

**Written Statement of Patrick Pinschmidt
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U.S. Department of the Treasury
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Chairman McHenry, Ranking Member Green, and members of the Committee, thank you for the opportunity to testify today regarding the Financial Stability Oversight Council (Council).

Next month will mark the fourth anniversary of the first meeting of the Council. The Council was created as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), a set of reforms designed to address flaws in our financial regulatory system that were made apparent by the financial crisis. Before the Council, no single authority was accountable for identifying, monitoring, and addressing risks to financial stability. Regulators focused on the institutions, functions, or markets within their jurisdictions, allowing some risks to fall through the cracks of the regulatory system.

With the establishment of the Council, federal and state regulators from across the system now meet regularly to coordinate and work together to respond to potential threats to financial stability. The Council has convened over 40 times since its first meeting in October 2010, providing a forum for close collaboration among its members. Over just the last year, the Council has considered issues including market volatility, the debt ceiling impasse, interest rate risk, developments in Europe and emerging economies, housing finance reform proposals, operational incidents in the equity markets, and risks to financial stability arising from cybersecurity threats.

Much of the benefit of the Council also comes from ongoing engagement among the staffs of its members on a near-daily basis. Independent regulatory agencies continue to be responsible for regulating the markets and institutions they oversee. But they are now also part of a process that enables them to look across the entire financial system to address risks that may not be confined to any single agency's jurisdiction. By bringing regulators together in this manner, the Council fulfills its statutory purposes of identifying risks to U.S. financial stability, promoting market discipline, and responding to emerging threats to the stability of the U.S. financial system.

Congress provided the Council with a number of tools to address risks to financial stability. If the Council identifies a risk that requires action, the Council carefully considers the appropriate response. In its annual reports to Congress, it can highlight potential emerging threats and make recommendations to address those threats. The Council can issue recommendations to existing primary financial regulatory agencies to apply new or heightened standards and safeguards for financial activities or practices that create or increase the risk of liquidity, credit, or other problems spreading among financial markets. The Council can also collect and facilitate improved sharing of information to assess risks to the U.S. financial system. To address

company-specific risks, the Council can designate nonbank financial companies and financial market utilities for heightened supervision and enhanced prudential standards.

The Council has used a number of these authorities to address potential risks. It has designated three nonbank financial companies for Federal Reserve supervision and enhanced prudential standards; designated eight financial market utilities for enhanced risk-management standards; issued for public comment proposed recommendations regarding money market mutual fund reform; and made specific recommendations in its annual reports regarding reforms to address vulnerabilities in the tri-party repo market and other areas.

In June of this year, the Secretary of the Treasury, in his capacity as the Chairperson of the Council, testified before the full Financial Services Committee to present the Council's 2014 annual report, which focused on nine areas that warrant continued attention and possibly further action from the Council's members:¹

- First, regulatory agencies and market participants should continue to take action to reduce vulnerabilities in wholesale funding markets, including tri-party repo and money market mutual funds, that can lead to destabilizing fire sales.
- Second, regulators should continue to work with policymakers to implement the significant structural reforms that are needed to reduce the taxpayers' exposure to risk in the housing market.
- Third, cybersecurity threats, infrastructure vulnerabilities, and other operational risks remain a top priority for the Council, and regulators should continue to take steps to prevent operational failures and improve resiliency.
- Fourth, as the financial system evolves in response to technological, competitive, and regulatory changes, regulators should remain attentive to financial innovations and the migration of certain activities outside of traditional financial intermediaries in a manner that could create financial stability risks.
- Fifth, U.S. regulators should continue to cooperate with foreign counterparts to address concerns about benchmark reference rates such as LIBOR.
- Sixth, regulators and institutions should remain vigilant in monitoring and assessing risks related to interest rate volatility, particularly as investors seek higher yields in a low interest rate environment.
- Seventh, Council member agencies should continue to work with the Office of Financial Research (OFR) to fill financial data gaps and address related issues of data quality and comprehensiveness.
- Eighth, regulators should continue implementation of Dodd-Frank Act reforms to reduce risk-taking incentives of large, complex, interconnected financial institutions.

¹The Council's annual reports are available at <http://www.treasury.gov/initiatives/fsoc/studies-reports/Pages/2014-Annual-Report.aspx>.

- And finally, there is a need for continued monitoring of adverse financial developments abroad and their potential impact on the U.S. financial system.

Since its creation four years ago, the Council has continued to mature as an organization and make progress in fulfilling its statutory responsibilities. The Council has built an organizational framework that supports openness and collaboration throughout every aspect of its work. In particular, I would like to highlight several areas in which the Council has made substantial progress.

The Council has fulfilled its statutory responsibilities through staff committees dedicated to supporting the Council's work. These committees, which draw upon the collective policy and supervisory expertise of each of the Council members and member agencies, institutionalize opportunities for open discussion, collaboration, and coordination. The Council's Deputies Committee, which meets bi-weekly, coordinates the activities of the Council and oversees the work of the other staff-level committees. Among other things, the Deputies Committee engages in consultations regarding Dodd-Frank Act rulemakings by member agencies. In May, the Council adopted bylaws for the Deputies Committee that provide the public with an understanding of the structure and role of the committee.

The Council has published four annual reports to Congress, and six additional studies or reports. The Council's annual report stands as a public testament to how the Council is executing its statutory duty to identify and respond to threats to financial stability. Each annual report is the product of a highly collaborative analysis and reflects the collective judgment of the Council members regarding potential emerging threats to financial stability. The annual report is an important example of the Council's commitment to sharing information about its work with Congress and the public in a clear and transparent manner. Each annual report documents for Congress and the public the Council's identification of risks in all corners of the markets, its assessment of how those risks might be transmitted to the broader financial system, and its recommendations for specific actions to mitigate those risks. As I noted earlier, the Council's 2014 annual report highlighted, among other areas, vulnerabilities in wholesale funding markets, the need for structural reforms to reduce taxpayers' exposure to risk in the housing market, cybersecurity threats and infrastructure vulnerabilities, and risks related to interest rate volatility.

The Council established a rigorous and fair process for evaluating nonbank financial companies for potential designation. The Council's designations authority addresses a key weakness brought to light by the financial crisis: the regulatory structure in place at the time allowed large, complex nonbank financial firms to pose risks to financial stability that were not subject to adequate supervision. Based on lessons learned from the crisis, the Dodd-Frank Act provides the Council with the authority to designate a nonbank financial company for supervision by the Federal Reserve and enhanced prudential standards, if the company could pose a threat to U.S. financial stability. Although a rulemaking was not required in this context, the Council developed a rule and guidance regarding this authority and provided the public with three separate opportunities to comment on the proposed approach and process. The Council's

thorough and careful analyses of individual firms include extensive interactions between the companies under consideration and staff of the Council members and member agencies. Together, for the three nonbank financial companies that have been designated by the Council, the firms submitted thousands of pages of information for the Council's consideration, met with the Council or staff dozens of times, and each received a lengthy written explanation of the Council's analysis before a designation was made.

The Council adopted a transparency policy, and further expanded it this year. At its first meeting in 2010, the Council voluntarily adopted a transparency policy that committed the Council to conducting its meetings in public whenever possible and to releasing minutes for all its meetings. Though no statute required the Council to do so, the Council is committed to conducting its business in an open and transparent manner and these steps have helped provide the public with insight into the Council's work.² In May of this year, the Council enhanced its transparency policy after a months-long review. The improvements include public statements both before and immediately after Council meetings that provide additional information about the Council's discussions. Much of the Council's work—particularly with regard to companies under consideration for potential designation—relies on sensitive company-specific information that would not be shared by firms or regulators without an expectation of confidentiality. Further, protection of this information is necessary to prevent destabilizing market speculation. Within this context, the Council is committed to conducting its business in an open and transparent manner.

The Council developed a website and notifications to keep the public informed. In December 2012, the Council redesigned its website to improve transparency, usability, and access to documents and reports. For example, as part of the Council's recent enhancements to its transparency policy, we now post a statement to the website immediately following each Council meeting regarding the Council's discussion, to provide more timely information in advance of the public release of minutes. The website also allows users to receive updates when new information is posted, and we notify over 5,000 current subscribers every time we update any web page.

The Council has worked closely with the Government Accountability Office (GAO) and Council of Inspectors General on Financial Oversight (CIGFO). Since its creation four years ago, the Council has participated in more than a dozen performance audits by the GAO and the CIGFO reviewing almost every aspect of the Council's work, with four audits ongoing today. In July, the CIGFO completed a review of the Council's transparency policy and found that the Council complied fully with its existing policy and that the recent revisions largely addressed the improvements they otherwise would have recommended.³ We have also engaged extensively

²Minutes for each Council meeting and webcasts of the Council's public meetings are available at <http://www.treasury.gov/initiatives/fsoc/council-meetings/Pages/default.aspx>.

³The CIGFO audit is available at <http://www.treasury.gov/about/organizational-structure/ig/Documents/CIGFO%20Audit%20July%202014.pdf>

with Congress through correspondence and member and staff briefings. Today is the tenth hearing for which Treasury has testified specifically regarding the Council.

The Council has actively sought and considered input from external parties. The Council has a track record of soliciting input from the public and stakeholders. For example, in May, the Council's Deputies Committee hosted a public conference on asset management to hear directly from industry representatives, academics, and other stakeholders on topics related to asset management. In December 2013, a bank chairman and CEO who leads industry efforts to address cybersecurity issues joined a public meeting of the Council to discuss strengthening the partnership between the private and public sectors in that area.⁴ Furthermore, the Council has requested public comment on its proposed processes for nonbank financial company designations, financial market utility designations, and the process for hearings conducted by the Council. And in the context of nonbank financial company designations, staff representing Council members frequently engage with firms and state regulators. In recent months, the Council has received a number of suggestions regarding its process for evaluating nonbank financial companies for potential designation, including some from members of this Committee. The Council is always interested in ways to improve its processes, and I expect that the Council will consider any potential changes in the coming months.

Conclusion

In summary, the Council plays a critical role in our financial regulatory system by bringing together federal and state financial regulators from across the financial system to identify and respond to risks to financial stability. The Council by its very existence fosters better communication and a more proactive response to emerging threats to financial stability.

The actions of the Council and its member agencies have made the financial system more stable and less vulnerable to economic or financial stress. I look forward to working with this Committee and Congress to continue to make progress in creating a more resilient and stable financial system.

⁴A recording of the webcast of this meeting is available at <http://treas.yorkcast.com/webcast/Play/d223201575c0439fa9511bb2ebcb1caa1d>.