board.

financial stability reports and that each voting member submit a signed statement stating whether the member believes that the FSOC is taking all reasonable actions to mitigate systemic risk.

The FSOC also has five standing functional committees, with each committee focusing on one of the following key issues: 1) designation of nonbank financial companies for supervision by the Federal Reserve; 2) designation of FMUs as systemically important; 3) recommendation to the Federal Reserve of heightened prudential standards applicable to SIFIs and large, interconnected bank holding companies; 4) orderly liquidation authority and resolution plans; and 5) data. There are also ad hoc groups for special issues and reports, such as a group currently working on the Volcker Rule, which under the Dodd-Frank Act prohibits proprietary trading and acquisition of an interest in hedge or private equity funds by insured depository institutions.

The FDIC has representatives on these five standing functional committees. In addition to participating on FSOC committees, the FDIC has a number of internal work streams, which focus on specific risk issues, policies, studies, and regulations.
A particular area of interest for the FDIC – and a source of a significant number of the FDIC's Dodd-Frank Act-related rulemakings – stems from the Act's mandate to end "Too Big to Fail." This includes our Orderly Liquidation Authority under Title II of the Act, our joint rulemaking with the Federal Reserve on requirements for resolution plans (or "living wills") that will apply to SIFIs and bank holding companies with total

consolidated assets of $50 billion or more, and the development of criteria for determining which firms will be designated as SIFIs by the FSOC.

SIFI Designation

An important responsibility of the FSOC is to develop criteria for identifying nonbank financial companies that will be subject to enhanced Federal Reserve supervision and therefore, subject to the resolution plan requirements. To protect the U.S. financial system, it is essential that SIFIs are identified promptly and receive the proper supervision so we do not find ourselves with a troubled firm that is placed into Title II liquidation without having a resolution plan in place.

The Dodd-Frank Act specifies a number of factors that can be considered when designating a nonbank financial company for enhanced supervision by the Federal Reserve, including: leverage; off-balance-sheet exposures; and the nature, scope, size, scale, concentration, interconnectedness and mix of activities. The FSOC will develop a combination of qualitative and quantitative measures of potential risks to U.S. financial stability posed by an individual nonbank institution. Once these measures are agreed upon, the FSOC may need to request data or information that is not currently collected or otherwise available in public filings.

Recognizing the need for accurate, clear, and high quality information, Congress granted the FSOC the authority to gather and review financial data and reports from nonbank financial companies and bank holding companies, and if appropriate, request

that the Federal Reserve conduct an exam of the company for purposes of making a systemic designation. By collecting information in advance of a designation, the FSOC can be much more judicious in determining which firms it designates as SIFIs. This will minimize both the threat of an unexpected systemic failure and the number of firms that will be subject to additional regulatory requirements under Title I of the Act.

Last October, the FSOC issued an Advance Notice of Proposed Rulemaking regarding the criteria that should inform the FSOC's designation of nonbank financial companies. The FSOC received approximately 50 comments from industry trade associations, individual firms, and individuals. On January 26, 2011, the FSOC issued a Notice of Proposed Rulemaking describing the criteria that will inform the FSOC's designation of nonbank financial companies and the processes and procedures established under the Dodd-Frank Act.

The comment period closed on February 25, 2011, and the FSOC received 43 comments. Many commenters requested that specific metrics be made available for public comment and included in the text of the rule.

The FSOC is committed to adopting a final rule as expeditiously as possible, with the first designations to occur shortly thereafter. The FDIC believes the final rule should be more descriptive as to the metrics that the Council will be considering.

Conclusion

The FDIC believes that the FSOC members are committed to the success of the Council, and we have been impressed with the quality of staff work in preparation for the meetings as well as the rigor and candor of the discussions. We also believe that the FSOC has provided a useful means for agencies to jointly write rules required by the Dodd-Frank Act and to seek input from other agencies on independent rules. The FDIC strongly supports the FSOC's collective approach to identifying and responding to risks.

The FSOC is an important new tool for financial regulators to close supervisory gaps and to maintain financial stability by identifying and dealing with risks before they pose a serious threat to the financial system. The FDIC is actively involved in many aspects of the FSOC, but is particularly focused with ending the chaos and costs associated with "Too Big to Fail." Working within the FSOC framework, the FDIC intends to expeditiously complete rulemakings and exercise its new authorities related to orderly liquidation authority and resolution plans so market participants will know the rules, and so that as stewards of the financial system, we will prevent a repeat of the recent financial crisis.

Thank you again for the opportunity to testify and I would be pleased to answer any questions.