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IMPLEMENTING THE DODD–FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

ON

EXAMINING THE MAJOR ASPECTS OF THE DODD-FRANK ACT

SEPTEMBER 30, 2010

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C O N T E N T S

THURSDAY, SEPTEMBER 30, 2010

IMPLEMENTING THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT

THURSDAY, SEPTEMBER 30, 2010

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:03 a.m., in room SD–538, Dirksen Senate Office Building, Hon. Christopher J. Dodd, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN CHRISTOPHER J. DODD

Chairman DODD. The Committee will come to order.

Let me welcome our distinguished panel of witnesses this morning. I cannot recall the last time we gathered in such a setting with all the representatives of the major financial regulatory bodies with us. Obviously, with the adjournment vote last night and when we planned this hearing some weeks ago, we were under the impression we were going to be in session at least, I think, another week. Obviously, the agenda changed. But, nonetheless, I thought this hearing was so important that I said to Richard that we wanted to move ahead with you. So I do not know how much participation we will actually get from Members, but I do not want you to believe that is a reflection of any feelings about any of you here this morning.

Senator SHELBY. They will probably like that.

Chairman DODD. Yes, fewer questions here from Members. But if we do get a quorum—and my hope is we do. I have discussed this already with Senator Shelby. We are going to move to executive session very quickly on a couple of housing measures that I believe have been agreed to. We have worked on them, and I think we can deal with them fairly quickly. So if that happens, we will interrupt the hearing, and I will apologize to whoever is speaking at that moment for the interruption when that moment occurs. But in the meantime, I am going to make some opening comments here. I will turn to Senator Shelby for any opening comments, and Jack is here with us, and since there are few of us here, if any other Members have additional thoughts they would like to express this morning, we will do that as well. And then we will go into a question period.

I am going to make the question period not 5 or 6 minutes but 10 minutes each Member because to try and have—even 10 minutes is not a great deal, but given the representation of our witnesses here, it will give each Member a chance maybe to get into a little more depth than you are probably able to in 5 or 6 minutes, if that is OK with you.

All right. Well, anyway, the hearing this morning is implementing the so-called "Dodd-Frank Wall Street Reform and Consumer Protection Act." And, again, we are very grateful for the presence of our witnesses.

I took over the chairmanship of this Committee nearly 4 years ago, in January of 2007, and over that time we have witnessed the near collapse of the American economy, a crisis that cost us millions of jobs, wiped out trillions of dollars in wealth and at long last provided the impetus for fundamental reform of our financial system. That reform should have happened a long time ago. Many could make that case.

For nearly 3 years, this Committee has held hearing after hearing identifying and examining gaps, overlaps, and shortfalls in a regulatory system that had not been updated since the 1930s.

Today I believe we can say, thanks to the hard work of Democrats and Republicans on this Committee—and I include every Member of this Committee who was involved in this effort—and with the sage counsel of our witnesses, many of whom are here today and whose perspectives we have considered carefully, we have delivered the reform our financial system needed and provided the American people with the economic stability that they deserve. We have put an end to too-big-to-fail bailouts and to an era in which executives on Wall Street felt free to gamble with other people's money in the belief that American taxpayers would be there for them if they lost.

Now, Americans and executives alike know with certainty that if a company puts itself in a position to fail, fail is exactly what it will do.

We have increased transparency and accountability in our markets, bringing the $600 trillion derivatives market into the open and preventing shady dealers from operating in the shadows.

We have established an early warning system so that we never again find out that a financial product or practice is unsafe only after it has already undermined the stability of our economy. And we have established an independent consumer financial protection agency to provide Americans with the clear and accurate information that they need to make good financial decisions as well as with the security that comes with knowing that someone is watching out for your interests and your interests alone.

But as you will notice, there is no "Mission Accomplished" banner hanging behind me here this morning in this Committee room. The work is not done at all. Hardly a mission accomplished. I have heard critics say that the new law leaves too much up to the regulators. But it was never my intention to have the U.S. Senate, the House of representatives, or the Congress as a whole do the job of regulators. Indeed, I do not think anyone wants the Senate or the Congress writing detailed prescriptions that require technical, expert knowledge. Nor could we afford to tie the regulators' hands with rigid legislative requirements that cannot be adapted to changing circumstances.

What we have done with this legislation is to eliminate the gaps, the overlaps, and the shortfalls that allowed some financial actors to game the regulatory structure and some parts of our financial system to go unregulated entirely.

The Glass-Steagall Act of 1933, which established the Federal Deposit Insurance Corporation, was 37 pages long. The Securities and Exchange Act of 1934 was 29 pages long. Those two acts laid the foundation for nearly 75 years of growth and innovation in our financial sector and prosperity for generations of Americans. But it took competent, energetic regulators to make those laws work.

Our bill is some 848 pages long, when you get just the actual text of the bill, because times have changed. Our financial system is far more complex than it was 80 years ago, and we are competing in a global marketplace, which was not the case almost a century ago. We were asked to reform the entire financial system, and that cannot be done in a handful of pages. But like the Glass-Steagall Act and the Securities and Exchange Act, it will require very good, competent, energetic regulators.

Now, I wish I could write a law that prohibits a trader from gambling away his firm's bottom line or an executive from putting short-term gains above long-term stability. But we cannot legislate morality, and goodness knows we cannot legislate wisdom. All we can do is establish a comprehensive framework and a clear path forward, and that is what we have tried to do with this legislation.

The regulators will have to interpret and enforce the law, and those who profit from the innovation and flexibility that define our financial system will have to remember that evading the rules of the road, in letter or in spirit, hurts all of us. This new law gives our President the ability to walk into the G20 meetings as a representative of a world leader in financial services with a framework for the rest of the world to follow.

When we first warned of the flaws in our system back in January of 2007, few thought we would end up on the path that we have traveled since. After all, if we are making money, what better proof of the soundness and stability of a system could there possibly be?

Well, I believe that our economy will grow again. People will make money, and policymakers will be tempted to forget the lessons of this crisis. But mark my words here this morning. There will be another crisis as certain as we are sitting here. Greed and recklessness will rear their heads again. And I can tell you with confidence that when that day comes, we have provided regulators with the tools they need to see it coming and to put a stop to it in time before it wrecks the economy as this crisis nearly did. But whether they will actually do so largely depends upon the foundation laid by those of you who are before us today and the jobs you do in the coming weeks and months to lay that foundation within your respective regulatory bodies.

With that, let me turn to my colleague from Alabama, Senator Shelby.

STATEMENT OF SENATOR RICHARD C. SHELBY

Senator SHELBY. Thank you, Mr. Chairman, and welcome to all of you. It is not the first time you have been here. I hope it will not be the last.

For millions of Americans, the passage of Dodd-Frank provides little comfort as they confront a harsh economic reality. The unemployment rate now stands at 9.6 percent. Economic growth is anemic. Bank lending remains depressed. And housing values continue to fall in many areas. Not since the Carter administration has the Nation's economy performed so poorly.

The response of the Administration and Democrats in Congress has been to enact a slew of new laws to expand the size and the scope of the Federal Government. With the stimulus bill, bank bailouts, Obamacare, and now Frank-Dodd, the Democratic majority has clearly articulated——

Chairman DODD. Dodd-Frank.

[Laughter.]

Senator SHELBY. Dodd-Frank. Interchangeable.

[Laughter.]

Senator SHELBY. Frank-Dodd, Dodd-Frank. You know, I think Frank would like that, Chris.

Chairman DODD. Let us wait and see how it works.

[Laughter.]

Senator SHELBY. I will call it Dodd-Frank. I do not think it is going to work. I hope it does.

With the stimulus bill, bank bailouts, Obamacare, and now, according to the Chairman, Dodd-Frank, the Democratic majority has clearly articulated its vision for the future: more Government, higher taxes, and greater control over the economy. For millions of Americans, however, the Democrats' vision has produced an unfortunate reality: higher unemployment, less access to credit, and trillions of dollars of Government debt on the shoulders of our children and our grandchildren.

Today we will examine the implementation of one of these bills, the recently enacted legislation known here as Dodd-Frank. Rather than address the core issues that produced the financial crisis, I believe the Dodd-Frank legislation adheres to the worn-out Washington theory that more is better—more regulation, more agencies, more bureaucrats, and more spending.

To make matters worse, the bill has delegated to bureaucrats the authority to devise dozens, if not hundreds, of new rules for our financial system. The law itself provides no specific guidance in any number of areas, including derivatives, consumer protection, and systemic risk. In many instances, Dodd-Frank has outsourced this Committee's responsibilities to unelected bureaucrats.

Typically, an implementation hearing involves Congress making sure that regulators are following the law as prescribed. Today, however, the roles will be reversed. We will be asking regulators to tell us what rules that they will be prescribing. Consequently, for all intents and purposes, the real authors of Dodd-Frank will be the bureaucrats in our financial regulatory agencies.

Let us remember that nearly all of the major financial institutions that failed were regulated institutions. Let us also remember that the regulators failed to use their already broad authorities to take the necessary steps to prevent the crisis. And, finally, let us remember that conflicting agency rules created opportunities for regulatory arbitrage.

By ignoring these failures and adding another level of bureaucracy to our already cumbersome financial structure, Dodd-Frank could potentially create an even more complex and dysfunctional system.

For example, Dodd-Frank instructed the SEC and the CFTC to jointly devise rules on derivatives. In doing so, the legislation intensifies the decades-long turf battle between the two agencies that we are quite familiar with. This likely ensures that the final rules will be more about protecting bureaucratic fiefdoms than protecting the overall financial system. Thus, rather than addressing the regulatory arbitrage in derivatives that we know AIG exploited, this bill exacerbates the problem. Additionally, by delegated the major policy decisions, and therefore most of the real work, to the regulators, the Dodd-Frank legislation undermines the effectiveness of our regulators by asking them to do too much.

For example, the Federal Reserve has approximately 70 rulemakings and studies it must complete over the next 18 months. How can we expect the head of any agency to properly devise and implement so many complex rules while also effectively discharging its existing responsibilities?

The recent financial crisis painfully demonstrated that errors, limitations, and conflicts of interest among regulators often play a key part in causing a systemic breakdown. The majority has promised the American people that Dodd-Frank will make our financial system safer and will help revive the economy. As time passes, however, I believe that it will become clear that neither is true. By extending the Government safety net over a much larger segment of our financial system, the stage, I believe, has been set for more severe economic crisis.

Under current law, the responsibility rests largely with the regulators to avoid future difficulties. Congress, however, can continue to exercise its oversight authority by having hearings such as this one today and also, when necessary, revisit the law and make changes consistent with our findings and the demands of the electorate. In this particular instance, change is not only a good thing; I believe it is inevitable.

Thank you, Mr. Chairman.

Chairman DODD. Thank you very much, Senator.

Does anyone else want to be heard on this matter before we turn to our witnesses?

[No response.]

Chairman DODD. Well, very good. Welcome to our witnesses, and I will be brief in our introductions because you are all well known to those of us on the Committee.

Neal Wolin is the Deputy Secretary of the U.S. Department of the Treasury, prior to that served in the Obama administration as Deputy Assistant to the President. We thank you, Neal, for being with us once again.

Chairman Ben Bernanke, as we all know, of the Federal Reserve, we thank you, Mr. Chairman, for being here this morning.

Sheila Bair, of the FDIC, has been before this Committee on numerous occasions over the last 3 or 4 years, and, Sheila, we thank you for your service—longstanding service, by the way. Of course, many of us knew Sheila when she was legal counsel to Bob Dole here in the Senate, so she knows very much what it is like to be on this side of the dais as well, so we thank you.

Mary Schapiro is Chairperson of the U.S. Securities and Exchange Commission, and, Mary, we thank you for being with us this morning, and we thank you for the work that you are doing.

Gary Gensler is Chairman of the Commodity Futures Trading Commission and, again, longstanding service to our Government and in the private sector as well. And, Gary, we thank you.

And John Walsh is the Acting Comptroller of the Currency. He assumed that position on August 15th, having previously served as Chief of Staff for Public Affairs for the OCC. We thank you very much, John, for being with us as well.

I would ask you to begin in the order I have introduced you, Neal. And if you can, try and keep it down to 5 to 6 minutes or so. And, again, all documentation or supporting materials that you think would be worthwhile for us to have as part of this hearing, we look forward to.

And let me just say, by the way, in response to Senator Shelby, without going into the details of his statement here, obviously with my departure in a few weeks from here, this Committee will have to continue its job, obviously, of the oversight function. And Bob Bennett and I will be on the outside watching as this all unfolds here. But, obviously, it will be very important. We did not——

Senator SHELBY. Corker will be here.

Chairman DODD. Well, we know Corker, and Tim Johnson will be here, with the gavel in his hand, we hope.

[Laughter.]

Chairman DODD. I know you were. I could not resist the—anyway, put that aside for a second. But the point being that what we did not write into the law—and you cannot, obviously, and that is, the job on this side of the dais, and that is, to have the oversight consistently on how this is all working. And that will be a very, very important function in addition to the other jobs that the Committee will assume come January. But I underscore that point very strongly. It will be very important to see how this is working and how we are performing.

So, with that, Neal, thank you again for being with us, and we will begin with your testimony. And, by the way, as I have said to Members, as soon as we have—I think we are getting close. Are we one away? Then we are going to interrupt to do a quick markup of two bills.

Neal.

STATEMENT OF NEAL S. WOLIN, DEPUTY SECRETARY, DEPARTMENT OF THE TREASURY

Mr. WOLIN. Mr. Chairman, Ranking Member Shelby, Members of the Committee, thank you very much for the opportunity to testify about Treasury's role in implementing the Dodd-Frank Act.

Mr. Chairman, 2 months ago, against tough odds, Congress enacted historic financial reform. Passing the Dodd-Frank Act was a major accomplishment for this country, and it would not have happened without your strong commitment and that of your colleagues.

Congress stood on the right side of history and with the millions of Americans who have lost their jobs, homes, and businesses as a result of a crisis caused by basic failures in our financial system.

Chairman DODD. Neal, I want to congratulate you. You have brought us a quorum.

[Laughter.]

Mr. WOLIN. Success.

Chairman DODD. So let me move us into executive session, if I may. Without objection, we will go into executive sessions.

[Whereupon, at 10:20 a.m., the Committee proceeded to other business.]

[Whereupon, at 10:22 a.m., the Committee was reconvened.]

Chairman DODD. We are back to regular session. Neal, go ahead.

Mr. WOLIN. Thank you, Mr. Chairman.

But the work required to make reform a reality, as you noted, Mr. Chairman, in your opening, is far from done. We now face the task of implementation.

I know this process can seem remote or distant to many Americans. It is enormously complex and involves unavoidably dense topics. So before providing you with an update on our efforts, I want to list our guiding principles. These are the basic things all Americans should know about how we are implementing reform.

We are moving as quickly and as carefully as we can. We are establishing full transparency.

Wherever possible, we will streamline and simplify Government regulation. We will create a more coordinated regulatory process. We will build a level playing field here at home and around the world for financial firms. We will protect the freedom for innovation that is absolutely necessary for growth. And we will keep Congress fully informed of our progress on a regular basis.

Mr. Chairman, Ranking Member Shelby, since passage, Treasury has been hard at work implementing reform. We immediately put in place a governance structure. We established teams dedicated to Treasury's four main responsibilities. Those responsibilities include helping to establish the Financial Stability Oversight Council, laying the groundwork for the Office of Financial Research, launching the Consumer Financial Protection Bureau, and creating a Federal Insurance Office.

In my written testimony, I have provided a detailed update on where we are with each office. But let me just say a few words about two of them: the Financial Stability Oversight Council and the Consumer Financial Protection Bureau.

Tomorrow, the Council will hold its first meeting. As Chair, Treasury respects the critical independence of regulators to fulfill their responsibilities. We are working with other Members to develop an approach that maintains that independence while maximizing the coordination required for the Council to fulfill its collective responsibility of promoting financial stability.

Tomorrow, I expect that the Council will take important first steps. It will consider draft bylaws. It will consider a proposal to seek public comment on the criteria to designate large, interconnected nonbank financial companies for consolidated supervision. And it will consider a proposal to seek public comment to inform recommendations the Council will make on how to implement the Volcker Rule.

Treasury has also made important progress standing up the Consumer Protection Bureau. Upon passage, we set up a staff implementation team with a clear division of responsibilities. They have focused on building the necessary infrastructure, such as human resources and IT and on the Bureau's key functions, including research, preparing for the supervision of financial institutions, and working with the various transferor agencies.

Mr. Chairman, let me just conclude by saying that Treasury and all the agencies involved in this process have and will continue to put enormous effort toward implementation and the ultimate goal of making our financial system safer and our economy stronger.

Chairman DODD. Thank you very much, Mr. Wolin. I appreciate it.

Chairman Bernanke, thank you.

STATEMENT OF BEN S. BERNANKE, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. BERNANKE. Thank you, Mr. Chairman.

Before I turn to my testimony, I would like to thank you and Senator Shelby and the rest of the Committee for helping get Senate confirmation of Janet Yellen and Sarah Bloom Raskin to the Federal Reserve Board. As you know and as I am going to discuss in my testimony, we have a great deal of work before us, and having them on the Board will help us enormously in carrying out the responsibilities that we have.

In the years leading up to the recent financial crisis, the global regulatory framework did not effectively keep pace with profound changes in the financial system. The Dodd-Frank Act addresses critical gaps and weaknesses of the U.S. regulatory framework, many of which were revealed by the crisis. The Federal Reserve is committed to working with the other financial regulatory agencies to effectively implement and execute the act, while also developing complementary improvements to the financial regulatory framework.

The act gives the Federal Reserve several crucial new responsibilities. These responsibilities include being part of the new Financial Stability Oversight Council, supervision of nonbank financial firms that are designated as systemically important by the Council, supervision of thrift holding companies, and the development of enhanced prudential standards for large bank holding companies and systemically important nonbank financial firms designated by the Council. In addition, the Federal Reserve has or shares important rulemaking authority for implementing the so-called "Volcker Rule restrictions" on proprietary trading and private fund activities of banking firms, credit risk retention requirements for securitizations, and restrictions on interchange fees for debit cards, among other provisions.

All told, the act requires the Federal Reserve to complete more than 50 rulemakings and sets of formal guidelines, as well as a number of studies and reports, many within a relatively short period. We have also been assigned formal responsibilities to consult and collaborate with other agencies on a substantial number of additional rules, provisions, and studies. Overall, we have identified approximately 250 projects associated with implementing the act. To ensure that we meet our obligations in a timely manner, we are drawing on expertise and resources from across the Federal Reserve System in areas such as banking supervision, economic research, financial markets, consumer protection, payments, and legal analysis. We have created a senior staff position to coordinate our efforts and have developed project reporting and tracking tools to facilitate management and oversight of all of our implementation responsibilities.

The Federal Reserve is committed to its longstanding practice of ensuring that all its rulemakings be conducted in a fair, open, and transparent manner. Accordingly, we are disclosing on our public Web site summaries of all communications with members of the public—including banks, trade associations, consumer groups, and academics—regarding matters subject to a proposed or potential future rulemakings under the act.

In addition to our own rulemakings and studies, we have been providing technical and policy advice to the Treasury Department as it works to establish the Oversight Council and the related Office of Financial Research. We are working with the Treasury to develop the Council's organizational documents and structure. We are also assisting the Council with the construction of its framework for identifying systemically important nonbank financial firms and financial market utilities, as well as with its required studies on the proprietary trading and private fund activities of banking firms and on financial sector concentration limits.

Additionally, work is well under way to transfer the Federal Reserve's consumer protection responsibilities specified in the act to the new Bureau of Consumer Financial Protection. A transition team at the Board, headed by Governor Duke, is working closely with Treasury staff responsible for setting up the new agency. We have established the operating accounts and initial funding for the Bureau, and we have provided the Treasury detailed information about our programs and staffing in the areas of rulemaking, compliance examinations, policy analysis, complaint handling, and consumer education. We are also providing advice and information about supporting infrastructure that the Bureau will need to carry out its responsibilities, such as human resource systems and information technology.

Well before the enactment of the Dodd-Frank Act, the Federal Reserve was working with other regulatory agencies here and abroad to design and implement a stronger set of prudential requirements for internationally active banking firms. The governing body for the Basel Committee on Banking Supervision reached an agreement a few weeks ago on the major elements of a new financial regulatory architecture, commonly known as Basel III. By increasing the quantity and quality of capital that banking firms must hold and by strengthening liquidity requirements, Basel III aims to constrain bank risk taking, reduce the incidence and severity of future financial crises, and produce a more resilient financial system. The key elements of this framework are due to be finalized by the end of this year.

In concordance with the letter and the spirit of the act, the Federal Reserve is also continuing its work to strengthen its supervision of the largest, most complex financial firms and to incorporate macroprudential considerations into supervision. As the act recognizes, the Federal Reserve and other financial regulatory agencies must supervise financial institutions and critical infrastructures with an eye toward not only the safety and soundness of each individual firm, but also overall financial stability. Indeed, the crisis demonstrated that a too narrow focus on the safety and soundness of individual firms can result in a failure to detect and thwart emerging threats to financial stability that cut across many firms.

A critical feature of a successful systemic or macroprudential approach to supervision is a multidisciplinary perspective. Our experience in 2009 with the Supervisory Capital Assessment Program—popularly known as the bank stress tests—demonstrated the feasibility and benefits of employing such a perspective.

The stress tests also showed how much the supervision of systemically important institutions can benefit from simultaneous horizontal evaluations of the practices and portfolios of a number of individual firms and from employment of robust quantitative assessment tools. Building on that experience, we have reoriented our supervision of the largest, most complex banking firms to include a quantitative surveillance mechanism and to make greater use of the broad range of skills of the Federal Reserve staff.

A final element of the Federal Reserve's efforts to implement the Dodd-Frank Act relates to the transparency of our balance sheet and our liquidity programs. Well before enactment, we were providing a great deal of relevant information on our Web site, in statistical releases, and in regular reports to the Congress. Under a framework established by the act, the Federal Reserve will, by December 1st, provide detailed information regarding individual transactions conducted across a range of credit and liquidity programs over the period from December 1, 2007, to July 20, 2010. This information will include the names of counterparties, the date and dollar value of individual transactions, the terms of repayment, and other relevant information. On an ongoing basis, subject to lags specified by the Congress to protect the efficacy of the programs, the Federal Reserve also will routinely provide information regarding the identities of counterparties, amounts financed or purchased and collateral pledged for transactions under the discount window, open market operations, and emergency lending facilities.

To conclude, the Dodd-Frank Act is an important step forward for financial regulation in the United States, and it is essential that the act be carried out expeditiously and effectively. The Federal Reserve will work closely with our fellow regulators, the Congress, and the Administration to ensure that the law is implemented in a manner that best protects the stability of our financial system and strengthens the U.S. economy.

Thank you, Mr. Chairman.

Chairman DODD. Thank you very much, Chairman Bernanke. And I should say, by the way—I did not say this at the outset; that is my failure—I want to thank all of you, by the way. We have had tremendous cooperation from all of you over the last several years as we worked our way through all of this, and particularly you, Chairman Bernanke, going back obviously to the very difficult days in the early fall of 2008. In my view, history will record that your involvement and your participation helped save this country, and so I appreciate very, very much what you did, and we are grateful to you for your service.

Sheila.

STATEMENT OF SHEILA C. BAIR, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Ms. BAIR. Chairman Dodd, Ranking Member Shelby, and Members of the Committee, thank you for the opportunity to testify on the FDIC's efforts to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Let me say at the outset what a pleasure it has been to work with you, Mr. Chairman, on this historic legislation, as well as on many other matters over the years. This is a bittersweet moment for me, as I am sure it is for many of us, in appearing before you for what may be my last time. I wish you well as you take on new challenges outside the Senate.

Chairman DODD. Thanks.

Ms. BAIR. I would also like to say farewell to Senator Bennett. It has been a pleasure to know you for many years, and this will probably be the last time I will be appearing before you, but I do not think there is anyone in the Senate who understands financial services better than you do, and your measured, balanced approach to these issues will be very much missed. I wish you well, as well.

As Chairman Dodd said, I believe it was 6 a.m. in the morning shortly after the final vote: "We have done something that has been badly needed, sorely needed for a long time and we hope will protect our country, create the kinds of jobs and wealth and optimism and trust once again in our financial system that has become so missing."

Senator Dodd, I can report to you this morning that at the FDIC, we are well on our way to putting this, "badly needed" Dodd-Frank Act into effect.

With the U.S. financial system now stable and healing, we are moving ahead with some initial rules to implement the orderly liquidation process created under the Dodd-Frank Act for systemically important financial companies.

To restore greater market discipline, it is essential that the liquidation rules make clear to equity shareholders and unsecured creditors that they, not taxpayers, are at risk when their company fails. We hope to publish this preliminary set of rules in the near future.

To more effectively carry out our new resolution responsibilities, we created a new Office of Complex Financial Institutions. This office will focus on monitoring risk at large complex institutions, reviewing their required resolution plans, and developing strategies to execute those plans should it become necessary. This office will also handle the staff work in connection with the new Financial Stability Oversight Council, of which the FDIC is a member.

To ensure that we have the information necessary to carry out the new orderly liquidation authority, we are working on implementing our new back-up examination and enforcement authority as granted by the Dodd-Frank Act. This authority will likely play a key role in planning for any potential liquidation of a systemically important financial company. Our Board also recently strengthened our existing Memorandum of Understanding with the other primary Federal regulators with respect to our back-up authority for insured depository institutions.

As part of ending "too big to fail," the Dodd-Frank Act also calls for the largest and most systemically important banks to meet higher capital requirements. These requirements, in concert with the new international leverage ratio and other Basel III standards, are a major step in strengthening the safety and soundness of the financial system and ensuring that credit is available.

Other important provisions in the Dodd-Frank Act that have not received as much public attention concern changes made to our authority as manager of the Deposit Insurance Fund. The FDIC has long held the view that the deposit insurance assessment system should cushion the impact of economic cycles on insured institutions. However, in practice, the opposite has tended to occur.

The FDIC Board will soon consider a long-term strategy for managing the Deposit Insurance Fund so that the fund can remain positive through a crisis without the need to impose sharp swings in the assessment rates. Our Board will look at assessment rates, a target reserve ratio, and a dividend policy consistent with long-term FDIC goals and statutory requirements, including the new minimum 1.35 percent reserve ratio.

We know the last two crises will eventually fade from public memory and the need for a strong fund will become less apparent. Therefore, actions taken now under the Dodd-Frank Act should make it easier for future FDIC Boards to resist pressure to reduce assessment rates or pay larger dividends at the expense of the long-term stability of the fund.

Finally, the FDIC is actively supporting the new Consumer Financial Protection Bureau established under the Dodd-Frank Act. We are working with the Treasury Department and other banking agencies to ensure a smooth transition and strong coordination as the CFPB is established. Further, the FDIC has taken internal steps to strengthen consumer protection by reorganizing our supervisory functions and creating a new Division of Depositor and Consumer Protection. This new division will direct our supervisory resources more effectively while maintaining the necessary coordination and information sharing between consumer protection and safety and soundness.

In conclusion, let me say the success of the Dodd-Frank Act will rise or fall depending on the commitment and enthusiasm of the various agencies to fully implement it in a timely manner.

Thank you for the opportunity to testify on the FDIC's efforts in implementing the Dodd-Frank Act, and I would be happy to answer any questions. Thank you.

Chairman DODD. Thank you very much, Chairman Bair, and thank you again for your tremendous involvement over these many, many months. We thank you immensely.

Chairman Schapiro, we thank you for being with us this morning. We thank you, as well, for your strong leadership of the SEC. It has been welcome.

STATEMENT OF MARY L. SCHAPIRO, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION

Ms. SCHAPIRO. Thank you very much. Chairman Dodd, Ranking Member Shelby, and Members of the Committee, thank you for inviting me to testify today on behalf of the Securities and Exchange Commission regarding our implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act. And let me add my thanks to you, Senator Dodd, to those of my colleagues for your leadership of the Committee and for shepherding regulatory reform through the legislative process.

The pace and scope of SEC rulemaking over the next year as we work to meet the Act's requirements will be unprecedented in our history. Given the scope and importance of the Act, we are taking great care to implement its many provisions effectively and on schedule and to do so in a transparent manner that incorporates significant public input at every step.

We believe that the successful execution of this landmark legislation depends in large part on receiving detailed comments from stakeholders across America's financial system. Thus, we began by immediately establishing a process for public comment that exceeds legal requirements, creating a series of e-mail boxes to which the public are invited to send preliminary comments, even before rules are proposed and the official comment periods begin. The response, with thousands of comments received on 31 different topics, has been extraordinary.

We recognize that the process of establishing regulations works best not only when all stakeholders are engaged, but when the discussions and meetings are transparent. Therefore, we ask those who request meetings with SEC staff to provide an agenda, which is posted on our Web site, along with the names of individuals participating in these meetings and copies of any written materials distributed.

In addition, SEC staff is committed to reaching out as necessary to solicit views from affected stakeholders who do not appear to be adequately represented by the public record on a particular issue and our Web site provides detailed information on our schedule for all rules and studies required by Dodd-Frank through July of 2011.

Our consultative efforts include close collaboration with our fellow regulators, as well. We are consulting and coordinating with the CFTC, the Federal Reserve Board, and the Departments of Treasury, State, and Commerce, and other agencies. Our Office of International Affairs is meeting weekly with our rule-writing staff to ensure appropriate coordination with our foreign counterparts. Our goal is to establish a seamless and effective framework that crosses agencies and borders and which encompasses the full spectrum of financial regulatory issues.

Since the July signing of the Act, the SEC has issued interim rules requiring the registration of municipal advisors, approved exchange rules eliminating broker discretionary voting on executive compensation, and revised Regulation FD to remove the exemption for NRSROs, or credit rating agencies. We have sought formal comments regarding the study we will conduct of the obligations of brokers, dealers, and investment advisors, and on the definitions of certain terms fundamental to derivatives regulation, including swap, securities-based swap, swap dealers, and others. And in recent weeks, the SEC has held three joint roundtables with the CFTC to inform our over-the-counter derivatives rulemaking.

Yet our work is just beginning. In October, we expect to release at least six new packages of proposed rules for public comment. These will include proposals that would, among other things, establish ownership limitations and governance requirements for security-based swap clearing agencies, enhanced due diligence disclosure in the asset-backed securities market, and require that corporate executive compensation and golden parachutes be subject to advisory shareholder votes. Also in the next month, we will adopt an interim final rule for reporting on pre-Act security-based swaps.

By the end of October, we will have also completed our administrative process of establishing each of the five new offices created by the legislation. We expect to appoint the heads of these new offices during the months of October and November.

Also in November, we expect to issue an additional nine new packages of proposed rules. These will include three separate derivatives rulemaking releases regarding antimanipulation rules, data repository registration, record keeping, and real-time reporting, and jointly with the CFTC, definitions and jurisdictional provisions to guide our OTC derivatives oversight.

By the end of the year, we will have proposed all rules required to restructure the derivatives market and to implement changes in investment advisor oversight.

By January, 6 months after passage, we will have completed and submitted several studies and reports to Congress, including one regarding the obligations of broker-dealers and investment advisors and one looking at ways to improve investor access to advisory and broker-dealer registration information. By then, we expect the broad SEC organizational review to have been completed and conveyed to Congress, as well.

In conclusion, we are engaged in a comprehensive effort to implement the Act. Indeed, we will write more than 100 rules and conduct more than 20 studies. And while we will undoubtedly encounter some bumps in the road, we are currently on track to meet the goals, mandates, and deadlines. We are ensuring that our process is fully transparent and that the full spectrum of views on every issue is heard and considered. And as we proceed with implementation, we will continue to work closely with Congress, consult with our fellow regulators, and listen to members of the financial community and the investing public.

Thank you for the opportunity to be here and I look forward to answering your questions.

Chairman DODD. Thank you, Chairman Schapiro, very, very much. I appreciate your diligent work. And let me make sure that in the case of all of you, your respective staffs and others who have been working so hard are recognized, as well, for their diligence.

Mr. Gensler, how are you? Thank you for coming.

STATEMENT OF GARY GENSLER, CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION

Mr. GENSLER. Good. Doing well. Thank you, Chairman Dodd. Good morning, Ranking Member Shelby, Members of the Committee. I thank you for inviting me to speak here today on the implementation of the Dodd-Frank Act, or the Frank-Dodd Act.

Chairman DODD. Wait until you go over to the House to make that comment.

[Laughter.]

Mr. GENSLER. I am honored to appear here today alongside my fellow regulators with whom we are working so closely to implement the Act and I am pleased to testify on behalf of the Commission and thank my fellow Commissioners. There are five of us each who are independent, Senate-confirmed, and will come and bring their views to these really crucial matters.

Before I move into the testimony, I do want to thank you, Chairman Dodd, for your leadership of the Banking Committee and in the Senate. On a personal note, I think we first met about 13 years ago when I was asked to serve in the Treasury Department, but also worked so closely with you on what became Sarbanes-Oxley, and it is bittersweet, and also Senator Bayh and Senator Bennett. I remember many private meetings and public meetings, so I thank you. As Sheila said, it is a bit bittersweet.

The Dodd-Frank Act requires the CFTC and the SEC working with our fellow regulators to write rules with regard to the derivatives area within 360 days. That means, if one is not counting, we have 289 days to go.

We set up 30 rule teams at the CFTC and publicly put this out, and we have two principles really guiding us. One is the law itself, not to over-read it, not to under-read it, but to do exactly, as best we can, what Congress intended to do and wrote in the 840 pages that the Chairman referred to.

Second is to have broad consultation, heavily both with fellow regulators and the public and the Congress, as well. We are working very closely with the SEC and the Federal Reserve particularly, but also all of my fellow regulators here today. Within 24 hours from the bill signing, we had 20 team leads over at the SEC for a joint meeting, and with the Federal Reserve and other regulators the following week. In fact, to date—we added it up—we have had 146 individual meetings of staffs or chairman-to-chairman level between the CFTC and fellow regulators. That is about 100 with the SEC and about 45 with all the other regulators to date.

We are also actively consulting with international regulators. I just returned yesterday from a 3-day trip to Brussels, where I met with all the different senior regulators there. I know my other regulators are doing the same. Two weeks ago, the European Commission put out their proposal on derivatives and it is very similar and consistent with the Dodd-Frank Act. Both have strong clearing requirements. Both have covering financial entities and have a commercial end user exception. Both use data repositories and have strong risk lowering standards for the dealers. And so we are working to harmonize to make sure as we go forward with the rule writing we are consistent with what they are doing internationally.

We are also soliciting broad public comments, as our other agencies are. We want to engage the public as best we can. We have had 3 days of roundtables with the SEC, and we have also had many public meetings which we, too, list on our site. I think we now have a list of 170 meetings on our site with all the details and participants and the major topics discussed.

We plan to actively publish rules starting tomorrow is our first public meeting, publishing proposals through the middle of December. We have coordinated that schedule mostly with the SEC, but we have shared that schedule with all of the fellow regulators and Treasury here today to try to coordinate with the FSOC.

So the next year of rule writing will test certainly the talented staff of the CFTC and my fellow Commissioners and me. Though we do have the resources to publish the rules and move forward on the rules, we do recognize we would need significantly more resources about a year from now to actually implement these.

With that, I look forward to taking any questions.

Chairman DODD. Thank you very much, Chairman Gensler.

Mr. Walsh, thank you for joining us and thank you for taking on the responsibilities at the OCC.

STATEMENT OF JOHN WALSH, ACTING COMPTROLLER OF THE CURRENCY, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Mr. WALSH. Thank you, Mr. Chairman. Chairman Dodd, Senator Shelby, Members of the Committee, it is an honor to testify before this Committee where I used to work as staff to Senator John Heinz under Senator Bennett's predecessor, Senator Jake Garn, and a privilege to testify before you, Mr. Chairman, on the Dodd-Frank Act as your service in the Senate draws to a close.

The Committee asked me to discuss our progress in implementing the Dodd-Frank Act, our plans for integrating the OTS staff and functions into the OCC, our plans for identifying employees to transfer to the Consumer Bureau, and our views about how Basel III furthers the objectives of the Act. My written statement also describes a few challenges we have encountered thus far in implementing the Act that may benefit from legislative clarification.

To meet the law's objectives, the OCC is drafting a number of new rules, some jointly with other agencies and some on a coordinated basis. The rules cover a broad range of issues, including regulatory capital, proprietary trading, derivatives margin requirements, and appraisals. The law also requires us to revise many of our existing regulations, and as the Office of Thrift Supervision is integrated into the OCC, we are charged with reviewing and republishing all OTS rules.

We have worked quickly to identify each of our rulemaking obligations and have established teams of agency experts to lead our work and to coordinate with interagency efforts, as appropriate. A group of senior managers is directing and coordinating this mammoth effort. My written statement also details specific tasks we have initiated, including support we have provided to the Financial Stability Oversight Council and an Advanced Notice of Proposed Rulemaking we have issued on the requirement to end reliance on credit ratings. We have begun work on an interagency basis to implement risk retention requirements for securitization and to limit excessive or inappropriate compensation, among other projects. We are still in the early stages of work on these projects and we have encountered some challenges detailed in my statement.

One of the most important tasks ahead for the OCC involves the transfer of most functions from the Office of Thrift Supervision. The OCC will take on the task of supervising Federal thrifts and writing rules for all savings associations, while responsibility for State chartered thrifts and thrift holding companies will go to the FDIC and the Federal Reserve, respectively.

Most OTS employees will transfer to the OCC and we are focused on ensuring the orderly and effective transfer of these functions and staff. The OTS employees transferring to the OCC have essential skills and knowledge of the thrift industry that will be important to the OCC in carrying out this new mission. I believe they will find the OCC a supportive and rewarding place to continue their careers, and we are looking forward to welcoming them to our agency.

We are mindful of the importance of communicating about the transition process, both with OTS employees and the thrifts they supervise. I recently wrote to all Federal thrift chief executive officers about the transition and I plan to continue reaching out to the industry. We are participating in industry events that provide opportunities to interact with thrift executives and we are developing an outreach program to provide information about the OCC's approach to supervision and regulation.

We also have an obligation to work with Treasury to identify OCC employees who have the skills to support the rulemaking, supervision, and examination functions that will transfer to the CFPB and who are interested in working for the new agency. We have been participating in planning for the new Bureau, and as the CFPB organization takes shape, we are committed to providing necessary support to that organization.

Finally, with respect to Basel III, we believe these capital and liquidity reforms which seek to improve the ability of banks to absorb shocks from economic stress advances the objectives of the Act. The Dodd-Frank Act addresses many of the same issues as Basel III, which seeks improvements to quality of capital, addresses systemic risk concerns, mitigates procyclicality, limits excessive leverage in the banking system, and establishes minimum liquidity standards. We think the Basel III framework strikes an appropriate balance by setting requirements for higher quality capital and liquidity while allowing the banking system to continue to perform its essential function of providing credit to households and businesses. Further, the extended transition period minimizes any short-term disruptions in financial services while the economy recovers.

Thank you for the opportunity to testify today. I would be happy to answer any questions.

Chairman DODD. Thank you very much. Thank you very much for your testimony.

What I am going to do if I can here is give a little more time to Members this morning, given the range of witnesses we have with us from the various regulatory agencies, so I will ask the Clerk to put a 10-minute time on. We will try and focus on that.

Let me pick up on the point, Secretary Wolin, you raised at the very outset of your remarks, the very good news that the Financial Stability Oversight Council will be meeting tomorrow to work on a number of issues. The substantive functions you have identified, others have, as well, including designating certain nonbank financial companies for supervision by the Federal Reserve, recommending heightened prudential standards for large interconnected financial companies, and several others that will be the job of this oversight council.

I am interested in hearing briefly from each of you—you have touched on this already—on, one, who will represent your organization at the Council, who will actually be there, who you are designating so we have a good idea of who that is, and what is your view of the key substantive priorities of the Council. There is a lot to take on here, but I would love to get some sense of how you prioritize those issues, at least in your view of who will be doing it.

And as I say this, let me also editorialize a bit here, because I—and again, a couple of you have raised this and I applaud you for doing so. We certainly expect the members of the Oversight Council to share information and to cooperate and to create an atmosphere where any agency is free to contribute in all of this. This organization is not intended to be a top-down but rather a collective fathering of equal partners in all of this, and I would expect no one to hide behind the work of the Fed or the Treasury, nor to be intimidated by it, and I say that respectfully, but obviously Treasury and the Fed have been very dominant players in all of this, but what I want to have happen here is that level of cooperation where each of you have a responsibility to bring your designated knowledge and expertise to the table and that that information is shared, creating a new culture.

One of the problems in the past has been I cannot legislate culture. None of us can here. But unless that culture changes on how we operate, that sharing of information that particularly an oversight council is going to need in order to succeed, if it is really going to work, that has to be a part of this. And again, we can designate responsibilities, but beyond that, it ultimately depends upon the leadership of the respective agencies to create that culture. And so I am interested in having you comment briefly on this, as well.

So let me run down with you, Neal, if I can, who is going to be at that table tomorrow and what are your priorities.

Mr. WOLIN. Thank you, Mr. Chairman. Secretary Geithner will be at the table chairing the meeting tomorrow for Treasury. I think the points that you made, Mr. Chairman, with respect to the cultural issues of the Council are critically important, because while on the one hand, the Council members have clearly their own independent regulatory authorities and those need to be respected, getting the information sharing and the sort of collaborative effort to make sure that the Council acquits its collective responsibility in the right way is also very, very important. So that is something we will be focusing on, I think.

In terms of priorities beyond getting that basic rhythm right, clearly, the Council has by statute four studies that it needs to do that are important, two relating to the Volcker provisions and one relating to risk retention in the securitization area, a final one having to do with the overall economic effect of this regulatory framework. Beyond that, the Council, I think, should and will prioritize the question of which nonbank financial institutions ought to be designated as systemic, and beyond just firms, also utilities.

So I think those are the core things beyond keeping abreast in a range of ways of the various members' views about what systemic risk exists in the system and how we are addressing them and how they ought to be addressed.

Chairman DODD. Let me just quickly say that I appreciate that Secretary Geithner will be at tomorrow's meeting. I am going to be as interested in who shows up at the following meetings. Too often, what happens is, again, this gets relegated to some very good people, I am sure, but it takes on less of a priority. And I do not expect the Secretary of the Treasury to show up at every meeting, but I would really like to know that there is someone, particularly someone who might happen to be coming before this Committee to be confirmed, that within that structure has the responsibility, whether it is the member of a commission that someone has designated, that that is the person who will be there so we in this Committee in the coming years will be able to have someone that comes before us from your respective agencies that we can talk to about this so it does not end up being, and I say this respectfully, of some staff member who has been just given the job to be there and we see this culture begin to return to where it has been.

I do not expect you to necessarily answer that question right now unless you know. Do you——

Mr. WOLIN. Well, let me say, Mr. Chairman, the Secretary has been very, very engaged in these implementation issues to date——

Chairman DODD. Right.

Mr. WOLIN. ——and he does absolutely expect to be very, very engaged in them, in the work of the Council on an ongoing basis, not just tomorrow. He will personally be very much involved, whether that means every single meeting, but I think that is his expectation. And a number of his senior staff, myself included, will continue to stay fully engaged, as well. So I think the basic answer is Secretary Geithner expects that he will be chairing these meetings on an ongoing basis.

Chairman DODD. All right. Well, that is good, and again, this is for all of you here, but I would recommend, because you will set the tone for years to come. Long after all of—certainly I am gone and you are gone, as well, who your successors are and how you set up this and begin to move this will become sort of the standard. And so it is very important how this starts, in a way.

Chairman Bernanke, do you have any thoughts on this?

Mr. BERNANKE. Yes, Mr. Chairman. I will be attending the meeting along with Governor Tarullo, who has been a point person for us on bank supervision and regulation, and I intend to be the regular representative for the Federal Reserve.

The Dodd-Frank Act provides for a Vice Chairman for Supervision at the Federal Reserve, which has not yet been nominated, but that person obviously would also play an important role going forward. I think this Council is very important. Given all these overlapping responsibilities, coordination is going to be extremely important. And in particular, many of the aspects required to set up this regime, designating systemically critical firms and utilities, for example, comes from the Council, and so that needs to be put in place that we can begin to implement the basic structure of the Act.

Chairman DODD. Great.

Ms. Bair.

Ms. BAIR. Yes. I will be attending, and, as long as I am Chairman, I will be representing the FDIC. I think it is very important that all the principals fully engage with this important effort.

In terms of priorities, I certainly agree with Deputy Secretary Wolin. Certainly, from the FDIC's perspective, a top priority should be the designation of nonbank systemic firms. This is closely related to our ability to be prepared, because that triggers a living will resolution planning requirement, and so early identification of those entities which the Council feels are systemic is very important.

Also, I hope that the Council will be forward-looking, identifying not just systemic institutions but systemic practices and emerging risks. We see some emerging risks now, and being forward-looking and proactive—to try to get ahead of them, identify them and deal with them before they become big problems—I think is a very important focus for the Council.

Certainly, coordination is an important function, too, but I think people of good will will work collaboratively together and share information and respect each other's respective spheres of expertise to get this work done. I think if we all start trying to rewrite each other's rules, though, this Council will become an impediment, not a way to facilitate reform. It is very important to get the balance right, and I think we all are committed to working together to make sure that happens.

Chairman DODD. Thanks very much.

Chairman Schapiro.

Ms. SCHAPIRO. Thank you. I will represent the Securities and Exchange Commission and I would certainly expect to be at every meeting of the Council.

Obviously, everyone has said designation of the nonbank financial institutions is really a critical and a high priority item. I would also say that from my perspective, because we have much to do to implement rules to fulfill the Volcker Rule requirements under the Act, we will be particularly interested in launching a study that predates the rule writing in that area and getting comment and getting the background that we need to do that in a thoughtful way.

Chairman DODD. Thanks.

Mr. GENSLER. Chairman Dodd, I expect to be there and at every meeting. I am not even sure under the Commodities and Exchange Act I could send somebody else to vote for me there, so I think that is pretty clear.

I would also compliment Treasury. I think they have been excellent. I mean, we are all sort of learning a new thing here, this Council——

Chairman DODD. Right.

Mr. GENSLER. ——but they have been excellent, seeking the advice. We are sort of at this end of the table. I would associate myself more with Senator Reed or my Senators from Maryland. Like the Senate, there are small States, they are middle States and large States, but the Treasury has been excellent in taking all of our views into being.

In terms of priorities for us, at least, one thing that we see over the many months ahead is to designate some clearinghouses to be systemically relevant. We currently oversee 14 clearinghouses. We think that might grow to 20 or so. But some small handful would be so important under Title VIII of the statute, the Council would designate them, and I hope tomorrow to at least highlight that we will do that. But it would certainly come months from now before that happens.

Chairman DODD. I appreciate that.

John.

Mr. WALSH. The basic operating rule is principal plus one. I expect to be there. I assume the Comptroller that is nominated by the Administration will be there. Our Chief National Bank Examiner is the support for our participation.

I think the key challenge over time is going to be figuring out how to assess systemic risk across the entire financial system. We need to gather the data that is available in the agencies and the private sector to begin mapping risk across the system. We need agencies to bring issues to the Committee and I think that will be the kind of challenge as it develops its work. And the overall challenge is getting consistent policy across a number of independent agencies. That is not so much a challenge for the FSOC, but the challenge we all face.

Chairman DODD. Right. Well, I will come back to that, and again, time is up. But let me ask just one quick question of you, Chairman Schapiro and Gensler—other questions I have would require participation by more, so I will wait for the next round.

And you touched on this, Chairman Gensler, on the derivatives market and the reaction internationally. It is not only obviously vast, but it knows no geographic boundaries obviously and poses some issues. The European Commission recently released its proposals it talked about, which will be debated and finalized to the European Union legislative process in the coming months.

Just again, you suggested this to be the case. Maybe develop it a little further, and Chairman Schapiro as well, based on what you know. And I know you were planning to be there, but for today's hearing. So I am grateful to you for being here today, but urge you to get over there quickly as well, given the importance. I know you cannot be two places at once.

[Laughter.]

Chairman DODD. Is the European approach consistent with where we are going on this? We have sort of a sense of that, but I do not want to put words in your mouth. That is very important to me, this harmonization idea, that we have a consistent set of rules to the extent we can around the world.

Mary, do you want to go first on that?

Ms. SCHAPIRO. I am happy to. I think Gary said it actually very well in his opening statement.

I think the European Union direction is broadly consistent with Dodd-Frank: mandatory clearing of all eligible contracts, reporting of OTC derivatives, strict capital and collateralization or other requirements when contracts remain between two counter-parties, where they are bilaterally cleared. There is a regulatory framework they will put in place for trade repositories, very similar to what we are doing here.

So I think there will obviously be details, but in broad scope it is quite surprisingly almost, in my way of thinking, consistent with the approach that we have taken in the United States.

Chairman DODD. You know we were told that this is the fact, and again I think we surprised a lot of people, but the fact that the Administration, we up here, led on this issue has an impact on what Europe has done. Is that a fair assessment?

Ms. SCHAPIRO. Oh, I do not think there is any question about it, that when we lead as the largest market in the world other countries look very carefully at what we have done, and we often look to other countries when they have led, to see if we can be consistent. I think there is broad appreciation among international regulators that while in every jurisdiction all the rules will not be identical, that it is in fact important to get them as close as possible, so that we do not see business migrate for the wrong reasons.

Mr. GENSLER. And I would just add I mean Commissioner Barnier, Michel Barnier, who is the European commissioner who has oversight of all of this and recommends to the parliament, and Sharon Bowles who sort of has either your or Chairman Frank's role in the parliament, we have been talking to them really since last summer and fall. And Treasury and the Federal Reserve have in addition to us. It has been an excellent partnership.

The clearing mandates are very similar—the idea that financials would come in and nonfinancials were out. They sort of have a clearing threshold, so some nonfinancials would have to come in, where we do not have that. They have these trade repositories and so forth.

The one distinct thing is they have said on the trading requirement they are going to take that up in about six or 7 months in a different legislative package. So there is some timing delay, and we will have to wait to see where that it is.

Chairman DODD. Thank you very much.

Senator Shelby.

Senator SHELBY. Thank you, Mr. Chairman.

Chairman Bernanke, as you well know, one of the goals of the Dodd-Frank legislation was to end Government bailouts. The FDIC was granted vast new powers under that legislation to resolve financial institutions, so that no one institution would be, as I understood it, too big to fail.

If the market still thinks that the Fed, the Federal Reserve, will rescue failing firms, it will continue to provide large financial institutions with below-market financing, perpetuating our already severe too-big-to-fail problem. With the passage of this legislation, Dodd-Frank, can you, or would you, categorically state that the Federal Reserve will never again rescue a failing financial institution such as AIG, for example?

Mr. BERNANKE. Senator, I can say that because Dodd-Frank has eliminated the authority that we used to address AIG, which was the ability to lend to an individual firm, so that whatever any future chairman may wish to do that authority is no longer available, first of all.

Senator SHELBY. Do you agree with that?

Mr. BERNANKE. I do agree.

Senator SHELBY. OK.

Mr. BERNANKE. And I supported that throughout, that eliminating that authority was entirely appropriate if we were able to develop a regime that would allow for an orderly wind-down of a firm, and Chairman Baer and the FDIC have been working very hard to develop a set of rules to govern that process.

I just may add I think the most important additional thing we need to do is to keep coordinating with our international colleagues because these firms are typically multinational and we would want to be able to work closely with foreign regulators as well.

Senator SHELBY. How important is it for this message and the legislation that we have passed that is going to end bailouts, how important is that to people running financial institutions?

Mr. BERNANKE. Well, it is extremely important, Senator. I know from a political point of view that American taxpayers do not want to be on the hook for these kinds of bailouts in the future.

Senator SHELBY. Do you blame them?

Mr. BERNANKE. I certainly do not blame them.

Senator SHELBY. OK.

Mr. BERNANKE. But from a financial regulatory point of view the other important aspect is that we want to have market discipline. We want to lenders to, large firms to believe that they can fail and therefore to take due care to make sure that the firms they are lending to are not taking excessive risks.

Senator SHELBY. What is your judgment on Basel III at the moment? Just sum it up.

Mr. BERNANKE. I think it is moving in a very productive direction. It has strengthened capital, raised capital requirements, improved the quality of capital which is very important. It has created an international leverage ratio. It has introduced liquidity requirements. It has addressed some cyclicality issues. So I do think it makes some very substantial progress on providing stability for our banking system. There is still work to do be done though.

Senator SHELBY. Chairman Schapiro, what is the SEC doing now to develop and also to implement a permanent solution to the credit rating agency that is deep and with us? I know it is complicated.

Ms. SCHAPIRO. It is complicated. And as you know, since 2006 when the Credit Rating Agency Reform Act passed, the agencies engaged in quite a lot of rulemaking with the very able assistance, I should say, of your former staff and Commissioner Kathy Casey. But under the new law we have a number of additional requirements that will go into place. So we have communicated with the rating agencies immediately that a number of the provisions take effect upon enactment of the law, do not require SEC rulemaking. So they need to change their governance, for example, and those efforts are underway.

We are also staff——

Senator SHELBY. How important is that to, say, every bringing back the securitization market?

Ms. SCHAPIRO. The role of credit rating agencies is one that is particularly important in the securitization market. The law repeals Section 436(g) which would no longer allow the use, or the reliance upon—it requires a credit rating agency's consent to their ratings being included in offerings. They will not consent thus far, and it is not clear whether securitizations on what basis will continue to go forward until we reach some kind of an accord with the rating agencies.

We have issued a no action letter to effectively remove the requirement from our rule that credit ratings be included where the offering is dependent upon the rating.

So we are working through those issues with the credit rating agencies. We are also establishing our credit rating agency office that the law requires, that will report directly to me. We are employing the examiners that will be necessary to put credit rating agencies on an annual examination cycle, which is particularly important and required under the law as well.

There are a number of rulemakings that will have to go forward relating to due diligence and other issues, reps and warranties in the asset-backed securities markets as well, that require the role of the rating agencies and the SEC to write rules.

Senator SHELBY. I hope it works.

Ms. SCHAPIRO. So do we. And Senator, I am sorry, I should just add that the law also requires us to evaluate all of our existing regulations and to remove reliance upon credit rating agencies in all of those rules, and that process is also well underway. We had already proposed that in the asset-backed securities markets for the use of shelf registration.

Senator SHELBY. Chairman Gensler, I want to get into your area if I can. You publicly argued against an end-user exemption from the clearing requirements in the derivatives title that we passed, and you have argued repeatedly for keeping any exemption as narrow as possible. What steps are you taking to ensure that your personal aversion to the end-user exemption does not interfere with your agency's mandate to carry out the Dodd-Frank legislation? What are you doing here and how will it affect the end user?

Mr. GENSLER. Senator Shelby, a very good question, but I took an oath of office and Congress writes the law. So we are going to adopt exactly what you have.

There is a clear end-user exception for anyone who is hedging or mitigating a commercial risk for nonfinancial firms, and I think that was a balance, to take that sort of 9 or 10 percent of the market out. Completely what we are going to do is comply with the law, and I think that was a balance that Congress appropriately made.

Senator SHELBY. OK. Thank you.

Secretary Wolin, each of the regulators charged with rulemaking under the legislation, Dodd-Frank, has publicly committed to specific steps to provide transparency during their respective processes. You are familiar with that. Will Treasury follow this lead and post on its Web site, or otherwise make public, the names and affiliations of individuals who meet with Treasury officials, including Special Assistant to Secretary Geithner, Ms. Elizabeth Warren? Will you do that? Will there be transparency there?

Mr. WOLIN. Senator Shelby, we will be, I think, in very short order publishing a transparency policy that will be similar to what you ask about and making clear that people can know who it is, senior officials at the Treasury.

Senator SHELBY. Going back to you, Chairman Schapiro, the SEC's experience in overseeing securities markets in which participants have the choice of several different trading venues, each of you, what are you doing to ensure that the CFTC has the benefit of the SEC's expertise in this area, and vice-versa maybe?

Ms. SCHAPIRO. I will let Chairman Gensler speak to this as well, but we do have a very different kind of a model in the U.S. equity markets. They are quite dispersed. There are multiple venues, exchanges, electronic communications networks and even internalization of securities transactions. And we think there is a lot of virtue, and there are some downsides as well, but a lot of virtue to that competitive model.

And we have spent a lot of time talking with the CFTC about the extent to which the exchange trading or swap execution facilities that will handle both security-based swaps and commodity swaps could benefit from understanding what has worked well in the equity markets, understanding they are not perfectly analogous.

Senator SHELBY. Gary, do you want to?

Mr. GENSLER. It has been tremendous cooperation, over 100 meetings with the SEC, and it feels a lot are around these trading venues.

I would add, not to muddy up the hearing, within the next couple days I think we will put out this May 6 supplemental report. There are a lot of lessons from there too, and our joint staffs. And we have a joint advisory committee of outside experts that are going to give us a lot of advice too which would address your point, and lessons from May 6 can apply even to the derivatives marketplace.

Senator SHELBY. Secretary Wolin, I want to get into the question with you. The Treasury Department, I believe on September the 21st, conducted a mortgage disclosure forum with consumer advocacy groups and others. In a press release surrounding the forum, Secretary Geithner stated in regard to the Dodd-Frank legislation, I quote, and he said: "Wherever possible, we are committed to expediting completion of the law's requirements ahead of statutory deadlines."

Earlier in the month, Secretary Geithner stated in his speech at New York University, and I will quote him again, and he says: "We want to move quickly to give consumers simpler disclosures for credit cards, auto loans and mortgages, so that they can make better choices, borrow more responsibly and compare costs." Those are his words.

These are laudable goals, but seem to require rule-writing authority which I do believe the new Consumer Financial Protection Bureau will not have until a director is appointed and confirmed by the Senate. Do you believe the Treasury has the writing authority without a confirmed director, and if so, why?

Mr. WOLIN. Senator Shelby, I think there is limited rule-writing authority, but it is constrained until such time as there is a confirmed director.

But I think in the meantime there is plenty of work to be done to get these various disclosures ready. It is an important piece of the legislation and an important part of the mandate of this new bureau. As you know, the mortgage disclosure example, the statute says it has to be done a year after the transfer date which would be July 21, 2012, and so we are keen to make sure that this new bureau is ready to move forward with its mandates and its focus, important focus on disclosure as quickly as it can do. So it is the Secretary's responsibility under the statute to stand this bureau up, and we want to give it as much of a running start as we can, consistent obviously with authorities.

Senator SHELBY. With the law.

Well, let me ask all of you this. First, it has been brought to my attention the Securities and Exchange Commission has posted its rulemaking agenda on its Web site. Will each of you do the same thing? We are interested in transparency and what is going on.

Anybody against that? The SEC is already doing it.

Mr. GENSLER. We did on the day the bill passed. We put the 30. We put them in buckets, but 30 teams. It was on our Web site.

Senator SHELBY. So you are willing to do that?

Mr. GENSLER. Oh, absolutely. I think we have, but we can do more.

Senator SHELBY. What about you, the Treasury?

Mr. WOLIN. Insofar as we have rulemakings, Senator Shelby, we will be transparent.

Senator SHELBY. What about at the Fed and rulemaking?

Mr. BERNANKE. We are going to be as clear as we can. We are in discussion with the others.

Senator SHELBY. What does that mean when you say "clear as you can"?

Mr. BERNANKE. Well, we have the following issue which we are working on very hard, which is that many of our rulemaking authorities are joint or consultative, and we just want to make sure that we are coordinated with the other agencies.

Senator SHELBY. Sure.

Mr. BERNANKE. And we have not yet quite got all those ducks in a row quite yet, but we will certainly try and make that information available.

Senator SHELBY. Let us know what you are doing.

Mr. BERNANKE. OK.

Senator SHELBY. Thank you, Mr. Chairman.

Senator REED [presiding]. Thank you, Senator Shelby.

Thank you for your testimony.

Secretary Wolin, in response to Senator Dodd's question about the systemic council, I think every respondent talked about the need for analytical evaluations, looking ahead, which raises the question of the Office of Financial Research. You and the President and Secretary Geithner have really the opportunity and obligation to create not just an organization but a culture which I hope is analytical and apolitical, which attracts the best minds that are looking across the system and forward. Can you give us an update as to where you all are in the process of appointing a head and getting that staffed?

Mr. WOLIN. Senator Reed, thank you. First of all, thank you for your leadership in creating the Office of Financial Research. It is, I think, a very important opportunity for the council and for the

Federal Government in general to have a much better handle on data and data analysis that can make sure that it is in a good position to fulfill its various regulatory responsibilities and systemic risk responsibilities appropriately.

We are hard at work in trying to begin setting up the structures that the statute requires. We want to do it consultatively with the other regulators, to make sure we know what data are already being collected and how they are being collected, so that we can move forward smartly on creating data standards and making sure that we do not duplicate efforts, either public sector or private sector efforts at data collection.

The President, I think is reviewing possibilities for who might be the first head of the OFR. We are very much focused on making sure that it is someone who has real experience and capacity in data collection, data analysis and its application in these important contexts.

And of course we want to make sure that the office, when it is stood up, has the independence that the statute intends for it. It is a part of the Treasury, but with independent leadership and budget capacity and so forth. And that is an important element so that the work of this office provides a clean, unbiased, unvarnished look at the issues which I think are critical and which give the Government, for the first time, a real set of potential tools that it has not had.

Senator REED. Thank you, Mr. Secretary.

Chairman Bernanke, in a similar vein, Title 9 of the bill requires, as you mentioned in your comments, the appointment of a Vice President or a Vice Chair for Regulatory Supervision at the Fed. Do you have any notion of when that might happen?

Mr. BERNANKE. I do not have any precise information. I know it is the Administration's responsibility. I know they are considering alternatives, but I have no specific information.

Senator REED. Switching gears, one of the provisions in the legislation in terms of the Volcker Rule allows an exemption for roughly 3 percent for an institution to continue proprietary trading. I must say Senator Levin and Senator Merkley were really the key people pursuing a much tighter regime. But nevertheless, can you give us an idea of how much additional capital an institution like that, if they have their proprietary trading operation continue, would have to carry? Is that something you have considered already?

Mr. BERNANKE. I am sorry, that the bank would have to carry?

Senator REED. That the bank would have to carry. Or, let me put it another way. Would you require additional capital as one of the sort of prudential ways in which you could protect the system from proprietary trading if an institution uses the 3 percent?

Mr. BERNANKE. Well, first of course, as you stated, Senator, there is a 3 percent of capital limit that a bank can dedicate to that.

Senator REED. Right.

Mr. BERNANKE. But, in addition, we have already in fact begun implementation of new rules for capital requirements for trading books, for trading of securities and those sorts of things.

Senator REED. So, essentially, you were already beginning to think about if one chooses this option to have additional capital even beyond what is required by the minimum rules?

Mr. BERNANKE. Well, on the Volcker Rule specifically we are of course engaged in the study, that we are working with the council to develop the study, and we will be working expeditiously to put in rules to implement the intent and to figure out what the appropriate exemptions and so on are.

On a separate track, the Basel II international capital requirements have already significantly increased the capital required against risky trading of all types that would be market-based trading as opposed to loans on the banking book.

Senator REED. Let me ask another question too. As you go forward monitoring these operations, will you have on a frequent basis, perhaps even daily basis, actual knowledge of the positions that these trading units will be taking and also what units the clients of the bank are taking? Will you have that detailed constant information?

Mr. BERNANKE. We do not have that information on a daily type basis now. We mostly operate via rules and policies, assuring that the bank or the bank holding company has a set of risk management tools that it is applying consistently, and then we check to make sure that is happening.

I think an open question is whether the Office of Financial Research will be gathering more detailed position information and the like, and that is certainly something that we may want to look at because that may be the only way in which to identify, across the system, crowded trades or other risks that might not be visible from the perspective of an individual institution.

Senator REED. I appreciate the systemic approach, but in just looking back it seems to me that the approach of looking at the risk assessment and evaluating it and seeing that they were doing what they said they were doing did not seem to be particularly helpful in many circumstances in the past. And if that is the approach that you choose to take, it very well may be ineffectual going forward. If these major institutions are going to have, under this exemption, a proprietary trading operation I would say, do you not think you need to know a lot more than just their risk policies and whether on a periodic basis they are doing what they say they are doing?

Mr. BERNANKE. We certainly do need to test what they are doing and to evaluate their positions, but realistically we cannot duplicate their entire operation.

Senator REED. I understand that.

Mr. BERNANKE. We are going to have to assess based on sampling and based on spot-checks and the like.

Senator REED. I think Chairman Schapiro has a comment.

Ms. SCHAPIRO. I was just going to add that since we have to define market-making and underwriting activities that are permissible under the Volcker Rule, one of the things that we will be looking to is a new large trader reporting system that we have proposed in the consolidated audit trail. That should help provide us with much more granular information about trading activities that we would hope we could then share with fellow regulators, to make a determination whether market-making has been exaggerated and goes beyond what is permitted under the rule and has become speculative or proprietary trading. So we are intent on working very closely with our colleagues on that.

Senator REED. Let me just say, both to Chairman Gensler and Chairman Schapiro, the comments this morning reflect a collaboration and cooperation that is recent, but is very commendable.

Just specifically, I know, Chairman Gensler, you are going to propose a rule tomorrow or in the next few days about clearing platforms.

Can you both comment on the collaboration that you have entered into in terms of making sure this rule is truly reflective of both your equities in the business of clearing derivatives?

Mr. GENSLER. The three things we are taking up tomorrow and all that we are taking up all the way through December, we are sharing not only drafts, but we share preliminary term sheets, and we try to collaborate.

On the governance rule tomorrow, I think Chair Schapiro can talk. They are about 10 days behind us. We could not quite get our commissioners' schedules lined up. As of now, I think they are nearly identical, the actual text and so forth. Now those 10 days may change something, but that is what our goal is on each one of these—to be, if not identical, nearly there. That is certainly.

And I think Mary and I have such a relationship. I know future chairs might not, but we have been benefited, and we want to use that.

Senator REED. Chairman Schapiro, do you have comments on that?

Ms. SCHAPIRO. No. I would agree completely. I think the cooperation really has been unlike anything I have ever seen in my all years in Government, and I think it is very positive. Even where we have had slightly different approaches, which I expect we will on some issues going forward, we are committed to asking questions about each other's approaches in our proposals, so that we can, even if we do not propose exactly the way, bring them back as close together as we can at final.

Senator REED. Mr. Walsh, please.

Mr. WALSH. Just on this thought about risk management systems, I think the recent experience showed in some cases that large, complex institutions thought they were managing particular portfolios and risks and lines of business in an effective way, but did not really capture all exposures and all risks across lines of business and across activities. Improving their internal MIS to capture risk positions across the whole firm is part of that effective risk management that Chairman Bernanke was referring to, and that is an emphasis going forward.

Senator REED. Now I think we have made progress, but my sense was, not specific to one regulator, is that there were these elaborate risk procedures and that you reviewed them. And if they made sense, sure, they were OK. And if you occasionally spot-checked them, that was great. But as you indicated, they did not seem to work.

I do not have a magic answer, but I think there has to be a much more textural or granular approach, even periodically. Otherwise, I think we will find ourselves right back where we were, and that would be unfortunate.

Thank you.

Chairman DODD. Thanks very much, Jack.

I appreciate, Chairman Gensler, you talked about how the two of you—you cannot speak for future people who sit in these chairs. All the more reason why you need to institutionalize a lot of this so that it does not become just a question of two people at this particular moment in time have that relationship. It will be very important in the years to come that that relationship between the CFTC and the SEC be a continuation of what you are doing. So anything you can do to institutionalize that so that people do not drift away, as they are apt to do in the coming years, would be very, very helpful as well.

Mr. GENSLER. I agree with that, and I am personally dedicated to figure that out.

Chairman DODD. And I want to just mention—Jack is finished. I did not say it earlier, but I am very grateful to all the Members of this Committee who worked so hard on all of this. And even though we did not end up with the kind of votes necessarily on this, an awful lot of this bill reflects an awful lot of work by a lot of Members of this Committee, not the least of which was the person I am about to introduce, and that is Bob Corker. So I would not want the moment to pass. That whole Title I, Title II that you and Mark worked on in large part is your effort and Mark's, so I thank you immensely for it.

Senator CORKER. Thank you, Mr. Chairman. I appreciate the way you have conducted this Committee for the entire time I have been on it. Thank you very much, and I will talk about that later.

And I appreciate each of you coming today, and nice to hear everybody is playing well with each other at the moment.

[Laughter.]

Senator CORKER. Secretary Wolin, the CFPB, the issue of consumer protection, I think there has been some discrepancy about whether it actually has rulemaking authority between now and July of 2011. You seem to indicate you think there is limited rulemaking ability. I wonder if you would expand upon that, because I think a lot of us think that during this transition there absolutely is no rulemaking authority until it is actually transitioned.

Mr. WOLIN. Thank you, Senator Corker. I think, you know, the Secretary has by statute a series of authorities to stand this Bureau up, and I think that those include, of course, working with the other regulators that are transferring both authorities and people as well as getting the Bureau ready to undertake its rulemaking and its supervision and enforcement authorities as of the transfer date next July.

I think the rulemaking authority is circumscribed, but I think the Secretary probably does have the capacity to do the things that I just talked about, getting these authorities and people transferred over——

Senator CORKER. But not real rules across the financial industry, then.

Mr. WOLIN. I think that is probably right. It is quite limited there. I think that is right, Senator.

Senator CORKER. So let me make sure I understand. So there are some abilities to stand the organization up, but I think what you are stating today is there is absolutely zero ability to make rules as it relates to consumer protection that relate to the financial system.

Mr. WOLIN. Well, again, Senator, you know, absolutely zero—I think that the Bureau, the Secretary on behalf of the Bureau in this transition phase as he is standing it up has the capacity to do the sorts of things we did last week: have fora, get on top of the issues, hear from people about what they think, and so forth.

Senator CORKER. Right.

Mr. WOLIN. I think the authority to actually issue a rule that would bind private parties, for example, in the mortgage area is a tough one until such time as there is a confirmed director.

Senator CORKER. Let me just—a tough one. That is a vague word. What I would like for you, if you would—I know we have had a good relationship. If you ever think that you have the ability to actually make a rule, would you make sure we all are aware of that?

Mr. WOLIN. Absolutely.

Senator CORKER. At present, it is my understanding, as I leave here today, that you do not have that authority until the organization is stood up in July of 2011.

Mr. WOLIN. Before we do any such thing or——

Senator CORKER. Well, before even thinking about doing——

Mr. WOLIN. ——comes to you.

Senator CORKER. ——thing, I hope that you will talk with us.

[Laughter.]

Mr. WOLIN. Fair enough.

Senator CORKER. Because I assume we would have a Senate-confirmed type of person in that position before you all started making rules.

Mr. WOLIN. The President obviously intends to nominate someone. He is reviewing candidates for that role right now, I think committed to making sure he gets the best candidate he can, and I believe that he hopes to be in a position to make a nomination on this role soon. And as I said, I think the rulemaking authority, insofar as you are talking about it, I think, Senator, depends on that process moving forward.

Senator CORKER. And being completed.

Mr. WOLIN. And being completed.

Senator CORKER. OK. I understand that the Treasury is going to be presenting a GSE proposal around January the 1st, and just—because I think like a lot of things we did over this last year, many of us will start working together on both sides of the aisle to try to figure out the most pragmatic way of doing that. Do you still plan on having something that is very tangible on January the 1st?

Mr. WOLIN. The statute requires it in January, and we intend to certainly meet the terms of the statute. We are hard at work on this topic, as I think you know, Senator, and we will come forward with an approach before that time.

Senator CORKER. And I assume you are involving other banking agencies and entities in that process.

Mr. WOLIN. We are, Senator. We are consulting broadly within the Government and without.

Chairman DODD. Let me make a suggestion to you as well. You are trying to involve people up here, and I think in this process of conversing about it, my recommendation would be, as someone who will not be here, there are a lot of people interested in this subject matter, you would be well advised to invite people to be a part of that discussion. You might find yourself on a better track when we come forward. Just a thought. Sorry to interrupt.

Senator CORKER. Yes, and I think—and I appreciate your intervening there? I think would be a good idea. I actually think there are a number of people on both sides of the aisle that want to solve the problem, and I think it would be good to have a little bit of discussion along the way. I know we are spending a lot of time in our office, and I know others are, too. So it is an issue that we all together have got to figure out a way to deal with. I cannot imagine anybody likes it the way that it is today, and so I would hope you would do that, and I thank you.

Do you have any idea about the criteria that the FSOC, I guess, as we are calling it now, is going to use to define a systemically important entity? I imagine there are a lot of companies around the country that are wondering if they are going to be in the sights or not. Do you have any indication as to what that criteria might be?

Mr. WOLIN. So let me first, just if I could, Senator, go back on the GSEs. We had a fantastic working relationship with you, Senator, and with all the Senators on this Committee on the Dodd-Frank legislation. We fully intend to have a similar relationship on GSEs. We look very much forward to working with you and others on the Committee and across Congress on what is clearly a critical issue on which we are going to have to work together.

On the matter of FSOC designations, I should say in the first instance this is really a question for the FSOC collectively to work through. As I said in my opening statement, I expect that tomorrow at its first meeting the FSOC members will consider a proposal to seek public comments on what those designation criteria ought to be so that we have, again, a robust conversation about that before the FSOC lands. But I think not for me to make a judgment, ultimately before the full range of the FSOC membership on the basis of whatever input it receives—and its own analysis, clearly—to make judgments about what those criteria ought to look like.

Senator CORKER. Chairman Bair, it is good to see you again. It has been a long time since you were meddling in all our affairs.

[Laughter.]

Senator CORKER. I am just kidding you, of course.

The interagency working group was going to set up, I guess, the risk retention standards and safe harbor. I know you sort of jumped out in advance of everybody in that regard, and I am just wondering if you have had any input from the other agencies. I know the OCC opposed that, and I wonder if you might just expand a little bit on that. And I really appreciate your input. I was not trying to be——

Ms. BAIR. If I could review the history of that. A number of members of the industry came to us late last year in anticipation of the new accounting rules, FAS 166 and 167, that changed the accounting treatment for securitized assets. It made it much tougher to get what we call true sale accounting where you have a clean sale and can move that off balance sheet.

We had a safe harbor that determined whether we would try to claw assets back that had been securitized if the bank fails, and we had relied on achieving true sale accounting to provide for that safe harbor.

The concern was that securitizations would no longer meet the true sale standard of the new accounting rule. So we provided some temporary safe harbor relief for everybody retroactively. But going forward, we thought, given all the problems in the securitization market, the incentives for lax lending, the losses that had been created for banks, the problems we were seeing with resolution activity with failed banks, that we should impose some conditions on the safe harbor. In addition to requiring risk retention, we worked very closely with the SEC on more granular loan level disclosure. This is something we had heard from the investment community that they wanted very much.

We tackled servicing issues, too. We have had a lot of problems with servicing, including lack of servicer oversight, and an inability to restructure loans because of restrictions in pooling and servicing agreements.

So we addressed what we thought were key issues in the conditions, and went out for two sets of comments on this. Consequently this has been going on for nearly a year. A 5-percent risk retention requirement is part of the, which is consistent with the SEC's proposal. The disclosure requirements are synched up with the SEC, to try to have one standard for everyone.

Yes, we decided to go ahead with the safe harbor rule that was expiring at the end of this month. It is important for people to understand we had to do something. If we did not do something, we would have disrupted the securitization market, especially all the outstanding securitizations currently in existence. We think what we did was prudent.

In addition, we put an auto-conform provision in our rule so that once the agencies do get together and define what a qualified residential mortgage (QRM) is, the 5-percent risk retention provision will no longer apply. And we are very eager to engage in that process. We hope that, to some extent, this will be an action-forcing event so those interagency rules can be done on a very timely basis. It is a 270-day timeframe that is provided by Dodd-Frank. We hope that is met. We would like to see it sooner than that.

Senator CORKER. And that is the timeframe to actually define a qualified residential mortgage?

Ms. BAIR. That is right. But pending interagency rules we presently do not have underwriting standards, and, frankly, we do not have a securitization market right now. Nothing is happening. I think a lot of it is because investors just do not have confidence to start it up again.

Senator CORKER. Why did the OCC object to the rule?

Mr. WALSH. A fairly straightforward thought that we have held the position since this was in a Notice of Proposed Rulemaking that it would be preferable to have a single policy on securitization across all markets and all securitizers. And we did not see any great downside to just extending the safe harbor for the 270 days and then having a set of rules in each venue that conform to one another. So it is a fairly straightforward point.

Ms. BAIR. And if I could just say——

Senator CORKER. Well, Mr. Chairman, I sense a slightly less playing well together than appeared. I think that these are the kind of things that are going to take a lot of oversight down the road. But if you want to respond.

Ms. BAIR. Well, thank you, Senator. The 5-percent risk retention is the law in Dodd-Frank. It clearly states that you have 5-percent risk retention unless the mortgages comply with new underwriting standards that will be developed by the agency. So we think we were quite consistent with the clear language of what the law is now under Dodd-Frank.

And, again, we hope this happens in 270 days. My experience with interagency rulemaking is that sometimes those deadlines are missed. The SAFE Act required simply that we do interagency rules to register mortgage originators. It was a 1-year timeline, and it took us 2 years.

FCRA is another example where the agencies overshot the statutory deadlines by a significant amount. So we think it is only prudent to have the 5-percent risk retention in place until these underwriting standards are developed, and if this can help facilitate a timely process, we welcome that, and we think that is very consistent with what is in the letter of the law now.

Senator CORKER. Mr. Chairman, thank you for letting me go a minute forty over, and I want to thank each of you for your testimony. This whole issue of securitization was one that I think we were all trying to understand how this 5-percent retention would work, and I do look forward to talking to each of you. This is obviously—especially in the commercial side. I mean, there is nothing happening right now.

Ms. BAIR. It does apply to commercial and to all other securitizations.

Senator CORKER. No. I understand that. I understand that. But as it relates to the securitization business in general, I mean, there are a lot of problems there, and I do look forward to working with each of you to try to deal with that. It looks like you want to say one more thing.

Ms. BAIR. The one private label securitization that I am aware of, did have a risk retention of 5 percent vertical and horizontal slice. So the one that was done did have this feature in it.

Senator CORKER. Well, there is a wealth of knowledge sitting at the table there, and we certainly look forward to working with you over the next couple of years.

Thank you.

Chairman DODD. Thank you very much.

Senator Bennet.

Senator BENNET. Thank you, Mr. Chairman. Thank you for having this hearing, and thanks to all of you for coming together. It is fun to have you in one place.

I think I would like to start with you, Chairman Bernanke and Chairman Bair, if you have got thoughts about this, too. You know, among ending the TARP and Basel III and setting up the infrastructure for the resolution authority, I wonder if you could tell the Committee what actual changes your agencies have been able to discern in behavior at the largest, most interconnected financial institutions. Is there less leverage, those kinds of things? What are you actually seeing? And, Chairman Bernanke, I was, as always, curious on the quantitative surveillance mechanism you talked about, whether you could describe that. Is that something that is up now? And how are you going to use it? What are the inputs going to be?

So those are my first two questions.

Mr. BERNANKE. Well, we are certainly seeing movement in the right direction in our banking system. Capital has been increased significantly. One of the results of our stress test was to not only increase capital but to increase the quality of capital, to have more common equity. All of the banking agencies are pushing the banking organizations to improve their management information, their risk management systems. Some of the banks were not as able as they should have been or we should have insisted they had been to identify risks on an enterprise-wide basis running into the crisis. And so progress is being made on those lines as well.

Obviously, this is a period where, given that we have just come through a crisis, banks are not, generally speaking, taking excessive risks. In fact, many of the portfolios are quite conservative, and so we will have to see how things evolve as the economy normalizes. But I do think things are moving in the right direction.

At the Fed we are moving toward a more, as I said, macroprudential and multidisciplinary approach. We are in the process of establishing a staff Office of Financial Stability which will draw on staff resources from a wide range of disciplines—economics, finance, payment systems, accounting, legal, *et cetera*—which in turn will provide inputs and analysis to other parts of our operation.

So, in particular, for example, we have revamped our supervisory organization to take a more multidisciplinary approach and, for example, to do stress tests which are based on alternative macroeconomic or financial scenarios. This Office of Financial Stability is responsible for generating the scenarios and their implications as an input into that stress test analysis. And so we are linking together these different parts of our expertise.

As you mentioned, we have a quantitative evaluation—sorry.

Senator BENNET. Let me stop you there before you do that. Had what you are describing been in place precrisis, what are the things that you think—the macroeconomic trends that you think you might have picked up that were not picked up by the Fed?

Mr. BERNANKE. Well, I think we would have identified some of the broad-based risks that were occurring, the broad-based leverage. Our Office of Financial Stability, besides providing inputs into bank supervision, is going to provide general monitoring functions looking across a range of markets and institutions and funding markets and the like, trying to support our membership in the FSOC and in our collaboration with other agencies.

So we plan to take a much more holistic viewpoint. I do not think people appreciate how much that, prior to the crisis, agencies were very focused narrowly on individual markets and institutions, and there were very significant gaps. And I think it is important for all of us to work together to make sure that those gaps and emerging risks are identified, and this is our intellectual framework for approaching that.

Senator BENNET. And I am sorry, before I interrupted you were about to talk about the quantitative surveillance mechanism.

Mr. BERNANKE. Yes. So we are combining with our traditional bank supervision, which goes and looks at the books of individual banks, sort of offsite analysis which looks, for example, at real estate trends and housing trends and house price trends, mortgage delinquency trends and the like and tries to make broader assessments based on market variables and on macro variables—you know, what some of the risks might be to the banking system. And interaction between those kinds of analyses and the supervisory analyses I think is very helpful. In particular, it was a very helpful addition to our stress tests that we did a little over a year ago that we were able to supplement the bank's assessment of the value of their mortgage with a model-based econometric analysis that drew on information about individual housing markets and the relationship of house prices to macroeconomic developments and the like.

Senator BENNET. That sounds to me like a big step in the right direction, and I am wondering how you are planning on sharing the results with the public. Or are you?

Mr. BERNANKE. We are considering how best to do that. Obviously, the first step is to make sure that our supervisory process is comprehensive and macroprudential, and that is what this is all about. But I think that we ought to think collectively, the people at this table as part of the Financial Stability Oversight Council, about what kinds of reports we would like to provide. I think Dodd-Frank requires a regular report from FSOC about financial stability and risks to financial stability. And one natural thing would be for our analysis to be part of the input to our collective reports to the Congress and to the public about the stability of the financial system.

Senator BENNET. Thank you.

Chairman Bair, do you have anything you want to add to the first part?

Ms. BAIR. Well, I think we are engaged in parallel efforts, and as the backup supervisor and insurer, we obviously rely heavily on the primary regulators, including the Fed, obviously, for holding company data where we just recently were given new authorities.

We have focused a lot, though, as had the Fed, on liquidity monitoring and annually reporting on liquidity profiles on an ongoing basis, including having consistent reporting and horizontal analysis to be able to identify outliers.

I think your original question was what has changed, really. I think the good news is underwriting standards have gotten a lot better, and I would like for the supervisors to take credit for that. I think that is as much to do with the market and all of this coming home to rest. But that has gotten significantly better, and I do think large financial institutions, at least insured depositories and their holding companies, are in much better shape now, are much more stable. I think the SCAP results with the increased capital at that time served us well.

And so I think this is giving us more time to put these new systems in place, but there is a lot of work to do. I think we just went too far in the other direction in assuming that the market would always correct without providing vigorous oversight. But there is a lot of groundwork to be done.

Senator BENNET. We are—and I know it is not the subject of this hearing, but just for the record, still in places like Colorado facing incredible challenges with small businesses' access to credit. And I do not think all of that is loan demand, but I am going to——

Ms. BAIR. Well, I would not disagree with you on that. I think there is a particular problem with small business credit, and I think we have tried to take a very balanced supervisory approach, telling our banks we want them to lend. For smaller banks, frankly, the loan balances are stronger than they are for the larger institutions.

Part of the problem, though, is a lot of the small business lending went through home equity lines or was collateralized by commercial real estate. Those values have gone down so significantly, the collateral just is not there anymore. That is a key part of the problem.

Senator BENNET. I think unleashing that again is obviously so critical to our economic recovery, and both anecdotally and also just in the broader trends that I am seeing, we are still not there.

I wanted to come back, Chairman Schapiro, to something that was of a lot of interest to me when we were doing this bill, which you talked about earlier with the Ranking Member, about what we are doing to minimize the conflicts of interest at the rating agencies. There was one provision in particular that had to do with the composition of the boards of directors of those agencies and having independent directors. And I was not sure in your answer to the Ranking Member whether that was happening. Are they complying with that? Are we on track there?

Ms. SCHAPIRO. We are monitoring it very closely. Right after the bill was signed, we sent a letter to all of the credit rating agencies informing them that all the provisions in the law that took effect upon enactment as opposed to waiting for the SEC to write rules, and that is one of them. So we are checking in on them on a regular basis. We would be happy to provide more specific information about where they are.

Senator BENNET. I would appreciate that. That would be tremendous.

Ms. SCHAPIRO. Sure.

Senator BENNET. Thank you. And the last question—and I am the last person who wants an unhappiness to break out here, but I wanted to ask you, Chairman Gensler, and you, Chairman Schapiro, about one particular rule that you are going to be writing, which is to determine what types of entities are considered major swap participants. How are you working together? What process is that going to look like to get to a result? Because part of also what I am hearing out there and just as a general matter, not related only to Wall Street reform, is just a sense of lack of predictability about things. What are the rules of the road? We need to understand that.

By the way, I think that is a sensitivity that everybody ought to have as you think about publishing the rules and publishing the notices of the meetings, that there are a lot of people out there that are feeling like they have got a complete lack of clarity about what the future is going to bring, which is important for us to hear and attend to. But in this specific case, what is the process going to look like?

Mr. GENSLER. I think you have raised two very good points, trying to lower regulatory uncertainty so that businesses out there can understand where we are. We are going to put out proposed joint rules on definitions like major swap participant. I think our current hope is to do that in the middle of November right before Thanksgiving. We are human. We may slip. But I think Congress really spoke to this. This category of major swap participant in the statute should be very small. Why is that? Because it is somebody who is not a swap dealer but has some systemic relevance. I think there were three prongs to it, but all three of them really speak that it has to have some—if it fell apart or defaulted, had to have some systemwide effect on the economy or the financial system.

So I think the majority, I would even say the vast majority, of end users I would envision—again, it is ten Commissioners between our two Commissions will have to comment on this. But I would envision it would be a very small set of companies because Congress really has spoken to this in that way.

Ms. SCHAPIRO. I would agree with that. I think the three criteria that are set out in the statute make it clear that this is not intended to be an enormous category of market participants.

The other thing we have done, though, because we recognize this is of such enormous interest, is we put out an Advanced Notice of Proposed Rulemaking to solicit comment on how should we define a number of things, including in this particular area. So that I think will help guide us as well. And it is important as well because a whole regulatory regime attaches to it, and that will be new for many market participants who might fall into this category.

So this is an area where I would expect we would get an enormous amount of comment, and we will listen to it very carefully.

Senator BENNET. Thank you very much. Thank you all for being here.

Thank you, Mr. Chairman.

Chairman DODD. Thank you, Senator. You have been very helpful down at the end of that table down there, but you have been very, very supportive and helpful in this process over the last couple years, and I personally want to thank you for it.

Senator Johanns, you, as well, have been a good friend. I appreciate your work.

Senator JOHANNS. Thank you, Mr. Chairman. Let me just say before I get started here, Mr. Chairman, it has been a pleasure working with you. I think you have handled your chairmanship and working with majority and minority in just a very, very fair way. I want to say that publicly and tell you how much I appreciate it as one of the new people here.

Let me, if I might, turn to, I think, the best people to ask this to would be Chairman Schapiro and Gensler. As you know, there was discussion about retroactivity of this legislation relative to derivatives in contracts that had already been entered into and I want to make sure that the record is clear in this hearing. Do you see any part of this legislation at all applying retroactively to derivative contracts that were entered into before the effective date of the legislation?

Mr. GENSLER. Senator, I think it is a very good question. I can only speak for myself, because again, five Commissioners, five Commissioners and other regulators, also, as the Federal Reserve and the prudential regulators have a very big role in setting capital and margin. But I think where this has come up the most and people have raised it in public and private meetings with me is whether, for instance, contracts that existed before the Act stand, and I think the Act is very clear they do.

But also some people have raised, what about clearing requirements or margin requirements and so forth, and I am just sharing one Commissioner's view. I think that we should look that that should be prospective, not retrospective in that regard, and I know that is something that a lot of people have raised, but I—this is a whole rule-writing process and a lot of Commissioners and fellow regulators.

Ms. SCHAPIRO. I would really agree with that. We have heard the issue most frequently in connection with whether margin requirements should now apply. We also appreciate, though, that legal certainty is absolutely critical in this area. So while my Commission has not dealt with this issue specifically, I think we would be hard pressed to suggest that there ought to be retroactive application of margin, but it is an issue we will discuss extensively and also continue to take public comment on.

Senator JOHANNS. Does anyone else want to weigh in on that?

Let me now go in maybe a bit of a different direction for each of you, actually. Having served as a cabinet member and attended meetings like this where you have a complex piece of legislation that involves a lot of various areas, I have to tell you that, quite honestly, I see conflict as somewhat of a positive thing, and I will just give you an example.

Sheila Bair, if we wanted your boss to be Tim Geithner, we could do that, but we do not want that. We like a certain amount of independence. The same way with Ben Bernanke. If we wanted your boss to be Tim Geithner, we could do that, also. I mean, the words do exist in the English language to make that occur if you can find the votes. But a decision has been made that you operate independently and that independence is important to the functioning of our financial system and your regulatory responsibilities, *et cetera*.

So I appreciate the spirit in which you come here, which is to try to say, well, we are getting along. I have sat through those meetings, and I did not want the EPA running the USDA, so if they attempted to, I pushed back. So I need to know, because I think this is very important for oversight responsibility, and I want to go right down the table here, I want to know very specifically the areas of conflict that have arisen and the area of conflict that you anticipate arising as you implement this legislation. I will start at this end, Mr. Secretary.

Mr. WOLIN. Senator, I think that just to sort of say generally, the independence of the regulator's point is obviously a critical one that I have mentioned already. Having said that, at least in the Financial Stability Oversight Council, having a cooperative spirit, establishing a rhythm to accomplish the collective responsibility of the Council itself is also important, and I suspect that in that context there will be plenty of good debates with people, as you say, as they should, taking different perspectives and offering different views. I think the important thing is that it be done in a way in which information is shared and that the group understands that the ultimate role of that Council is distinct from the individual independent responsibilities of the regulators as regulators is something that is also important.

The Council has not had its first meeting yet, so I think it is too early to tell, really, how that all is going to work out. It is in early days. I think that as we at Treasury feel like we have tried to convene representatives of all the members of the FSOC in creating a governance structure and a set of bylaws by which the Council can govern its affairs, it has been a conversation that has been very helpful. People have approached it in a very cooperative spirit. They have not always agreed on exactly——

Senator JOHANNS. What are you not agreeing upon? You know, we might want to weigh in here, and we have a responsibility to provide oversight. We want this implemented right. Even though I did not support it, I want it implemented right. So——

Mr. WOLIN. You know, I do not think, Senator, there are disagreements as such, meaning sort of clear fault lines. I think on the question of what should be the appropriate transparency policy of the Council, what should be, you know, the structure by which votes are taken, all those things, people have different views and they express those views, but I do not think I am in a position to say there has been controversies or fault lines. It has been a good, cooperative effort in that respect. You know, that may change. The Council is in its nascence and we will see how it does in its first meeting tomorrow. But I think from this point, from the point of enactment to the cusp of the first meeting, it has been quite collegial and people have been approaching it as they have said here at this table, and there are others, of course, who are members not at this table, in a very helpful way.

Senator JOHANNS. Chairman Bernanke.

Mr. BERNANKE. So I will not take time agreeing with you about independence. I think it is very important for a lot of good reasons.

One of the strategic decisions in the bill is to have a lot of shared responsibilities, so for supervision, oversight of utilities, of banks, of large complex institutions and the like, in many cases, there are multiple regulators who have responsibilities shared and the like. I think that was the right decision because these are complex entities and different viewpoints, multiple sets of eyes are good. But I think, inevitably, there will be some disagreements or frictions at some point.

But I have to tell you honestly, and I am not just trying to put a happy face here, is that in terms of the substance of the rule writings that we have so far addressed, I do not see any deep or principled controversies at this point, just an issue here on the margin. So the Federal Reserve in particular is working with everybody on this table and we have found it to be very productive.

I would say there is some pressure arising from the fact that there is so much to do so quickly, and so it is sometimes a challenge to make sure that everybody has been appropriately consulted and all the input has been taken and still meet all the deadlines. So there are some challenges here. But I do not see any—at this point, I do not see any deep conflicts or differences in point of view that are going to threaten the implementation of this Act.

Senator JOHANNS. Chairman Bair.

Ms. BAIR. Well, I think there are a lot of different perspectives in a lot of different areas, and I agree with you, I think that is not an unhealthy thing. I think that is a healthy thing. You come together and try to find the right solution based on different perspectives.

And I would echo what Chairman Dodd said at the beginning, that I think we should all come together collegially. I think it is a dangerous dynamic if one or two players try to drive everything else, and I do not think that will happen.

I think in just about all the major areas, we bring different perspectives to the table. I do not think that it is a bad thing and I certainly do not see anything that would rise to the level where it would need a legislative fix. We are honored that you gave us so much flexibility and authority and that you defer to our hopefully good expertise and wise judgment in writing these rules and implementing this law, and so I think we all are committed fully to doing that. But there will be differences and we will need to overcome them, but I do not think that that is really an unhealthy thing.

Senator JOHANNS. Chairman Schapiro.

Ms. SCHAPIRO. I think I, needless to say, believe deeply in the independence of the SEC, and I know every agency up here feels that way. But you should not take the fact that we are here in agreement on many things at this early stage as a sign that we have not had lots of rigorous debate behind the scenes about very specific issues. Where we can resolve those issues among us, we want to do that. Where we cannot, we will sometimes present the public through the comment process with options and alternatives for ways to address issues where we are not all perhaps entirely synced up to see what the experts and the public think might be the right answer on a particular issue.

So there is lots of debate and discussion. There are very different perspectives that are being brought to bear on each and every one of these issues. But I think there is also tremendous commitment to try to get to the right answer for the American people in every single thing we do. Where we cannot, we might have some differences and agencies will have to go forward doing what they believe is the right thing under their statutory mandates.

But I think so far, it is actually working the way you would want, with that healthy tension yet a spirit of collaboration.

Mr. GENSLER. I would echo the thoughts about independence, which are very important, but the collaboration. I mean, I think it is what the American public expects of us. I think with nearly 10 percent unemployment, they even expect it more, and this was the worst financial crisis, where the regulatory system failed, as well. It was not just the financial system that failed.

You asked where there have been disagreements. I will say in the clearing area, one area that we are supposed to oversee, and it might be sort of selfish of the CFTC, we want to have clearing standards that are rigorous enough that the Federal Reserve and the bank regulators think they can withstand the test of time, but also that international regulators will find our clearinghouses equivalent and they will stamp them that the international regulators will allow the U.S. clearinghouses. So there is also a selfish goal, in a sense, for American commerce that these things have that.

We did have a little bit of an arms race on transparency. These four agencies and now maybe Treasury, I mean, we all sort of, how we could be voluntarily, not do more than the law on transparency and the rule writing. I think that was healthy.

I do foresee some debates in the future on how the SEC and CFTC take on this swap thing, because futures regulation and securities regulation is not always aligned. We are trying, and Mary and I have been committed to avoid regulatory arbitrage, but does that mean this new swaps regulation should be more aligned with securities regulation, more aligned with futures regulation, or somewhere in the middle? And so that is where we will have a healthy debate, no doubt.

Senator JOHANNS. I have some colleagues that—I have gone over my time, and so I hate to cut it off here, and maybe there will be an opportunity for you to offer your thoughts, but Mr. Chairman, again, thanks for your leadership on this. It has been a pleasure being on this Committee with you.

Chairman DODD. That is a great question to ask, Mike, on this, because for years, in fact, it was the independence and sort of the stovepipe approach that created it. It seemed to almost not only enshrine independence, which we want, but also seemed to enshrine conflict without the ability to sit together and come to some common answers where you could. So the very idea of this oversight council is designed to perpetuate the independence, but also to take, as Chairman Bernanke pointed out, the collaborative multiple sets of eyes to look at a situation that one set of eyes or one perspective might not see as clearly.

So this is obviously going to be an experiment. There has been nothing like it before. It is going to require a lot of hard work. So I was very pleased to hear that so many of the principals intend to stay involved in this process, because what can happen too often is it gets related to people down the line and then it begins to fracture and fall apart and does not succeed with that goal of getting the cooperation necessary.

So it is a great question and goes to the heart of whether or not this is going to work. You and I cannot legislate that.

Senator Akaka.

Senator AKAKA. Thank you very much, Mr. Chairman. I, too, want to add my thanks to you for your hard work here on the Dodd-Frank Wall Street Reform and Consumer Protection Act, and I want to thank the Committee, too, for all the hard work to ensure that the Act makes a strong and clear commitment to the protection and education and empowerment of our investors and consumers.

Now that we have enacted this historic legislation, I am committed to ensuring that the provisions of the Act will provide tangible assistance and protection to hard-working Americans are soundly implemented. I worked to develop many of the Act's provisions to increase financial literacy and empower hard-working Americans and promote informed financial decision making, and so I want to go to that ladder and work on one part of it.

Secretary Wolin, Title 12 of the Dodd-Frank Act will help unbanked and underbanked families by increasing access to bank and credit union accounts. It will also establish programs to develop small dollar loan alternatives to high-cost and predatory financial products. These provisions are particularly important to me personally because I grew up in an unbanked family. What is being planned to increase access to mainstream financial institutions and services?

Mr. WOLIN. Thank you, Senator Akaka, and thank you for your leadership on this extremely important set of issues. We are very focused on implementing Title 12 and to continuing our work on the unbanked. As you know, I think we are staffing up in this area at the Treasury. We have been working to really survey the landscape. We have had some pilot projects, I think you know, focusing on the unbanked and providing opportunities to access, working with private sector entities. There has been a lot of excellent work that has been going on in the States and among a pretty wide range of cities. So we are gearing up.

We are, of course, looking forward to being funded in this area, which is important for us to really take advantage fully of the important opportunities that Title 12 presents. We are very excited to work on this set of issues because we believe that it is critical to the engagement of a wide range of Americans in our economy and allowing them to do the kinds of things that they need and want to do to meet their own aspirations.

So we are hard at work. We will continue to be hard at work and we very much look forward to continuing to work with you as we move forward.

Senator AKAKA. Thank you. Chairman Bernanke, consumers that sent portions of their earnings to family members abroad can experience serious problems in these remittance transactions. The Dodd-Frank Act requires meaningful disclosures of the remittance transaction costs and establishes an error resolution process to protect consumers. The Act also instructs the Federal Reserve and Treasury to expand the use of ACH, Automated Clearinghouse System, for remittance transfers to foreign countries.

My question to you is, why is it important to provide these remittances protections and make greater use of the ACH system?

Mr. BERNANKE. Senator, this has been an area of interest for me personally and for the Federal Reserve for a long time. Remittances are an important contact point between many unbanked, particularly immigrant families and the financial system, and it is often an entree into the normal mainstream financial system. And so we want to make that as safe and inviting as possible.

The Federal Reserve, as part of its payment systems responsibilities, has been involved for a long time in the transmission of remittances, for example, agreements we have done with Mexico and other countries. And we will continue, of course, to look for ways to reduce the cost and increase the efficiency of remittances via ACH as required by the bill.

I would like to say a world in particular about disclosures and error corrections. As you mentioned, because of language and other issues, people who use remittances are particularly vulnerable to disclosure problems, and so it is very important that they understand the services that they are receiving and what the terms of that service are.

So we are already undertaking, already hard at work implementing the disclosure requirements of Dodd-Frank, and one thing in particular that we are doing, which we have used a lot in our consumer protection efforts in the last few years, is using consumer testing; that is, we actually either directly or engage an outside organization to try different disclosures on real-life consumers and then see how well they understand, how much they get the information, how accurately they understand what the disclosure is trying to provide. And we found this to be very successful in the past, and I am hopeful that the new Bureau will adopt these consumer-testing practices because we think they are very constructive.

So we are doing that now, and we are looking forward to developing proposed rules along the schedule that the act requires.

Senator AKAKA. Thank you for what you are doing on that.

Chairman Bair, I comment the FDIC for working to improve financial literacy, develop affordable financial products, and improve access to mainstream financial institutions. I know that these issues are important to you, and I respect your perspective on them.

What must be done to ensure that the Dodd-Frank Act's economic empowerment activities are implemented in a meaningful way?

Ms. BAIR. Well, I think there are a number of new and important tools that are provided in Title 12, and some build off of programs we have already, especially in the small-dollar loan area. We initiated a pilot a few years ago to try to get some brave banks to try to come up with an economically viable small-dollar loan product that would provide a low-cost alternative to payday loans. And it was quite successful. We were very pleased and are actively trying to get other banks to start offering that type of product.

As you know, our Money Smart curricula has been very successful, and we have issued the high school version of it as well. It is used quite extensively.

Also we have set up our own advisory committee on economic inclusion. When I became Chairman, that was one of the first things I did. The committee has a lot of good minds from the banking sector and the community sector, to try to help bring more people into mainstream financial services—products and services that are appropriate for them, and not ones that can end up costing a lot of money.

These new tools will be very important, and certainly the new Consumer Financial Protection Bureau will also put an added focus on this area. I am hoping that one of the outgrowths of this crisis is that we will get back to more traditional banking services. There was an article in the papers today about how more banks are now offering small-dollar loans, seeing it as an economically viable alternative, because such loans are clearer to understand than credit cards and are a one-shot deal that are perhaps easier for folks to manage.

There may be actually some positive things coming out of this in terms of banks getting back to basics, consumers understanding they need to have their eyes open, and then certainly the new Consumer Financial Protection Bureau providing better, consistent rules and disclosures. I think these will all be very helpful things.

Senator AKAKA. Thank you very much.

Chairman Schapiro, I am pleased that the Dodd-Frank Act will significantly improve investor problems. The act establishes the Office of Investor Advocate within the Commission. It provides the Commission with the authority to require more meaningful presale disclosures. The Commission will also conduct the studies on investor financial literacy and on obligations of broker-dealers and investment advisers.

Can you please update the Committee on the Commission's work to implement these provisions and explain how they can improve investor protection?

Ms. SCHAPIRO. I would be happy to, and you and I have had many conversations over the years about the importance of investor literacy.

I will say we are benefited in all these initiatives that we are undertaking now by the fact that we have really revitalized our Office of Individual Investor Education and Advocacy. As just an example of that, for the first time, we brought a large group of high school teachers to the SEC this summer to train them in how to impart education about financial matters throughout their course work, and also in specialized courses. And it is a program that was enormously successful and we will continue.

We do have the investor literacy study that you mentioned. We are in the project planning stage right now. It will focus on the current levels of literacy in this country, how to increase particularly, as you mentioned, transparency of fees and expenses so investors can understand what they are paying for the product that they are buying and can compare products in a simpler way because they will understand the fees and expenses.

We are also looking at what have been the most effective private and public sector efforts so that we can model our own SEC investor literacy efforts on ones that have been successful. And we are looking at investing goals and behaviors as part of this study as well. We will report to Congress within the 24-month period.

We are also in the process of standing up the Office of the Investor Advocate which will report directly to me and will have a role throughout the agency in ensuring that while we believe we always have investors in the forefront of everything we do, particularly in the rulemaking process, this will be a focal point to help ensure that the retail investor voice is heard as we engage in many of our Dodd-Frank and other rulemakings going forward.

Senator AKAKA. Thank you very much for your responses.

My time has expired, Mr. Chairman, and I want to wish you well and thank you for your work as Chairman of this Committee.

Chairman DODD. Thank you, Senator, very much. And let me just say thank you as well for your insistence over the years on financial literacy. I was speaking to the Economic Club of Washington last evening, and I talked about the financial literacy and the importance of it, beginning at the elementary school level. Getting people familiar with just basic math techniques and balancing a checkbook and doing other things can contribute significantly to this. And no one has done more consistently over the years to advocate on that than Senator Akaka of Hawaii. So we all owe you a debt of gratitude. There were not many applause lines in the speech last night, but that was one of them, on financial literacy.

Evan, thank you, by the way. We will be leaving together in January, and I thank you for your friendship and support on this Committee. You have been a great Member of this Committee and a great member of the Senate, so thank you.

Senator BAYH. Well, thank you, Mr. Chairman. All 12 years I have been privileged to serve in this body, we have served together in the Banking Committee. Have you considered establishing an alumni group?

[Laughter.]

Senator BAYH. We can be charter members. And I would like to thank all of our witnesses today for your contributions.

It occurred to me, Mr. Chairman, that while those of us on this side of the dais may have been the architects of this legislation, these men and women will be the builders who will be responsible for taking abstract concepts and turning them into a reality that will really deliver for the American people. And so I want to thank you for your dedication to making that process successful.

Chairman Gensler, I was really heartened to hear about the sort of tension about more transparency. Very often tension leads to, you know, sort of the lowest common denominator kind of decision making, but maybe we are having a race to best practices here. That would be a happy outcome, indeed. So I congratulate you for that, and the others. I guess some of the reports of some tension have been exaggerated, and that is a good thing. Reconciling independence and consensus building is not always easy, but I am confident that all of you at the table here can get that job done.

Mr. Wolin, let me start with you, and I want to follow up on something that Senator Corker raised, and that is with regard to the new consumer protection entity. As I understood your testimony, you are allowed to stand up this agency and do some practical things and gather information, sort of laying the predicate for rulemaking, but really cannot get into the meat of rulemaking absent a confirmed head of the entity. Is that a fair summary of your interaction with Senator Corker?

Mr. WOLIN. Yes, I think—Senator Bayh, I appreciate the—thank you, Mr. Chairman. I thank you, Senator Bayh, for the opportunity to comment on this further.

I think there are a range of rulemaking authorities that do hinge importantly on there bring a Director confirmed. There are authorities that the Secretary has under Section 1066 of the bill that will allow him to do the business of transferring and so forth and to make sure that the rulemaking and the supervision and so forth that the new Consumer Bureau receives from the various other Federal agencies from whom they are receiving those authorities can go forward. So that would include rulemaking but in that context——

Senator BAYH. Well, I think we could agree that—and I understand all that, and you do not want to get unduly constrained here.

Mr. WOLIN. Right.

Senator BAYH. That is a job for the lawyers to kind of work through. But I think we would all agree that there appears to be some significant area of rulemaking that will be impacted if there is not a confirmed head of the agency. Is that a fair statement?

Mr. WOLIN. I think it is important for the Bureau to have its full authorities for there to be a confirmed Director.

Senator BAYH. Well, my question to you, what would be the practical implications if no one was confirmed for a considerable period of time?

Mr. WOLIN. I am not sure, Senator, exactly what those would be. We are continuing to sort of work those true. There is an awful lot of work to do between now and then. The statute explicitly contemplates that work. Once the various agencies that are contributing authorities that will become the Bureau's authorities as of next July 21st, there will still be a lot of room for the agency, the new Bureau, to do its work as it goes forward.

You know, the President is committed to putting forward a nomination for a Director for the Senate to consider, and hopefully to confirm, and I think that, as I said earlier, I believe he will be doing that soon.

So I think there are a lot of things that the Bureau is seized with currently and will continue to be seized with.

Senator BAYH. The reason for my question—and, Chairman, if you were raising your hand, please feel free to jump in. The reason for my question was the crisis uncovered some significant areas where enhanced consumer protection is important, in spite of best efforts. And so some of us have, you know, reasonable hopes for this Bureau. And yet I do not have to tell all of you, including you, Chairman, how difficult it is to get people confirmed under the current environment up here, even in fairly noncontroversial, fairly straightforward situations. It is a practice I refer to as hostage taking for unrelated reasons. It is unfortunate, but it is a fact of life. Who knows what is going to happen in November? It is entirely possible that getting confirmations done in a new Congress may be even more difficult, particularly for a Bureau as significant and complex as this one. So it is a call for the President, but it seems to me that somewhere in the calculus confirmability is going to be a factor that has to be weighed. And, of course, sometimes people—you know, you can also just decide to have a fight even if confirmability may be unlikely.

Mr. BERNANKE. Senator, I just want to assure you that there will be no lacuna in rulemaking for consumer protection. Until such time as that authority is transferred, the Federal Reserve will aggressively pursue its responsibilities, and we are, in fact, working very hard on the mortgage rules that are in Dodd-Frank, for example, and we will continue to do that at the same time as we work with the Treasury and the new Bureau to make sure there is a smooth transition at the appropriate time.

Senator BAYH. That is an excellent point. I had breakfast this morning with Dan Tarullo, and we were going over some of this, and he was informing me about the progress that was being made. So I want to compliment you on that.

I am just kind of thinking beyond the horizon posttransfer about how, you know, vital the new entity will be, and it seems that having someone in there who is confirmed is going to be an important part of that. Thank you both for your responses with regard to that.

Secretary Wolin, again, something for you. This involves—and perhaps, Chairman, you as well—the Volcker Rule. Only Congress could come up with a situation like this where you have to give your recommendations about implementation of the rule, and, indeed, it has to be put into effect in some form. But then there is a 9-month study period, and these timelines are not, you know, contemporaneous.

And so my question to you is: Since you have got to opine in some ways about how to implement this rule, in fact, go forward with implementing some iteration of the rule, what weight, if any, will this study have in the decisions that are ultimately made since the study may be completed after some of the decisions have been required to have been made?

Mr. BERNANKE. Well, there is a study which the Council has to complete by January 21st, and the Federal Reserve is very much engaged in working with the Council in doing that. It will be a considerable time after that before any of these rules are actually implemented. In particular, I think there is a 9-month period——

Senator BAYH. A 9-month lag time, right.

Mr. BERNANKE. Lag time, and then even once the rules are in place, there is a 2-year conformance period, which could even be extended further, if necessary. So I do not think that there will be any situation where rules will be put in place and then rescinded because we decided they were not such a good idea.

Senator BAYH. Well, the reason for the study, as I recall, was that many of us understood that there was a potential risk here that probably had to be dealt with, but we were concerned we were taking a ready-fire-aim approach to handling this. So we wanted to make sure that, you know, all of you with authority here sat down, really analyzed what the risk was, what the most effective way to go about handling it was, and then we would ultimately put into place whatever that mechanism might be. That was really the heart of my question, to kind of make sure that whatever we end up doing, it is informed by your analysis rather than put into place and then the analysis comes out later and may have led to a different result if we had known about it beforehand.

Mr. Wolin.

Mr. WOLIN. Senator, I think that is exactly the intention. The FSOC is meant to do the studies the Chairman noted on the Volcker Rule set of issues that will then provide recommendations to the regulators who have to make rules in this area, will inform that work, so it will be sequenced, I think, in the proper way.

Senator BAYH. This very brief question, you do not have to jump in, but it might go to all of you. Those of us up here on the Hill like to think when we are finalizing these things and the cake has been sufficiently baked that it really cannot be changed a whole lot. We agree to engage in colloquies on the floor of the Senate, and these will carry some significant weight when historians and others look to divine congressional intent in analyzing legislation.

I am curious. Will you grant some weight to congressional colloquies where we take the opportunity to say for the record what our intent was? Or is that in the legal realm of what the lawyers would refer to as an advisory opinion, interesting but not granted a whole lot of weight?

Ms. BAIR. Well, as a former Senate staffer, I take this very seriously. Yes, committee reports, floor statements, colloquies, yes, absolutely carry weight. I think the Collins amendment, for instance, is something that is of key interest, and we strongly support it. The legislative history there and floor colloquies were quite informed and informative, as was the case in a number of other areas.

So, yes, I think we absolutely need to make sure we are adhering to both the letter and the spirit of Congress' intent, and the legislative history is quite important in that regard.

Senator BAYH. Thank you, Chairman Bair, and I would not expect any of you to come up here and say, "Well, no, Senator we are not paying any attention to what you had to say when this was enacted." But there were some colloquies with regard to Volcker, and some—OK.

[Laughter.]

Senator BAYH. Well, unfortunately, mental telepathy is not a part of my toolkit. No psychic abilities on the panel.

I do think it is important with regard to Volcker and some of these other things that you look at what was said, give it, you know, fair consideration in trying to make the ultimate determinations about what Congress intended and so forth. So enough said. But there are some in this area that I would recommend to your consideration.

My last question—and, Chairman, if I could go over by a minute or two, I might just have another brief one.

Chairman DODD. No problem at all. Go ahead.

Senator BAYH. Chairman Gensler, this involves you. It is great to see you again. You have been a friend for many years, and I congratulate you on the excellent work you have done, and, indeed, you were somewhat clairvoyant back in the day about what might have happened with regard to the crisis, and now you are in a position to do something about it going forward. So it is good to see you, and I am grateful for your leadership.

These are somewhat technical. What is your view on whether regulators have the authority to impose margin requirements on end users? And, again, I am talking about the end users themselves, not the transactions.

Mr. GENSLER. I thank you for that compliment. I do not think anybody was clairvoyant. But the Dodd-Frank Act does say that to lower risk of the swap dealers and to lower risk of the financial system as a whole, various regulators sitting here would have an authority to set capital margin on these dealers. If they are banks, it is the bank regulators, and nonbanked we get involved as well with the SEC. And this is an area where Congress has spoken very clearly. There is a letter—even Chairman Dodd and Chairman Lincoln wrote a letter on this right as the bill was going forward, but there were many colloquies. So we are all taking that together.

If I might say, as I understand the intent, it was that a certain group of end users, the nonfinancial end users, are out of clearing and then, as Chairman Dodd put in his letter, would be considered to be out of this margin requirement.

So we are taking all of that together and taking it very seriously, the intent of Congress that the financial system, about 90 percent of the swaps transactions are between financials and financials, and it is only about this 9 or 10 percent that is——

Senator BAYH. Well, that gets to my next to the last question, which does involve end users. And I have discussed the importance of, to the extent we can, the harmonization of global standards to prevent forum shopping and all that kind of thing. Basel is dealing with that in his arena. As I understand it, the EU has moved forward with regard to end users and have taken their approach. You know, you are now going to look at what we are doing, and I would ask you what kind of effort we will make to harmonize these things and, to the extent that there is some disparity, what implications that will have on our competitiveness if the Europeans have taken on approach and we take perhaps a more restrictive approach?

Mr. GENSLER. I, after 3 days overseas—I just returned yesterday—am very optimistic. They put forward their proposals 2 weeks ago. Their clearing requirement, for instance, on this end user issue aligns very similarly. Financial companies would have to use the clearinghouses. Nonfinancials would have, you know, a choice. They do not have to use it, unless they meet a certain clearing threshold, a certain size. We do not have that. Congress has spoken clearly. If you are mitigating a commercial risk, you are out of the clearinghouse.

But I think it is very aligned. Swap data repositories are very aligned. They say they are going to take up the trading mandate later in what they call MiFID review, which is about 6 months away.

Senator BAYH. Good. Well, I would encourage you to keep an eye on that because to the extent that they are not harmonized, they can lead to some consequences that could hurt us commercially.

Mr. GENSLER. And if I might say, Senator, also, we are taking it to heart in our proposed rules. So in our memos up to our fellow Commissioners and the harmonization with the SEC, where Congress has left this discretion—in many ways Congress has decided, but if they have left this discretion, we want to harmonize with the international—where we think the Europeans will end up on this, and the other regulators.

Senator BAYH. Thank you.

Chairman, if I can have just 1 minute with Chairman Bernanke?

Chairman DODD. Yes, certainly.

Senator BAYH. We have talked before about the Basel process. You talked about it here today, and I am delighted to hear your opinion that it is moving in a positive direction, capital requirements, quality of capital, liquidity and so forth. I understand some of our European friends have some domestic challenges that they have got to address. We need to be realistic about that.

So my question to you is: Were you satisfied with the progress that has been made with regard to quality of capital, those things that will be counted and those things that perhaps will not? Are we moving sufficiently, are they moving sufficiently that this will harmonize in a way that is good for the global financial system?

Mr. BERNANKE. Yes, I think we have made a lot of progress. There is now a much larger focus on common equity as the principal source of loss absorption. There is very restricted ability to use other types of assets. No more than 15 percent can be noncommon. And in negotiating that, we particularly limited some of the types of capital that Europeans had used, minority interest and things of that sort that we did not feel were particularly good forms of capital.

So we really have made substantial progress, and I think it was a very important achievement. And the FDIC and the OCC joined the Federal Reserve at the meeting in Basel, and we all worked together, I think, to get a good international agreement.

Senator BAYH. Good. Well, let me thank each of you again for your public service. It has been a privilege for me to work with you, and, Chairman Dodd, with you as well.

Chairman DODD. Thanks. Thanks, Evan, very much.

Chairman Bernanke, I did not ask you the question, but I presume I will get the same answer, and that was: Was the fact that we moved when we did here, with the legislation, was that helpful in terms on the derivatives section, for instance in your view, or not?

Mr. BERNANKE. Well, I am less informed about the derivatives than Chairman Gensler and Chairman Schapiro.

Chairman DODD. Well, on the capital.

Mr. BERNANKE. But broadly speaking, on capital and on many of the issues there is absolutely great interest in what we have done around the world, and we have moved first, and we have set an important and high bar, and I think it has been very well received internationally.

Chairman DODD. Let me ask you. I am not going to submit a lot of questions because you have a lot of work to do, and the last thing I want you to do is answer a lot of questions here while the efforts get underway, but just a couple of things come to mind.

Let me ask, and I want to give you a chance to jump in because Mike Johanns asked a question. He got down as far as you and did not give you a chance to respond, and I want you to do that.

But in doing so, Title 3 of our bill transfers the safety and soundness functions, personnel, property and funds of the OTS, primarily the OCC, but also the FDIC and the Fed. And let me parenthetically say that I have great respect and admiration for the people who worked at OTS. I mean this is not an indictment of this decision to close down that regulatory body, and this is awkward, and it is difficult.

It is very important to me that this be done well and that the people who worked at the OTS be treated with a lot of respect and understanding. I just want to know how that is going. This is a difficult time for everybody in the Country, and to do something like this can be tremendously disruptive obviously to a family and their concerns.

I know we tried to accommodate that in the bill, but I wonder if you might just give me a quick answer as to how we are doing on that, and then if you want to respond to the Mike Johanns question.

Mr. BERNANKE. Well, I mean we are working hard at it. I have had a number of meetings with Acting Director Bowman. Our management teams have met. In fact, they are meeting this afternoon in New York to kind of start talking about how we are going to integrate the supervisory staffs and functions together.

Tremendous effort being made to ensure that we find the right places and the right fit for people at OTS in the agency. They clearly have skills and abilities that we need. We need the people to come and do the work. There is going to be about a 50 percent increase in the number of institutions we are called upon to supervise, and we cannot do that without the talent and contribution of OTS staff. So we are working very hard to encourage them to look to a career in the combined agency.

It would be very bad to have them go elsewhere. So we are working very hard.

Chairman DODD. I am going to ask you to keep the Banking Committee staff informed as to how that is going, the progress.

Mr. BERNANKE. Absolutely.

Chairman DODD. So we have a good understanding of it and how it is functioning.

Mr. BERNANKE. Absolutely.

Chairman DODD. So they know someone is also working with you and watching carefully.

Mr. BERNANKE. Right, and we have to report to Congress at the end of 6 months.

Chairman DODD. I knew that, but even during this time period I would like to know how it is going.

Mr. BERNANKE. Yes. OK.

Chairman DODD. Anything you want to respond to Mike Johanns at all? I saw you wanted to say something, and then we cut you off.

Mr. BERNANKE. Well, I mean the only thing I would say is that there is always some tension in the interagency process. I think it essentially has less to do with people's interests and goals being aligned than with kind of differences in mission and approach and agencies, and that sort of thing.

But we are an independent agency within the Treasury. We participate in a lot of interagency discussions. We do interagency rulemaking with the other banking agencies. Congress has kind of endorsed, even expanded, the need for that kind of coordination, but you know there are policy differences. We work those out. You know. I mean it is a process that can sometimes be torturous, but it does work, and it will work again.

Chairman DODD. Good. Chairman Bernanke, let me thank you for your comments about the residential, the mortgage issues, and the Fed is working on those.

And underscore Evan Bayh's question. Look, this is important as well, and you had Bob Corker raise it. I know the Administration is working on this, and I have raised the issue. You have got to have a confirmable nominee, and we have got to get someone in place.

Otherwise, we are going to be—look, this is a controversial section of the bill. I do not have any illusions. Regardless of the outcome of the election in November, they are going to moving to try to get rid of this bureau, and it is going to be a lot easier to get rid of it has not gotten up and gotten started, and demonstrating the value and the importance of it.

So it is at risk in my view until we get someone in, running the place and demonstrating what it can do and the kind of rules it is going to develop. And believe me, there will be people out to get rid of it. So be confident of that conclusion.

But let me ask, if I can, ask both Sheila Bair and Chairman Bernanke. Headlines this morning were in the *Washington Post*—I do not know if in the other papers—about JPMorgan and foreclosure issues. We had the problems with the mortgage servicing company called Ally, formerly GMAC, regarding certain improper actions by its employees and foreclosing on people's homes. Those stories are very troublesome.

Obviously, I guess I congratulate JPMorgan this morning for making the decision it did. I did not read the whole story.

But I wonder if you might comment, both of you, on this situation. I know it is not exactly the subject matter here, but I would be remiss if I did not raise it with you, given attention that is going on. And the numbers of foreclosures, I mean this last month or so we have seen actually those increases.

Ms. BAIR. Well, we are still learning about it ourselves. The OCC might have something to add on this as well, as the primary regulator of these large institutions.

I think it is troubling, and it is just a further indication of how wrong we went with the mortgage origination process and securitization process, which was deeply tied to some of the breakdown in what would ordinarily be expected in terms of underwriting standards—in terms of documentation, in terms of perfecting title. So it is troubling.

So we will learn more about it, but I think it underscores that going forward we need to be very careful. We want to bring the securitization market back. We want to bring it back in the right way. We want a GSE exit strategy, but we want to make sure the alternative promotes stability in the mortgage market.

It just is another indication that too many things went wrong in the mortgage origination process, leading into this crisis.

Also, as you know, Chairman Dodd, we have been longtime proponents of trying to rework mortgages as an alternative to foreclosure where it makes economic sense, and it frequently does make sense. So I think we continue to push and advocate for that in various venues.

But this is very unfortunate, and we are still learning more. I would also defer to the Federal Reserve.

Chairman DODD. Mr. Walsh, do you want to make any comments at all?

Mr. WALSH. Well, just to say that obviously when evidence emerges, and has emerged in this case, of deficiencies in the process of reviewing and approving these individual cases, we immediately went and talked to people both at JPMorgan Chase and at the other half-dozen large servicers where we are dealing, and instructed them to go back once again.

I mean we have been to them a number of times to make sure they were ramping up processing to keep pace both in particular with the mortgage modifications that we were all hopeful would increase, as they have done, but not obviously to anyone's satisfaction, but asked them to go back and look at those processes again. There are State laws that require quite specific requirements for the review and approval of cases, and they must comply with those laws and have clearly had deficiencies in processing.

We both want to see that they fix the processing problems, but also to look to see whether there is specific harm that has been caused in individual cases. So we will be looking both for the procedural improvements, but also any evidence of harm to consumers.

Chairman DODD. Chairman Bernanke, any comments on this?

Mr. BERNANKE. Only that it has been a managerial challenge to the banks to deal with these foreclosures, modifications, *et cetera.*

Chairman DODD. Right.

Mr. BERNANKE. And they have not always met that challenge, and we continue to press them through guidance and supervision to ramp up and to make sure they have the people and that they are responding quickly to borrowers, and the like. Unfortunately, that has not always happened.

Chairman DODD. Yes. Sheila, I know that Ally is regulated by the FDIC.

Ms. BAIR. Well, actually that was in the holding company. The insured depository institution was not involved in the mortgage activities. It was not in the bank.

Chairman DODD. Well, listen, again I think it is one of these areas that I am sure the Committee will want to be kept informed, even during this period. We are not in session here as these stories are breaking. The staff, I know, and I would appreciate it if you would keep us posted as to how this matter is resolving itself.

With that, again I thank all of you. I am very impressed, by the way, at the amount of work being done. I mean there is always that given the time and all the other issues you have to grapple with. The fact that all of you seem to be working very, very hard, and your staff are, to fulfill the commitments of the legislation. That is very good news.

So I am very grateful to all of your being here this morning and sharing your testimony with each other, and we look forward to working with you.

We are going to have a couple of hearings in the lame duck session when we come back after the elections. So I will look forward to seeing some of you then. In the meantime, I thank you all again for your service and your contribution to this effort.

The Committee will stand adjourned.

[Whereupon, at 12:52 p.m., the hearing was adjourned.]

[Prepared statements and responses to written questions supplied for the record follow:]

PREPARED STATEMENT OF SENATOR TIM JOHNSON

Thank you Mr. Chairman for holding this hearing today. First, I want to thank you for your leadership. Without your hard work, we would not have passed the historic Dodd-Frank legislation. Second, given the extensive scope of the Dodd Frank legislation and the fact that much of it is subject to regulatory interpretation and rulemaking, our work is certainly not finished, and I look forward to today's hearing.

There is obviously a lot of ground to cover with our witnesses today, but I think it is important to begin these conversations, and today's hearing certainly provides us with an opportunity to identify important issues that will need more attention. I suspect as we further identify these areas, there will be many more oversight hearings in the future.

As both the regulators and industry proceed with the initial stages of Dodd-Frank implementation it is important for us to hear from the regulators on the priorities they are making, and the potential challenges they are facing. I know I am hearing from constituents in my State who are concerned about this stage of implementation, and I thank the witnesses for being here today to talk about these concerns.

I believe there are some issues, including derivatives, the "Volcker Rule," market making, insurance and capital standards, to name a few, where it is going to be vitally important that we get the rules right, ensure that we harmonize these rules internationally, and guarantee that our Nation's consumers and investors continue to be protected.

Additionally, as we create the new agencies and entities mandated by Dodd Frank, we must do it thoughtfully and carefully. Strong systemic risk regulation, common sense consumer and investor protection, certainty and having Federal and international expertise on insurance are all key to a stable economy and a strong financial services sector. We need to put the right people and resources in place to ensure that these agencies and council succeed.

Last, I want to commend all of today's witnesses for their hard work. This is not a simple task, and I hope that you will come to this Committee with your concerns and that your doors will be open for our questions and concerns.

Thank you.

PREPARED STATEMENT OF SENATOR DANIEL K. AKAKA

Mr. Chairman, thank you for convening this hearing today on the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act. I thank my fellow Members on the Committee for working with me to ensure that the Act makes a strong and clear commitment to the protection, education, and empowerment of investors and consumers. Now that we have enacted this historic legislation, I am committed to ensuring that the provisions in the Act that will provide tangible assistance and protection to hard-working Americans are soundly implemented.

Most Americans participate in the financial system by accessing credit to meet short-term household needs or relying on financial products to achieve personal goals, such as purchasing a home, supporting family members living abroad, planning for retirement, or financing a child's education. I worked to develop many of the Act's provisions to increase financial literacy, empower hardworking Americans, and promote informed financial decision making.

I developed Title XII of the Act together with my friend, Senator Herb Kohl of Wisconsin, to improve access to mainstream financial institutions. Too many low- and moderate-income families are forced to rely on costly and predatory financial products to meet their households' financial needs. Title XII will establish grant programs to bring more Americans into the financial mainstream by providing access bank and credit union accounts. A small dollar loans program will also be established to make available safer alternatives to predatory financial products.

The Consumer Financial Protection Bureau will have the authority to restrict predatory financial products and unfair business practices in order to prevent unscrupulous financial services providers from taking advantage of consumers. An Office of Financial Education is established within the Bureau and the Director of the Bureau will become the Vice Chairman of the Financial Literacy and Education Commission. The Bureau should be established and operate in accordance with these functions and responsibilities in order to provide essential consumer protections and encourage coordination and improvement of all Federal financial literacy activities.

Investors will greatly benefit from improvements within the Securities Exchange Commission and the additional investor protection responsibilities that are provided to the Commission under the Dodd-Frank Act. I am pleased that the Office of the Investor Advocate will be created within the Commission. The Investor Advocate is exactly the kind of external check, with independent reporting lines and independently determined compensation that could not be provided within the existing structure of the Commission. The Commission will also be required to conduct a study of financial literacy among investors and develop a strategy based on its results. The Dodd-Frank Act also provides the Commission with the authority to require meaningful disclosures be provided to retail investors prior to the purchase of a financial product or service.

I commend the Commission and the other Federal agencies represented here today for moving expeditiously to implement the Dodd-Frank Act. Already, the Commission requested public comment for a study on the obligations of brokers, dealers, and investment advisers. There is a harmful and unnecessary regulatory gap in the regulatory standards of care which investment advisers, brokers, and dealers must adhere to. Investment advisers are held to a fiduciary standard that imposes strong and meaningful obligations on them to investors. Yet, brokers and dealers are only held to an inferior and inadequate suitability standard. Investors are entitled to reliable and accurate investment advice from these financial professionals. It is important to the protection of investors that a fiduciary duty be uniformly applied to investment advisers, brokers, and dealers.

The Dodd-Frank Act also includes landmark consumer protections for remittance transactions. It will require simple disclosures about the cost of sending remittances to be provided to the consumer prior to and after the transaction. A complaint and error resolution process for remittance transactions will also be established. These improvements will provide essential protection to the many people in Hawaii and across the country who send significant portions of their income to relatives who live abroad.

We enacted this legislation to address inadequacies in the financial regulatory system and make necessary improvements to the safeguards that protect investors and consumers. Now, it is important that the Act is implemented in a sound and timely manner. I applaud the respective agencies for promptly beginning their respective implementation processes, and I look forward to each of the witnesses' testimonies today. Thank you, Mr. Chairman.

PREPARED STATEMENT OF NEAL S. WOLIN

DEPUTY SECRETARY, DEPARTMENT OF THE TREASURY

SEPTEMBER 30, 2010

Chairman Dodd, Ranking Member Shelby, and Members of the Committee, thank you for the opportunity to testify about the progress Treasury has made in implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act).

Introduction

Two months ago, against tough odds, Congress enacted the strongest set of financial reforms since those that followed the Great Depression. The Dodd-Frank Act will ultimately reshape our financial system and will affect us all in a number of important ways.

The Act builds a stronger financial system by addressing major gaps and weaknesses in regulation that helped cause the financial crisis that led to the recession. It puts in place buffers and safeguards to reduce the chance that another generation will have to go through a crisis of similar magnitude. It protects taxpayers from bailouts. It brings fairness and transparency to consumers of financial services. And it lays the foundation for a financial system that is pro-investment and pro-growth.

Mr. Chairman, passing this bill was no easy task. It would not have happened without your strong commitment and that of your colleagues to make sure that meaningful reform became a reality.

You stood on the right side of history and with the millions of Americans who have lost their jobs, homes and businesses as a result of a crisis caused by basic failures in our financial system.

But the work is far from done. Enacting financial reform was just the beginning.

Guiding Principles

Implementing the Dodd-Frank Act is a complex undertaking. Effectively describing the process requires terms that are often unavoidably dense, making reform seem distant to many. So before outlining the steps we have taken to date, I want to detail the broad principles guiding our efforts.

First, we are moving as quickly and as carefully as we can.

Wherever possible, we are quickly providing clarity to the public and the markets. But the task we face cannot be achieved overnight. We have to write new rules in some of the most complex areas of finance; consolidate authority spread across multiple agencies; set up new institutions for consumer protection and for addressing systemic risks; and negotiate with countries around the world. In getting this done, we are making sure to get it right.

Second, we are bringing full transparency to this process.

As we write new rules, we will be consulting a broad range of groups and individuals. And as we seek their input, the American people will be able to see who is at the table. Draft rules will be published. Everyone will be able to comment. And those comments will be publicly available.

Third, wherever possible, we will streamline and simplify Government regulation.

Over the years, our financial system has accumulated layers upon layers of rules, which can be overwhelming. That is why alongside our efforts to strengthen and improve protections through the system, we will avoid duplication and seek to eliminate rules that do not work.

Fourth, we will create a more coordinated regulatory process.

Ahead of this crisis, gaps and inconsistencies between regulators proved to be a major failure. Gaps allowed risks to grow unattended and inconsistencies allowed an overall race to the bottom. Better coordination will help prevent a recurrence.

Fifth, we will build a level playing field.

A level playing field must exist not just between banks and nonbanks here in the United States, but also between major financial institutions globally. We are setting high standards at home while working tirelessly to persuade the international community to follow our lead. We welcome the agreement just reached in Basel. It substantially raises the level of capital major banks must hold whether they operate out of New York or London or Frankfurt.

Sixth, we will protect the freedom for innovation that is absolutely necessary for growth.

Our system allowed too much room for abuse and excessive risk. But as we put in place rules to correct for those mistakes, we have to achieve a careful balance and safeguard the freedom for competition and innovation that are essential for growth.

Seventh, we are keeping Congress fully informed of our progress on a regular basis.

Implementation Update

Treasury has been working hard to implement the sweeping reforms of the Dodd-Frank Act since enactment.

Immediately after passage, we put in place a governance structure that oversees Treasury's role to implement financial reform. The bulk of the work is being done by teams dedicated to our core responsibilities such as helping to establish the Financial Stability Oversight Council (Council); laying the groundwork for the Office of Financial Research (OFR); launching the Consumer Financial Protection Bureau (CFPB); and creating a Federal Insurance Office (FIO).

These teams provide an update to a steering committee of senior Treasury officials who meet every day and consider options, make decisions, push implementation forward, and, where appropriate, make recommendations for the Secretary.

Let me now discuss in greater detail our actions around each of our core responsibilities.

The Financial Stability Oversight Council

With respect to the Council, we are focused on three things: approach, structure and execution.

First, the Council has a clear statutory mandate and overarching responsibility to identify risks to financial stability, respond to any emerging threats in the system and promote market discipline. This is a mandate that previously did not exist. In the lead-up to this crisis, the regulatory framework focused regulators narrowly on individual institutions and markets, which allowed gaps to grow and inconsistencies to emerge that allowed arbitrage and weakened standards. Before the Dodd-Frank Act, no single institution had responsibility for monitoring and addressing risks to financial stability. The Act fixes that through the creation of the Council.

To carry out its mandate, the Council has been given an important role in several consequential regulatory decisions. These include which major nonbank financial and critical financial market utilities firms will be subject to heightened supervision, and what prudential standards should be applied to those firms. The Council will also closely monitor the financial system as a whole, looking out for any emerging threats and, where they exist, make recommendations on how to address them.

As Chair, Treasury respects the critical independence of regulators to fulfill their responsibilities. We must develop an approach that maintains that independence while maximizing the coordination required for the Council to achieve its mission of financial stability. The Dodd-Frank Act makes agencies collectively accountable for this mission. While each agency has authority and mandate for a specific part of the financial sector or for certain aspects of its functioning, we need to develop an approach for the Council and its members of collective accountability for financial stability. This approach will promote the coordination, cooperation, and information sharing necessary for success.

Our second focus is on structure.

Tomorrow, the Council will have its first meeting. In advance of that meeting, senior officials from each member agency have been looking at how best to set up the Council's governance structure. They have drafted bylaws, and I expect those will be considered tomorrow.

Member agencies have also discussed setting up a committee structure to promote shared responsibility and make the best use of each member's expertise. This plan would entail forming committees around the Council's various statutory responsibilities, and around core issues that relate closely to systemic risk where more than one agency has a significant interest.

For example, we have proposed committees for designating certain nonbank financial firms and financial market utilities, for drafting recommendations for heightened prudential standards, and for monitoring and reporting on threats to financial stability. The Council members and their deputies would set the priorities for each of the committees, which will draw upon the expertise of each member agency and be chaired by one or more members.

Our third focus is on execution.

While we settle on structure, the Council has already begun its work because its duties commenced immediately upon enactment. Member agencies have already formed staff working groups to begin taking action. And, thanks to significant, joint work by staff of the member agencies, we expect that the Council will be in a position to take important steps toward fulfilling several of its core responsibilities at its meeting tomorrow.

At that meeting, in addition to adopting organizational documents, I expect the Council to consider a resolution to seek public comment on the criteria for designating nonbank financial companies for heightened supervision.

I also expect the Council will consider tomorrow a resolution to seek public comment to inform recommendations the Council will make on how to implement statutory restrictions on banking institutions' proprietary trading and investments in private funds (the "Volcker Rule"). In addition to that study, the Council must also study and make recommendations for implementing the concentration limit; study the macroeconomic effects of risk retention requirements; and study the economic implications of financial regulation. Work on those reports is also underway.

The Office of Financial Research

In drafting the Dodd-Frank Act, Congress recognized that better information and analysis will be critical to the success of the Council and its member agencies. In the lead-up to this crisis, financial reporting failed to adapt to an ever evolving financial system. Both supervisors and market participants lacked data about the buildup of leverage in the rapidly growing shadow banking system. Policymakers and investors responded to the crisis with inadequate information about the interconnectedness of firms and associated risks. That is why the Dodd-Frank Act created the Office of Financial Research.

As the statute requires, the OFR will have a Data Center to set standards for financial reporting and improve the quality of data that supervisors and market participants rely to manage risk.

These standards will make it easier to spot emerging threats. For example, more consistent and complete reporting of derivatives will make it easier to track how they redistribute risk through the system. Data standards will also improve market discipline as individual firms will be better able to assess their own risks, and standardization may lower firms' costs over the long run.

In addition to standards, the Data Center is required to develop and publish key reference data that identify and describe financial contracts and institutions. Regulators and supervisors as well as private firms and investors rely on such reference data to analyze risk. Gaps and inconsistencies in existing reference sources inhibit meaningful analysis. The OFR will seek to close gaps and increase consistency to improve risk analysis and strengthen market discipline.

To help the Council fulfill its role, the Dodd-Frank Act mandates that the OFR have a Research and Analysis Center. Although no analytic effort, no matter how thoughtful, can anticipate all risks, the OFR can help identify undue concentrations of risk such as took place at AIG before the crisis. And the OFR can help ensure that when the next crisis begins to emerge the Government has the information and analytical tools it needs to respond appropriately.

The OFR will be headed by a director nominated by the President and confirmed by the Senate. The director will have an independent obligation to report to Congress on threats to the financial system. We envision a director who combines the capacity to lead a cutting edge research program with experience both in managing data systems and in risk analysis.

Until there is a confirmed Director, the Treasury staff team working on creating the OFR has been hard at work planning its functions and gathering input from regulators and private parties. Our OFR team will continue to coordinate closely with other members of the Council.

We will move quickly to complete a census of existing data standardization initiatives and existing sources of reference data. The OFR will work to maximize the effectiveness of existing private sector efforts.

The OFR must not duplicate existing Government data collection efforts or impose unnecessary burden. That is why we are working with the regulators to catalogue carefully the data they already collect to ensure the OFR relies on their data whenever possible, as the Act requires. The OFR will help Government get the most out of existing data by facilitating sharing among agencies. We are also identifying existing private data sources to improve risk monitoring without imposing new burdensome data collection mandates.

When we have finished assessing existing public and private data initiatives, we will move quickly to draw up detailed plans for OFR to facilitate and advance these initiatives without duplication or unnecessary burden. We also are developing organizational structure, hiring procedures and pay structures, information technology, and other requirements.

Our efforts to establish the OFR will stay focused on ensuring that the OFR protects private information and trade secrets. The Act provides strict protections for data security and confidentiality and we take seriously our obligation to implement these protections fully. In the coming months our OFR team will be developing confidentiality policies and procedures for the OFR and its data centers that meet the highest data security standards.

We will in all these efforts continue to seek advice and expertise from the private sector, academia, and Congress. Working with the Council we will seek to formalize our outreach by establishing advisory committees. The lessons and information we take back will be built into the foundations of the OFR.

The Consumer Financial Protection Bureau

The CFPB will be an independent bureau of the Federal Reserve with the mission of ensuring transparency in consumer financial products and services and protecting consumers from abuse and deception. It will consolidate existing rulemaking authorities for consumer financial products and services. And it will consolidate agencies' existing functions for supervising the very largest banking institutions for compliance with consumer financial protection laws. It also will supervise many nonbank financial firms that sell consumer financial services, an entirely new Federal function.

The Act charges the Secretary with standing up the CFPB. Under his leadership we set up a staff implementation team with a clear division of responsibilities right after enactment. The team has working groups focused on setting up key functions of the CFPB such as research, preparing for the supervision of financial institutions, and working with the transferor agencies. Other working groups are focused on building the CFPB's supporting infrastructure (*e.g.,* finance and budget, records management, legal services, human resources, information technology, procurement, and other operations).

Elizabeth Warren is leading Treasury's effort to create the CFPB as the Secretary's Special Advisor. She will chair a steering committee of senior Treasury officials dedicated to overseeing CFPB implementation and reporting to the Secretary.

The team is tracking and projecting the CFPB's expenses, working with GAO to build audit requirements for FY2011, and developing a budget model. The team is also analyzing and aligning salary structures of agencies transferring staff to the CFPB, and building a pay and compensation system that fulfills the unique requirements of the Act. Initial privacy protocols are being developed and data management systems are being built.

The Secretary has designated July 21, 2011, as the date on which the CFPB will assume existing authorities of seven agencies (OCC, OTS, FDIC, NCUA, FRB, FTC, and HUD). Six of these agencies will also transfer staff to the CFPB. We are developing protocols with these agencies for determining how many people will transfer and for determining how the agencies will jointly identify which specific employees will transfer.

We have made substantial progress preparing the CFPB to incorporate staff and assume authorities from other agencies. We have begun planning and preparations for certain rules mandated by the Dodd-Frank Act so the CFPB can meet statutory deadlines. We have met with the agencies that will transfer rulemaking authority to coordinate and ensure a smooth transfer. We are coordinating fulfillment of certain rule-writing mandates under the Dodd-Frank Act with the Federal Reserve Board to speed clarity for the market and meet statutory deadlines.

We are also hard at work to ensure a smooth transfer of consumer compliance supervision for banks, thrifts, and credit unions with assets exceeding $10 billion. Senior experts in consumer compliance supervision of large banks—detailed to Treasury from the banking agencies—are laying plans for staffing, training, and information systems. We will make sure to coordinate examination schedules with prudential regulators to avoid unnecessary burden.

Federal Insurance Office

FIO will provide the Federal Government for the first time dedicated expertise regarding the insurance industry. The Office will monitor the insurance industry, including identifying gaps or issues in the regulation of insurance that could contribute to a systemic crisis in the insurance industry or the United States financial system. The director of FIO will advise the Council on these matters as a nonvoting member. FIO may receive and collect data and information on and from the insurance industry and insurers; enter into information-sharing agreements; analyze and disseminate data and information; and issue reports.

Under the Act, the director of this office must be a senior career civil servant, and we are committed to finding a top caliber person to fill the job. Last week we posted a vacancy notice and we will move as fast as the civil service hiring process allows. Meanwhile, existing Treasury staff has started the work of FIO.

We will make every effort to ensure a cooperative and collaborative relationship with the National Association of Insurance Commissioners (NAIC). Senior Treasury officials and staff are engaging frequently with the NAIC as well as other interested parties. We are establishing with NAIC a framework within which FIO and the States, as the functional regulators, can work hand-in-hand.

And we are also making plans for a system that will provide FIO with industry and insurer data and information, including data to monitor access to affordable insurance products by traditionally underserved communities and consumers, minorities, and low- and moderate-income people.

We are working to engage effectively with representatives of other countries on insurance prudential issues. We will also be working closely with the United States Trade Representative.

Conclusion

This economic crisis was caused by fundamental failures in our financial system. And over the past few years, those failures have cost us dearly—millions of lost jobs, trillions in lost savings, thousands of failed businesses, homes foreclosed, retirements delayed, educations deferred.

Financial reform addresses those failures so no future generation has to pay such a price. But it also rebuilds our financial system so that it can once again be an engine for economic growth.

For much of the last century our financial system was the envy of the world. From London to Shanghai, it was analyzed and even emulated for its creativity and efficiency in finding innovative ways to channel savings towards credit and capital, not just for the biggest companies but also for the individual entrepreneurs who had a good idea and a solid plan.

The Dodd-Frank Act will help ensure that our financial system becomes safer, stronger and, just as in the past century, the world leader.

Thank you.

PREPARED STATEMENT OF BEN S. BERNANKE

CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

SEPTEMBER 30, 2010

Chairman Dodd, Ranking Member Shelby, and other Members of the Committee, thank you for the opportunity to testify about the Federal Reserve's implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act).

In the years leading up to the recent financial crisis, the global regulatory framework did not effectively keep pace with the profound changes in the financial system. The Dodd-Frank Act addresses critical gaps and weaknesses of the U.S. regulatory framework, many of which were revealed by the crisis. The Federal Reserve is committed to working with the other financial regulatory agencies to effectively implement and execute the act, while also developing complementary improvements to the financial regulatory framework.

The act gives the Federal Reserve several crucial new responsibilities. These responsibilities include being part of the new Financial Stability Oversight Council, supervision of nonbank financial firms that are designated as systemically important by the council, supervision of thrift holding companies, and the development of enhanced prudential standards for large bank holding companies and systemically important nonbank financial firms designated by the council (including capital, liquidity, stress test, and living will requirements). In addition, the Federal Reserve has or shares important rulemaking authority for implementing the so-called "Volcker Rule restrictions" on proprietary trading and private fund activities of banking firms, credit risk retention requirements for securitizations, and restrictions on interchange fees for debit cards, among other provisions.

All told, the act requires the Federal Reserve to complete more than 50 rulemakings and sets of formal guidelines, as well as a number of studies and reports, many within a relatively short period. We have also been assigned formal responsibilities to consult and collaborate with other agencies on a substantial number of additional rules, provisions, and studies. Overall, we have identified approximately 250 projects associated with implementing the act. To ensure that we meet our obligations in a timely manner, we are drawing on expertise and resources from across the Federal Reserve System in areas such as banking supervision, economic research, financial markets, consumer protection, payments, and legal analysis. We have created a senior staff position to coordinate our efforts and have developed project-reporting and tracking tools to facilitate management and oversight of all of our implementation responsibilities.

The Federal Reserve is committed to its long-standing practice of ensuring that all its rulemakings be conducted in a fair, open, and transparent manner. Accordingly, we are disclosing on our public Web site summaries of all communications with members of the public—including banks, trade associations, consumer groups, and academics—regarding matters subject to a proposed or potential future rulemaking under the act.

In addition to our own rulemakings and studies, we have been providing technical and policy advice to the Treasury Department as it works to establish the oversight council and the related Office of Financial Research. We are working with the Treasury to develop the council's organizational documents and structure. We are also assisting the council with the construction of its framework for identifying systemically important nonbank financial firms and financial market utilities, as well as with its required studies on the proprietary trading and private fund activities of banking firms and on financial-sector concentration limits.

Additionally, work is well under way to transfer the Federal Reserve's consumer protection responsibilities specified in the act to the new Bureau of Consumer Financial Protection. A transition team at the Board, headed by Governor Duke, is working closely with Treasury staff responsible for setting up the new agency. We have established the operating accounts and initial funding for the bureau, and we have provided the Treasury detailed information about our programs and staffing in the areas of rulemaking, compliance examinations, policy analysis, complaint handling, and consumer education. We are also providing advice and information about supporting infrastructure that the Bureau will need to carry out its responsibilities, such as human resource systems and information technology.

Well before the enactment of the Dodd-Frank Act, the Federal Reserve was working with other regulatory agencies here and abroad to design and implement a stronger set of prudential requirements for internationally active banking firms. The governing body for the Basel Committee on Banking Supervision reached an agreement a few weeks ago on the major elements of a new financial regulatory architecture, commonly known as Basel III. By increasing the quantity and quality of capital that banking firms must hold and by strengthening liquidity requirements, Basel III aims to constrain bank risk-taking, reduce the incidence and severity of future financial crises, and produce a more resilient financial system. The key elements of this framework are due to be finalized by the end of this year.

In concordance with the letter and the spirit of the act, the Federal Reserve is also continuing its work to strengthen its supervision of the largest, most complex financial firms and to incorporate macroprudential considerations into supervision. As the act recognizes, the Federal Reserve and other financial regulatory agencies must supervise financial institutions and critical infrastructures with an eye toward not only the safety and soundness of each individual firm, but also overall financial stability. Indeed, the crisis demonstrated that a too narrow focus on the safety and soundness of individual firms can result in a failure to detect and thwart emerging threats to financial stability that cut across many firms.

A critical feature of a successful systemic or macroprudential approach to supervision is a multidisciplinary perspective. Our experience in 2009 with the Supervisory Capital Assessment Program (popularly known as the bank stress tests) demonstrated the feasibility and benefits of employing such a perspective.[1] The stress tests also showed how much the supervision of systemically important institutions can benefit from simultaneous horizontal evaluations of the practices and portfolios of a number of individual firms and from employment of robust quantitative assessment tools. Building on that experience, we have reoriented our supervision of the largest, most complex banking firms to include a quantitative surveillance mechanism and to make greater use of the broad range of skills of the Federal Reserve staff.

A final element of the Federal Reserve's efforts to implement the Dodd-Frank Act relates to the transparency of our balance sheet and liquidity programs. Well before enactment, we were providing a great deal of relevant information on our Web site, in statistical releases, and in regular reports to the Congress. Under a framework established by the act, the Federal Reserve will, by December 1, provide detailed information regarding individual transactions conducted across a range of credit and liquidity programs over the period from December 1, 2007, to July 20, 2010. This information will include the names of counterparties, the date and dollar value of individual transactions, the terms of repayment, and other relevant information. On an ongoing basis, subject to lags specified by the Congress to protect the efficacy of the programs, the Federal Reserve also will routinely provide information regarding the identities of counterparties, amounts financed or purchased and collateral pledged for transactions under the discount window, open market operations, and emergency lending facilities.

To conclude, the Dodd-Frank Act is an important step forward for financial regulation in the United States, and it is essential that the act be carried out expeditiously and effectively. The Federal Reserve will work closely with our fellow regulators, the Congress, and the Administration to ensure that the law is implemented in a manner that best protects the stability of our financial system and strengthens the U.S. economy.

PREPARED STATEMENT OF SHEILA C. BAIR

CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

SEPTEMBER 30, 2010

I appreciate the opportunity to testify on the priorities of the Federal Deposit Insurance Corporation (FDIC) for implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act). I also want to thank the Committee Members and staff for their hard work to enact this landmark legislation. With new resolution powers for nonbank financial companies, the establishment of the Financial Stability Oversight Council and the creation of the Consumer Financial Protection Bureau (CFPB), the Dodd-Frank Act provides financial regulators with the tools that are needed to protect against future financial crises.

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[1] *See,* Ben S. Bernanke (2010), "The Supervisory Capital Assessment Program—One Year Later", speech delivered at the Federal Reserve Bank of Chicago 46th Annual Conference on Bank Structure and Competition, held in Chicago, Ill., May 6, *www.federalreserve.gov/newsevents/speech/bernanke20100506a.htm;* and Daniel K. Tarullo (2010), "Lessons from the Crisis Stress Tests", speech delivered at the Federal Reserve Board International Research Forum on Monetary Policy, Washington, March 26, *www.federalreserve.gov/newsevents/speech/tarullo20100326a.htm.*

In addition to specific requirements to strengthen our financial system, there are important areas where the Dodd-Frank Act establishes broad policy direction while leaving the details of implementation to financial regulators. Implementing the Dodd-Frank Act in a way that will enhance the stability of our financial system as Congress intended, and not just as a regulatory compliance exercise, is a responsibility that the FDIC views with utmost importance.

The Dodd-Frank Act assigns the FDIC a large number of responsibilities for implementing reform. The FDIC is authorized to write 44 rulemakings—some of which are discretionary—including 18 independent and 26 joint rulemakings, new or enhanced enforcement authorities, new reporting requirements and numerous other actions. Implementation will require extensive coordination among the regulatory agencies and will fundamentally change the way we regulate large complex financial institutions.

It is imperative that regulators work together, with both speed and openness in the implementation of the Dodd-Frank Act in order to dispel uncertainties and foster a smooth transition by the industry. To achieve this end, the FDIC has already taken several steps to enhance the transparency of our rulemaking process. First, we announced that we would hold a series of public roundtables with external parties to discuss particular aspects of implementation and to provide input on draft regulations to carryout the Act. To date, we have held two roundtables. The first focused on the new orderly liquidation authority provisions of the Dodd-Frank Act. The second roundtable addressed the FDIC's current Deposit Insurance Fund (DIF) management and risk-based assessment system and changes made by the Dodd-Frank Act. Information on our roundtables is posted on our public Web site.

The FDIC is also disclosing on our Web site the names and affiliations of private sector individuals who meet with senior FDIC officials to discuss how the FDIC should interpret or implement provisions of the Dodd-Frank Act that are subject to independent or joint rulemaking. Moreover, in addition to the longstanding practice of publishing public comments on our Web site that are received through our rulemaking process, we are encouraging general input from the public on how the FDIC should implement the new law. The comments already received have been published on our Web site and we will continue this practice in advance of formal rulemaking.

Implementation of Dodd-Frank

The recent financial crisis exposed the short-comings of the current regulatory regime for addressing large, nonbank financial companies that posed systemic risk. Specifically, the Government was forced to either prop up a failing institution with expensive bailouts or allow a disorderly liquidation through the normal bankruptcy process. The bankruptcy of Lehman Brothers triggered a liquidity crisis that led to the bailout of AIG and massive public assistance to most major U.S. banking organizations. An orderly closure and liquidation is essential if we are to prevent such crises from occurring in the future. Many provisions of the Dodd-Frank Act are designed to reduce risk to the financial system and economy by enhancing the supervision of large nonfinancial companies or by facilitating their orderly closing and liquidation in the event of failure. The Dodd-Frank Act provides a new comprehensive regulatory regime that, coupled with higher capital standards, is designed to reduce risk in both individual firms and the wider financial system. Further, in order to reduce risk in the system to reasonable levels, it must be made clear to these companies that their financial folly could result in losses to shareholders and bondholders and in the dismissal of their senior managers.

My testimony reviews the top priorities of the FDIC in implementing the Dodd-Frank Act, which include: resolution plan requirements and orderly liquidation authority, systemic risk oversight, capital and liquidity requirements, and consumer protection. In addition, I will discuss other important implementation issues with respect to reliance on credit rating agencies, back-up examination and enforcement authorities, supervision of State chartered thrifts and changes to the deposit insurance system that should smooth the effect of economic cycles on IDIs by maintaining steady assessment rates and allowing the FDIC to maintain a positive fund balance during a financial crisis.

Orderly Liquidation Authority and Resolution Plans

The new resolution plan requirements and orderly liquidation authority are fundamental tools necessary to close large, systemically important financial companies and end "Too Big to Fail." The new requirements will ensure that the largest nonbank financial companies can be wound down in an orderly fashion without costing taxpayers billions of dollars in the form of bailouts. From the FDIC's more than 75 years of bank resolution experience, we have found that clear legal authority and transparent rules on creditor priority—coupled with adequate information and cooperation—are critical tools for the effective advance planning of a large, orderly liquidation.

Legal Authorities for Orderly Liquidation

The Dodd-Frank Act provides for orderly liquidation of covered "financial companies"—that is, those financial companies (including bank holding companies) for which a systemic risk determination has been made that failure and resolution under otherwise applicable law would have "serious adverse effects on financial stability in the United States." Title II of the Act vests the FDIC with legal resolution authorities similar to those for insured depository institutions (IDIs). Once the FDIC is appointed as receiver, it is required to carry out an orderly liquidation of the financial company. In order to implement this authority, the FDIC must determine: how a company will be closed; how assets of the receivership will be sold; how claims will be determined and paid; and what policies and safeguards must exist to ensure that the taxpayers do not bear losses. We are currently establishing processes needed to make these determinations.

In August, the FDIC Board of Directors approved the creation of an Office of Complex Financial Institutions (OCFI), that will, among other things, carry out the FDIC's new authority to implement orderly liquidations of systemically important bank holding companies and nonbank financial companies that fail. I will discuss the new OCFI in more detail later.

Information Necessary for Liquidation

Without access to information, the FDIC's legal authority for liquidation under the Dodd-Frank Act would be insufficient for implementing an effective and orderly liquidation process. For example, the court-appointed trustee overseeing the liquidation of Lehman Brothers found that Lehman Brothers' lack of a disaster plan "contributed to the chaos" of its bankruptcy and the liquidation of its brokerage.[1] This is fully consistent with the FDIC's experience. Without advance planning, the FDIC could not have effectively resolved the many insured banks that have failed. Recognizing this, the Dodd-Frank Act created supervisory and regulatory powers designed to give the FDIC information and cooperation from the largest financial companies and other regulators, and the authority to conduct extensive advance planning.

The new legislation requires the FDIC and the Board of Governors of the Federal Reserve System (FRB) to jointly issue regulations within 18 months of enactment of the Dodd-Frank Act to implement new resolution planning and reporting requirements that apply to bank holding companies with total assets of $50 billion or more and nonbank financial companies supervised by the FRB. Importantly, the statute requires both periodic reporting of detailed information by the largest financial companies and the development and submission of a plan "for rapid and orderly resolution in the event of material financial distress or failure." The resolution plan requirement in the Dodd-Frank Act appropriately places the burden on financial companies to develop their own plans in consultation with the FDIC and the FRB.

We are in the beginning phase of implementation and are closely coordinating the development of the resolution plan regulatory requirements with the FRB. This new resolution plan regulation will require financial companies to look critically at the often highly complex and interconnected corporate structures that have emerged within the financial sector. For a resolution plan to be viewed as credible and facilitating orderly resolution under the Bankruptcy Code as required by the Act, it must provide a clear discussion with regard to corporate structure and key business operations. The plan should describe which assets and liabilities belong to which legal entities, identify functions or services provided by third parties and who within the financial firm has the relevant information about these functions.

These large complex firms are continuously growing and changing, which yields complex and opaque legal and operating structures. Over time, these can present obstacles not only to regulators, but also to the firm's management. Resolution plans can clarify a financial firm's risks and lines of authority and control, which can ultimately benefit the firm.

The existence of a resolution plan will generate financial benefits, as inefficiencies associated with resolving a company without sufficient background information will be alleviated, financial system resiliency will be improved, and systemic risk will be reduced. Taken together, the new resolution powers, the enhanced regulatory and supervisory cooperation mandated in the law, and the resolution planning authority provide an infrastructure to end "Too Big to Fail."

[1] *See,* James W. Giddens, Trustee for the SIPA Liquidation of Lehman Brothers Inc., Trustee's Preliminary Investigation Report and Recommendations, United States Bankruptcy Court Southern District of New York, Case No. 08-01420 (JMP) SIPA, p. 8 ff.

In fact, we view resolution planning as such a critical matter that we already have used the FDIC's preexisting authority to propose a requirement for resolution planning for certain large IDIs. In May of this year the FDIC issued a notice of proposed rulemaking which would set forth information-reporting requirements intended to provide the FDIC with key information regarding operations, management, financial aspects and affiliate relationships. Further, the proposed rulemaking would require a contingent resolution plan to be submitted to the FDIC that describes how the IDI could be effectively separated from the rest of the organization. The Dodd-Frank Act goes one step further by mandating an orderly resolution plan for the entire organization.

The Dodd-Frank Act lays out steps that must be taken with regard to the resolution plans. First, the FRB and the FDIC must review the company's plan to determine credibility and utility in facilitating an orderly resolution under the Bankruptcy Code. Making these determinations will necessarily involve the agencies having access to the company and relevant information. If a plan is found to be deficient, the company will be asked to submit a revised plan to correct any identified deficiencies within a time period determined by the agencies. The revisions must demonstrate that the plan is credible and would result in an orderly resolution under the Bankruptcy Code. The revised plan could include changes in business operations and corporate structure to facilitate implementation of the plan. If the company fails to resubmit a plan that corrects the identified deficiencies, the Dodd-Frank Act authorizes the FRB and the FDIC to jointly impose more stringent capital, leverage or liquidity requirements. In addition, our agencies may impose restrictions on growth, activities or operations of the company or any subsidiary, until such time as an acceptable plan has been submitted. In certain cases we may force divestiture of portions of the nonbank financial firm.

Systemic Risk

The Dodd-Frank Act addresses systemic risk in several ways. As discussed above, each systemically important financial company must submit a periodic orderly resolution plan that is reviewed by the FDIC and the FRB and assessed for its credibility and ability to facilitate an orderly resolution under the Bankruptcy Code. In addition, the FDIC will have the authority to liquidate such entities in the event of failure. The Act also addresses the macro-oversight of the financial industry by establishing the Financial Stability Oversight Council (Council), strengthening liquidity and capital requirements, and prohibiting the use of credit ratings for regulatory purposes.

Financial Stability Oversight Council

The Dodd-Frank Act established the Council and vested it with the responsibility for identifying financial companies and practices that could create systemic risk in the future and taking actions to mitigate identified risks. The Council's success will be determined by the willingness of its members to work together closely and expeditiously to implement the Council's duties and to do so in a way that is not just a "paper exercise." One of the highest priorities for the Council is to establish the criteria for identifying systemically important financial companies to be subject to enhanced prudential supervision by the FRB. The Dodd-Frank Act specifies a number of factors that can be considered when designating a nonbank financial company for enhanced supervision, including: leverage; off-balance-sheet exposures; and the nature, scope, size, scale, concentration, interconnectedness and mix of activities.

This process of identifying the nonbank financial companies that should be subject to FRB oversight is likely to be involved and take considerable time. It may be prudent to begin the process by qualifying a small group of companies that are clearly subject to this provision of the Act while the Council members work through the details necessary to identify the more nuanced cases. Once a nonbank financial company is identified and subject to FRB supervision, the company must file an orderly resolution plan with the FRB and the FDIC, as discussed earlier.

Another key priority for the Council is to identify potentially systemic activities and practices. The Council needs to have a forward-looking focus to identify emerging risks and recommend that the primary regulators take quick action to mitigate those risks. At the same time, the Council members must work together to develop the most effective recommendations for enhanced prudential standards for the range of potentially systemic financial companies and activities. It is important to remember that the Council was formed to take a long-term, macro viewpoint. It was not meant to interfere with or complicate the ability of the independent agencies to fulfill their statutory mandates and move ahead with clearly needed reforms. We look forward to collaborating with our colleagues to assure continued progress in strengthening the stability of our financial system and utilizing our respective authorities and individual areas of specialized expertise to close regulatory gaps which contributed so greatly to the financial crisis.

In order to accomplish its challenging tasks, I believe that the Council should begin with experienced and capable staff from each of the member agencies to work as a team in implementing the Council's responsibilities. Interagency working groups should be established to take full advantage of the knowledge and unique perspective of each member agency.

To meet these implementation objectives, as I previously mentioned, the FDIC has recently reorganized and established the OCFI to help carry out its responsibilities under the Act. To support the priority of systemic risk oversight, the OCFI will perform continuous review and oversight of bank holding companies with more than $100 billion in assets as well as nonbank financial companies designated as systemically important by the Council. It will also be responsible for carrying out the FDIC's new orderly liquidation authority over those systemic companies that fail. Further, the OCFI will monitor risks among the largest and most complex financial institutions and develop plans for the contingency that one or more of these companies might fail. The OCFI will work closely with our counterparts at the U.S. Department of the Treasury (the Treasury Department), the FRB, and the other banking agencies to ensure that the Dodd-Frank Act is implemented in a way that makes prudential supervision and orderly liquidation of designated nonbank financial companies as effective as possible.

Bank Capital and Liquidity Requirements

One of the fundamental lessons of the financial crisis was the disastrous economic consequences of insufficient capital in the global banking system. Over time, the regulations that were in place allowed the financial system to become excessively leveraged and insufficiently liquid. Excessive leverage fueled a credit bubble and decreased the ability of financial institutions to absorb losses.

Through the auspices of the Basel Committee on Banking Supervision (Basel Committee), the Federal Reserve Board, the FDIC and our fellow U.S. banking regulators have been working with other supervisors and central bank governors throughout the world to increase both the level and loss-absorption capacity of capital. While important work remains to be done, as I will describe later in this testimony, the agreements reached in July and September by the Basel Committee and it's oversight body—the Group of Central Bank Governors and Heads of Supervision (GHOS)—will do much to improve both the quantity and quality of capital and discourage excessive leverage and excessive risk-taking by large international banking organizations.

The agreement sets out new explicit numerical minimum requirements for common equity, calculated for regulatory purposes in a way that is intended to ensure that such equity is fully available to absorb losses. It also includes capital buffers designed to encourage banks to hold capital well above regulatory minimums so they can absorb losses and keep lending during a crisis; increases in capital requirements for the counterparty credit risk arising from derivatives exposures; explicit regulatory liquidity ratios; and of critical importance, an internationally agreed leverage ratio. All of these elements are subject to an extraordinarily long phase-in period.

A great deal of attention has been directed to the potential impact of these requirements. While the agreement does represent a significant strengthening of requirements, we believe achieving the new capital levels will be easily manageable with the extremely long transition period. First, none of these enhancements will take effect until January 1, 2013, over 2 years from now. At that time, a 3.5 percent minimum ratio of tier 1 common equity to risk-weighted assets is introduced—but without, at that time, a requirement for any of the new regulatory deductions. For U.S. banks, a 3.5 percent common equity requirement is clearly a nonevent.

During the 5 years following January 1, 2013, new regulatory deductions from capital would be phased-in incrementally. In the U.S., the most important of these deductions would come from the phase-out of Bank Holding Companies' tier 1 capital recognition of trust preferred securities. This phase-out is part of both Basel III and the Dodd-Frank Act, and appropriately so since these instruments did not prove to be loss-absorbing in the crisis and their prevalence greatly weakened the capital strength of the U.S. banking industry and increased the FDIC's insurance losses.

There is also a more-stringent cap on the recognition of deferred tax assets in tier 1 common equity. When the value of these assets depends on future income, they are not really available to absorb loss in a severe scenario. It is likely, however, that banks would avoid much of this deduction simply by realizing the value of these deferred tax assets over time through earnings.

Another important deduction includes a tighter cap on the capital recognition of mortgage servicing rights and the deduction of all other intangible assets (goodwill, by far the largest category of intangible assets, has long been deducted from regulatory capital). While the value of mortgage servicing rights can be volatile, they clearly have value and the U.S. delegation argued successfully that the full deduction of this asset proposed by the Basel Committee in December was unwarranted. Finally, deductions of certain large financial equity investments and cross-holdings are designed to reduce the double-counting of capital in the financial system. We anticipate banks will avoid many of these types of deductions simply by selling or restructuring their holdings.

Just as these deductions would be phased in gradually, the higher numerical requirements would also be phased-in, even more gradually. This would include a capital buffer over and above the minimum common equity ratio. The minimum plus buffer for tier 1 common as a percentage of risk-weighted assets would increase from the 3.5 percent on January 1, 2013, to 7 percent on January 1, 2019. Corresponding figures (minimum plus buffer) by 2019 for tier 1 and total capital would be 8.5 percent and 10.5 percent respectively. The leverage requirement that tier 1 capital be at least 3 percent of the sum of balance-sheet assets and selected off-balance-sheet assets would not take effect until January 1, 2018.

The agreement also includes important new requirements for liquidity. A new Liquidity Coverage Ratio requires banks to hold sufficient high quality liquid assets to meet cash needs during a 30-day stress scenario. While simple in concept, implementing this ratio requires many key assumptions and definitions. The agreement includes an observation period to allow for potential adjustments if needed. Another proposed liquidity ratio, the Net Stable Funding Ratio, in essence attempts to ensure that illiquid assets are not funded with volatile liabilities. This ratio is still under development.

Determining the amount of new capital that banks would ultimately need to retain through earnings or raise externally during the next 8 years under these requirements is extremely difficult. Some of the specific required deductions may be avoidable as noted above. Deductions or extremely high capital charges affecting certain speculative grade or unrated securitizations may be largely avoidable as well, as banks sell, restructure or allow these exposures to pay down over time.

Our own analysis, that assumes no mitigating actions by the banks and that the full increase in risk-weighted assets estimated by the Quantitative Impact Study (QIS) is realized, suggests that overwhelmingly, U.S. banks can meet the new requirements through retained earnings over time, with no need to tap external equity markets.

Our view is that while the evidence supported the case for still higher requirements, the agreement is a major strengthening of current rules and an acceptable compromise given the multiple perspectives represented in the negotiations.

Thus, the requirements agreed by the GHOS would go a long way to strengthen the U.S. banking system, but there is more to be done. First, the GHOS and the U.S. banking agencies have affirmed that further steps will be taken to augment the loss absorbing capacity of systemically important banks. The FDIC places a high priority on these efforts, and believes that they are needed to help avoid a recurrence of the events of the Fall of 2008.

The Dodd-Frank Act establishes a mandate for the largest and most systemically important banks to have capital requirements that are higher than those applying to community banks, for systemically important nonbank financial companies to be subject to strong and appropriate capital regulation, and for depository institution holding companies to serve as a source of financial strength to banks. The Dodd-Frank Act requirement that is most critical to ensuring that all this happens is Section 171.

Section 171 states that the generally applicable capital requirements shall serve as a floor for any capital requirement the agencies may require. Without this provision, the Nation's largest insured banks and bank holding companies could avoid being held to higher capital standards, simply by using their own internal risk metrics under the agencies' rules implementing Basel II's "advanced approaches" to compute the risk-weighted assets against which they hold capital. Section 171 also provides that the generally applicable insured bank capital requirements will serve as a floor for the capital requirements of depository institution holding companies, and of nonbank financial companies supervised by the FRB pursuant to the Dodd-Frank Act. These important requirements will help ensure that holding companies do serve as a source of strength for their banks rather than as a vehicle for increasing leverage, and will address gaps and inconsistencies in regulatory capital between banking organizations and systemically important nonbank financial companies.

The FDIC attaches enormous importance to working with our fellow regulators to promptly implement these important requirements of Section 171.

Limitation on Reliance on Credit Rating Agencies

Another lesson of the financial crisis is the importance of performing independent due diligence on the underwriting standards and credit risks posed by credit exposures contained within structured products such as mortgage-backed securities and credit derivative products. To this end, the Dodd-Frank Act requires the regulatory agencies to remove all references to, or reliance on, credit ratings and substitute credit-worthiness standards developed by the agencies.

On August 25, 2010, the banking agencies published a joint Advance Notice of Proposed Rulemaking seeking comment on a number of alternatives to the use of credit ratings within the various U.S. bank regulations and capital standards that reference such ratings. While we are interested in seeing industry comments on the alternatives, we also recognize the significant challenges involved with developing credit worthiness standards for the broad range of exposures and complex securities structures that exist within today's financial system.

Consumer Protection

I have long argued for increased consumer protections and fully supported the creation of the CFPB. Put bluntly, consumer protections need to be beefed up especially for nonbank providers of financial services. There is ample evidence that consumers did not understand the consequences of the subprime and nontraditional mortgages that were sold to them during the buildup of the housing bubble. That is why basic consumer protections are a fundamental piece of our regulatory infrastructure, and the new CFPB has much work to do to bolster these protections.

As you know, under the Dodd-Frank Act, the FDIC maintains compliance, examination and enforcement responsibility for over 4,700 insured institutions with $10 billion or less in assets. The CFPB assumes responsibility to examine, and enforce for compliance with Federal consumer financial law, the 46 institutions we now supervise that have more than $10 billion in assets or that are affiliates of institutions with over $10 billion in assets. Even for these large organizations the FDIC will have back-up authority to enforce Federal consumer laws and address violations.

The Committee has asked about the transfer of employees to the new CFPB. We recognize the tremendous importance of working closely with our colleagues at the Treasury Department and the other banking agencies to ensure a smooth transition and the need for ongoing agency coordination once the transition is complete. Above all, we are fully committed to a fair transition and the equitable treatment of employees. With these goals in mind, we have taken a number of preliminary steps to begin the transfer process.

Initially, two senior employees are being detailed to the Treasury Department to work on a wide range of examination and legal issues that will confront the CFPB at its inception. We are also actively engaged with the Treasury Department in helping to determine staffing levels and identify skill sets needed for the CFPB. Recognizing that FDIC employees have developed expertise, skills, and experience in a number of areas to benefit the CFPB, we fully expect some employees will actively seek an opportunity to assist the CFPB in its earliest stages, or on a more permanent basis.

Related to the creation of the CFPB, the Dodd-Frank Act changes the composition of the FDIC Board of Directors by replacing the position held by the Director of the Office of Thrift Supervision (OTS) with the Director of the CFPB. Given the importance of consumer protections as part of financial reform, it is appropriate that the Director of the CFPB is a member of our Board.

In addition to this change to the Board's governance structure, the FDIC has taken steps to raise the stature and attention of consumer protections by creating a new division within FDIC with consumer protection as its focus. The new Division of Depositor and Consumer Protection will be created through the transition of staff from our existing Division of Supervision and Consumer Protection. We also will transfer employees from our existing research staff to the new Division to perform consumer research and Home Mortgage Disclosure Act (HMDA)/fair lending analysis. We also are in the process of strengthening our legal workforce dedicated to supporting depositor and consumer protection functions. Finally, to maintain synergies between safety and soundness and consumer protection, FDIC risk management staff will continue to work closely with the FDIC's depositor and consumer protection staff.

Additional FDIC-Related Dodd-Frank Act Provisions

The Dodd-Frank Act provides the FDIC with new and enhanced authorities related to examinations and supervision of nonbank financial companies supervised by the FRB, IDIs, and their holding companies. Among other things, the Act provides the FDIC with back-up examination authority for systemically important nonbank financial companies, and bank holding companies. The Act also transfers regulatory authority over State chartered thrifts from the OTS to the FDIC. In addition, the Act mandates changes to the DIF that will allow the FDIC to more effectively manage the Fund.

Back-up Examination and Enforcement Authority

The Dodd-Frank Act grants the FDIC new authorities to examine systemically important nonbank financial companies and bank holding companies with at least $50 billion in assets for the purposes of implementing the FDIC's orderly liquidation authority. These back-up examinations may only be conducted in certain circumstances and only if the FDIC Board decides they are necessary to determine the condition of the company and other conditions are met.

Before conducting a back-up examination, the FDIC will review available resolution plans submitted by the company, as well as available "reports of examination." We will coordinate with the FRB to the maximum extent practicable to minimize duplicative or conflicting examinations. However, consistent with FDIC's methods for resolving IDIs, back-up examination authority likely would play a key role in the planning for any potential orderly liquidation of a systemically important financial company under Title II of the Dodd-Frank Act. The information obtained from examinations (along with the information obtained through the resolution plan review process) is crucial for planning an effective liquidation.

Similarly, the Dodd-Frank Act gives the FDIC back-up enforcement authority over a depository institution holding company if the conduct or threatened conduct of the holding company poses a risk to the DIF. This new authority recognizes that the activities and practices of the holding company may affect the safety and soundness of the IDI.

With respect to our existing back-up examination authority for IDIs prior to passage of the Dodd-Frank Act, the FDIC Board voted on July 12 to revise its Memorandum of Understanding (MOU) with the other primary Federal banking regulators to enhance the FDIC's existing back-up authorities over IDIs that the FDIC does not directly supervise. The revised agreement will improve the FDIC's ability to access information necessary to understand, evaluate, and mitigate its exposure as deposit insurer, especially to the largest and most complex firms.

The complexity and opaqueness of large, complex depository institutions requires the FDIC to have a more active on-site presence and greater direct access to information and bank personnel in order to fully evaluate the risks to the DIF. The need to revise the existing MOU was previously identified in a report by the Offices of Inspector General of the FDIC and the Treasury Department.[2] They criticized the then-existing MOU because it limited the FDIC's ability to make its own independent assessment of risk to the DIF and required the FDIC to place unreasonable reliance on the work of the primary Federal regulator.

Our new back-up supervision MOU meets the recommendations of the Inspectors' General report and the commitment for action that I made personally in response to the recommendations. Further, I believe that the new agreement strikes a reasonable balance between preserving the role of the primary Federal regulator and providing the FDIC with the information that is critical to meet our statutory responsibilities. While much work lies ahead in implementing the terms of the new MOU, the FDIC will benefit from the stronger and more robust agreement. However, we also recognize that our ultimate success will depend heavily upon our ability to work together collectively as regulators and to respect the roles and responsibilities that we have each been given to protect the financial system.

FDIC's Authority Over State Chartered Thrifts

We have initiated discussions with the OTS, the Office of the Comptroller of the Currency (OCC), and the FRB to ensure a smooth transition of OTS personnel and the approximately 60 State-chartered OTS institutions that will become FDIC-supervised pursuant to the regulatory realignment in the Dodd-Frank Act. An implementation plan for the transfer of OTS powers and personnel will be developed in coordination with the other Federal banking agencies. As you know, the Act sets the transfer date for OTS functions at 1 year after enactment, with a possibility for a 6-month extension. Prior to the implementation date, the FDIC, in consultation with the OCC, will identify and publish a list of OTS orders and regulations that the

[2] Offices of Inspector General of the FDIC and The Treasury, Evaluation of the Federal Oversight of Washington Mutual Bank, Report No. EVAL-10-002, April 2010. *http://www.fdicoig.gov/reports10/10002EV.pdf.*

FDIC will enforce. We plan to use the systems currently in place to communicate with the management of these institutions during the transition phase. We are confident that the FDIC will have the resources needed to effectively supervise these institutions.

Changes to the DIF Under the Dodd-Frank Act

The FDIC has experienced two banking crises in the years following the Great Depression. In both of these crises, the balance of the insurance fund became negative, hitting a low of negative $20.9 billion in December 2009, despite high assessment rates and despite other extraordinary measures in the most recent crisis, including a special assessment of $5.5 billion. However, prepaid assessments of approximately $46 billion maintained the fund's liquidity.

The FDIC has long advocated that the deposit insurance assessment system should smooth the effect of economic cycles on IDIs, not exacerbate them. In practice, however, the opposite has tended to occur—rates have been low during prosperous times and high during crises. At the very least, assessment rates should not increase during a crisis.

In the Dodd-Frank Act, Congress granted the FDIC increased flexibility to manage the DIF to achieve goals for deposit insurance fund management that the FDIC has sought for decades but has lacked the tools to achieve. The provisions of the Act, used to their fullest extent, should allow the FDIC to maintain a positive fund balance even during a banking crisis and maintain steady assessment rates throughout economic and credit cycles.

Specifically, the Dodd-Frank Act raised the minimum level for the Designated Reserve Ratio (DRR) from 1.15 percent to 1.35 percent and removed the requirement that the FDIC pay dividends of one-half of any amount in the DIF above a reserve ratio of 1.35 percent. The new legislation also allows the FDIC Board, in its sole discretion, to suspend or limit dividends when the reserve ratio reaches 1.50 percent. Going forward, the dividend policy set by the Board (combined with assessment rates) will directly determine the size of the DIF.

The FDIC has analyzed various trade-offs among assessment rates, dividend policies and reserve ratio targets. The analysis shows that the dividend rule and the reserve ratio target are among the most important factors in maximizing the probability that the DIF will remain positive during a crisis, when losses are high, and in preventing sharp swings in assessment rates, particularly during a crisis. This analysis also shows that the DIF minimum reserve ratio (DIF balance/estimated insured deposits) should be about 2 percent in advance of a banking crisis in order to avoid high deposit insurance assessment rates when IDIs are strained by a crisis and least able to pay.

The FDIC Board will soon be considering a long-term strategy for DIF management, including assessment rates, a target reserve ratio, and a dividend policy, consistent with long-term FDIC goals and achieving the statutorily required 1.35 percent DIF reserve ratio by September 30, 2020. It is important to take advantage of this new fund management authority while the need for a sufficiently large fund and stable premiums are apparent to most. Memories of the last two crises will eventually fade and the need for a strong fund will become less apparent. Action taken now by the FDIC's present Board, taking advantage of the tools granted by the Dodd-Frank Act, will make it easier for future Boards to resist inevitable calls to reduce assessment rates or pay larger dividends at the expense of prudent fund management.

In addition, among the various rulemakings that will be required to implement the DIF-related provisions in the Dodd-Frank Act, the FDIC Board will issue notice-and-comment rulemaking later this fall to implement the requirement that we change the assessment base from domestic deposits to average assets less average tangible equity.

This change, in general, will result in shifting more of the overall assessment burden toward the largest institutions, which rely less on domestic deposits for their funding than do smaller institutions.

Conclusion

In creating the Dodd-Frank Act, Congress enacted an historic package of financial reforms that will shape the financial industry for decades to come. Not only are these reforms needed to address the problems and abuses that led to the crisis, but they also offer the opportunity to create a financial system that will once again support the American economy, and not the other way around. A stable, profitable and internationally competitive U.S. financial services industry is in everyone's interest.

This financial reform is about better aligning incentives—internalizing the costs of leverage and risk taking—so that financial institutions can safely and efficiently channel capital to its highest and best use in our economy. If our economy is to prosper and if our Nation is to meet the economic challenges looming ahead, our financial sector simply must do its job better.

As we meet today, much remains to be done. The FDIC has begun its rulemaking tasks and is committed to a quick, transparent process to allow the financial industry to readily adapt to the new environment. We have reorganized ourselves internally to produce the focus and accountability needed to ensure the orderly liquidation of nonbank financial entities, the control of systemic risk, and the enhancement of consumer protections. We are working with our regulatory counterparts to quickly and carefully issue regulations to implement the Dodd-Frank Act. We are approaching these complex tasks with both a sense of urgency and a view toward their long-run efficacy.

The stakes are high. If we fail to create effective frameworks now for exercising our authorities under Dodd-Frank, we will have forfeited this historic chance to put our financial system on a sounder and safer path in the future. We must not let this tremendous opportunity go to waste. Thank you for today's hearing. I look forward to answering any questions.

PREPARED STATEMENT OF MARY L. SCHAPIRO

CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION

SEPTEMBER 30, 2010

Chairman Dodd, Ranking Member Shelby, and Members of the Committee: Thank you for inviting me to testify today on behalf of the Securities and Exchange Commission regarding our implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act" or "Act"). As you know, the Dodd-Frank Act fills a number of significant regulatory gaps, brings greater public transparency and market accountability to the financial system, and gives the SEC important tools to better protect investors.

The Act includes over 100 rulemaking provisions applicable to the SEC, many of which require action within 1 year. It also requires the SEC to conduct more than twenty studies and create five new offices. While this is a very significant task, we are fully committed to fulfilling our mandates under the Act, as well as our preexisting responsibilities.

My testimony today will describe our progress and plans for implementing the Dodd-Frank Act, particularly with respect to those issues that you specifically inquired about: derivatives regulation, clearance and settlement activities, registration of private fund advisers, credit rating agency regulation, corporate governance and executive compensation regulation, reforms to the asset-backed securitization process, the standard of care applicable to financial intermediaries, and other improvements to investor protection.

Process and Priorities

Let me begin by discussing our overall approach to implementing the new rules, studies, reports, offices and other actions mandated or contemplated by the Dodd-Frank Act.

Internal Processes

To hit the ground running, we established new internal processes and formed cross-disciplinary working groups for each of the major rulemaking initiatives and studies, and designated team leaders for each effort. Our rule-writing divisions and offices are meeting weekly to review the status of rulemakings and studies and to plan for the upcoming weeks. My office and the Office of the General Counsel oversee and coordinate much of this planning effort, and all Commissioners are provided with both written weekly updates and monthly oral briefings on status.

Public Consultation

We also have enhanced our public consultative process by expanding the opportunity for public comment beyond what is required by law. To maximize the opportunity for public comment and to provide greater transparency, less than a week after the President signed the Act, we made available to the public a series of e-mail boxes to which interested parties can send preliminary comments before the various rules are proposed and the official comment periods begin.[1] These e-mail

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[1] SEC Chairman Schapiro Announces Open Process for Regulatory Reform Rulemaking, Press Release 2010-135 (July 27, 2010), *http://www.sec.gov/news/press/2010/2010-135.htm.*

boxes are on the SEC Web site, organized by topic. Since July 27th, the public has been providing preliminary comments on 31 topics, including over-the-counter (OTC) derivatives, private funds, corporate disclosure, fiduciary duty, credit rating agencies, and other areas in which the SEC will be conducting rulemaking and studies over the next 12 to 18 months. We also specifically solicited comment on the definitions contained in Title VII of the Act,[2] on the interim final rule on temporary municipal advisor registration and on the study we have undertaken regarding the effectiveness of the existing legal and regulatory standards of care for broker-dealers and investment advisers when providing personalized investment advice about securities to retail investors.[3]

Through this process, we are receiving a wide variety of views. Indeed, our request for comment on the investment adviser/broker-dealer study alone has generated over 3,000 individualized comments.

Transparency

We recognize that the process of establishing regulations works best when all stakeholders are engaged and contribute their combined talents and experience, and our staff and Commissioners are trying, within reasonable time constraints, to meet with anyone who seeks to meet with us on these issues. We have increased transparency for meetings with interested members of the public.[4] We are asking those who request meetings to provide an agenda, and we are posting on our Web site the agendas and names of individuals participating in these meetings, along with copies of any written materials that are distributed at those meetings. In addition, staff will reach out as necessary to solicit views from affected stakeholders who do not appear to be fully represented by the developing public record on a particular issue. Thus far, our approach has resulted in meetings with a broad cross-section of interested parties. To further this public outreach effort, the Commission is holding public roundtables and hearings on selected topics. For example, to further inform our OTC derivatives rulemaking efforts under Title VII of the Act, our staff has held three joint roundtables with the CFTC staff regarding key swap and security-based swap matters.[5]

Coordination With Other Regulators

We are meeting regularly, both formally and informally, with other financial regulators. Staff working groups consult and coordinate with the staffs of the CFTC, Federal Reserve Board and other prudential financial regulators, as well as the Department of the Treasury, the Department of State, the Commerce Department, and the Comptroller General. Because the world today really is a global marketplace and what we do to implement many provisions of the Act will affect foreign entities that do business within our shores, our Office of International Affairs is consulting bilaterally and through multilateral organizations with counterparts abroad, and is meeting biweekly with our rule-writing staff to ensure appropriate coordination with our foreign counterparts. In short, we remain committed to working closely, cooperatively and regularly with our fellow regulators to strengthen our regulatory structure.

Priorities

To help us timely complete all rulemakings, as well as studies, reports, and other actions, required under the Act, we have prioritized our activity into four principal categories.

The first category includes all matters that require very rapid action. A number of provisions of the Dodd-Frank Act became effective immediately upon, or shortly after, the Act's date of enactment, and required prompt interpretive guidance, changes to administrative practice, or removal of inconsistent regulations, including:

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[2] Advance Joint Notice of Proposed Rulemaking—Definitions Contained in Title VII of Dodd-Frank Wall Street Reform and Consumer Protection Act, Rel. No. 34-62717 (Aug. 13, 2010), *http://www.sec.gov/rules/concept/2010/34-62717.pdf.*

[3] Study Regarding Obligations of Brokers, Dealers, and Investment Advisers, Rel. No. 34-62577 (July 27, 2010), *http://www.sec.gov/rules/other/2010/34-62577.pdf.*

[4] *See,* SEC Press Release 2010-135 (July 27, 2010), *http://www.sec.gov/news/press/2010/2010-135.htm.*

[5] Joint Public Roundtable on Swap Execution Facilities and Security-Based Swap Execution Facilities, Rel. No. 34-62864 (Sept. 8, 2010), *http://www.sec.gov/rules/other/2010/34-62864.pdf;* Joint Public Roundtable to Discuss Data for Swaps and Security-Based Swaps, Swap Data Repositories, Security-Based Swap Data Repositories, and Real-Time Public Reporting, Rel. No. 34-62863 (Sept. 8, 2010), *http://www.sec.gov/rules/other/2010/34-62863.pdf;* and Joint Public Roundtable on Governance and Conflicts of Interest in the Clearing and Listing of Swaps and Security-Based Swaps, Rel. No. 34-62725 (Aug. 16, 2010) *http://www.sec.gov/rules/other/2010/34-62725.pdf.*

- Adopting an interim final rule that establishes a procedure for municipal advisors to satisfy temporarily the requirement that they register with the Commission by October 1, 2010, as required by Section 975 of the Act; [6]
- Amending our rules that were in conflict with Dodd-Frank's provision that the auditor attestation requirement of Section 404(b) of the Sarbanes-Oxley Act does not apply with respect to nonaccelerated filers; [7]
- Issuing an interpretation clarifying the requirement for audits of broker-dealers pending implementation of the authority over such audits granted to the Public Company Accounting Oversight Board by the Dodd-Frank Act; [8] and
- Providing interim guidance on calculating the net worth standard for an accredited investor, to reflect the elimination of a person's principal residence in the calculation, as required by Section 413 of the Act; [9]

The second category of priorities includes matters that require action within 1 year from the date of enactment of the Act. This category includes the bulk of the rulemakings, reports, and studies about which the Committee inquired. As discussed in more detail below, we have made significant progress on many of the action items in this category. We have performed analyses, reviewed preliminary comments received in response to our public solicitation for comment, and are making substantial progress in preparing draft rule proposals for public comment.

The third category of priorities includes items that require action more than 1 year from the date of enactment, and the fourth category includes items for which there is no prescribed statutory deadline.

To help the public track our progress as we take actions to implement the Act, we have created a new section on our Web site that provides greater detail about our schedule for implementation, along with links to completed actions. [10] We think this will provide a useful reference tool to both the investing public and the financial industry as we proceed with implementation.

I will now turn to the specific items raised by the Committee.

Reform Initiatives

OTC Derivatives

Title VII of the Dodd-Frank Act provides a comprehensive framework for the regulation of the OTC derivatives market. Working with other regulators, and the CFTC in particular, we are writing rules that address, among other issues, capital and margin requirements; mandatory clearing; the operation of execution facilities and data repositories; business conduct standards for swap dealers; and public transparency for transactional information. Under the Act, primary jurisdiction over swaps is divided between the SEC and the CFTC. The SEC has primary jurisdiction over security-based swaps, and the CFTC has primary jurisdiction over other swaps, such as energy and agricultural swaps. To prevent gaps, regulatory arbitrage and confusion, the SEC and CFTC will engage in joint rulemaking regarding issues including the definition of terms like "swap," "security-based swap" and "security-based swap agreement."

We have done much already in preparation for making rule proposals in this area. Jointly with the CFTC, we have held three staff roundtables on the topics of conflicts of interest, data repositories, reporting and dissemination, and execution facilities. We also solicited comment in our Advance Joint Notice of Proposed Rulemaking regarding key definitional terms. Based on input from these roundtables and the comment letters on key definitions, as well as other comment letters received, we anticipate soliciting public comment on a number of proposed rulemakings in this area in the coming months.

As part of our collaborative outreach, our rulemaking teams are working closely with the corresponding teams at the CFTC to coordinate our efforts. While the Act requires the SEC and CFTC to adopt joint rules further defining key definitional

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[6] Temporary Registration of Municipal Advisors, Rel. No. 34-62824 (Sept. 1, 2010), *http://www.sec.gov/rules/interim/2010/34-62824.pdf.*

[7] Internal Control Over Financial Reporting in Exchange Act Periodic Reports of Non-Accelerated Filers, Rel. No. 33-9142 (Sept. 15, 2010), *http://www.sec.gov/rules/final/2010/33-9142.pdf.*

[8] Commission Guidance Regarding Auditing, Attestation, and Related Professional Practice Standards Related to Brokers and Dealers, Rel. No. 34-62991 (Sept. 24, 2010), *http://www.sec.gov/rules/interp/2010/34-62991.pdf.*

[9] Interpretation of Section 413(a): Corporation Finance Compliance & Disclosure Interpretation Section 179.01 (July 23, 2010); *http://www.sec.gov/divisions/corpfin/guidance/securitiesactrules-interps.htm.*

[10] *See, http://www.sec.gov/spotlight/dodd-frank.shtml.*

terms relating to jurisdiction and certain categories of market participants, we believe that collaboration with the CFTC, the Federal Reserve Board and other prudential regulators also is essential for the rulemakings where joint action is not required by the Act. Our overarching goal is to build on the foundation established by Congress in Title VII of the Act to create a robust and workable framework for regulating the derivatives market.

We expect to propose and adopt Title VII rules in a series of actions, beginning in October and proceeding over the next few months. We fully expect to meet the deadlines described in the Act.

Clearance and Settlement

Our staff also is working closely with the Federal Reserve Board and the CFTC to develop, as required by Title VIII of the Act, a new framework to supervise systemically important financial market utilities, including clearing agencies registered with the Commission. For example, Commission staff has been actively coordinating with the other agencies to develop rules regarding submission of notices by systemically important financial market utilities with respect to rules, procedures, or operations that may materially affect the risks presented.

Commission staff also has discussed with the other agencies the new authority granted to SEC and CFTC to develop standards for these financial market utilities. Moreover, the SEC and CFTC staffs have begun working with staff from the Federal Reserve Board to develop a framework for consulting and working together on exams of systemically important financial market utilities consistent with Title VIII. This added layer of protection, or "second set of eyes," called for by the Act provides assurance that the U.S. financial system receives well coordinated oversight from all relevant supervisory authorities.

We expect to propose our first set of Title VIII rules in December.

Private Fund Adviser Registration and Reporting

By July 2011, all large hedge fund advisers and private equity fund advisers will be required to register with the Commission.[11] Under the Act, venture capital advisers and private fund advisers with less than $150 million in assets under management in the United States will be exempt from the new registration requirements, although the Act does provide for record keeping and reporting by these advisers.[12] In addition, family offices will not be subject to registration.[13] In order to implement the exemptions, the Commission must propose and adopt rules. The staff is planning to propose rules on all of these matters between October and December of this year.

Our staff also has begun work regarding the collection of systemic risk information from private fund advisers as required by Title IV of the Act. In this regard, our staff has had informal discussions with staffs from the CFTC and other regulators regarding what categories of potentially reportable information would be consistent with the Act. In addition, we are working with the International Organization of Securities Commissions and various foreign regulators, most particularly the United Kingdom Financial Services Authority, regarding hedge fund systemic risk reporting. The goal of these consultations is to gain a better understanding about what categories of data would be useful and necessary for assessing the potential systemic risks posed by hedge funds, and how comparable this data would be with data from other countries.

Credit Rating Agency Initiatives

The Dodd-Frank Act requires the SEC to establish a new Office of Credit Ratings, conduct annual exams of each nationally recognized statistical rating organization (NRSRO), report on the collective results of those exams, and conduct studies relating to credit rating agencies regarding, among other things, NRSRO independence,[14] conflicts of interest[15] and standardizing ratings terminology.[16] We are in the process of establishing this office, and are actively recruiting for its new director. We also are identifying the staff from existing divisions who should be transferred to this new office, and have posted 25 new credit rating agency examination positions.

The Commission is required to undertake approximately a dozen NRSRO-related rulemakings. The Act requires the SEC to address internal controls and procedures,

[11] *See,* Title IV of the Dodd-Frank Act.
[12] *See,* Section 408 of the Dodd-Frank Act.
[13] *See,* Section 409 of the Dodd-Frank Act.
[14] *See,* Section 939C of the Dodd-Frank Act.
[15] *See,* Section 939F of the Dodd-Frank Act.
[16] *See,* Section 939 of the Dodd-Frank Act.

conflicts of interest, credit rating methodologies, rating methodology transparency and performance, analyst training, credit rating symbology, and disclosures accompanying asset-backed securities ratings. [17] To meet the July 2011 deadline for these rules, the staff plans to recommend rule proposals to the Commission by early next year. In addition, the SEC, and all other Federal agencies, must review and report to Congress on existing references to credit ratings in their rules and undertake rulemaking to eliminate these references. [18] SEC staff has begun this review in preparation for drafting the report and proposed rulemaking.

In addition, this week the Commission issued an amendment to Regulation FD that implements Section 939B of the Act, which requires that the SEC amend Regulation FD to remove the specific exemption from the rule for disclosures made to NRSROs and credit rating agencies for the purpose of determining or monitoring credit ratings. The amendment will be effective upon publication in the Federal Register.

Many of the credit rating agency provisions of the Act became effective immediately upon enactment. Therefore, shortly after the Act was signed by the President, we sent letters to each NRSRO asking how it planned to comply with these new requirements. In addition, SEC staff asked each NRSRO to describe the impact of the repeal of the expert liability exemption formerly available to NRSROs for ratings used as part of a securities registration statement. We are evaluating the responses to these requests, will conduct appropriate follow-up, and will examine these issues as part of our annual examinations of the NRSROs.

Corporate Governance and Executive Compensation Reforms

Section 951 of the Act requires a shareholder advisory "say-on-pay" vote on executive compensation at least once every 3 years and a separate advisory vote at least once every 6 years on whether the say-on-pay resolution will be presented for shareholder approval every 1, 2, or 3 years. In addition, in any proxy statement asking shareholders to approve a merger or similar transaction, the Act requires disclosure about, and a shareholder advisory vote to approve, compensation related to the transaction, unless the arrangements were already subject to the periodic say-on-pay vote. The Act also requires every institutional investment manager subject to Exchange Act Section 13(f) to report at least annually how it voted on any of the required votes. The staff is preparing rule proposals to address each of these new requirements. The Commission's goal is to adopt final rules in time to inform the 2011 proxy season. We anticipate that the Commission will propose rules designed to implement these provisions in the next few weeks.

The Act also requires the rules of each national securities exchange to be amended to prohibit brokers from voting uninstructed shares on the election of directors (other than uncontested elections of directors of registered investment companies), executive compensation, or any other significant matter, as determined by the Commission by rule. [19] The Commission previously approved changes to New York Stock Exchange (NYSE) Rule 452 to prohibit broker voting of uninstructed shares in director elections, as well as similar changes for several other national securities exchanges. [20] On September 9, 2010 the Commission approved further changes to the NYSE rules to prohibit broker voting on all executive compensation matters. [21] On September 24, 2010, the Commission approved corresponding changes to the Nasdaq rules, [22] and we anticipate that corresponding changes to the rules of other national securities exchanges will be considered by the Commission in the near future.

By April 2011, the Commission is required to adopt—jointly with other financial regulators—incentive-based compensation regulations or guidelines that apply to covered financial institutions, including broker-dealers and investment advisers,

[17] *See,* Subtitle C, Title IX of the Dodd-Frank Act.

[18] *See,* Section 939A of the Dodd-Frank Act.

[19] *See,* Section 957 of the Dodd-Frank Act.

[20] *See,* New York Stock Exchange Rule 452.11(19) and Listed Company Manual Section 402.08(B)(19); Securities Exchange Act Release No. 34-60215 (July 1, 2009), *http://www.sec.gov/rules/sro/nyse/2009/34-60215.pdf;* Securities Exchange Act Release No. 34-61732 (March 18, 2010), *http://www.sec.gov/rules/sro/cboe/2010/34-61732.pdf;* Securities Exchange Act Release No. 34-61733 (March 18, 2010), *http://www.sec.gov/rules/sro/chx/2010/34-61733.pdf;* Securities Exchange Act Release No. 34-61292 (January 5, 2010), *http://www.sec.gov/rules/sro/nyseamex/2010/34-61292.pdf;* and Securities Exchange Act Release No. 34-62775 (August 26, 2010), *http://www.sec.gov/rules/sro/phlx/2010/34-62775.pdf.*

[21] *See,* Securities Exchange Act Release No. 34-62874 (September 9, 2010), *http://www.sec.gov/rules/sro/nyse/2010/34-62874.pdf.*

[22] *See,* Securities Exchange Act Release No. 34-62992 (September 24, 2010), *http://www.sec.gov/rules/sro/nasdaq/2010/34-62992.pdf.*

with assets of $1 billion or more.[23] The regulations or guidelines will prohibit incentive-based compensation practices that encourage firms to take inappropriate risks and will require firms to disclose to their respective appropriate financial regulator their incentive-based compensation structures. The Commission staff has met with other regulators in preparation for drafting either proposed regulations or guidelines. To meet the April 2011 adoption deadline, we anticipate that the staff will submit proposed rules to the Commission for consideration as soon as December.

The Dodd-Frank Act also requires the Commission to write rules mandating new listing standards relating to the independence of compensation committees and establishing new disclosure requirements and conflict of interest standards that boards must observe when retaining compensation consultants.[24] Under the Act, these rules must be adopted by the Commission within 360 days from the date of enactment of the Act, and we anticipate that the staff will submit proposed rules for the Commission's consideration by year end.

In addition, the Act requires the Commission to amend our executive compensation disclosure rules to require public companies to disclose information showing the relationship between executive compensation actually paid and the financial performance of the company,[25] as well as information about the total annual compensation of the chief executive officer, the median annual total compensation of all other employees, and the ratio of these two amounts.[26] Rule amendments also are mandated that will require public companies to disclose in their annual meeting proxy materials whether any employee or director is permitted to purchase financial instruments designed to hedge any decrease in market value of equity securities granted as part of their compensation.[27] Finally, the Act requires the Commission to adopt rules mandating changes to listing standards requiring companies to implement and disclose "clawback" policies for recovering from current and former executive officers incentive-based compensation paid during any 3-year period preceding a material accounting restatement.[28] We currently anticipate that the staff will submit proposed rules for the Commission's consideration by the middle of next year.

Also related to corporate governance, the Act confirmed the Commission's authority to adopt rules that facilitate shareholders' ability to nominate director candidates.[29] The Commission had proposed such rules in May 2009, before the Act's enactment, and we approved final rules on August 25, 2010.[30] Further, Section 972 of the Act requires the Commission to adopt rules requiring an issuer to disclose in its annual proxy statement the reasons why it has chosen the same or different people to serve as chairman of the board and chief executive officer. The Commission adopted Item 407(h) of Regulation S–K in December 2009, which requires this information to be disclosed.

Asset-Backed Securities

Section 943 of the Dodd-Frank Act requires the Commission to adopt rules on the use of representations and warranties in the market for asset-backed securities (ABS). Also, Section 945 of the Act requires the Commission to issue rules requiring an asset-backed issuer in a Securities Act registered transaction to perform a review of the assets underlying the ABS, and disclose the nature of such review. Under the Act, both sets of rules must be adopted by the Commission by January 14, 2011, and we expect to propose rules in these areas within the next few weeks. We also are working on rules prohibiting material conflicts of interest in certain securitizations[31] and rules requiring the disclosure of information regarding the assets backing each tranche or class of security.[32] We expect that these rules also will be proposed by the end of the calendar year, and considered for adoption in early 2011.

Our efforts to advance the securitization reform envisioned by the Act are not limited to writing new rules. The Act also addresses risk retention (*i.e.,* the require-

[23] Section 956 requires the SEC to adopt these regulations or guidelines jointly with the Federal Reserve, Office of the Comptroller of the Currency, the FDIC, the Office of Thrift Supervision, the National Credit Union Administration Board, and the Federal Housing Financing Agency.

[24] *See,* Section 952 of the Dodd-Frank Act.

[25] *See,* Section 953(a) of the Dodd-Frank Act.

[26] *See,* Section 953(b) of the Dodd-Frank Act.

[27] *See,* Section 955 of the Dodd-Frank Act.

[28] *See,* Section 954 of the Dodd-Frank Act.

[29] *See,* Section 971 of the Dodd-Frank Act.

[30] *See,* Release No. 33-9136, Facilitating Shareholder Director Nominations (Aug. 25, 2010), *http://www.sec.gov/rules/final/2010/33-9136.pdf.*

[31] *See,* Section 27B of the Securities Act, as added by Section 621 of the Dodd-Frank Act.

[32] *See,* Section 942(b) of the Dodd-Frank Act.

ment that a securitizer retain an economic interest in a material portion of the credit risk for any asset that it transfers, sells, or conveys to a third party) in connection with securitization. The Act mandates two studies on risk retention: one to be conducted by the Federal Reserve Board in coordination and consultation with the Commission, among other agencies, which is due October 19, 2010. The other study is to be conducted by the Chairman of the Financial Stability Oversight Council, and it is due January 14, 2011.[33] Accordingly, we are providing advice and assistance to the Federal Reserve Board in connection with the first study. We are working with other regulators to jointly create the risk retention rules, including the appropriate amount, form and duration of required risk retention, and the definition of qualified residential mortgages. For example, to encourage discussion of these issues, the staff in the Division of Corporation Finance communicated with Treasury and other regulators shortly after the Act's enactment, raised relevant questions and provided preliminary staff thoughts on the risk retention provision. In light of the Act's April 15, 2011, deadline for prescribing rules in this area, we currently are planning for Commission consideration of proposed risk retention rules by year end.

Municipal Securities

Section 979 of the Dodd-Frank Act requires the SEC to establish an Office of Municipal Securities to administer the rules pertaining to broker-dealers, advisors, investors, and issuers of municipal securities. The new office will coordinate with the Municipal Securities Rulemaking Board on rulemaking and enforcement actions. We expect to create the new office by the end of October, transfer existing staff performing these duties to that office, and begin recruiting for the new director, who will report directly to the Chairman.

Section 975 of the Act also requires the registration of municipal advisors with the Commission. This new registration requirement becomes effective on October 1, 2010. On that date, it becomes unlawful for any municipal advisor to provide advice to a municipality unless registered with the Commission. As noted above, on September 1, the Commission adopted an interim final rule establishing a temporary means for municipal advisors to satisfy the registration requirement. The SEC staff is working on proposed final registration rules for the Commission's consideration.

Studies and Reports

The Dodd-Frank Act requires the Commission to conduct a significant number of studies and issue numerous reports, some on a periodic basis. As with our rulemaking efforts, we have prioritized these studies and reports and assigned teams to address each of them. While I have already referenced some of the studies we are conducting in conjunction with rule writing, I want to share with you our progress on three studies that relate to topics about which the Committee specifically requested information.

Investment Adviser-Broker Dealer Standard of Care Study

Section 913 of the Dodd-Frank Act mandates that we study the effectiveness of existing legal or regulatory standards of care for broker-dealers and investment advisers for providing personalized investment advice and recommendations about securities to retail customers. Under Section 913, we must produce a report on the study to the Senate Committee on Banking, Housing, and Urban Affairs, and the House of Representatives' Committee on Financial Services. The report regarding the study is due to the Committees in January 2011.

We are moving rapidly to meet the report's January deadline. Six days after the date of enactment of the Dodd-Frank Act, we published a request for public input, comments, and data on issues related to the effectiveness of existing standards of care for brokers-dealers and investment advisers, and whether there are gaps, shortcomings, or overlaps in the current legal or regulatory standards. In response, we received more than 3,000 individualized letters, including letters from investors, financial professionals, industry groups, academia, and other regulators. Staff is reviewing the comments, and the views of these commenters will be reflected in the report on our study.

We established a cross-divisional working group to implement the study. To help further inform our study and consistent with our public outreach on these issues, from August to October, the working group is meeting with as many interested parties representing a variety of perspectives as possible. We also requested assistance

[33] As a member of the Financial Stability Oversight Council, the Chairman of the SEC is actively participating in this study.

from State regulators and FINRA with the aspects of the study involving their efforts, such as examinations and enforcement.

At the completion of the study, the Act gives the SEC the authority to write rules, including rules that could create a uniform standard of conduct for professionals who provide personalized investment advice to retail customers. Under the Act, any new standard can be "no less stringent" than the standard applicable to investment advisers under sections 206(1) and (2) of the Investment Advisers Act of 1940. The Commission's ultimate rulemaking in this area will, of course, be informed by what we learn from our study and from the comments we receive.

Internal Operations

A top challenge is continuing to strengthen the SEC's organization itself—its structure, daily operations, personnel, technological infrastructure, and resources—to meet its statutory responsibilities and adapt to the ever changing realities of our dynamic markets. To assist the SEC in assessing its operational efficiency, Section 967 of the Dodd-Frank Act directs the agency to engage the services of an independent consultant to study a number of specific areas of SEC internal operations and the SEC's relationship with self-regulatory organizations (SROs).

To quickly implement this provision, we sought and received formal reprogramming approval from our House and Senate Appropriations Subcommittees to fund the study. On August 3, 2010, the SEC's Office of Acquisitions issued a formal solicitation (a Request for Quotation, or RFQ) describing the work to be performed and asking contractors to submit bids that describe their qualifications and discuss their plans to carry out the work. Bids were required to be submitted by August 27. Once a contract is awarded, the contractor will be given 150 days to conduct its study, and to prepare recommendations to the SEC and to Congress. We have already formed the working team of staff that will be made available to assist the consultant as requested.

Financial Literacy

Section 917 requires the Commission to conduct a broad study regarding the financial literacy of investors. The study will focus on, among other things, the current level of financial literacy of individual investors and how to increase the transparency of expenses and conflicts of interest in investment products such as mutual funds. Additionally, we will be studying the most effective private and public efforts to educate investors. I have asked the Commission's Office of Investor Education and Advocacy (OIEA), which is focused in this area, to take the lead on the study. The staff is currently working on a project plan, including developing an organizational framework, an analysis of required resources, and a calendar of expected completion dates of various project milestones. I expect OIEA will complete the study within the next 18 months, and we will be prepared to submit the required report to Congress within the two-year period reflected in the statute.

Agency Growth and Infrastructure

New Offices

The Act requires the SEC to establish five new offices, four of which will report directly to the Chairman. We are consulting with our appropriations committees regarding the reprogramming of funds needed to establish these new offices. I have previously mentioned the new Office of Credit Ratings and Office of Municipal Securities in connection with rulemaking in these areas. The other three offices are:

Whistleblower Office. Section 924 requires us to establish a new Whistleblower Office. We already have posted a job announcement for the head of the new office, and we expect the office to include a senior special counsel and at least four additional employees. The office will be located within the Division of Enforcement and will work closely with that division's Office of Market Intelligence, which is dedicated to the handling of tips, complaints, and referrals. The primary functions of the new office will include: (1) performing intake, tracking, and record keeping of whistleblower tips; (2) overseeing the review process for eligible whistleblower claims and presenting recommendations concerning whistleblower awards; and (3) communicating with the general public, the Commission, and reporting to Congress on the whistleblower program. The first report to Congress on the whistleblower program will be provided on October 30, 2010.

Staff in the Division of Enforcement, with assistance from other divisions and offices, is actively working to draft implementing regulations for the whistleblower program. Pending the issuance of these regulations (due no later than 270 days after the date of enactment of the Act), the staff has been and will continue to be able to receive whistleblower complaints. Also, information for potential whistleblowers has been posted on our Web site.[34] Already, since the passage of the Act, we have seen a slight uptick in the number of tips and complaints received, and, more importantly, an uptick in the quality of complaints.

Office of the Investor Advocate. Section 915 requires the SEC to establish an Office of the Investor Advocate, headed by an Investor Advocate who reports directly to the Chairman. The office will assist retail investors in resolving significant problems they may have with the Commission or with SROs. The Investor Advocate also will identify areas in which investors would benefit from changes in Commission regulations or SRO rules; identify problems that investors have with financial service providers and investment products; and analyze the potential impact on investors of proposed Commission regulations and SRO rules. The Investor Advocate must report to Congress annually on its activities, including information on the steps the Investor Advocate has taken to improve investor services and responsiveness of the Commission and SROs to investor concerns; a summary of the most serious problems encountered by investors; and recommendations for administrative and legislative actions to resolve problems encountered by investors. The Investor Advocate also must hire an Ombudsman, whose activities will be included in the Advocate's reports to Congress. The Commission must adopt regulations establishing procedures for responding to all recommendations submitted to the Commission by the Investor Advocate. We have developed a position description, and are actively recruiting.

Office of Minority and Women Inclusion. Section 342 requires specified financial agencies, including the SEC, to establish an Office of Minority and Women Inclusion that is responsible for all matters of the agency relating to diversity in management, employment, and business activities, other than enforcement of civil rights laws. The director of this Office will report to the Chairman. The director will develop and implement standards for: equal employment opportunity and the racial, ethnic, and gender diversity of the workforce and senior management of the SEC; increased participation of minority-owned and women-owned businesses in the programs and contracts of the agency, including standards for coordinating technical assistance to such businesses; and assessing the diversity policies and practices of entities regulated by the SEC.

Additionally, the director will advise the Chairman on the impact of the policies and regulations of the SEC on minority-owned and women-owned businesses. We have solicited comments from our internal Diversity Council on the structure of this new office, as well as several external groups. This is an area in which our request for suggestions from the public has been helpful. We are drafting the director position description, and plan to begin recruiting for this position very soon.

Hiring

As noted earlier, the Dodd-Frank Act not only requires the Commission to complete a significant number of rulemakings, studies, and reports, it also expands the role of the SEC in the regulation of OTC derivatives, private fund advisers, credit rating agencies, and other areas of the financial industry. To enable us to carry out these new responsibilities, we will need additional resources, and in particular, additional staff.

We have been working to develop estimates of the resources that will be needed to achieve the full implementation of Congress' regulatory reform mandate. While the dollar cost of full implementation will depend greatly on the effective date of new rules, the timing of hiring, and other factors, we currently estimate that the SEC will need to add approximately 800 new positions over time in order to carry out the new or expanded responsibilities given to the agency by the legislation.

If Congress were to appropriate the funds to support this increase in the agency's workforce, then the SEC would need to be ready to act swiftly to recruit and hire hundreds of additional personnel. To accomplish this, the SEC is enhancing our human resources staff and streamlining our hiring process. Improvements include simplifying the application process and maintaining a searchable database of applicants, so that it is possible to interview for a vacancy as soon as it appears rather than having to go through the lengthy posting process each time. Being able to better tailor, target and speed recruiting will enhance the quality of the applicant pool and help the agency more efficiently acquire the necessary talent to perform effectively in an increasingly complex financial environment. The expanded streamlined hiring authority included in the Dodd-Frank Act will help these efforts.

[34] *See, http://www.sec.gov/complaint.shtml.*

Technology

The SEC's Office of Information Technology is currently collaborating with the principal rule-writing divisions and offices to gather and develop the technology requirements that will be necessary to implement the legislation and the associated rulemaking. We currently anticipate technology investment will be required to implement a variety of changes to our responsibilities included in the Dodd-Frank Act, such as those relating to SRO rulemaking, regulation of security-based swap intermediaries, disclosure filing requirements, regulation of security-based swap execution facilities and data repositories, advisor registration, equipment to enable improved audits of market participants, end user equipment for additional staff expected to be hired, and changes to our filing and registration management and reporting systems.

Our "EDGAR" team, which operates our disclosure system for public company filings, will assist in the deployment of changes to the asset-backed securities disclosure system in December 2010, and changes to existing forms, items, and exhibits to improve disclosure. While many of the technology requirements remain under development at this stage, the Office of Information Technology, under the leadership of our new Chief Operating Officer, will remain closely engaged with our operating divisions and offices and work to provide responsive solutions to enable implementation of the legislation.

Conclusion

The Dodd-Frank Act provides the SEC with important tools to better meet the challenges of today's financial marketplace. While implementation of the Act clearly will require a major effort, this effort is already well underway at the SEC. While we undoubtedly will encounter some bumps along the way, we are on track to meet the goals, mandates and deadlines specified in the Act and to do so in a transparent and inclusive manner. As we proceed with implementation, we look forward to continuing to work closely with Congress, our fellow regulators and members of the financial and investing public. Thank you for inviting me here today to share with you our progress on and plans for implementation. I look forward to answering your questions.

PREPARED STATEMENT OF GARY GENSLER

CHAIRMAN, COMMODITY FUTURES TRADING COMMISSION

SEPTEMBER 30, 2010

Good morning Chairman Dodd, Ranking Member Shelby, and Members of the Committee. I thank you for inviting me to today's hearing on implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act. I am honored to appear at today's hearing alongside fellow regulators with whom we are working so closely to implement the Dodd-Frank Act. I also look forward to joining my fellow panelists as members of the new Financial Stability Oversight Council (FSOC). I am pleased to testify on behalf of the Commodity Futures Trading Commission (CFTC). I also thank my fellow Commissioners for their hard work and commitment on implementing the legislation.

Before I move into the testimony, I want to thank Chairman Dodd for his leadership on the Banking Committee and in the Senate. On a personal note, I would like to thank Chairman Dodd for his support over the last 13 years. I first worked with Chairman Dodd in the late 1990s during my time in the Treasury Department. I again worked closely with Chairman Dodd on the Sarbanes-Oxley Act. He actually introduced the first bill in committee on that issue before Chairman Sarbanes did so. I am honored and pleased to have had this most recent chance to once again work with Chairman Dodd on what became the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Implementing the Dodd-Frank Act

The Dodd-Frank Act brings three critical reforms to the previously unregulated swaps marketplace. These reforms lower interconnectedness and risk in the financial system while promoting transparency. First, the Act requires swap dealers to come under comprehensive regulation. Second, the Act moves the bulk of the swaps marketplace onto transparent trading facilities—either exchanges or swap execution facilities (SEFs). Third, the Act requires clearing of standardized swaps by regulated clearinghouses to lower risk in the marketplace.

The Dodd-Frank Act is very detailed, addressing all of the key policy issues regarding regulation of the swaps marketplace. To implement these regulations, the Act requires the CFTC and Securities and Exchange Commission (SEC), working with our fellow regulators, to write rules generally within 360 days. That means that we have 289 days left. At the CFTC, we have organized our effort around 30 teams who have been actively at work. We had our first meeting with the 30 team leads the day before the President signed the law.

Two principles are guiding us throughout the rule-writing process. First is the statute itself. We intend to comply fully with the statute's provisions and Congressional intent to lower risk and bring transparency to these markets.

Second, we are consulting heavily with both other regulators and the broader public. We are working very closely with the SEC, the Federal Reserve, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency and other prudential regulators. Within 24 hours of the President signing the Dodd-Frank Act, more than 20 of our rule-writing team leads were meeting at the SEC with their counterparts. Our staff was having similar meetings the following week with staff from the Federal Reserve.

Specifically, our rule-writing teams are working with the Federal Reserve in several critical areas: swap dealer regulation, clearinghouse regulation and swap data repositories, though we are consulting with them on a number of other areas as well. With the SEC, we are working on the entire range of rule writing, including those previously mentioned as well as trading requirements, real time reporting and key definitions. To the best of our ability, we will be aligning our public meeting schedule with the SEC. Tomorrow, the CFTC will hold a public meeting to consider rules relating to (1) an interim final rule relating to the time frame for reporting preenactment unexpired swaps to a swap data repository or to the Commission, (2) proposed rules regarding financial resources of clearing organizations and (3) proposed rules regarding governance of clearinghouses, designated contract markets (DCMs) and SEFs.

Coordination with the SEC, the Federal Reserve and other regulators has been strong both at the staff level and at the Chairman's level. I have personally met with leaders at each of my fellow regulators testifying here this morning, starting the week the President signed the bill. In each circumstance, we have continued the active dialogue, including both exchanging written materials as well as having additional meetings.

In addition to working with our American counterparts, we have reached out to and are actively consulting with international regulators to harmonize our approach to swaps oversight. I returned yesterday from Brussels where I met with senior European regulators. In particular, our early discussions have focused on clearing requirements, clearinghouses more generally and data repositories. Two weeks ago, the European Commission released their detailed proposal to bring regulation to the swaps marketplace. Based upon their release and the Dodd-Frank Act, I am confident that we will bring strong and consistent regulation to the American and European swaps markets. Each of our rule-writing teams will be referring to these new proposals in Europe as we seek consistency in our regulatory approaches.

We also are soliciting broad public input into the rules. This began the day the President signed the Dodd-Frank Act when we listed the 30 rule-writing teams and set up mailboxes for the public to comment directly. We want to engage the public as broadly as possible even before publishing proposed rules.

In some circumstances, we are organizing roundtables with the SEC to hear specifically on particular subjects. We have had three days of meetings to date, which have been very beneficial. So far we have heard from investors, market participants, end-users, academics, exchanges and clearinghouses on key topics including governance and conflicts of interest, real time reporting, swap data record keeping, and SEFs. Based on how helpful these have been, we intend to have additional roundtables in the next month or two.

Additionally, many individuals have asked for meetings with either our staff or Commissioners to discuss swaps regulation. In the first seven weeks after the bill was signed, we had more than 141 such meetings. We are now posting on our Web site a list of all of the meetings CFTC staff or I have with outside organizations, as well as the participants, issues discussed and all materials given to us.

We plan to actively publish proposed rules in the fall, using weekly public Commission meetings for this purpose. Our first such meeting will be tomorrow at 9:30 am. Public meetings will allow us to propose rules in the open. With each proposed rulemaking, we will solicit public comments for a period not less than 30 days. Since a number of the rules we are publishing have Paperwork Reduction Act requirements and thus must stay open for public comment for at least 60 days, we have to publish our proposed rulemakings quickly. This is as it generally takes us four to 6 months to review all of the public comments on proposed rules and finalize those rules. Though as with any such plan, some things may be delayed, our current goal is to publish the vast majority of our proposed rules by the end of December.

We already have published one final rulemaking regarding retail foreign exchange transactions. Further, with the SEC, we have published an advanced notice of proposed rulemaking seeking comments on the definitions of key terms in the Dodd-Frank Act.

Regulating the Dealers

Now I will address just a few of the key areas where we will write rules regulating the swaps marketplace. The first is regulating the dealers. Six of our rule teams are focused specifically on this area. One team is working jointly with the SEC on defining key terms, such as "swap dealer" and "major swap participant." Another team is working on registration requirements for dealers. We also have teams working on business conduct standards, capital and margin requirements and rules for segregating customer funds.

It is estimated that as many as 200 entities may register with the CFTC as swap dealers. This includes:

- Approximately 80 global and regional banks currently known to offer swaps in the U.S. Of the International Swaps and Derivatives Association's (ISDA) 830 members, 209 are "Primary Members." Under ISDA's bylaws, a firm is only eligible for primary member status if it deals in derivatives for purposes other than "risk hedging or asset or liability management." Though many of the dealers in emerging markets may not seek to register in the U.S., it is likely that most, if not all, of ISDA's global and international members would;
- Approximately 60 affiliates of existing swap dealers, based upon the Dodd-Frank Act's Section 716 requirement that banks push out their swaps desks to affiliates;
- Approximately 40 nonbank swap dealers currently offering commodity and other swaps; and
- Approximately 20 potential new market makers that wish to become swap dealers.

I would emphasize, however, that at this point these numbers are only preliminary estimates. The final numbers will, of course, depend upon the decisions of market participants as well as the outcome of the rulemaking process.

In addition to regulating dealers, we also are tasked with regulating major swap participants. The major swap participant category is comprised of entities that are not swap dealers but whose participation in the swaps market is substantial enough to significantly affect or present systemic risks to the economy or the financial system as a whole.

Transparent Trading Requirement

In addition to regulating swap dealers, the Dodd-Frank Act brings transparency to the swaps marketplace by requiring standardized swaps to trade on exchanges or SEFs. A SEF is "a trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants." We have five teams focused on writing rules related to trading. It is anticipated that as many as 30 new entities will register as SEFs or DCMs. That is in addition to the 16 futures exchanges that we already regulate.

Congress also mandated that if a swap both is clearable and it is "made available for trading" on a SEF or an exchange, then there is a mandate that it be traded on such a facility. Congress also has been very specific that market participants and end-users will benefit from real time reporting and that such posttrade transparency must be achieved "as soon as technologically practicable" after a swap is executed. Further, the statute says that one of the goals of SEFs is "to promote pretrade transparency in the swaps market," though it appropriately authorizes the CFTC to write rules to facilitate block trades.

Centralized Clearing

The Dodd-Frank Act requires that standardized derivatives be cleared through central clearinghouses. At the CFTC, we have six teams focused on rules related to clearing, including determining which contracts will be subject to the mandatory clearing requirement. Though we do not yet know the total number of contracts that will be submitted for clearing, and the Commission may be able to group many by class, the largest swaps clearinghouse currently clears nearly one million unique contracts. It is anticipated that the number of registered derivatives clearing organizations will increase from 14 to around 20 as a result of the Dodd-Frank Act.

Furthermore, for the first time, some derivatives clearinghouses may be designated systemically important by the FSOC. For those clearinghouses, there will be enhanced rules for financial resources, risk management and other prudential standards. In this regard, we are consulting very closely with the Federal Reserve and international regulators. We recognize the need for very robust risk management standards, particularly as more swaps are moved into central clearinghouses.

Data

Moreover, the Dodd-Frank Act for the first time sets up a new registration category called swap data repositories (SDRs). The bill requires registrants—including swap dealers, major swap participants, SEFs and DCMs—to have robust record keeping and reporting, including an audit trail, for swaps, and to report each swap to an SDR or to the regulators.

We anticipate rules in this area to require SDRs to perform their core function of collecting and maintaining swaps data and making it directly and electronically available to regulators. We also anticipate rules governing how data must be maintained by registrants and sent to the data repositories.

Position Limits

In January, the CFTC proposed rules to restore position limits in the four major energy futures contracts. Position limits have long been relied upon in futures market regulation to address the effects of excessive speculation and position concentration. Fixed limits that had been in effect for energy contracts were removed in 2001. Under the Dodd-Frank Act, the CFTC now is required to publish rules setting aggregate position limits on exempt and agricultural commodities across markets, including futures, swaps that perform significant price discovery functions and linked contracts on foreign boards of trade that operate in the U.S. As a result, the CFTC has withdrawn its January proposed rule and will build off that proposal and comments that were received as we write a new rule that satisfies the Dodd-Frank Act's mandate.

The Commission currently administers position limits on nine exchange-listed agricultural futures contracts. Under the Dodd-Frank Act, the CFTC is required to set position limits on more than 30 commodities. In general, the Act requires that rules establishing position limits be completed within 180 days from the date of enactment for energy and metals and within 270 days for agricultural contracts.

Foreign Boards of Trade

The Dodd-Frank Act empowers the CFTC to require that a foreign board of trade (FBOT) offering direct access to U.S. persons register with the Commission. This requirement replaces the agency's no-action regime, under which FBOTs were permitted to offer access to U.S. investors upon meeting certain conditions.

Conclusion

The next year of rule writing will test the very talented staff of the CFTC. Our staff has significant expertise regulating the on-exchange derivatives markets that will translate well into regulating the over-the-counter swaps markets. Still, we need significant new resources.

The President's budget called for $261 million for the CFTC for fiscal year 2011, which is a substantial boost in funding. The House Appropriations Subcommittee with jurisdiction over the CFTC matched the President's request. The Senate Appropriations Subcommittee with jurisdiction over the CFTC boosted that amount to $286 million. Though we have the resources to write the rules required by Dodd-Frank, we will need more staff to implement and enforce them in the years to come.

The CFTC faces challenges in the months ahead, but we are prepared and geared up to meet those challenges. We look forward to continuing our excellent collaboration with other regulators to implement the Dodd-Frank Act. Thank you, and I would be happy to take questions.

PREPARED STATEMENT OF JOHN WALSH

ACTING COMPTROLLER OF THE CURRENCY, OFFICE OF THE COMPTROLLER OF THE CURRENCY

SEPTEMBER 30, 2010

Statement Required by 12 U.S.C. §250: The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

Chairman Dodd, Senator Shelby, and Members of the Committee, I appreciate the opportunity to describe the initiatives the Office of the Comptroller of the Currency (OCC) has undertaken to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The Committee's letter of invitation asked the OCC to address several key topics: (1) the OCC's priorities in implementing the Dodd-Frank Act and the progress we have made; (2) the OCC's plans for integrating the staff and functions of the Office of Thrift Supervision (OTS) into the OCC; (3) the OCC's plans for identifying employees for transfer to the Bureau of Consumer Financial Protection (CFPB); and (4) our views about how Basel III will further the objectives of the Dodd-Frank Act. My testimony addresses each of these areas in turn. We also offer some additional thoughts for the Committee's consideration on a few aspects of the legislation that present particular implementation challenges.

Rulemaking and Policy Initiatives

The Dodd-Frank Act directs the OCC to draft rules, some jointly with other agencies and others on a coordinated basis, on a broad range of topics, including: regulatory capital; permissible proprietary trading, hedge fund, and private equity fund investments (the so-called "Volcker rule"); derivatives margin requirements; executive compensation; and real estate appraisals, among others. The OCC will need to revise some regulations to address statutory changes. Moreover, our new role as primary supervisor for Federal savings associations will require us to review and republish rules issued by the OTS. For each of these rulemaking obligations, we have established an interdisciplinary team of agency experts dedicated to lead the OCC's efforts and to work with interagency teams, where appropriate, to develop the new rules.

The legislation also requires other financial regulatory agencies to consult with primary supervisors as those other agencies draft studies or develop regulations or standards, since there may be implications for the safety and soundness of depository institutions. Accordingly, we have designated OCC experts to advise the other financial regulatory agencies about the potential impact on the institutions we supervise and their customers.

Taken together, these responsibilities constitute an implementation challenge of unprecedented scale. A large number of staff professionals will be assigned to work on the financial regulatory reform provisions of the Dodd-Frank Act, and we have established a senior management oversight group within the OCC to direct and coordinate our effort.

Among our efforts, the OCC is supporting the organization of the Financial Stability Oversight Council (FSOC), which is chaired by the Secretary of the Treasury and includes as members, among others, the heads of the Federal banking agencies, including the Comptroller of the Currency; the Director of the CFPB; the Chairs of the Securities and Exchange Commission (SEC) and Commodities Future Trading Commission (CFTC); and the Director of the Federal Housing Finance Agency (FHFA). The FSOC's mission is to identify risks to financial stability that could arise from the activities, material financial distress, or failure of large, interconnected financial companies; to recommend standards for implementation by the agencies in specified areas; to promote market discipline; and to respond to emerging threats to the stability of the U.S. financial system.

In addition, a number of implementation projects are already underway. In August, we sought comment through an Advance Notice of Proposed Rulemaking (ANPR) on the implementation of section 939A of the Dodd-Frank Act. This section directs the Federal agencies to review regulations that require an assessment of the creditworthiness of a security or money market instrument, and remove any references or requirements involving credit ratings and substitute an alternative standard of creditworthiness. Apart from capital rules, the OCC's regulations use credit ratings in several different ways, most significantly in setting the criteria for determining which "investment securities" national banks may acquire as permissible investments. Through the ANPR, the OCC sought comment on the implementation of section 939A with respect to these regulations and others governing securities offerings and international activities where credit ratings are referenced. The ANPR also set forth considerations underlying the reliance on credit ratings and requested comments on potential alternatives to the use of credit ratings.

Separately, we also joined in an interagency ANPR to assess the impact of section 939A on the banking agencies' regulatory capital rules, which currently reference credit ratings in four general areas: (1) the assignment of risk weights to securitization exposures; (2) the assignment of risk weights to claims on, or guaranteed by, qualifying securities firms; (3) the assignment of certain regulatory capital add-ons for trading assets held by banks with large trading portfolios; and (4) the determination of the eligibility of certain guarantors and collateral for purposes of the credit risk mitigation framework under the advanced approaches rules.

One active interagency project involves standards for uncleared swaps. Sections 731 and 764 of the Dodd-Frank Act require the banking agencies, the Farm Credit Administration, and the FHFA to promulgate margin requirements for uncleared swap transactions by swap dealers and major swap participants subject to the agencies' jurisdiction. The agencies are engaged in discussions to establish the design of the margin requirements and margin levels, in light of the risk standards for such rules established by the Dodd-Frank Act.

On another front, an interagency group consisting of the Federal banking agencies, the SEC, Housing and Urban Development (HUD), and the FHFA, has begun to discuss the design of several rulemakings mandated by section 941 risk-retention requirements. Section 941 generally mandates that the agencies publish rules requiring securitizers (and in some cases, originators of securitized assets) to retain at least 5 percent of the credit risk of the loans they package and sell through securitizations. Lower risk retention levels may be allowed for specific loans, particularly mortgages, if they are underwritten according to prudential standards to be set by the agencies through the rulemaking process.

The OCC has also begun work on the provisions in section 956 which require the Federal agencies jointly to prescribe regulations or guidelines requiring the disclosure of certain incentive-based compensation arrangements and prohibiting compensation arrangements that encourage inappropriate risk-taking by financial institutions.

In addition, an interagency working group consisting of the FSOC's member agencies has begun providing input to the FSOC as it initiates its study of proprietary trading and hedge fund and private equity fund investments with a view to making recommendations to the banking agencies and the SEC when they promulgate regulations for the implementation of section 619.

As we begin to implement the Dodd-Frank Act, we also have identified some notable implementation challenges that may be of interest to the Committee. These include the practical effects of prohibiting the use of credit ratings in regulations under section 939A. Ambiguities in section 171, relating to baselines for existing and future leverage and risk-based capital requirements, also raise a number of issues that pose implementation challenges and, as in the case of section 939A, could pose significant burdens on smaller banking institutions. There also appears to be an inconsistency in the duties assigned to the banking agencies and the CFPB with regard to fair lending that creates confusion in responsibilities. These issues are more fully discussed in Attachment A to this testimony.

Transfers of Agency Functions

The Dodd-Frank Act transfers from OTS to the OCC supervisory responsibilities for Federal savings associations, as well as rulemaking authority relating to all savings associations. Under the statute, all OTS employees will be transferred to either the OCC or the Federal Deposit Insurance Corporation (FDIC) no later than 90 days after the "transfer date," which is 1 year after enactment unless extended for an additional 6 months by the Secretary of the Treasury. The allocation is to be based generally on the proportion of Federal *versus* State savings associations regulated by the OTS.

The Dodd-Frank Act also establishes the CFPB as an independent bureau in the Federal Reserve System. Certain existing authorities of the banking agencies, HUD, and the FTC for consumer protection regulations are to be transferred to the CFPB, along with responsibility for overseeing compliance with a number of listed consumer protection standards applicable to depository institutions with assets of more than $10 billion. Employees from the banking agencies, HUD, and the FTC will be transferred to the CFPB as part of this process.

Thus, the OCC is uniquely challenged with respect to transfers of functions under the Dodd-Frank Act because we are both absorbing significant new functions and a significant number of new staff as a result of the integration of the OTS into the OCC, while at the same time transferring functions and some associated personnel in connection with the organization of the CFPB.

Integration of Specified OTS Functions Into the OCC

Although the legislation preserves the thrift charter and the Home Owners' Loan Act, the OTS is abolished 90 days after the transfer date. The OCC recognizes its important responsibilities under the Dodd-Frank Act to ensure the orderly and effective transfer of functions and personnel from the OTS to the OCC and to assure efficient and effective supervision and regulation of Federal thrifts, and we have already taken a number of steps to begin this process. To centralize efforts in this area, the OCC established a transition team and appointed a senior agency official to coordinate and supervise the implementation of all issues involving the integration of OTS functions and responsibilities. Transition team members have begun working with their counterparts at other agencies to identify and address mutual concerns and issues for resolution. While it is early in that process, and many details are yet to be determined, I can provide some details regarding our planning for the transfer of personnel and supervisory functions, as well as the transfer of funds, property, and systems.

Transfer of Personnel and Supervisory Functions. The Dodd-Frank Act provides that the OCC will become the appropriate Federal banking agency for Federal savings associations, and the FDIC will assume that role for State savings associations. All OTS employees are to be transferred to the OCC or FDIC no later than 90 days after the transfer date. The Director of the OTS, the Comptroller of the Currency, and the Chairperson of the FDIC will jointly determine the number of OTS employees needed to perform the functions transferred and identify employees for transfer to the OCC or FDIC. While the final number of OTS employees who will transfer to the OCC has not yet been determined, the preponderance of OTS-supervised institutions are Federal savings associations that will be supervised by the OCC and, thus, under the personnel transfer provisions in the Dodd-Frank Act, a correspondingly large portion of OTS employees would be transferred to the OCC. We believe that the orderly transfer of these individuals from the OTS to the OCC is essential to the success of integrating the supervision of federally chartered savings associations into the OCC. We also recognize that these staff members have critical knowledge and insight into the unique mission and resulting supervisory challenges associated with the thrift industry. The OCC is working with the OTS to plan and ensure an orderly transfer of authority and responsibilities to ensure the effective supervision of both national banks and Federal thrifts.

To ensure the success of this transition, we are guided by a basic principle that informs the legislation, that there will be no gaps in supervision as we expand our supervisory framework to include Federal thrifts. Our goal is a rigorous, consistent, and balanced supervisory approach for all of the institutions that we will supervise.

The 1,300 nationally chartered community banks that we currently supervise use a variety of business models, including a significant number of institutions that look very similar to thrifts with a preponderance of long-term assets. We also supervise other types of specialized institutions, including credit card banks and trust banks. Because of this diversity of experience, our examiners understand the importance of evaluating the condition and future prospects of each institution based on its unique characteristics and performance, as well as its local market conditions.

We also recognize the importance of communicating regularly with the industry throughout this process. Among other things, the OCC is developing an outreach program for thrift executives to provide information and perspective on the OCC's approach to supervision and regulation. This one-day program will be held at various locations throughout the country and will be cohosted by an OCC District Deputy Comptroller and an OTS Regional Director. During these sessions, our senior examiners will explain how we examine banks, including the development of individually tailored supervisory strategies based on the unique risks facing each institution. The program also will describe the functions of our district counsel and district licensing activities. We expect these events to take place in the first and second quarters of 2011.

In addition to the thrift-focused programs, OCC bank supervision managers have begun participating in industry events that provide interaction with thrift executives in group settings as well as individual conversations to expand the industry's awareness of the OCC, its policies, procedures, and supervision philosophy. I also sent a personal letter to the chief executive officers of all Federal savings associations to begin the process of communication that will be so important to the transition.

As part of our transition effort, our human resources specialists are also working closely with their OTS counterparts to review employee positions, duties, and responsibilities to ensure proper alignment of transferring OTS staff in the combined organization. Consistent with the legislation, this process will ensure that OTS employees are treated equitably with regard to status and tenure, and that pay and other benefits will be protected.

We are undertaking a business line approach in these early stages. Each of our business units is coordinating with its counterparts at the OTS to review positions, responsibilities, and business processes to determine the best means of integrating staff and their functions into the OCC. We have found this interaction at a business line level promising in establishing relationships and identifying issues of mutual concern. To the extent practicable, transferred employees will be placed in OCC positions with functions and duties similar to those they had prior to their transfer. In some instances, we already have jointly identified opportunities to detail OTS staff to assist with our current responsibilities.

Our general intent is to integrate transferred employees into the OCC's organizational structure and pay plan as soon as possible and to maintain existing OCC human resources policies. At the same time, we will work closely with our OTS counterparts to review and analyze personnel policies and practices and to identify and resolve any significant differences.

The transition team also is reviewing and comparing employee benefits and any related contracts, including those under the Financial Institutions Retirement Fund (FIRF), which covers some OTS employees, and other supplemental retirement benefits. The OCC is reviewing the FIRF plan to determine what actions need to be taken to ensure that it is in a position to meet obligations to employees and retirees under that program. As reported in the OTS Annual Report for fiscal year 2009, the estimated OTS FIRF pension shortfall as of July 1, 2009, was $80.7 million.

One area that we have identified as critical to the combined success of the OCC and the OTS is the role of training, even at this early stage in the integration process. As a result, we have begun to review each agency's training and certification programs to ensure that existing and transferred employees have the training and skills necessary to supervise both national banks and Federal savings associations. This review will identify areas where OCC and OTS training programs overlap, as well as gaps that need to be addressed. While the legislation does not require additional certification for transferred OTS employees to continue supervising the types of institutions that they supervised prior to the transfer, additional training may be required before transferred employees can supervise national banks. As a first step in integrating our examination workforce, we are developing plans to enroll recent OTS hires in OCC national bank examiner training courses.

Effective communication is key to managing organizational change as large as this and, as we work through these details over the next 10 months, I recognize the importance of keeping employees fully informed. Our communications staff and bank supervision leadership team are working closely with OTS managers to keep employees informed throughout this transition, to demonstrate that the OCC recognizes the importance and value of OTS employee experience, to communicate expectations clearly, and to ensure that OTS employees are aware of the value provided by the OCC's professional work environment and comprehensive benefits and compensation package. While we are still working on answers to many employee questions, establishing regular communication helps to ensure that employees remain focused on their mission while having access to information they need to make informed decisions about their careers.

As OTS employees look toward this transition, I am confident they will find the OCC a supportive and rewarding place to continue their careers. We are proud that responses from our own employees documented by the Office of Personnel Management's Employee Viewpoint Survey placed the OCC in the top five places to work among more than 220 Federal agency subcomponents. As our staff expands to include former OTS employees, we will continue our commitment to providing a competitive, comprehensive package of compensation and benefits that meets our employees' needs and allows us to retain and attract the talent and experience necessary to perform our important and expanded mission.

Transfer of Funds, Property, and Systems. The OCC's Chief Financial Officer is working closely with his counterparts to review the financial position, statements, and existing obligations of the OTS to ensure that the OCC will have the financial resources necessary to support the supervision of the Federal savings associations and meet the obligations the OCC must assume in the transfer, particularly relating to the unfunded OTS liabilities of the FIRF noted previously. This review includes determining any changes that may be needed to the assessment structure to provide for combined supervision in the future. As this review progresses, the OCC is committed to working closely with the OTS and the FDIC to keep supervised financial institutions fully informed.

Also, as we review the financial considerations associated with integrating the OTS into the OCC, we are working closely with the OTS to review the status of leased office space supporting the mission of thrift supervision, including the leasing decisions required over the next 2 years. This review includes an assessment of space needs to support thrift supervision staff throughout the country, as well as the continuing space requirements for more than 3,000 current OCC employees.

Another important issue relating to the transfer of OTS functions to the OCC involves the transfer and integration of information technology systems and assets. The OCC's Chief Information Officer is working closely with his OTS counterpart to develop a comprehensive inventory of assets and systems, to compare OCC and OTS systems, and to determine the most effective method of integrating these assets and systems. In developing this transition plan, the OCC is sensitive to the impact that systems change can have on the employees, as well as the industry, and will take care to minimize any potential disruption.

While today's testimony provides a high-level view of the processes the OCC has begun to ensure the effective transfer of staff and functions from the OTS to the OCC, the OCC also is working with the OTS, FDIC, and Federal Reserve Board to develop the report to Congress that is due in January 2011. This report will provide additional details of the initiatives taken to implement the Dodd-Frank Act.

Transfers of Specified Functions to the CFPB

The Dodd-Frank Act transfers to the CFPB authorities of specified agencies to issue rules, orders, and guidelines under certain Federal consumer financial laws, plus the authority of the Federal banking agencies to supervise and examine insured depository institutions of over $10 billion in asset size for compliance with enumerated Federal consumer financial laws.

In addition, the legislation provides for the transfer of personnel to the CFPB for two purposes. First, each transferor agency, including the OCC, must jointly determine with the CFPB the number of employees necessary to support the rulemaking and supervision examination functions transferred to the CFPB. Second, the CFPB and each of the agencies must jointly determine the number of employees necessary to perform certain additional functions that are authorized to the CFPB, but that also continue to be performed by the agencies. These functions include, for example, research, financial literacy, and responses to consumer complaints.

We are working with the Treasury staff that are organizing the CFPB until a Director is appointed to set up a process to identify personnel that could be transferred. This involves identifying those OCC employees who have both the skills needed by the CFPB and are interested in transferring to the CFPB. To facilitate this, we have solicited expressions of interest from employees who may be interested in moving to the CFPB.

To further the understanding of our current operations, we also have provided extensive materials to Treasury staff, including organizational charts describing our consumer protection functions, details about the national banks with more than $10 billion in assets that the CFPB will assume responsibility to examine, position descriptions, and FTE requirements for supervision. In addition, we have provided extensive information about the complaint processing function performed by the OCC's Customer Assistance Group, including key operating statistics. As the CFPB's organizational activities accelerate, we are prepared to work with appropriate Treasury staff that is working on the CFPB start-up to follow-through on all these areas.

Relationship Between the Dodd-Frank Act and Basel III

The recent initiatives of the Basel Committee on Banking Supervision (Basel Committee), including establishing additional prudential standards for large, internationally active banks and setting contingent capital requirements, are focused on many of the same issues and concerns that the Dodd-Frank Act sought to address.

In response to the financial crisis, the Basel Committee initiated a comprehensive reform package designed to strengthen global capital and liquidity requirements and promote a more resilient banking sector. These reforms, often referred to as "Basel III," seek to improve the ability of banks to absorb the shocks of economic stress, thereby strengthening the financial system and reducing risks to the real economy. As described in more detail below, the OCC believes that implementation of the Basel III rules by the Federal banking agencies will serve to advance the objectives of the Dodd-Frank Act, and certain other Basel-initiated measures may also satisfy particular requirements of Dodd-Frank.

Current Basel III Proposal

The Basel Committee published two consultative papers in December 2009, seeking comment on a series of substantive changes to the standards governing internationally active banks. These changes involved the tightening of the definition of what counts as regulatory capital by placing greater reliance on higher quality capital instruments, expanding the types of risk captured within the capital framework, establishing more conservative minimum capital ratio and buffer requirements, providing a more balanced consideration of macroprudential and systemic risks in bank supervision practices and capital rules, and establishing for the first time an international leverage ratio requirement and global minimum liquidity standards. As a complement to the consultation process, the Basel Committee also initiated a quantitative impact study to better assess the impact of these proposals on individual banks.

On July 26, 2010, the Group of Governors and Heads of Supervision (GHOS), the oversight body of the Basel Committee, reached broad agreement on the overall design of the capital and liquidity reform package. On September 12, 2010, the GHOS and the Basel Committee announced an agreement on the remaining major elements of the Basel III revisions—the calibration of the new, higher capital ratios that banks will be expected to maintain and phase-in arrangements of the revised framework. A more detailed description of the enhancements introduced by the Basel III rules is provided in Attachment B to this document.

The establishment of higher minimum ratios significantly strengthens existing capital requirements by requiring more capital per dollar of measured exposure. This change alone will materially enhance the resiliency of the banking sector and broader financial system to economic shocks. The September GHOS agreement also sets forth harmonized implementation and transition arrangements for national authorities, with implementation of the new requirements beginning January 1, 2013, with all aspects of the revisions fully phased-in by 2019. This transition period is intended to give institutions the opportunity to implement the new prudential standards over time, and thus alleviate the potential for associated short-term pressures on the cost and availability of credit to households and businesses.

The Dodd-Frank Act and Basel III

The provisions of the Dodd-Frank Act relating to capital and liquidity share the broad objectives and address many of the same issues as the Basel III enhancements noted above. Since the Basel III enhancements can take effect in the U.S. only through formal rulemaking by the banking agencies, the steps the OCC and other agencies are taking to implement Dodd-Frank may present an opportunity to integrate the Basel III agreement with the heightened standards required by Dodd-Frank in various areas.

Enhancing the Level, Quality, and Stringency of Capital Requirements. Basel III and the Dodd-Frank Act both seek to establish conservative, stringent capital standards, especially for large financial institutions. In addition, Basel III and the Dodd-Frank Act enhance the quality and consistency of regulatory capital, limiting the ability of trust-preferred securities and other similar instruments to qualify as Tier 1 capital. More generally, Basel III raises the level, quality, consistency, and transparency of capital instruments. Significantly, the Basel Committee has focused considerable attention on common equity, which is superior to other capital instruments in its ability to absorb losses, and articulated a more conservative basis for what qualifies as regulatory capital. Basel III also revises regulatory requirements to ensure that all material risks confronting financial companies—especially the risks held in trading portfolios and the risks posed by complex structured finance transactions, including certain securitization positions—are appropriately reflected in regulatory capital requirements. Finally, Basel III establishes materially higher minimum ratio requirements for internationally active banks.

Macroprudential and Systemic Risk Considerations. Both Basel III and the Dodd-Frank Act focus increased attention on macroprudential and systemic risk considerations in bank supervision practices and capital rules, including efforts to address excessive interconnectedness of financial sector exposures and the establishment of improved incentives for the use of central clearing houses for OTC derivatives. The Dodd-Frank Act also establishes more formal mechanisms and requirements to identify risks to the financial stability of the U.S. through the establishment of the FSOC and compels action to prevent or mitigate such risks, especially as they relate to large, interconnected financial institutions.

Mitigating Procyclicality of Regulatory Requirements. Both Basel III and the Dodd-Frank Act focus on cyclicality concerns and the potential benefits of contingent capital instruments. Basel III seeks to mitigate procyclicality in the regulatory capital regime through the development of countercyclical buffers and the study of the potential uses and design of contingent capital instruments. Similarly, the Dodd-Frank Act requires the Federal banking agencies to make capital standards countercyclical and provides the agencies discretion to require large interconnected financial institutions to maintain a minimum amount of contingent capital that is convertible to equity in times of financial stress.

Leverage Ratio Requirements. Basel III and the Dodd-Frank Act advance similar objectives in seeking to limit excessive leverage in the banking system. Basel III establishes for the first time an international leverage ratio requirement that seeks to discourage excessive leverage in the banking system. The U.S. currently limits leverage based only on a bank's on-balance sheet assets. However, the Basel III leverage ratio also accounts for certain off-balance sheet exposures that could contribute to the build-up of leverage. Along the same lines, the Dodd-Frank Act mandates that large, interconnected financial institutions be subject to more stringent prudential standards and requirements, including standards relating to leverage limits.

Liquidity Requirements. Both the Dodd-Frank Act and Basel III call for the establishment of minimum liquidity standards to promote bank resilience to stressed funding conditions, such as those experienced during the recent financial crisis. In this regard, Basel III addresses both short-term resilience and long-term structural liquidity mismatches. Basel standards are consistent with the Dodd-Frank Act, which mandates that large, interconnected financial institutions be subject to more stringent prudential standards and requirements relating to liquidity.

Next Steps

While the key elements of the Basel III framework have been set forth, much work will be needed to implement those enhancements plus the related elements of the Dodd-Frank Act. For example, over the remaining months of 2010, the international agreements need to be more fully articulated as a concrete set of standards. This will be followed in the U.S. by a formal rulemaking process that will take into account, through public notice and comment, the views of all interested parties. In addition, there are also many details in terms of the interaction between the Dodd-Frank Act and Basel III provisions that need to be sorted out.

The OCC fully supports the Basel III reforms to capital and liquidity standards. The agreements represent a significant step forward in reducing the likelihood and severity of financial crises, and lay the foundation for a more stable banking system that is both less prone to excessive risk-taking and better able to absorb losses. We think the framework strikes an appropriate balance between introducing more stringent requirements for banks, while allowing the banking system to continue to perform its essential function of providing credit to creditworthy households and businesses. Furthermore, the extended transition period minimizes any short-term disruptions in financial services during a period of fragile economic conditions.

Conclusion

The OCC appreciates the opportunity to testify on the initiatives we have taken to date to implement the provisions of the Dodd-Frank Act. We also would be pleased to provide additional information as the Committee continues to review Dodd-Frank Act implementation.

Attachment A- Particular Implementation Issues That May Warrant Clarifying Amendments

Section 939A – Review of Reliance on Credit Ratings

Section 939A of the Dodd-Frank Act requires each federal agency to review "(1) any regulation issued by such agency that requires the use of an assessment of the credit-worthiness of a security or money market instrument; and (2) any references to or requirements in such regulations regarding credit ratings." Each federal agency must then "modify any such regulations identified by the review . . . to remove any reference to or requirement of reliance on credit ratings and to substitute in such regulations such standard of credit-worthiness as each respective agency shall determine as appropriate for such regulations." In developing substitute standards of credit-worthiness, an agency "shall seek to establish, to the extent feasible, uniform standards of credit-worthiness" for use by the agency, taking into account the entities it regulates that would be subject to such standards.

The federal banking agencies are considering a wide range of approaches for developing alternative credit-worthiness standards. Any alternative must appropriately measure credit risk, should provide for timely and accurate updates as the quality of a particular asset deteriorates or improves, and must be transparent and replicable so that banks of varying size and complexity, as well as supervisors, can arrive at the same assessment for similar assets. However, various approaches present certain advantages and disadvantages. For example, developing broad exposure categories based on objective criteria established by regulators, similar to the current approach of the agencies' general risk-based capital rules, could be relatively easy to implement, but any such standard likely would be both over- and under-inclusive because it would lack risk sensitivity. More risk-sensitive approaches could include developing broad qualitative and quantitative credit-worthiness standards that banking organizations could use, subject to supervisory oversight, to measure the credit risk associated with various exposures. However, a more refined differentiation of credit risk may be achievable only at the expense of greater implementation burden, and if the alternative is not reasonably simple to implement, it may be an undue burden, especially for smaller banking institutions.

The federal banking agencies' risk-based capital rules currently reference NRSRO credit ratings in four general areas: (1) the assignment of risk weights to securitization exposures; (2) the assignment of risk weights to claims on, or guaranteed by, qualifying securities firms; (3) the assignment of certain regulatory capital add-ons for trading assets held by banks with large trading portfolios; and (4) the determination of the eligibility of certain guarantors and collateral for purposes of the credit risk mitigation framework under the advanced approaches rules. For example, in the case of asset-backed securities, a security rated AAA will receive a risk weight of 20 percent, whereas a security rated BB will receive a risk weight of 200 percent.

In addition to the OCC's capital rules, regulations regarding permissible investment securities, securities offerings, and international activities each reference or rely upon NRSRO credit ratings. For example, to be bank permissible, an investment security must not be "predominantly speculative in nature." The OCC rules provide that an obligation is not predominantly speculative in nature if it is rated investment grade or, if unrated, is the credit equivalent of investment grade. The term "investment grade," in turn, is defined as a security rated in one of the four highest rating categories by two or more NRSROs (or one NRSRO if the security has been rated by only one NRSRO). In addition, under current OCC rules, a security that is offered and sold pursuant to SEC rule 144A is deemed marketable if it is rated investment grade or the credit equivalent of investment grade.

OCC regulations also require disclosures related to national bank-issued securities that include references to investment grade ratings. For example, the regulations establish an optional abbreviated registration system for debt securities that meet certain criteria, including a requirement that the security receive an investment grade rating.

Finally, pursuant to section 4(g) of the International Banking Act (IBA), foreign banks with federal branches or agencies must establish and maintain a capital equivalency deposit (CED) with a member bank located in the state where the federal branch or agency is located. The IBA authorizes the OCC to prescribe regulations describing the types and amounts of assets that qualify for inclusion in the CED, "as necessary or desirable for the maintenance of a sound financial condition, the protection of depositors, creditors, and the public interest." Among the assets the OCC has deemed permissible are certificates of deposit, payable in the U.S., and banker's acceptances, provided that, in either case, the issuer or the instrument is rated investment grade by an internationally recognized rating organization, and neither the issuer nor the instrument is rated lower than investment grade by any such rating organization that has rated the issuer or the instrument.

Issues surrounding credit ratings were a significant factor in market overconfidence that contributed to subsequent losses in the markets for mortgage-backed securities in 2008-2009. The Dodd-Frank Act implements measures to address these issues, including structural changes at the ratings agencies, greater SEC oversight of the ratings process, and loan-level disclosures to investors in asset-backed securities.[1] However, the prohibition against references to ratings in regulations under section 939A goes further than is reasonably necessary to respond to these issues. Rather than disregard credit ratings, it may be more appropriate to assess their strengths and weaknesses and to supplement ratings with additional analysis in appropriate cases. We suggest that section 939A be amended to direct regulators to require that ratings-based determinations be confirmed by additional risk analysis in circumstances where ratings are likely to present an incomplete picture of the risks presented to an institution, or

[1] The Dodd-Frank Act gives the SEC significantly enhanced oversight authority over NRSROs. It creates the Office of Credit Ratings within the SEC that would be responsible for promoting credit rating accuracy and credit rating agency independence. This would include conducting annual examinations of NRSROs; promulgating requirements to eliminate conflicts of interest; and creating a form that would be used to explain to users of credit ratings information relating to the assumptions and data used in developing each rating, along with other information about the NRSRO. The Dodd-Frank Act also directs the SEC to prescribe rules concerning qualitative and quantitative methodologies used to determine credit ratings.

where those risks are heightened due to concentrations in particular asset classes.

Section 171 – Leverage and Risk-Based Capital Requirements

Section 171 of the Dodd-Frank Act, relating to leverage and risk-based capital requirements, states that the capital requirements applicable to large systemically important financial institutions must be at least as strict as the requirements that apply to all other banking institutions. The section also provides that the federal banking agencies may not amend the current capital rules in a way that would lead to "quantitatively lower" capital requirements in the future. However, the language describing the appropriate way to measure the baseline for determining whether one capital requirement is more strict, or not "quantitatively lower" than another, as well as the language describing the baseline from which such measurements must be made, is unclear. Depending on how the federal banking agencies interpret section 171, it could be read to require some or all banks to calculate their capital requirements several different ways using multiple different frameworks. In addition to implementation and burden issues, the confusion surrounding the applicability of different capital requirements could serve to undermine recent international efforts to improve bank capital requirements.

Resolution of these ambiguities is important to the agencies' efforts to improve their regulatory capital requirements and comply with other sections of the Dodd-Frank Act. For example, as discussed above, compliance with the provisions of section 939A will require the federal banking agencies to amend their respective capital rules to remove and replace references to credit ratings. Because doing so will require substantial amendments to their capital requirements, the agencies will have to resolve how section 939A and section 171 can be read together. For example, complications could arise if section 171 is read to require banks to calculate and compare their minimum capital requirements under any new capital rules with those in place at the date of enactment of the Dodd-Frank Act because this comparison would result in banks having to apply rules that require the use of credit ratings.

Respective Roles of the Banking Agencies and CFPB in Fair Lending Matters

Other implementation difficulties arise outside the rulemaking context. One example concerns the respective roles of the banking agencies and the CFPB in supervising and enforcing fair lending provisions for insured depository institutions with total assets greater than $10 billion. The federal banking agencies currently oversee depository institutions' compliance with the Fair Housing Act, the Equal Credit Opportunity Act, and the Federal Reserve Board's Regulation B, using interagency exam guidelines issued by the Federal Financial Institutions Examination Council. This includes a program of screening using data reported under the Home Mortgage Disclosure Act and other factors for risk-based identification of institutions for further assessment, as well as random sampling of institutions.

Under the Dodd-Frank Act, the banking agencies will continue to perform this function for institutions under our supervision with $10 billion or less in total assets. For larger institutions, the legislation assigns exclusive supervisory responsibility for "federal consumer financial laws" to the CFPB. The definition of "federal consumer financial laws" includes the Equal Credit Opportunity Act and Regulation B, but not the Fair Housing Act. If the intent of the legislation is for the CFPB to supervise larger institutions for compliance with the Equal Credit Opportunity Act and Regulation B, but for the federal banking agencies to supervise such institutions' compliance with the Fair Housing Act, this result risks significant inefficiency and potential confusion regarding accountability in this area. We urge reconsideration of this jurisdictional split.

Attachment B – Basel III Changes to Basel II

Changes to the Definition of Capital

The Basel III framework recognizes the importance of banking organizations maintaining a strong capital base with a significant proportion consisting of common shareholders' equity that is most able to absorb losses. Thus, the framework defines two components of Tier 1 capital, common shareholders' equity (Tier 1 common) and additional going concern Tier 1 capital (Tier 1 capital), and establishes minimum risk-based capital ratios for both measures.

In addition, the framework strengthens the definition of Tier 1 capital to exclude hybrid instruments that did not prove to be loss absorbing during the recent financial crisis. Basel III contains a detailed set of criteria that an instrument must satisfy in order to qualify as Tier 1 capital. The criteria include a requirement that the banking organization has complete discretion to cancel any dividends or distributions (e.g., the instrument must be non-cumulative) and that the instrument be perpetual. As a result, trust-preferred securities issued by U.S. bank holding companies would not qualify as Tier 1 capital under the Basel III changes.

Basel III also establishes criteria for the inclusion of minority interest[1] in the definition of Tier 1 common. Minority interest issued in the form of common stock by a subsidiary that is a bank will be eligible for inclusion in Tier 1 common of the parent banking organization. If the amount of minority interest exceeds the minimum capital requirement of the subsidiary, the excess amount will be deducted from Tier 1 common in proportion to the minority interest share.

Basel III specifies a number of deductions and adjustments that must be made to Tier 1 common to ensure its ability to absorb losses. The deductions and adjustments would be made to Tier 1 common prior to calculating the risk-based capital ratios. While U.S. banking organizations currently apply a number of deductions and adjustments to Tier 1 capital under the existing capital rules, in several cases the Basel III deductions are more conservative. Under Basel III, the total amount of mortgage servicing assets, deferred tax assets related to timing differences, and significant investments in financial institutions will be limited, in the aggregate, to 15 percent of a banking organization's Tier 1 common, with each item separately limited to 10 percent of Tier 1 common.[2] Any

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[1] A minority interest is the portion of the equity in a consolidated subsidiary attributable to the owners of the subsidiary other than the parent. Minority interests also are known as non-controlling interests.

[2] Under the agencies' existing risk-based capital rules, mortgage servicing assets, in conjunction with purchased credit card relationships and nonmortgage servicing assets, are includable in Tier 1 capital up to an amount equal to 100 percent of Tier 1 capital with no more than 25 percent of Tier 1 capital consisting of purchased credit card relationships and non-mortgage servicing assets. The amount includable in Tier 1 is the lesser of 90 percent of the fair value or 100 percent of the remaining unamortized book value. (Basel III requires the full deduction of purchased credit card receivables and non-mortgage servicing assets). Under the agencies' existing risk-based capital rules, deferred tax assets generally are includable in Tier 1 capital up to the lesser of (a) the amount of those assets that the banking organization could reasonably expect to realize within one year based on its estimate of future taxable income, or (b) 10 percent of Tier 1

amount of those assets held by a banking organization above those limits will be fully deducted from Tier 1 common. All intangibles other than mortgage servicing assets would be fully deducted from Tier 1 common.

Under Basel III, unrealized gains and losses on all AFS securities would be included in Tier 1 common. In other words, the impact of unrealized gains and losses on AFS securities would flow through to Tier 1 common, such that Tier 1 common would be reduced by any unrealized losses and increased by any unrealized gains on AFS securities. This approach follows the accounting treatment of including unrealized gains and losses in common shareholder's equity, which was used by many market participants during the financial crisis to assess banking organizations' financial strength and solvency. In contrast, under the agencies' existing regulatory capital rules, unrealized gains and losses on AFS debt securities generally are excluded from Tier 1 capital.

Changes to the Measurement of Risk (Risk-Weighted Assets)

In addition to the changes in the measurement of capital, Basel III also enhances the measurement of risk. That is, the denominator of the risk-based capital ratios has been changed to incorporate more fully certain risks that were not appropriately addressed previously.

One of the more significant changes is the treatment of exposures held in a banking organization's trading account. The revisions to the capital requirements for the trading book include the following:

- Stressed Value at Risk – this charge is similar to the currently measured value at risk, but with the model calibrated to a period that reflects significant financial stress appropriate to the banking organization's current portfolio.
- Incremental Risk Capital – the standards have been revised to better capture the default and credit migration risk of positions held in the trading book.
- Securitization positions – the capital requirements for securitization positions in the banking book has been replicated for similar positions in the trading book, thereby addressing a significant regulatory capital arbitrage.

A second significant change relates to the expansion of the capital framework to cover risks resulting from the volatility of the "credit valuation adjustment." The current framework addresses counterparty credit risk as a default and credit migration risk, but does not fully account for market value losses that can materialize because of a counterparty's deterioration short of default.

A third change contained in Basel III requires that estimates of counterparty credit risk must include data from a period of market stress, thereby increasing the conservatism of these estimates. Furthermore, Basel III will continue to provide capital-related incentives to clear derivative transactions with a central counterparty.

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capital. The existing risk-based capital rules do not require the deduction from Tier 1 capital of significant investments in financial institutions.

Basel III will increase the amount of capital held for credit exposures to large financial companies to better capture the interconnectedness of these firms and the potential contagion effects. The new calibration will require roughly 25 percent more capital than the previous calibration for a bank's credit exposure to large financial companies and highly leveraged entities such as hedge funds.

International Leverage Ratio

The Basel III revisions also introduce for the first time an international leverage ratio as a supplementary measure to the risk-based framework. The leverage ratio is intended to help contain the build-up of excessive leverage in the banking system and introduce additional safeguards against model risk and measurement error.

Unlike the current leverage ratio in U.S. capital regulations, the Basel III ratio also incorporates the potential leverage generated by off-balance sheet exposures. In addition, the Basel III leverage ratio makes adjustments to capture potential leverage resulting from derivative transactions and makes adjustments with respect to derivatives to adjust for international accounting differences.

The New Minimum Thresholds of the Ratio of Capital to Risk-Weighted Assets

The Basel Committee conducted a Comprehensive Quantitative Impact Study(CQIS) to estimate the effect on the measured capital ratios arising from the various proposed changes to the definition of capital and the measurement of risk-weighted assets. Based on that survey, as well as comments from banking organizations, the Committee discussed a range of possible minimum required thresholds for each of the three risk-based ratios and the leverage ratio. The Basel Committee reached a consensus on the minimum thresholds shown in Table 1.

Table 1
Minimum Required Risk-Based Capital Ratios

	Tier 1 Common	Tier 1 Capital	Total Capital
Minimum	4.5%	6.0%	8.0%
Conservation Buffer	2.5%		
Minimum plus Buffer	7.0%	8.5%	10.5%
Range for Countercyclical Buffer	0.0 – 2.5%		
Leverage Ratio	-	3.0%	-

The new minimums for the required risk-based ratios are substantially higher than under Basel I and II. However, these new minimums will be phased in over a relatively long transition period, as shown in Table 2 below.

Liquidity

The Basel III changes also introduced for the first time global minimum liquidity standards. The Basel Committee has sought to address two separate but complementary objectives through the development and implementation of these standards.

The first objective is to increase the short-term resiliency of a bank's liquidity risk profile. This can be accomplished by ensuring that banks have a sufficient level of unencumbered high quality liquid resources to survive an acute supervisor-specified stress scenario lasting for one month. The Basel Committee developed the Liquidity Coverage Ratio (LCR) to achieve this objective. The LCR essentially requires a bank to maintain a stock of unencumbered "high quality liquid assets" that should at least equal the estimated "net cash outflows." Net cash outflows are the expected cash inflows minus cash outflows adjusted for stressed conditions. The standard is defined as follows:

$$\frac{\textit{Stock of High Quality Liquid Assets}}{\textit{Net Cash Outflow over } 30 \textit{ days}} \geq 100\%$$

The stock of high quality liquid assets will be defined to include two tiers. Tier I assets are comprised of the most liquid assets – cash, central bank reserves, marketable securities, and government or central bank debt. Tier II assets, while still meeting the standards required of "high quality liquid assets," possess a lesser liquidity value than Tier I assets and, therefore are subject to valuation haircuts and maximum contribution limits. Specifically, Tier II assets include: high quality corporate and covered bonds, with a 20 percent haircut; and government and public sector entity assets qualifying for the 20 percent risk weighting under Basel II, with a 10 percent haircut. The overall size of Tier II assets will be capped so that Tier II assets can contribute no more that 40 percent of the total stock of liquid assets. In the United States, GSE debt and GSE guaranteed mortgage-backed securities fall within the definition of public sector entity assets and, therefore, are subject to the 10 percent valuation haircut and the maximum contribution limit.

The second objective of the Basel Committee in this area is to increase the medium- and long-term resiliency of banks' liquidity risk profile. This can be accomplished by creating additional incentives for banks to fund their activities with more stable sources of funding on an ongoing basis. The Basel Committee developed the Net Stable Funding Ratio (NSFR) to achieve this objective and to complement the short-term requirements of the LCR. The NSFR requires a minimum amount of funding that is expected to be stable over a one-year time horizon based on liquidity risk factors assigned to assets and off-balance sheet liquidity exposures. The NSFR essentially requires that a bank's "available stable funding" should at least equal its "required stable funding." The metric is defined as follows:

$$\frac{\textit{Available Amount of Stable Funding}}{\textit{Required Amount of Stable Funding}} \geq 100\%$$

Available Stable Funding (ASF) includes capital, preferred stock maturing in one year or more, liabilities with maturities of one year or more, and stable deposits. Required stable funding (RSF) includes a broad spectrum of a bank's assets and off-balance sheet exposures. Supervisory assumptions are used to calculate ASF and RSF.

The Basel Committee issued its proposal in December 2009. In 2010, the Committee analyzed industry comments and conducted a CQIS in order to assess the effects of the proposals on the banking industry. In July 2010, the Committee issued a revised set of calibrations of the liquidity standards contained in the December 2009 proposal. However, work continues on both standards with an expected revised draft due by year-end 2010. At that time, the standards will enter into an observation period before final implementation (for details see Table 2 below).

Transition

The phasing in of the minimum Tier 1 common threshold will begin on January 1, 2013. This two-year delay is intended to give banks ample opportunity to prepare for the higher standard. The transition to the higher Tier 1 common standard will encompass a three-year interval, with the minimum requirement starting at 3.5 percent in 2013 and increasing by one-half percentage point in each of the subsequent two years. The 2.5 percentage point conservation buffer will be phased in starting in January 2016, and will last four years. At the conclusion of 2018 (on January 1, 2019), the minimum ratio plus the capital conservation buffer will be fully implemented.

The Basel Committee settled on this gradual phase-in based on the substantially higher level of the fully phased-in Tier 1 common minimum. The fully phased-in minimum requirement of 4.5 percent is more than two times the current *de facto* U.S. and international minimum of two percent.[3] In addition, the calculation of this higher minimum is more conservative, as described earlier. Adding to this 4.5 percent minimum an additional conservation buffer of 2.5 percentage points, which banking organizations must meet to avoid dividend and compensation constraints, results in a ratio that is almost four times the current requirement for common equity.

The other Basel III enhancements, including new leverage requirements and liquidity standards, are also subject to a gradual monitoring and implementation schedule to ensure that they operate as intended. The full phase-in schedule is restated below.

[3] The current *de facto* two percent common equity standard is based on the fact that the current Tier 1 standard is four percentage points, with the expectation that common equity comprise the predominant form of the Tier 1 measure.

Table 2
Phase-In of New Minimum Regulatory Capital and Liquidity Ratio Threshold Requirements
(January 1 of each year)

	2011	2012	2013	2014	2015	2016	2017	2018	2019
Leverage Ratio	Monitoring		Parallel Run/Disclosure 1/1/2015						
Minimum Common Equity			3.5%	4.0%	4.5%	4.5%	4.5%	4.5%	4.5%
Capital Conservation Buffer						.625%	1.25%	1.875%	2.5%
Minimum Common Equity plus Conservation Buffer			3.5%	4.0%	4.5%	5.125%	5.75%	6.375%	7.0%
Phase-In of Deductions from Common Equity				20%	40%	60%	80%	100%	100%
Minimum Tier 1 Capital			4.5%	5.5%	6.0%	6.0%	6.0%	6.0%	6.0%
Minimum Total Capital			8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%
Minimum Total Capital plus Conservation Buffer			8.0%	8.0%	8.0%	8.625%	9.125%	9.875%	10.5%
Capital instruments that no longer qualify as Tier 1 or Tier 2 capital			Phase out over ten years beginning 2013						
Liquidity Coverage Ratio	Observation period begins				Introduce minimum standard				
Net Stable Funding Ratio		Observation period begins						Introduce minimum standard	

RESPONSES TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM NEAL S. WOLIN

Q.1. Secretary Wolin, does the Obama administration believe that "too-big-to-fail" is dead?

A.1. Through the creation of an orderly liquidation authority, the Dodd-Frank Wall Street Reform and Consumer Protection Act (DFA) ends "too-big-to-fail." Under the DFA, the Federal Deposit Insurance Corporation has the authority to wind down any firm whose failure would pose substantial risks to our financial system. Under this liquidation authority, failing firms will be placed into a Government-run receivership, holders of common stock and other providers of regulatory capital to the firm will be forced to absorb any losses, and culpable management of the firm will be terminated.

Q.2. Section 155 of Dodd-Frank requires that during the 2-year period following enactment the Federal Reserve Board provide to the Office of Financial Research "an amount sufficient to cover the expenses of the Office."

Secretary Wolin, what has Treasury determined to be the amount necessary to cover expenses of the Office of Financial Research for the remainder of the year?

A.2. The Office of Financial Research (OFR) submitted an initial funding request of $2.1 million to the Federal Reserve Board. These funds are being used for planning and initial implementation of Congressional mandates for the OFR. Estimated expenses for all of FY2011 and FY2012 will be reflected in the President's Budget for FY2012. We will provide details regarding those estimates once the Budget is published.

Q.3. Chairman Bernanke and Secretary Wolin, the Fed and Treasury provided extraordinary Government support when it bailed out AIG during the recent crisis. The spirit of part of Title II of Dodd-Frank is to promote transparency of Fed emergency actions. In that same spirit, I wonder if you can provide some information about taxpayer investments in AIG.

First, how much taxpayer-funded assistance did the Government provide to AIG? Second, to date, and given current market prices of AIG financial instruments—not projections of future values—how much have U.S. taxpayers lost because of that bailout?

A.3. Aggregate peak Federal Reserve Bank of New York and Treasury commitments to AIG totaled $180 billion. The aggregate amount of outstanding Government support to AIG is approximately $93 billion. When that support is valued using current market prices, the taxpayer has not incurred a loss. Instead, the current market value of the $93 billion of taxpayer investment (in the form of loans to and investments in AIG and its related entities)—based on AIG's closing stock price on January 26—is approximately $120 billion. This represents approximately $27 billion of profit to the taxpayer.

Q.4. Secretary Wolin, the new "Assistant to the President and Special Advisor to the Secretary of the Treasury on the Consumer Financial Protection Bureau," Elizabeth Warren, writes the following in Chapter 6 of her populist 2003 book titled *The Two Income Trap*:

"The only way to stop predatory lending once and for all is to go directly to the heart of the loan—the interest rate. Limiting the amount of interest that creditors can charge avoids the hide-and-seek game over what is and what is not 'predatory,' offering instead a simple, effective means of regulation."

Secretary Wolin, given Ms. Warren's calls for usury ceilings on allowable interest rates and other forms of price controls in credit markets, and given her Special Advisor status, does Treasury plan to have the CFPB set allowable prices for credit and nationwide ceilings on interest rates?

A.4. The Treasury does not plan to have the Bureau of Consumer Financial Protection ("Consumer Financial Protection Bureau" or "CFPB") set allowable prices for credit and nationwide ceilings on interest rates.

Q.5. Secretary Wolin, you testified that Treasury and those in charge of "standing up" the CFPB will "soon" have a transparency policy available. When do you expect to have a transparency policy available?

When will Treasury make available, publicly and to this Committee, the names, affiliations and agendas of individuals who meet with Treasury officials, including Assistant to the President and Special Advisor to the Secretary of the Treasury on the Consumer Financial Protection Bureau Ms. Elizabeth Warren?

A.5. The Department of the Treasury strongly supports increased transparency in Government, and the Secretary has committed to implementing the DFA in an open and transparent manner. On November 1, 2010, Treasury implemented a transparency policy that applies to in-person meetings in which Treasury employees who are Deputy Assistant Secretaries or Treasury officials of equal or higher rank participate. Meetings involving Special Advisor to the Secretary Elizabeth Warren are subject to the transparency requirements promulgated under this policy.

Treasury's transparency policy requires meetings between these Treasury officials and private sector individuals or entities and nongovernmental organizations that are set up to discuss policy implementation of the Dodd-Frank Act be posted to the Treasury Department's Web site. Disclosure consists of: (1) the date of the meeting; (2) the names and titles of all covered Treasury participants; (3) the names and affiliations of all non-Treasury participants, and; (4) a list of the primary topics of conversation related to Dodd-Frank implementation.

Meeting disclosures will be posted to the Treasury Web site by the last day of each month, covering meetings that took place during the previous month. For example, the first posting occurred on December 30, 2010, and covered meetings that took place in November 2010.

In addition, on a monthly basis, Professor Warren posts her full calendar—with minimal redactions—on the Treasury Web site.

Q.6. Mr. Wolin, while the Dodd-Frank Act prohibits Treasury from creating any new programs under the Troubled Asset Relief Program (TARP), it does not affect the TARP's October 3, 2010, expiration as defined in the Emergency Economic Stabilization Act (EESA). While some say that Dodd-Frank ends TARP, it is important to remain clear that TARP bailout money will continue to flow even with provisions of the Dodd-Frank Act.

According to the Congressional Oversight Panel's September 16, 2010, report titled September Oversight Report: Assessing the TARP on the Eve of Its Expiration, with respect to the Treasury Secretary's authority under TARP:

> EESA, which was signed into law on October 3, 2008, is clear that the Secretary cannot extend his authority under the TARP beyond October 3, 2010. Section 120(b) of EESA reads: 'The Secretary, upon certification to Congress, may extend the authority under this Act to expire not later than 2 years from the date of enactment of this Act.' The phrase 'the authority under this Act' would seem to capture all authority provided under EESA; however, the statute allows for one exception. Section 106(e) of EESA stipulates: 'The authority of the Secretary to hold any troubled assets purchased under this Act before the termination date in Section 120, or to purchase or fund the purchase of a troubled asset under a commitment entered into before the termination in Section 120, is not subject to the provisions of Section 120.'
>
> Section 106(e) provides Treasury with two specific authorities. First, it allows Treasury to hold its investments made through the TARP after October 3, 2010. Second, it allows Treasury to continue to use the TARP to fund TARP commitments, provided Treasury had made those commitments prior to October 3. Treasury has committed TARP funding to a variety of programs that it has not yet fully funded to their allocated amounts. Many of these programs will continue to receive TARP funding well beyond October 3, 2010. HAMP represents the largest commitment of TARP dollars yet to be expended. Treasury considers its HAMP contracts to be 'financial instruments' or 'commitments to purchase troubled assets' and, therefore, captured under Section 106(e). According to Treasury, the modification payments 'made to servicers are the purchase prices for the financial instruments' or troubled assets. As a result, Treasury plans to continue to fund HAMP and make modification payments to mortgage servicers in the years ahead.
>
> Treasury has noted to the Panel that it will lose some of its flexibility to alter operational aspects of HAMP after October 3. First, it will not be able to enlist new servicers to HAMP. Treasury has explained to the Panel that in its view the authority under Section 106(e) 'to purchase or fund the purchase of a troubled asset under a commitment entered into before the termination' of TARP requires Treasury to have entered into a HAMP contract with a mortgage servicer on or prior to October 3, 2010. Treasury has also explained to the Panel that it will lose its ability to use committed dollars under HAMP if a servicer were to drop from the program after TARP's expiration. To provide it with more flexibility and maximize HAMP com-

> mitted dollars, Treasury has informed the Panel that it is exploring changes to the way in which purchase prices are calculated for HAMP contracts. Currently, the purchase price in a HAMP contract is a set dollar amount under Treasury's proposed plan, purchase prices will instead be based on a formula. This change will enable Treasury to preserve RAMP funding after TARP's expiration date. According to Treasury, under the new arrangement, if a servicer were to discontinue participation in HAMP, the funds that had been committed to that servicer would not lapse, or become unavailable for further use, but instead would be spread among the remaining servicers. The change would be made by issuance of a supplemental directive. (Footnotes in original text omitted.)

Mr. Wolin, would you elaborate on any changes in Treasury's TARP programs designed to maintain TARP money availability for future uses, to ensure that money will be available so that programs can continue to receive TARP funding "well beyond October. 3, 2010," or so that Treasury can preserve TARP funding after TARP's expiration date?

A.6. Treasury has implemented its TARP programs-including the housing programs described above-pursuant to its statutory authority under the Emergency Economic Stabilization Act (EESA). As you note, EESA requires that purchases or commitments to purchase troubled assets be entered into by October 3, 2010.

In regard to the Home Affordable Modification Program (RAMP), Treasury entered into contracts with various mortgage servicers prior to October 3, 2010. Each contract originally specified a maximum purchase price by Treasury—a fixed dollar amount that represented the maximum amount of TARP funding available to each servicer under the program. Treasury periodically adjusted the maximum purchase prices based on its analysis of the respective servicers' volume of eligible loans and their performance under the program.

On October 1, 2010, Treasury issued revised guidance regarding each servicer's maximum purchase price. According to the guidance, each servicer's maximum purchase price will be adjusted in the future—beginning on January 1, 2011, and updated at the beginning of each calendar quarter, or at other intervals chosen by Treasury—pursuant to a preestablished, set formula. It is important to note that the revised guidance did not change the total funding that already had been committed under RAMP, or the participants in the program. Instead, it merely provided a mechanism to shift resources among servicers based on their capacity and implementation of the program. In other words, it ensured that taxpayer resources are being allocated in an effective and efficient manner.

Q.7. The Financial Stability Oversight Council is an important feature of Dodd-Frank. During the conference, my amendment was adopted to clarify the role of the Council and the Federal Reserve. My amendment gave the Council responsibility for financial stability regulation. Up to that point, the legislation had colocated this responsibility at the Fed and the Council. The Congressional intent is clear that you, as members of the Council, are responsible for all policy matters related to financial stability. After the Council acts, implementation of your policy determinations will fall to the individual Federal financial regulators, including, of course, the Fed.

With this in mind, I would like each of you to comment on your preparations to serve on the Council: Have you directed your staff to examine and study all of the issues that will come before you? Are you prepared to participate on the Council, not as a rubber stamp for the Chairman of the Council, but as a fully informed individual participant?

A.7. As Chair of the Financial Stability Oversight Council (FSOC), Treasury is fully prepared to participate, together with the other members of the Council, in all aspects of the FSOC's work and is committed to ensuring that the FSOC accomplishes its objectives.

The duties of the FSOC commenced upon enactment and the work of implementation started immediately. Member agencies have been full participants in the FSOC's work addressing matters related to financial stability.

The FSOC has already taken important steps to fulfill its duties in a rigorous, transparent manner. At its first three meetings, the FSOC released requests for public comment regarding the criteria for designations of nonbank financial firms and financial market utilities for supervision by the Federal Reserve. In addition, the FSOC released an integrated implementation roadmap reflecting the priorities and statutory requirements of the FSOC and its member agencies over the first 18 months of implementation of the Dodd-Frank Act.

In its most recent meeting, the FSOC released a study on effective implementation of the Volcker rule (Section 619 of the DFA) and the concentration limit on growth by acquisition (Section 622 of the DFA). The FSOC also released a notice of proposed rulemaking on the process and criteria to designate nonbank financial firms for consolidated supervision. We intend to build upon this collaborative approach for all matters that come before the FSOC.

Q.8. Secretary Geithner has argued that there is a strong case to be made for continuing Government guarantees of mortgage-backed securities. Additionally, the Federal Reserve published a paper that proposes Government guarantees of a wide range of asset backed securities, including those backed by mortgages, credit cards, autos, student loans, commercial real estate, and covered bonds. While some may believe that the Government will charge fair prices for Government guarantees, the history of Government run insurance programs suggests that things will not go well.

Does anyone on the panel support extending or increasing Government insurance against losses on asset backed securities which, it seems to me, socializes risk, puts taxpayers on the hook for losses, and protects Wall Street against losses?

A.8. The Administration is committed to carefully considering a wide range of reform alternatives. Treasury is performing thorough analysis of these alternatives and consulting with a wide array of stakeholders in order to determine the potential consequences of various reform proposals.

It is important to emphasize that the current level of Government involvement in the market is neither sustainable nor desirable. In formulating its plan for reform, the Administration is committed to crowding in private capital as soon as is practicable and places a high priority on ensuring significant private sector involvement in the future structure of mortgage finance. Should any form of Government guarantee survive the rigorous review of alternatives by Congress, it would have to be accurately priced to reflect the risk.

Q.9. Please provide the Committee with an implementation schedule that includes:

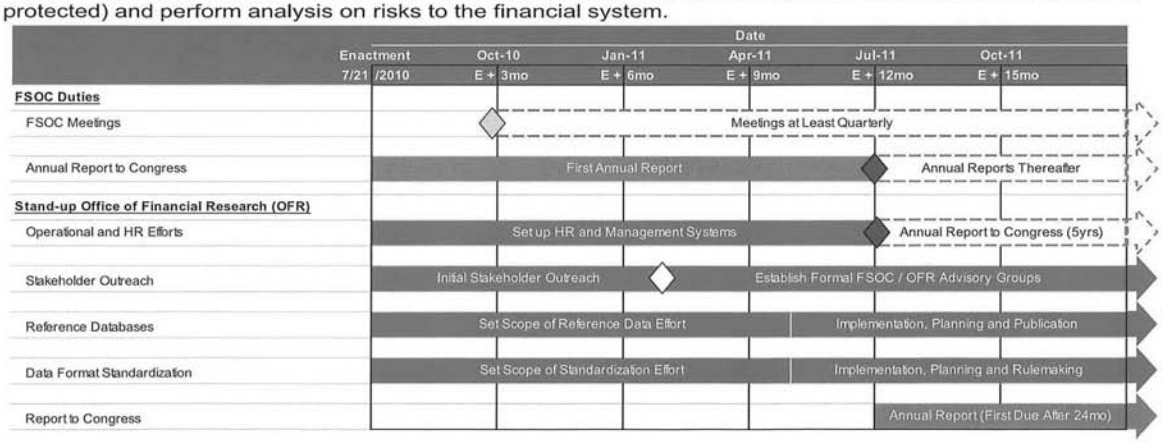
(a) a list of the rules and studies that your agency is responsible for promulgating or conducting under Dodd-Frank and the date by which you intend to complete each rule or study; and

(b) a list of the reorganizational tasks your agency will undertake to fulfill the mandates of Dodd-Frank and the date by which you intend to complete each task.

A.9. Please see attached timelines.

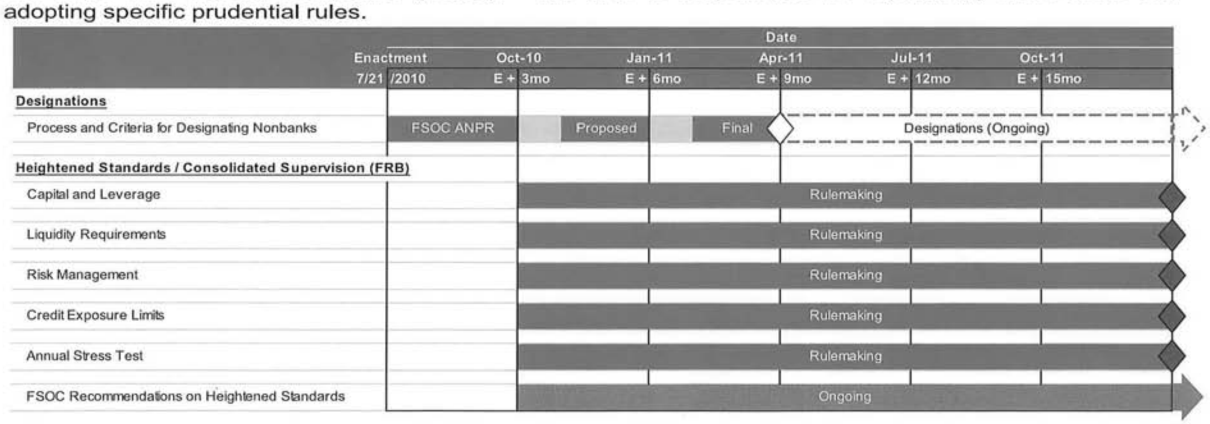
Monitoring Systemic Risk

The task of monitoring systemic risk throughout the financial system is primarily the responsibility of the FSOC which must submit an annual report to Congress and respond to emerging threats. The FSOC is supported by a new Office of Financial Research (OFR) with a responsibility to set standards for data reported and collected, to collect and publish data (while ensuring that business confidential information is protected) and perform analysis on risks to the financial system.



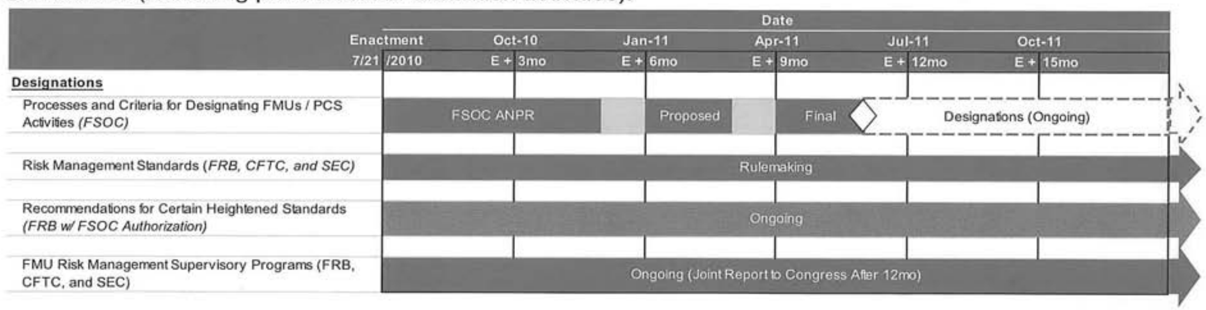
Oversight of Large, Interconnected Financial Companies

The Act, for the first time, provides for consolidated supervision and heightened prudential standards for large, interconnected nonbank financial companies. The FSOC has the authority to designate nonbank financial companies for consolidated supervision and to recommend heightened standards for these firms and large bank holding companies (BHCs). The FRB is responsible for supervising these firms and adopting specific prudential rules.



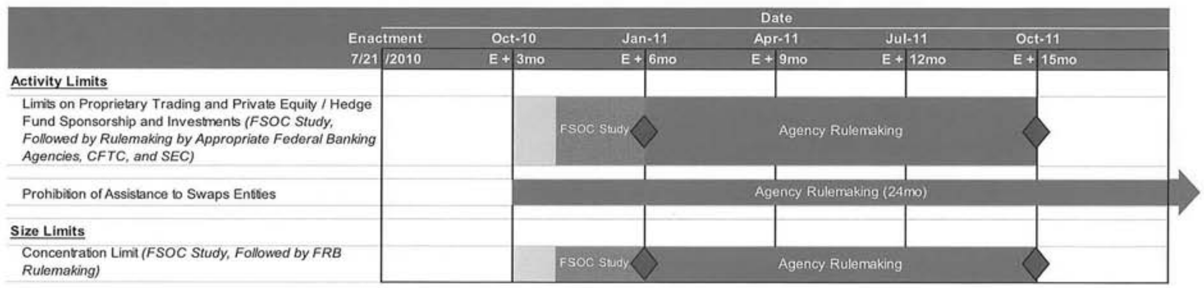
Systemic Financial Market Utilities and Payment, Clearing, and Settlement Activities

The Act provides a framework for the oversight of systemically important financial market utilities (FMUs) and payment, clearing, and settlement (PCS) activities by financial institutions. The Act defines an *FMU* as a multi-lateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the FMU, and a *PCS activity* as an activity carried out by one or more financial institutions to facilitate the completion of financial transactions (excluding pre-trade and execution activities).



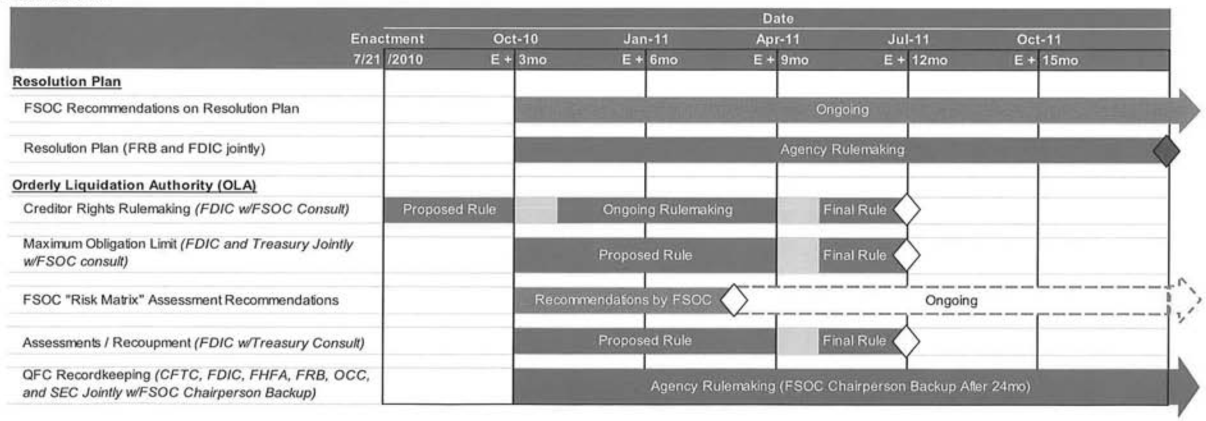
Constraining Activities and Size of Financial Institutions

The Act includes measures to constrain proprietary trading and private fund investments for institutions with access to deposit insurance. The Act also limits the growth of the largest financial institutions by acquisition.



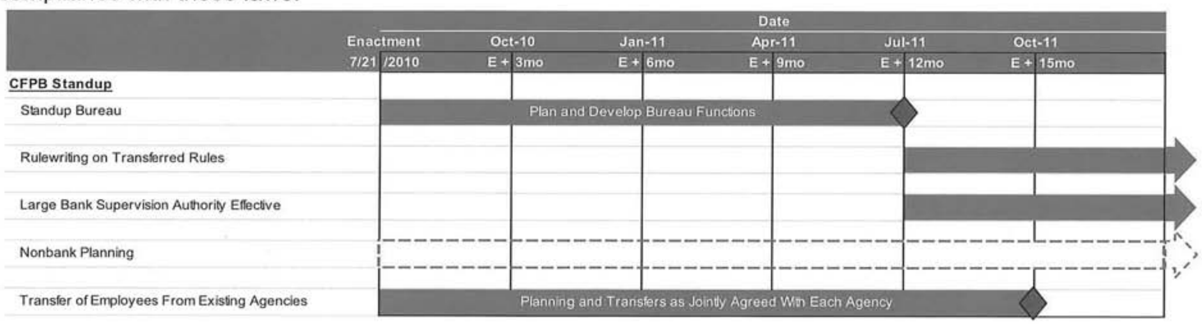
Resolution Plans and Orderly Liquidation Authority

The Act requires the FRB and the FDIC to issue joint rules requiring large interconnected financial firms to periodically submit plans for their rapid and orderly resolution ("resolution plans"). The Act also provides the FDIC with authority to write rules and policies to implement the Orderly Liquidation Authority. In many cases, the rulemaking, policies and procedures require consultation with, or concurrence of, the FSOC or its members.



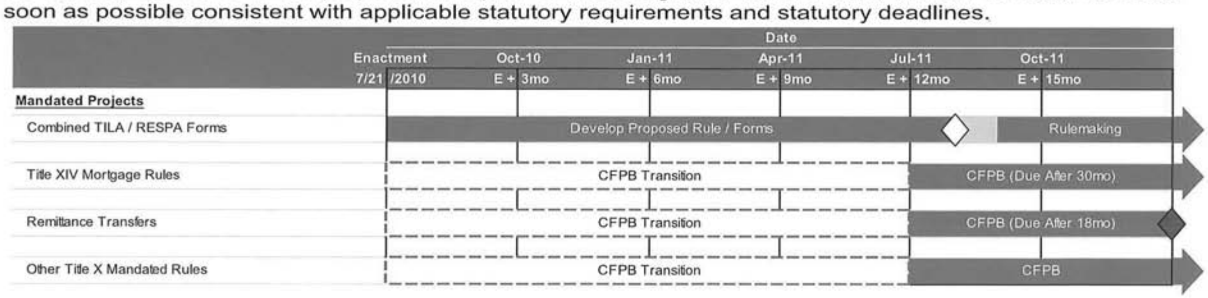
Consumer Protection – CFPB Standup

The Act creates an independent Consumer Financial Protection Bureau (CFPB) to consolidate certain authorities that are currently spread across seven federal agencies and to begin examining nonbank financial services providers. The CFPB will be responsible for conducting research, providing financial education, maintaining a nationwide consumer complaint response unit, writing rules to implement federal consumer financial laws, and supervising very large banks and key nonbank financial services providers for compliance with those laws.



Consumer Protection – Regulations

The Act mandates that regulations be written to effectuate new consumer protections for mortgages, remittances, and other products. Rulemaking authority for most provisions is vested with existing agencies until July 21, 2011, when the authority transfers to the CFPB and various other new authorities take effect. If the existing agencies do not propose rules prior to the designated transfer date, the CFPB would do so as soon as possible consistent with applicable statutory requirements and statutory deadlines.



RESPONSES TO WRITTEN QUESTIONS OF SENATOR BROWN FROM NEAL S. WOLIN

Q.1. Over the last 15 years, the 6 biggest banks grew from having assets equal to 17 percent of GDP to 63 percent of GDP. The four largest banks control about 48 percent of the total assets in the Nation's banking system. And the 5 largest dealer banks control 80 percent of the derivatives market and account for 96 percent of the exposure to credit derivatives.

Part of the Volcker Rule, section 622 of the Dodd-Frank Act, requires the Financial Stability Oversight Council (FSOC), to study and make recommendations concerning the effects of financial sector concentration on financial stability, moral hazard, efficiency, and competitiveness in the financial system. Subject to these recommendations, no company will be permitted to hold more than 10 percent of the liabilities held by all financial companies, with some significant exceptions.

What are effects does concentration in the financial industry have on financial stability, moral hazard, efficiency, and competitiveness?

A.1. The FSOC believes that the concentration limit that is contained in Section 622 of the DFA will have a positive impact on U.S. financial stability. Specifically, the FSOC believes that the concentration limit will reduce the risks to U.S. financial stability created by increased concentration arising from mergers, consolidations or acquisitions involving the largest U.S. financial companies. Restrictions on future growth by acquisition of the largest financial companies ultimately will prevent acquisitions that could make these firms harder for their officers and directors to manage, for the financial markets to understand and discipline, and for regulators to supervise. The concentration limit, as structured, could also have the beneficial effect of causing the largest financial companies to either shed risk or raise capital to reduce their liabilities so as to permit additional acquisitions under the concentration limit. Such actions, other things equal, would tend to reduce the chance that the firm would fail.

Although the FSOC expects the impact of the concentration limit on moral hazard, competition, and the availability of credit in the U.S. financial system to be generally neutral over the short- to medium-term, over the long run the FSOC expects the concentration limit to enhance the competitiveness of U.S. financial markets by preventing the increased dominance of those markets by a very small number of firms.

Q.2. Given that the six biggest banks alone have about $7.4 trillion in liabilities, almost 53 percent of GDP, do you think this provision will meaningfully restrict the size of financial institutions?

A.2. The concentration limit is one of several regulatory tools, including the tougher prudential standards for the largest, most interconnected financial institutions and the new orderly liquidation authority, designed to work in a complementary fashion to restrain the risks posed to financial stability by the largest, most interconnected firms.

Q.3. The Basel Committee on Banking Supervision set the so-called "Basel III" minimum capital requirements for banks at 8 percent, with an additional 2.5 percent buffer. But a recent study by the Bank for International Settlements (BIS) suggests that the optimal capital ratio would actually be about 13 percent. The Financial Stability Oversight Council (FSOC), of which your organizations are a member, will recommend capital requirements for systemically important financial companies.

Do you favor increasing capital for systemically important financial companies above the 10.5 percent Basel ITI ratio, and closer to the 13 percent number?

A.3. A subsequent amendment to Basel II by the Basel Committee (effective at the beginning of 2012) will increase capital requirements on risky securitizations and bank trading book activities that affect the largest banks, thereby reducing the perverse incentives for these banks to engage in such activities. The Basel Committee estimates these changes will increase the capital requirements for these activities by a factor of three to four times.

Basel III substantially increases the quantity of common equity required to absorb losses, while also increasing the deductions from the amount of common equity for risky activities. These changes will increase the common equity requirement by more than three times, before even considering more stringent capital deductions that will mostly affect the largest banks. Capital requirements for counterparty credit risk, which particularly affects the largest banks, are also being increased. Moreover, Basel III introduces, for the first time, a global leverage ratio standard and a global liquidity ratio standard. The Basel III requirements are rigorous and are designed to ensure that major banks hold enough capital to withstand losses as large as what we saw in the depths of this recession and still have the ability to operate without turning to the taxpayer for extraordinary help. We are confident this agreement will make our financial system more stable and more resilient.

The Basel Committee has stated that it is "conducting further work on systemic banks and contingent capital in close coordination with the FSB." As our supervisors and regulators work to meet the requirements of the Dodd-Frank Act, it is important to align international financial rules so as to ensure level playing field.

Q.4. Would you be comfortable establishing progressive capital requirements that increase as institutions grow larger?

A.4. We fully endorse the Dodd-Frank Act which requires that the largest firms face higher prudential standards, including higher capital requirements. These firms should be forced to internalize the cost of the risks they impose on the financial system, and to strengthen their ability to withstand shocks and downturns.

Basel III effectively will increase capital requirements for the largest banks by increasing the quantity and quality of capital that banks must hold, as well as the capital requirements for securitization, trading book activities, and counterparty credit risk. These new standards will better align regulatory capital requirements with the risks to which banks are exposed.

The Basel Committee has stated that it is "conducting further work on systemic banks and contingent capital in close coordination with the FSB." As our supervisors and regulators work to meet the requirements of the Dodd-Frank Act, it is important to align international financial rules so as to ensure a level playing field.

Q.5. Wall Street often argues that higher capital means higher costs for borrowers, and DIS has estimated that for each 1 percent of increased capital, banks will have to raise rates by 15 basis points (0.15 percent). Do you believe that banks could adapt to new capital requirements in ways that do not pass costs on to customers and borrowers, for example, by cutting outsized salaries and bonuses?

A.5. We are confident that the increased capital standards will make the system safer and provide an economic benefit in the long run. Basel III gives banks a meaningful transition period to meet the new standards. The new capital standards will not become effective until the beginning of 2013, and banks will not have to meet the full minimum common equity capital requirement until the beginning of 2015. The definition of capital will become progressively more stringent between 2013 and 2018. U.S. banks moved quickly to raise capital after the 2009 stress tests, and as a result, U.S. financial institutions should be in a very strong position to adopt the new global standards. Banks should be able to meet these new requirements through future earnings or equity issuance.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR TESTER FROM NEAL S. WOLIN

Q.1. Section 1022(b) of the Dodd-Frank bill requires that in rulemaking, the Consumer Financial Protection Bureau shall consider "the impact of proposed rules on covered persons, as described in section 1026, and the impact on consumers in rural areas."

What specific processes and infrastructure will the Bureau develop to ensure that it has adequate understanding of the impact of proposed rules on community banks and credit unions with assets of less than $10 billion?

How will Treasury work with the FDIC, the Federal Reserve and NCUA to ensure that Bureau has the institutional knowledge to understand the impact of proposed consumer protection regulations on community banks and credit unions?

What infrastructure will you develop to ensure the coordination and sharing of information between the Bureau and the FDIC and the Federal Reserve in cases in which the rule writing and examination and enforcement authority is split among agencies?

A.1. The Bureau of Consumer Financial Protection (Consumer Financial Protection Bureau or CFPB) implementation team is building infrastructure and processes to enable CFPB to acquire the knowledge it needs to understand and fully consider the impact of any future proposed rules on rural consumers and on banks and credit unions With assets of less than $10 billion.

The implementation team plans to work with Federal supervisors of these institutions to develop processes for consultation. The implementation team is also working with other Federal supervisors on written agreements for exchanging supervisory information about institutions SQ that CFPB can maintain an ongoing understanding of their business models and conditions.

The implementation team is also making preparations to comply with obligations under the Regulatory Flexibility Act to consider the impact of proposed regulations on the smallest banks and credit unions and, in certain cases, to establish panels to seek direct input from such institutions before proposing a regulation.

The CFPB implementation team is analyzing what other processes and infrastructure will be useful in this effort. Elizabeth Warren, Special Advisor to Secretary Geithner, is meeting regularly with community bankers across the country to get their perspectives on the impact of consumer protection regulations on community banks and credit unions.

Q.2. Mr. Wolin, during your testimony you referenced efforts that Treasury is undertaking to develop a simpler mortgage disclosure form to provide better choices for consumers. Over the past several years, Congress has enacted a number of mortgage disclosure provisions which in some cases have led to more paperwork without necessarily better informing consumers.

As it relates to mortgage disclosure, will the Bureau be conducting an analysis of all existing disclosure requirements to simplify requirements or will these efforts be layered on top of existing requirements? Will the Bureau evaluate the effectiveness of existing efforts and eliminate requirements that are ineffective?

A.2. The CFPB is currently reviewing mortgage disclosure requirements as a whole and working to ensure that they promote informed consumers and competitive markets and do not impose unnecessary requirements on banks. The CFPB will not simply layer new requirements upon requirements that are outdated or ineffective. As part of this process, the CFPB will consolidate Federal mortgage disclosures as required by the DFA. This consolidation will improve disclosure for consumers and reduce unwarranted burdens for banks.

Q.3. Will the Treasury Department designate a senior staff member who is participating in the transition efforts of the Consumer Financial Protection Bureau to serve as a liaison to community banks and credit unions, specifically those with assets of less than $10 billion?

A.3. The CFPB implementation team is setting up a robust outreach function for the CFPB, including creating an office devoted to small business and community banks. Staff is already working with small banks and credit unions, expanding the outreach efforts of Elizabeth Warren and making certain that the perspectives of small banks and credit unions are well-represented: within the consumer agency.

Q.4. Can you provide me an update on your agencies progress in implementing the property appraisal requirements of Title XIV of Dodd-Frank? What process will you use to develop and implement these requirements?

A.4. Section 1472 of Title XIV adds a new section to the Truth in Lending Act. This provision vests the initial responsibility to implement appraisal independence requirements with the Federal Reserve Board (Board). As the statute requires, the Board released an interim final rule on October 18, 2010.

With the exception of the Board's interim final rule, Section 1472 provides joint rule-writing authority for appraisal independence to the Board, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the National Credit Union Administration Board, the Federal Housing Finance Agency, and the Consumer Financial Protection Bureau. Similarly, Sections 1471 and 1473 amend the Truth in Lending Act and provide joint rulemaking authority to those same agencies with respect to requirements for in-person appraisals and appraisal management companies. As with other rules that are required to be implemented on an interagency basis, we expect the agencies to work cooperatively to adopt all the rules relating to appraisals under Title XIV by the statutory deadline of January 21, 2013.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR KOHL FROM NEAL S. WOLIN

Q.1. Title XII of Dodd Frank "encourage[s] initiatives for financial products and services that are appropriate and accessible for millions of Americans who are not fully incorporated into the financial mainstream." I helped author Section 1206 of the Act which enables the Community Development Financial Institutions Fund to establish a grant program within to encourage affordable small dollar lending through loan-loss reserve funds and provision of technical assistance. Can you please describe the Department's implementation plan for these new programs?

A.1. The Treasury Department's Community Development Financial Institutions and Office of Financial Education and Financial Access are working together to ensure the agency is ready to implement Title XII once appropriations are secured. In the near future, the Treasury Department will publish in the Federal Register one or more "Request for Comments" documents, so that it can better gauge from the public the key issues to consider when standing up these new initiatives, should appropriations be made available.

Although we have begun these initial steps, appropriated resources will be needed to implement the Small Dollar Loan Program and other proposed programs, such as Bank On USA, which are envisioned under Title XII. Funding for Title XII initiatives is necessary to capitalize on the important economic empowerment opportunities provided by Dodd-Frank.

In the mean time, we will continue to work with community based organizations, financial institutions, financial education providers, and local officials to ensure that we will be able to quickly implement Title XII programs once funding becomes available.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CRAPO FROM NEAL S. WOLIN

Q.1. We need to fix our Nation's broken housing finance system and reduce the Government's involvement in the housing market from current levels where the GSEs and FHA are guaranteeing about 95 percent of all new mortgages. According to the August FHFA report, Fannie Mae and Freddie Mac have burnt through $226 billion in capital since the middle of the 2007. Some alternatives being discussed range from a completely privatized housing finance system to a system in which the Government takes the first-loss position in the entire conforming mortgage market.

Please describe the options and rationale in each category the Administration is considering for its comprehensive reform proposal for the GSEs?

A.1. The Administration is considering a wide range of reform proposals in conjunction with its commitment to present a proposed reform white paper, as mandated by the DFA. The Administration is committed to meeting with and collecting input from a wide range of stakeholders to ensure that options and rationale for each type of reform is carefully considered. We look forward to working with Congress to deliver a reformed housing finance system as soon as practical.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR TESTER FROM BEN S. BERNENKE

Q.1. Section 1022(b) of the Dodd-Frank bill requires that in rulemaking, the Consumer Financial Protection Bureau shall consider "the impact of proposed rules on covered persons, as described in section 1026, and the impact on consumers in rural areas."

What specific guidance and resources will the FDIC and the Federal Reserve provide to the Bureau to ensure that it can adequately understand the impact of proposed rules on community banks with assets of less than $10 billion?

A.1. Where our experience as the supervisor of community banks suggests that a proposed rule could create compliance difficulties for these banks or affect credit availability, the Federal Reserve would use the public comment process to offer its analyses on the impact of the proposed rule. In addition, I would expect our analyses to suggest possible alternatives that would also be effective in protecting consumers.

Q.2. What infrastructure will the Fed and FDIC develop to ensure the coordination and sharing of information with the Bureau in cases in which the rule writing and examination and enforcement authority is split among agencies?

A.2. With the implementation of the Dodd-Frank Act, the Director of the Consumer Financial Protection Bureau will join the Federal Reserve and the other depository institution supervisory agencies as a member of the Federal Financial Institutions Examination Council (FFIEC). The Consumer Compliance Task Force of the FFIEC promotes policy coordination, a common supervisory approach, and uniform enforcement with respect to consumer protection laws and regulations. The member agencies of the FFIEC have processes in place to share appropriate supervisory information among the agencies, as needed. The Bureau's participation in the FREC should ensure that it is in the same position as the other agencies with regard to information sharing.

Q.3. Can you provide me an update on your agencies progress in implementing the property appraisal requirements of Title XIV of the Dodd-Frank Act? What process will you use to develop and implement these requirements?

A.3. Sections 1471 and 1472 of the Dodd-Frank Act amend the Truth in Lending Act (TILA). Section 1471 establishes certain property appraisal requirements for a category of loans designated "higher-risk mortgages," including a physical property inspection of the interior of the mortgage property in connection with a higher risk mortgage and a second appraisal of such properties under certain circumstances. Rulemaking authority under Section 1471 is delegated to the Federal Reserve Board (Board), FDIC, OCC, NCUA, FHFA, and Bureau. However, those rules must be based on final rules to be issued under Section 1411, which establishes minimum lending standards for residential mortgage loans. The rules under Section 1471, like all other rules required under Title IV where no specific deadline is provided, must be issued within 18 months after July 21, 2011.

Section 1472 of the Dodd-Frank Act amends TILA to establish requirements for appraisal independence in connection with home-secured loans. Section 1472 mandates that the Board issue interim final rules within 90 days after enactment. On October 18, 2010, the Board issued an interim final rule implementing the appraisal independence, mandatory reporting, and customary and reasonable fee requirements of section 1472. Section 1472 also authorizes the Board, FDIC, OCC, NCUA, FHFA, and Bureau to jointly issue regulations to address appraisal report portability.

Section 1473 of the Dodd-Frank Act directs the Board, FDIC, OCC, NCUA, FHFA, and the Bureau to jointly develop rules for appraisal management companies and automated valuation models. These mandates have been identified in the Board's Dodd-Frank related project work and will require the formation of an inter-agency working group to draft proposed regulations for comment and, after consideration of these comments to issue final regulations. This section also directs the Board, FDIC, OCC, and NCUA, in consultation with the Bureau, to assess the agencies' appraisal regulatory threshold for 1-to-4 single family residences for reasonable protection of consumers. All rules required under section 1473 must be issued within 18 months after July 21, 2011.

Section 1473 also directs the agencies to address the requirements for appraisal reviews in their appraisal regulations. It should be noted that the agencies already address appraisal review practices in the Interagency Appraisal and Evaluation Guidelines and, more recently, the agencies issued proposed revisions to these guidelines. Appraisal review practices are addressed in the proposed revisions to these guidelines. The section also prohibits in conjunction with the purchase of a consumer's principal dwelling the use of broker price opinions as the primary basis to determine the value of a piece of property for the purpose of a loan origination of a residential mortgage loan secured by such piece of property. While the Act does not direct the agencies to issue regulations to implement this requirement, the Board will consider this mandate in safety and soundness regulations and guidance on collateral valuation practices.

Other provisions of section 1473 of the Dodd-Frank Act direct the FFIEC Appraisal Subcommittee to take certain actions, including its operations, the oversight of State appraisal regulatory authorities, and appraisal management companies. The Board has a representative on the Appraisal Subcommittee. Similar to the Dodd-Frank Act project planning that is occurring at the Board, the Appraisal Subcommittee is developing its own plan and time table for implementing the Dodd-Frank mandates. This month, as mandated by the Dodd-Frank Act, the Appraisal Subcommittee adopted an increase in the National Appraiser Registry fee from $25 to $40. To provide the State appraiser regulatory agencies with sufficient time to implement this change, the new fee becomes effective on January 1, 2012.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM SHEILA C. BAIR

Q.1. Chairman Bair, Section 331 of Dodd-Frank requires that the FDIC change its assessment base for computing insurance premiums.

When will the FDIC change its insurance premium assessment base, and will the change be effective on a specific future date that the FDIC chooses or will it be retroactive?

A.1. As a result of the Dodd-Frank Act, an insured depository institution's (IDI's) assessment base will be calculated using average consolidated total assets less average tangible equity (with the possible exception of banker's banks and custodial banks, which the Dodd-Frank Act allows the FDIC to treat differently). This change constitutes a substantial revision to the deposit assessment system, which, by statute, can only be made after notice and opportunity for comment. On November 9, 2010, the FDIC Board of Directors adopted a notice of proposed rulemaking with request for comment on the changes to the assessment base mandated by Section 331 of the Dodd-Frank Act and their anticipated effect. The proposal has a 45-day comment period. The FDIC also proposes to make the changes effective April 1, 2011, and looks forward to the comments on all aspects of the proposed rulemaking.

The FDIC is committed to implementing the Dodd-Frank Act in the most expeditious manner possible and considered the possibility of making the application of the new assessment base retroactive to passage of the Dodd-Frank Act. However, to determine assessments using the new assessment base requires that a number of changes be made to the Consolidated Reports of Condition (Call Report) and Thrift Financial Report (TFR) that render retroactive application of the new assessment base operationally infeasible, both for insured depository institutions and the FDIC. Additionally, retroactively applying such changes could introduce significant legal complexity and introduce unacceptable levels of litigation risk. For these reasons, the FDIC did not propose applying the new assessment base retroactively.

Q.2. Chairman Bair, your testimony identifies that Dodd-Frank address macro-oversight of the financial industry in part by prohibiting the use of credit ratings for regulatory purposes.

Given that interpretation of the law, what is the FDIC going to eliminate credit ratings from regulations and when will the process be completed?

A.2. On August 10, 2010, the FDIC and the other Federal banking agencies issued an advanced notice of proposed rulemaking (ANPR) seeking comment on alternatives to the use of credit ratings. The ANPR listed a number of principles that the agencies believe any alternative standard of creditworthiness must meet, described the use of credit ratings in the agencies' capital rules, and discussed possible approaches to alternative standards of creditworthiness. The comment period closed on October 25, 2010. To date the FDIC has received 23 comments, which we are reviewing. The FDIC and the other banking agencies also held a roundtable discussion on this issue with industry and other participants in early November. A summary of the items discussed and other materials from the participants will be posted on the FDIC and Federal Reserve Websites. In addition, the FDIC Board, on November 9, 2010, approved the issuance of a notice of proposed rulemaking to update the FDIC's risk-based assessment system for large banks. This rule proposes eliminating any reliance on long-term debt issuer ratings in determining risk-based assessments for large banks.

We anticipate timely completion of all the necessary rulemaking to implement Section 939A of the Dodd-Frank Act.

Q.3. Chairman Bair, under Dodd-Frank, certain firms in distress may be resolved under an alternative process to bankruptcy which would be managed by the FDIC, if regulators so desire. The idea seems to be to provide the firm, or some or all of its counterparties, with funds, or "additional payments," that would not be available in a bankruptcy. There are then mechanisms available for the Government to try to recover funds over time from the firm's assets, creditors, or industry. Recently, you stated that "The authority to differentiate among creditors will be used rarely and only where such additional payments are 'essential to the implementation of the receivership or any bridge financial company.'"

Chairman Bair, what criteria would or could the FDIC use to determine whether payments are "essential" to implementation of a receivership or bridge company, and what protections exist to ensure that the criteria do not include political considerations?

A.3. On October 4, 2010, the FDIC issued a notice of proposed rulemaking addressing certain orderly liquidation authority provisions of the Dodd-Frank Act. Of particular significance, the proposed rule would clarify that the authority to make additional payments to certain creditors will never be used to provide additional payments, beyond those appropriate under the statutorily defined priority of payments, to shareholders, subordinated debt holders and bondholders. The FDIC, in this proposed rule, is proposing that these three types of creditors of the covered financial company could never, as a legal matter, meet the statutory criteria for receiving such additional payments.

To emphasize that all unsecured creditors should expect to absorb losses along with other creditors, the proposed rule clarifies the narrow circumstances and procedures under which other creditors, including short-term debt holders, could receive any additional payments or credit amounts under Sections 210(b)(4), (d)(4), or (h)(5)(E). Under the proposed rule, such payments or credit amounts could be provided to a creditor only if the FDIC Board of

Directors, by a recorded vote, determines that the payments or credits are necessary (i) to maximize the value of the assets of the covered financial company; (ii) to initiate and continue operations essential to implementation of the receivership or any bridge financial company; (iii) to maximize the present value return from the sale or other disposition of the assets of the covered financial company; or (iv) to minimize the amount of any loss realized upon the sale or other disposition of the assets of the covered financial company. The proposed rule further provides that the authority of the Board to make this decision cannot be delegated to management or staff of the FDIC. By requiring a vote by the Board, the proposed rule would require a decision on the record and ensure that the governing body of the FDIC has made a specific determination that such payments are necessary to the essential operations of the receivership or bridge financial company, to maximize the value of the assets or returns from sale, or to minimize losses.

Fundamental to an orderly liquidation of a covered financial company is the ability to continue key operations, services, and transactions that will maximize the value of the firm's assets and avoid a disorderly collapse in the marketplace. The FDIC has long had authority under the Federal Deposit Insurance Act to continue operations after the closing of a failed insured bank, if necessary, to maximize the value of the assets in order to achieve the "least costly" resolution or to prevent "serious adverse effects on economic conditions or financial stability" (12 U.S.C. 1821(d) and 1823(c)). Under the Dodd-Frank Act, the corresponding ability to continue key operations, services, and transactions is accomplished, in part, through authority for the FDIC to charter a bridge financial company. The bridge financial company is a completely new entity that will be freed from the shareholders, debt, senior executives, or bad assets and operations that contributed to the failure of the covered financial company or that would impede an orderly liquidation. Shareholders, debt holders, and creditors will receive "haircuts" based on a clear priority of payment set out in section 210(b). As in prior bridge banks used in the resolution of large insured depository institutions, however, the bridge financial company authority will allow the FDIC to stabilize the key operations of the covered financial company by continuing valuable, systemically important operations in order to maximize value.

Q.4. Recent news reports have detailed disturbing information about servicers' foreclosure processes. Allegations have ranged from forged documents to the signing of eviction notices without review.

What evidence have your agencies found in regards to these charges?

What actions have been undertaken by your agencies both to address this situation and to prevent future abuses?

What policies and procedures have your agencies put in place to ensure compliance with State laws, and when were they implemented?

A.4. The FDIC is very concerned about the devastating impact foreclosures are having on homeowners, the American economy and the banking industry. As the primary Federal supervisor for nearly 5,000 State-chartered insured institutions, we vigilantly monitor compliance with consumer protection requirements and aggressively pursue enforcement actions to address any violations of law. Upon initial review, it appears that FDIC-supervised nonmember State banks have not engaged in, and have limited exposure to, loans with affidavits signed by "robo-signers." However, the FDIC is closely monitoring the situation and will continue to work closely with State officials to ensure compliance with applicable Federal and State banking laws and regulations.

We have contacted the FDIC's loss-share and LLC partners and are receiving certifications that all past and future foreclosure claims filed under the loss-share agreement are compliant with the law. We will deny loss-share payments for any foreclosures that are found not to be compliant with State laws or not fully remediated. We are independently verifying full compliance, with a priority on owner-occupied properties.

Through our backup examination authority, our examiners also are working with other regulators on site at the major mortgage servicers. Our activities include direct verification of the loan file documentation handled by the "robo-signers" and review of the servicer's loan modification practices and their record keeping for ownership of the underlying loans. The agencies also are working together to evaluate the role played by the Mortgage Electronic Registry Service or "MERS."

Once we have complete and thorough information regarding the extent of the foreclosure documentation problems on an individual and systemwide basis, we will be in a better position to determine what actions should be taken to prevent a recurrence of this situation.

Q.5. Chairman Bernanke and Chairman Bair, have your agencies developed prototypes or templates for what information will be contained in living wills and for how frequently updates of living wills might be required of certain financial institutions?

Do you intend to develop living wills in concert with the international regulatory community and, if so, have you made any progress yet?

A.5. The FDIC and the Federal Reserve Board are in the initial stages of exploring the joint rulemaking on Resolution Plans (or "living wills") required by Section 165(d) of the Dodd-Frank Act. We will work with the Federal Reserve Board to produce a consensus template on information to be contained in the living wills and the required updating frequency within the 18 month timeframe required by the Act. In addition to the Dodd-Frank Act requirements, the FDIC already has been working extensively with domestic and international supervisors, especially over the past 2 years, to establish requirements for living wills with respect to certain large and complex, internationally active financial firms.

In May 2010, the FDIC issued a notice of proposed rulemaking entitled "Special Reporting, Analysis and Contingent Resolution Plans at Certain Large Insured Depository Institutions" (75 FR 27464 (May 17, 2010)). This proposed rule would require specific reporting and resolution planning by insured depository institutions with greater than $10 billion in total assets that are owned or controlled by a parent with total assets of more than $100 billion. This proposed rule articulated minimum requirements for a resolution plan, including information on organizational structure; business activities, relationships and counterparty exposures; capital structure; intragroup funding, transactions, accounts, exposures and concentrations; cross-border elements and any other material factors. The proposed rule would require annual updates with the additional proviso that "material information elements should be updated more frequently as reasonable and necessary, given the risk profile and structure of the institution relative to its affiliates and to demonstrate the capacity to provide specific information when needed (*e.g.,* deposit flows, intragroup funding flows, short-term funding, derivatives transactions, or material changes to capital structure or sources)."

Additionally, at the 2009 Pittsburgh G20 Summit, in response to the recent financial crisis, the G20 Leaders called on the Financial Stability Board (FSB) to propose possible measures to address the "too-big-to-fail" and moral hazard concerns associated with systemically important financial institutions. Specifically, the G20 Leaders called for the development of "internationally consistent firm-specific contingency and resolution plans." The FSB considered the issue and presented its Principles for Cross-border Cooperation on Crisis Management in April 2009 at the London G20 Summit. The FSB principles were based on the ongoing work of the Basel Committee on Banking Supervision's Cross-border Bank Resolution Group (CBRG) (cochaired by the FDIC since 2007). The CBRG's detailed final Report and Recommendations were issued on March 18, 2010, emphasizing the importance of preplanning and the development of practical and credible plans to promote resiliency in periods of severe financial distress and to facilitate a rapid resolution should that be necessary.

The FSB's Principles for Cross-Border Cooperation on Crisis Management commit national authorities to ensure that firms develop adequate contingency plans and highlight that information needs are paramount, including information regarding group structure and legal, financial and operational intragroup dependencies; the interlinkages between the firm and financial system (*e.g.,* in markets and infrastructures) in each jurisdiction in which it operates; and potential impediments to a coordinated solution stemming from the legal frameworks and bank resolution procedures of the countries in which the firm operates. The FSB Cross-border Crisis Management Working Group has recommended that supervisors ensure that firms are capable of supplying in a timely fashion the information that may be required by the authorities in managing a financial crisis. The FSB recommendations strongly encourage firms to maintain contingency plans and procedures for use in a wind-down situation (*e.g.,* fact sheets that could easily be used by insolvency practitioners) and to regularly review these plans to ensure that they remain accurate and adequate.

U.S. and international supervisors, along with the firms, have been active and responsive to the FSB's requirements. Development of resolution plans is progressing well in most jurisdictions, with individual countries being at various stages of development. Crisis management group sessions have been conducted and the

FDIC and its sister agencies are committed and engaged in the iterative process of establishing viable crisis management plans.

Q.6. The Financial Stabilty Oversight Council is an important feature of Dodd-Frank. During the conference, my amendment was adopted to clarify the role of the Council and the Federal Reserve. My amendment gave the Council responsibility for financial stability regulation. Up to that point, the legislation had colocated this responsibility at the Fed and the Council. The Congressional intent is clear that you, as members of the Council, are responsible for all policy matters related to financial stability. After the Council acts, implementation of your policy determinations will fall to the individual Federal financial regulators, including, of course, the Fed.

With this in mind, I would like each of you to comment on your preparations to serve on the Council: Have you directed your staff to examine and study all of the issues that will come before you? Are you prepared to participate on the Council, not as a rubber stamp for the Chairman of the Council, but as a fully informed individual participant?

A.6. As you point out, when the Dodd-Frank Act established the Council, it vested the Council with the responsibility for identifying financial companies and practices that could create systemic risk and taking action to mitigate those identified risks. In order to accomplish these challenging tasks, the Council needs experienced and capable staff from each of the member agencies to work as a team in implementing the Council's responsibilities. The FDIC is an active participant on a number of staff-level interagency working groups analyzing and providing input on the development of study reports and rulemakings. These working groups develop proposals with appropriate direction and review from senior agency management, including the FDIC Chairman. For example, prior to the first meeting of the Council on October 1, 2010, an interagency working group developed and vetted the Advance Notice of Proposed Rulemaking aimed at collecting information on the types of things the Council should consider when deciding whether a nonbank financial company should be subject to heightened prudential supervision by the Federal Reserve and subject to the resolution plan requirement in section 165(d) of the Act.

With this in mind, we have a significant number of staff throughout the FDIC in various disciplines that are diligently and carefully analyzing and developing positions on Council-related issues. In addition, the FDIC recently established the Office of Complex Financial Institutions, which, in part, was created to support the priority of systemic risk oversight.

The FDIC is committed to participating on the Council as a fully informed and engaged participant. In many ways, the Council's success will be determined by the willingness of its members to work together closely to implement the Council's duties. And, while the FDIC looks forward to collaborating with our colleagues to assure continued progress in strengthening the stability of our financial system, I also value the diverse views and opinions that each agency's unique perspective and expertise will bring to the table. By utilizing each agency's respective authorities and individual areas of specialized expertise to close regulatory gaps, the Council will be able to successfully carry out its objectives and prevent financial crises in the future.

Q.7. Secretary Geithner has argued that there is a strong case to be made for continuing Government guarantees of mortgage-backed securities. Additionally, the Federal Reserve published a paper that proposes Government guarantees of a wide range of asset backed securities, including those backed by mortgages, credit cards, autos, student loans, commercial real estate, and covered bonds. While some may believe that the Government will charge fair prices for Government guarantees, the history of Government run insurance programs suggests that things will not go well.

Does anyone on the panel support extending or increasing Government insurance against losses on asset backed securities which, it seems to me, socializes risk, puts taxpayers on the hook for losses, and protects Wall Street against losses?

A.7. Asset-backed securitization has grown in recent decades into an important means of channeling global savings into credit products for U.S. businesses and households outside of the traditional banking system. However, misaligned incentives and risky practices in this "shadow banking system" directly contributed to the housing bubble and the financial crisis. While the Dodd-Frank Act contains a number of measures to reform private securitization and the institutions that engage in this process, future legislation will be needed to reform the Government-sponsored mortgage enterprises (GSEs), whose implicit Federal backing also contributed to excessive growth and risk taking by these companies.

The financial reforms of the 1930s were designed to provide greater stability in our economy and to ensure that credit remains available to U.S. businesses and households in good times and bad. Following the recent financial crisis, more research should be done on the nature of the market failures that can arise in securitized asset markets and the extent to which Government backing is needed to address those market failures.

Any proposal for either a continuation of Federal backing for mortgage instruments or an expanded Federal role in backing other types of assets must meet three basic tests. First, it must respond to a clearly defined market failure that can be addressed by Government involvement. Second, any Government backstop must be explicit in nature, clearly delineated in advance and accounted for in a transparent fashion on the Government balance sheet. Third, any type of explicit Government backstop must be actuarially priced so that its direct beneficiaries—the lenders and borrowers in these markets—end up footing the bill instead of taxpayers.

These are the basic rules that govern the FDIC's program of Federal deposit insurance. The confidence of the American public in the FDIC guarantee was one of the stabilizing forces in this crisis that helped to prevent an outcome that could have been far worse. As financial markets continue to evolve in the future, there will always be an essential role for the Federal Government in preserving financial stability. But it is incumbent on us, as stewards of that Government involvement, to write and enforce a clear set of rules that protect taxpayers and prevent bailouts that undermine both fairness and financial stability.

Q.8. Please provide the Committee with an implementation schedule that includes a list of the rules and studies that your agency is responsible for promulgating or conducting under Dodd-Frank and the date by which you intend to complete each rule or study.

A.8. The FDIC has committed to implement the reforms required by the Dodd-Frank Act as quickly and transparently as possible, and within the statutory deadlines, where applicable. As part of the FDIC's efforts to improve transparency, the agency posts its planned and completed initiatives to the publicly available FDIC Initiatives Web site. The site, available at *http://www.tdic.gov/regulations/reform/initiativcs.html* and presented at the end of this response, includes the FDIC's financial reform initiatives completed to date and projected through the end of the first quarter of 2011. This site is updated weekly to reflect progress made. We hope this site will be a useful tool for finding up-to-date information on the FDIC's financial reform efforts. By the end of this quarter, the projections will be extended to the second quarter of 2011 and will continue to be updated quarterly. An additional resource for financial reform implementation information is the U.S. Department of the Treasury's Integrated Implementation Roadmap, available at *http://www.treasury.gov/FSOC/docs/FSOC%20Integrated%20Roadmap%20-%20October%201.pdf.* This document includes implementation information for many of the interagency rules, with timelines extending through the end of 2011.

The following table includes the rules the FDIC is responsible for promulgating, as well as the applicable statutory deadlines, if any. Items currently included on the FDIC Initiatives Web site with a projected completion date are marked with an asterisk. In some instances, the Dodd-Frank Act provides for agency discretion in rulemaking. Where the FDIC has exercised its discretion not to promulgate a rule at this time, it has not been listed below.

Rules and Studies

Rule or study; agencies, authority	Statutory Deadline
Study on the economic impact of regulatory limitations intended to reduce systemic risk; as member, FDIC assists in Financial Stability Oversight Council (FSOC) study; § 123	By January 17, 2011
* Mandatory rules for Resolution Plans; Board of Governors of the Federal Reserve System (FRB) and FDIC jointly;§ 165(d)(8)	Not later than January 21, 2012 (18 months from date of enactment)
Regulations implementing self-administered stress tests for financial companies; Each primary federal regulatory agency, in coordination with the FRB and the Federal Insurance Office; § 165(i)(2)	Statutory deadline for FRB regulations is January 21, 2012. FDIC will adopt a comparable schedule
* Minimum Leverage Capital Requirements; Appropriate Federal Banking Agencies; §171(b)(1)	No statutory deadline
* Minimum Risk-Based Capital Requirements; Appropriate Federal Banking Agencies; § 171(b)(2)	No statutory deadline
* Capital requirements for activities that pose risks to the financial system; Appropriate Federal Banking Agencies; § 171(b)(7)	No statutory deadline
Mandatory regulations defining "consolidated revenues" criteria for "financial company predominantly engaged in activities financial in nature"; FDIC, in consultation with Secretary of Treasury (Secretary); § 201(b)	No statutory deadline
Mandatory rules for orderly liquidation of covered brokers and dealers; SEC and FDIC jointly, in consultation with SIPC; § 205(h)	No statutory deadline
* Discretionary implementation rules as necessary or appropriate for orderly liquidations of covered financial companies; FDIC, in consultation with FSOC; § 209	No statutory deadline
* Mandatory Regulations on calculation of the Maximum Obligation Limitation; FDIC and Secretary jointly, in consultation with FSOC; § 210(n)(7).	No statutory deadline
Orderly Liquidation—Rules governing payment of post-insolvency interest to creditors (authorized, not mandated); FDIC; § 210(a)(7)(D)	No statutory deadline
Orderly Liquidation—Records retention requirements; FDIC; § 210(a)(16)(D)	No statutory deadline

Rule or study; agencies, authority	Statutory Deadline
Regulations for inflation adjustment for wage claims against financial company in receivership; FDIC; § 210(b)(1)(C) & (D)	No statutory deadline
Proper measure of actual, direct, compensatory damages caused by repudiation (optional regulation); FDIC; § 210(c)(3)(E)	No statutory deadline
Mandatory QFC recordkeeping rules; primary financial regulators jointly; § 210(c)(8)(H)(i)-(iv)	Not later than July 21, 2012
Assessments to repay Treasury (post appointment); FDIC, in consultation with Secretary; § 210(o)(6) Also clawbacks for certain additional payments to creditors	No statutory deadline
Regulations prohibiting covered financial company asset sales to certain persons; FDIC; § 210(r)(1)	No statutory deadline
Mandatory regulations regarding executive compensation (Clawbacks and definition of "compensation"); FDIC; § 210(s)(3)	No statutory deadline
Mandatory regulations for industry-wide ban against senior executives and directors responsible for systemic failure; FDIC and FRB jointly, in consultation with FSOC; § 213(d)	No statutory deadline
* Mandatory Regulations redefining assessment base; FDIC solely; § 331(b)	No statutory deadline
* Mandatory dividend regulations; FDIC; § 332	No statutory deadline
Offset assessments when Designated Reserve Ratio grows between 1.15 and 1.35 percent by September 30, 2020, for IDIs smaller than $10 billion; FDIC; § 334(e)	Offset required when reserve ratio reaches 1.15% and ends when the reserve ratio reaches 1.35 % by September 30, 2020.
* Mandatory regulations implementing permanent $250,000 deposit insurance coverage; FDIC; § 335	No statutory deadline, but effective immediately—completed.
* Mandatory regulations implementing temporary unlimited deposit insurance coverage for non-interest bearing transaction accounts (sunsets December 31, 2012); FDIC; § 343	Statute effective December 31, 2010
Mandatory regulations for Source of Strength requirement for BHCs, S&LHCs, and other companies that control IDIs; appropriate federal banking agencies (AFBAs) jointly; § 616(d)	July 21, 2011
Volcker Rule - Mandatory regulations prohibiting proprietary trading and acquisition of interest in hedge or private equity funds by IDI or company that controls IDI or affiliates; SEC, CFTC, and AFBAs; Joint rule for insured depository institutions (IDIs) with FSOC coordinating;§ 619	Due 9 months after FSOC Report (which is due by January 21, 2011)

Rule or study; agencies, authority	Statutory Deadline
Joint review and report to FSOC and Congress on the activities permissible for a bank entity; AFBAs jointly; § 620	Report due March 21, 2012
Rulemaking on minimum standards for conducting swap activities; Prudential regulators, (including banking agencies for IDIs); §§ 716 & 754	24 months after the effective date of section 716, which is 360 days after enactment
Capital and margin requirements for swap and securities-based swap dealers and major swap and securities-based swap participants; Prudential regulators, in consultation with SEC and CFTC; § 731/764	Due under statute the later of 360 days after enactment or, in the case of regulations, at least 60 days after a final rule is published
Regulations on foreign currency futures; AFBAs, CFTC, and SEC (not jointly); § 742	No statutory deadline
International harmonization of swaps regulation; The CFTC, SEC, prudential regulators & foreign regulatory authorities; § 752(a)	No statutory deadline
Mandatory regulations over when a Financial Market Utility must provide notice before changing its rules, procedures, or operations; Each supervisory agency, in consultation with FRB; § 806(e)(1)(B)	No statutory deadline
* Remove regulatory references to credit ratings, and substitute our own credit-worthiness standards; All federal agencies; § 939A	Review must be completed by July 21, 2011
Mandatory regulations governing credit risk retention in asset-backed securitizations; federal banking agencies (FBAs) and the SEC, jointly with FSOC coordination; § 941(b)	By April 18, 2011
Mandatory regulations governing credit risk retention in asset-backed securitizations backed by residential mortgages; FBAs, SEC, HUD Secretary, and the FHFA jointly with FSOC chair coordinating; § 941(b)	By April 18, 2011
* Mandatory joint regulations or guidelines on enhanced compensation structure reporting and prohibiting inappropriate incentive-based payment arrangements; AFBAs, NCUA, SEC & FHFA, jointly; § 956	April 21, 2011
Mandatory procedural rules governing setting aside of CFPB rules; members of FSOC, FSOC; § 1023	No statutory deadline
Mandatory rulemaking against retaliation against an IDI or other covered person that institutes an appeal of a conflicting supervisory determination; CFPB, Prudential Regulators, jointly; § 1025(e)(4)(E)	No statutory deadline
Regulations and procedures governing a broadly available FDIC Debt Guarantee Program; FDIC, in consultation with Secretary; § 1105(b)(1)	As soon as practicable

Rule or study; agencies, authority	Statutory Deadline
Property appraisal requirements for higher cost mortgages; FRB, OCC, FDIC, NCUA, FHFA, and CFPB; (Appraisal Subcommittee of FFIEC); § 1471	No statutory deadline
Optional appraisal report portability joint regulations; FRB, OCC, FDIC, NCUA, FHFA, and CFPB; (Appraisal Subcommittee of FFIEC); § 1472(a)	
Mandatory jointly issued minimum requirements for registration of appraisal management companies; FRB, OCC, FDIC, NCUA, FHFA, and CFPB; (Appraisal Subcommittee of FFIEC); § 1473(f)	No statutory deadline
Mandatory jointly issued requirements for the reporting of the activities of appraisal management companies to Appraisal Subcommittee; FRB, OCC, FDIC, NCUA, FHFA, and CFPB; (Appraisal Subcommittee of FFIEC); § 1473(f)	No statutory deadline
Mandatory jointly issued regulations to implement quality controls standards for automated valuation models; FRB, OCC, FDIC, NCUA, FHFA, and CFPB; (Appraisal Subcommittee of FFIEC); § 1473(q)	No statutory deadline
Study on core and brokered deposits; FDIC; § 1506(b)	Report due to Congress July 21, 2011

FDIC Initiatives under the Dodd-Frank Wall Street Reform and Consumer Protection Act

The FDIC is responsible for implementing a number of initiatives under the Dodd-Frank Wall Street Reform and Consumer Protection Act. Here are some of our recent accomplishments and upcoming plans to carry out our responsibilities under the Act.

Objectives Completed

Restoration Plan & Deposit Insurance Fund (DIF) Management Proposed Rules
Adopted a revised Restoration Plan to meet the new statutory goal for the DIF reserve ratio, and issued an NPR to set a new designated reserve ratio, implement a dividend policy, and set assessment rates (October 19, 2010). Comments on the NPR due by November 26, 2010. Notice and NPR §§332 & 334.
Section 332 of the Dodd-Frank Wall Street Reform and Consumer Protection Act
Section 334 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

DIF Assessment Base Proposed Rule
Issued an NPR to implement changes to the assessment base used to determine risk-based premiums for insured depository institutions, §331(b); proposed changes to the risk-based pricing system necessitated by changes to the assessment base. (November 9, 2010).
Notice and NPR §331
Also proposed changes in a separate NPR on assessments for large banks.
Notice and NPR §331
Section 331 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Initial Orderly Liquidation Proposed Rule
Issued NPR on initial rules relating to orderly liquidation authority and requested comments responding to additional questions aimed at a more comprehensive orderly liquidation rulemaking (October 12, 2010). Comments due on NPR by November 18, 2010; comments on additional questions due by January 18, 2011. NPR §209; View Comments
Section 209 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Unlimited Deposit Insurance Coverage for Non-interest Bearing Transaction Accounts Final Rule
After consideration of comments on NPR, issued final rule implementing temporary unlimited deposit insurance coverage for non-interest bearing transaction accounts (November 9, 2010). Comment Period closed October 15, 2010. View Comments; Final Rule §343
Section 343 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Deposit Insurance Coverage Limit Final Rule
Issued Final Rule implementing permanent increase in deposit insurance coverage to $250,000 (August 10, 2010). Final Rule §335

Section 335 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Review of Regulatory Use of Credit Ratings and Request for Comment
Issued joint Advance Notice of Proposed Rulemaking (ANPR) to request public comment on other measures of creditworthiness (as alternatives to credit ratings) for use in capital regulations (August 10, 2010). Comment period closed October 25, 2010. ANPR §939A; View Comments
Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Events Completed

Conducted Roundtable Regarding New Resolution Authority
Held first in a series of roundtable discussions with external parties on new resolution authority for systemically important nonbank financial companies and bank holding companies (August 31, 2010). (Roundtables are webcast live and subsequently archived and available for viewing.) Roundtable Agenda - Title II; Archived Webcast

Conducted Roundtable Regarding New Deposit Insurance Assessment Authority
Held roundtable discussion on the new deposit insurance assessment authority and policies for Deposit Insurance Fund (DIF) management (September 24, 2010). Roundtable Agenda - §§331, 332, & 334 Archived Webcast
Section 331 of the Dodd-Frank Wall Street Reform and Consumer Protection Act
Section 332 of the Dodd-Frank Wall Street Reform and Consumer Protection Act
Section 334 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Conducted Roundtable Regarding Resolution Plans
Co-sponsored, with Federal Reserve Board, a roundtable discussion on the resolution plans subject to joint FDIC/Federal Reserve Rulemaking and required for systemically important nonbank financial companies supervised by the Federal Reserve and bank holding companies under the Dodd-Frank Act (November 4, 2010).
Roundtable Agenda - §165 Archived Webcast
Section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Conducted Roundtable Regarding Credit Ratings
Co-sponsored, with Federal Reserve Board, a roundtable discussion on credit ratings (November 10, 2010).
Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Objectives Planned: October - December 2010

Designated Reserve Ratio Final Rule
After consideration of comments on the October NPR proposing a DIF Designated Reserve Ratio of 2%, issue a final rule.
Section 334 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Enhanced Compensation Structure Proposed Rule
Issue an NPR implementing enhanced disclosure and reporting of compensation arrangements and prohibiting incentive-based payment arrangements that encourage inappropriate risk taking by covered financial companies, §956.
Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Objectives Planned: January - March 2011

Diversity
Establish new Office of Minority and Women Inclusion, §342.
Section 342 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Credit Risk Retention ("Skin in the game") Proposed Rule
Issue NPR requiring credit risk retention for asset backed securitizations. Rules must require any securitizer to retain at least 5% of credit risk in assets it transfers through a securitization, subject to an exception for securitizations backed by Qualified Residential Mortgages, § 941
Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Resolution Plans Joint Proposed Rule
Develop joint NPR with Federal Reserve Board to implement resolution plan requirements for certain nonbank financial companies and bank holding companies, as described in connection with the November 4, 2010 Roundtable, §165(d).
Section 165(d) of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Minimum Risk-based Capital Requirements
Implement the required risk-based capital floor for the advanced approaches risk-based capital rules (Basel II), §171.
Section 171 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Initial Orderly Liquidation Final Rule
After close of comment period on the initial Orderly Liquidation NPR, consider comments, and issue Final Rule, §209.
Section 209 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Orderly Liquidation – Maximum Obligation Limitation Proposed Rule
Issue an NPR, jointly with the Secretary of the Treasury, and in consultation with the Financial Stability Oversight Council, governing the calculation of the Maximum Obligation Limitation, applicable to any FDIC borrowing from Treasury for the orderly liquidation of a specific systemically important nonbank financial company or bank holding company, §210(n)(7).
Section 210(n)(6) & (7) of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Capital and Margin Requirements
Develop joint NPR to implement capital and margin requirements for swap dealers, major swap participants, security-based swap dealers, and major security-based swap participants under each prudential regulator's jurisdiction, §731.
Section 731 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Enhanced Compensation Structure Final Rule
After consideration of comments on the NPR, issue final rule implementing enhanced disclosure and reporting of compensation arrangements and prohibiting incentive-based payment arrangements that encourage inappropriate risk taking by covered financial companies, §956.
Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Regulatory Use of Credit Ratings Proposed Rule
Review existing references to credit ratings in statutes and regulations; propose revisions to regulations that contain references to credit ratings,

§939A.
Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Objectives Planned: April - July 2011

Credit Risk Retention ("Skin in the game") Final Rule
Review comments on NPR and issue Joint Final Rule to require any securitizer to retain at least 5% of credit risk in assets it transfers through a securitization, with an exception for securitizations backed by Qualified Residential Mortgages, § 941.
Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Enhanced Compensation Structure Final Rule
Review comments on NPR and issue Joint Final Rule to implement enhanced disclosure and reporting of compensation arrangements and to prohibit incentive-based payment arrangements that encourage inappropriate risk taking by covered financial companies, § 956.
Section 956 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Broader Implementation Rules for Orderly Liquidations Final Rule
After close of comment period for additional questions included in the initial Orderly Liquidation NPR, issue ANPR, consider comments, and issue NPR and Final Rules that are more comprehensive than the initial rules adopted earlier, §209.
Section 209 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

QFC Recordkeeping Proposed and Final Rules
Issue joint NPR and, after consideration of comments, Final Rule regarding Qualified Financial Contract (QFC) recordkeeping requirements for financial companies, § 210(c)(8)(H). [QFCs are contracts between financial companies — including commodities, forward contracts, and repos — that can pose systemic risks when there are settlement failures. The Dodd-Frank Act requires the Federal primary financial regulatory agencies to adopt rules necessary to assist the FDIC in the event of an orderly liquidation].
Section 210 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Identify OTS Regulations and Orders for FDIC Enforcement
Identify and publish a list of the OTS regulations and orders that FDIC will enforce after the transfer of OTS supervision of state thrifts to FDIC, § 316(c)(3).
Section 316(c) of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Stress Tests for Financial Companies Proposed Rules
Issue an NPR (in coordination with FRB and Federal Insurance Office) regarding requirements for self-administered stress tests for FDIC-regulated depository institutions with total consolidated assets of more than $10 billion, § 165(i)(2).
Section 165 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Prohibitions on Proprietary Trading ("Volcker Rule") Proposed Rule
Issue a Joint NPR (with other Federal Banking Agencies with FSOC coordinating) prohibiting proprietary trading and acquisition of an interest in hedge or private equity funds by insured depository institutions, § 619.
Section 619 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Core and Brokered Deposit Study

Conduct a study on the use of core and brokered deposits and provide a written report to Congress with legislative recommendations, if any, to address concerns in connection with the definitions of core and brokered deposits, § 1506.
Section 1506 of the Dodd-Frank Wall Street Reform and Consumer Protection Act

Q.9. Please provide the Committee with an implementation schedule that includes a list of the reorganizational tasks your agency will undertake to fulfill the mandates of Dodd-Frank and the date by which you intend to complete each task.

A.9. 1. In August, the FDIC Board of Directors approved the creation of an Office of Complex Financial Institutions (OCFI) that will:

- perform continuous review and oversight of banks and bank holding companies with more than $100 billion in assets, as well as nonbank financial companies designated as systemically important by the FSOC to be supervised by the FRB;
- monitor risks among the largest and most complex financial institutions and develop plans for the contingency that one or more of these companies might fail; and
- carry out the FDIC's new authority to implement orderly liquidations of systemically important bank holding companies and nonbank financial companies that fail.

2. We are establishing a new division within FDIC with consumer protection as its focus. The new Division of Depositor and Consumer Protection will be created through the transition of staff from our existing Division of Supervision and Consumer Protection. We also will transfer employees from our existing research staff to the new division to perform consumer research and Home Mortgage Disclosure Act (HMDA)/fair lending analysis. On October 12, the FDIC announced the appointment of Mark Pearce as director of the new division. He will assist in the orderly set-up of the division by January 2011. We also are in the process of strengthening our legal workforce dedicated to supporting depositor and consumer protection functions.

3. In addition, the FDIC—jointly with the Board of Governors, the OCC, and the OTS—is developing an implementation plan for the transfer of OTS powers and personnel. Upon completion of the implementation plan, it will be forwarded to the Committee on Banking, Housing, and Urban Affairs, among others, for review. Any additional organizational changes required will be outlined in that document.

4. Section 342 of the Dodd-Frank Act requires the FDIC and other specified agencies to establish an Office of Minority and Women Inclusion (OMWI) within 6 months of enactment of the new law, which is January 21, 2010. We are currently considering how many additional staff will be needed, how best to integrate the work of the OMWI with our operating divisions, and whether to advertise the position of Office Director for applicants outside the FDIC. While our Board of Directors has not yet made any final decisions on how the Office will be organized and led or how many staff will be authorized, the FDIC is having robust discussions among senior management on how to best transition our existing functions to the OMWI and expand the functions to include the important new responsibilities under Section 342 of the Dodd-Frank Act.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR BROWN FROM SHEILA C. BAIR

Q.1. Over the last 15 years, the 6 biggest banks grew from having assets equal to 17 percent of GDP to 63 percent of GDP. The four largest banks control about 48 percent of the total assets in the Nation's banking system. And the 5 largest dealer banks control 80 percent of the derivatives market and account for 96 percent of the exposure to credit derivatives.

Part of the Volcker Rule, section 622 of the Dodd-Frank Act, requires the Financial Stabilty Oversight Council (FSOC), of which your organizations are a member, to study and make recommendations concerning the effects of financial sector concentration on financial stability, moral hazard, efficiency, and competitiveness in the financial system. Subject to these recommendations, no company will be permitted to hold more than 10 percent of the liabilities held by all financial companies, with some significant exceptions.

What effect does concentration in the financial industry have on financial stability, moral hazard, efficiency, and competitiveness?

A.1. Financial firms can reduce risk by diversifying across product lines and by serving wider geographic areas. The risk reducing benefit is realized as a financial firm grows in size and is able to offer more products and operate in wider markets. However, once a firm operates across almost all available business lines on a nationwide basis, it has exhausted any benefit from diversification. At this point, the firm has a risk profile that mirrors the overall risk of the market and general economic conditions. Risk is further concentrated when these financial firms become important counterparties and service providers to many transactions that facilitate financial intermediation in the economy. These issues became apparent during the financial crisis when large, complex financial organizations—because they are so interconnected—contributed to instability of the financial system.

Q.2. Given that the six biggest banks alone have about $7.4 trillion in liabilities, almost 53 percent of GDP, do you think this provision will meaningfully restrict the size of financial institutions?

A.2. Section 622 will restrict growth through merger that would put the combined firm above the 10 percent limit as implemented by regulation. However, as this question and the preamble suggest, this still represents significant concentration of industry assets and liabilities in a handful of companies.

As we have discussed in prior testimony, the notion of "Too-Big-to-Fail" (TBTF) led to a system of "privatized profits and socialized risks." This was exacerbated by other misaligned incentives throughout the financial system that led to a substantial buildup of risks in the system and the resulting crisis. The key to addressing the concentration and moral hazard issue is not only setting size and market share limits, but more importantly, addressing market perceptions that certain institutions are TBTF. If TBTF can be effectively eliminated, it will realign systemically important institutions' risk and reward framework and instill market discipline on investors and counterparties.

Q.3. How should this rule be implemented to address financial stability, moral hazard, efficiency, and competitiveness?

A.3. We are in agreement that limiting a single institution's size is prudent and helps reduce concentration risk to not only the deposit insurance fund but to the broader financial system. The FDIC and other members of the FSOC are participating in the study and recommendations required by Section 622 of the Dodd-Frank Act. The study should address many of your concerns about concentration in the financial industry including how concentration affects financial stability, moral hazard, and the efficiency and competitiveness of U.S. financial firms. The results of the study are due in January.

Q.4. Can you identify any potential loopholes in the existing provision?

A.4. Section 622 gives the FSOC wide latitude to make recommendations to the Board of Governors to issue regulations under the section, including definition of terms, as necessary. This allows the FSOC and the Board to close loopholes that may appear.

Q.5. As I've made clear before, I think the largest financial firms in this country are just too large, and that their massive size threatens our economic security and puts us at risk in future crises.

I think the rise of proprietary trading was one of the key drivers behind the massive growth in our largest financial institutions. Firms were taking on ever increasing prop trading positions, often with highly unstable short term financing, and when things froze up, the house of cards collapsed. The Volcker Rule looks to stop this risk.

I know that my colleagues, Senator Merkley and Senator Levin, drafted section 619 of the Dodd-Frank Act to ensure broad coverage of the prohibition on proprietary trading by banks, and meaningful restrictions on the largest nonbank financial firms. Nevertheless, one of the concerns I have is that firms may try to evade the restrictions. Particularly, I'm concerned that if the regulators set a definition of "trading account" that is too narrow, it might not capture all of the risks of proprietary trading. These evasions could only happen if the regulators ignore the clear direction of the law to stop proprietary trading.

Are you prepared to take a broad view on the definition of "trading account" and examine and prevent proprietary trading, wherever it occurs?

A.5. Historically, regulatory capital requirements for trading positions have been lower than requirements for banking positions, providing firms with an incentive to take a broad view of the trading account. However, we understand that the advent of the Volcker Rule could realign these incentives such that firms may be motivated to move some proprietary trading positions outside the trading account. As a result, we agree that the definition of "trading account" should be viewed broadly.

We believe the exemptions to the prohibition on proprietary trading—particularly the exemptions related to customer accommodation, hedging, and market-making and underwriting—present a more significant threat to the adoption of a meaningful ban on proprietary trading. We will work with the other regulators to define these exemptions as narrowly as possible.

Q.6. In short, are you prepared to use the full power of the Merkley-Levin provisions to cut the size and riskiness of our banks so they get back to the business of lending to families and businesses?

A.6. The provisions that strictly limit investments in hedge funds and private equity firms are important checks on the ability of banking organizations to increase both their size and risk profile through opaque structures.

The Basel Committee on Banking Supervision set the so-called "Basel II" minimum capital requirements for banks at 8 percent, with an additional 2.5 percent buffer. But a recent study by the Bank for International Settements (BIS) suggests that the optimal capital ratio would actually be about 13 percent. Going forward, the FSOC will recommend capital requirements for systemically important nonbank financial companies.

Q.7. Do you favor increasing capital for systemically important financial companies above the 10.5 percent Basel III ratio, and closer to the 13 percent number?

A.7. The regulatory capital requirements for banks should reflect the risk of the bank itself and the risk the bank poses to the broader financial system. For large systemically important banks, we have been working with the Basel Committee on Banking Supervision and the Financial Stability Board, as well as the other banking regulators, to develop systemic capital surcharges for systemically important banks. The total risk-based capital requirement as proposed by the Basel Committee is 10.5 percent. Any systemic surcharge would be added on top of that 10.5 percent minimum requirement.

Q.8. Would you be comfortable establishing progressive capital requirements that increase as institutions grow larger?

A.8. The regulators are discussing how we might apply a graduated surcharge for systemically important banks. It is certainly a credible option.

Q.9. Wall Street often argues that higher capital means higher costs for borrowers, and BIS has estimated that for each 1 percent of increased capital, banks will have to raise rates by 15 basis points (0.15 percent). Do you believe that banks could adapt to new capital requirements in ways that do not pass costs on to customers and borrowers, for example, by cutting outsized salaries and bonuses?

A.9. One of the very clear lessons of the recent financial crisis is that banks did not have enough capital or enough high quality capital. Increasing the amount and quality of capital does have a cost and the BIS estimate does provide a reasonable benchmark. Although the cost of capital is an element of pricing of credit, pricing also should reflect risk inherent in credit exposures. The financial crisis revealed that banks offered credit products at artificially low prices. As these prices are adjusted to more appropriately reflect risk, the cost of some credit products will increase and others may decrease.

Although there is not a direct correlation between compensation and cost of credit, the compensation issues are being addressed as mandated by section 956 of the Dodd-Frank Act.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR TESTER FROM SHEILA C. BAIR

Q.1. Section 1022(b) of the Dodd-Frank bill requires that in rulemaking, the Consumer Financial Protection Bureau shall consider "the impact of proposed rules on covered persons, as described in section 1026, and the impact on consumers in rural areas."

What specific guidance and resources will the FDIC and the Federal Reserve provide to the Bureau to ensure that it can adequately understand the impact of proposed rules on community banks with assets of less than $10 billion?

A.1. As the primary supervisor of community banks and their Federal deposit insurer, the FDIC is particularly sensitive to the regulatory environment in which community banks operate. With regard to the many consumer financial protection laws for which the FDIC has examination and enforcement authority, but not rulewriting authority, the FDIC has long made it a practice to convey detailed information or concerns to the agencies with rulemaking authority. The examples include, but are not limited to, the Truth in Lending Act, the Electronic Fund Transfer Act, the Real Estate Settlement Procedures Act, and Section 5 of the Federal Trade Commission Act relating to Unfair and Deceptive Acts or Practices.

Under the Dodd-Frank Act, the FDIC will not have primary rulemaking authority for consumer financial protection laws; however, the FDIC will retain consumer protection examination and enforcement authority for institutions with assets of $10 billion or less. The Dodd-Frank Act will likely strengthen the consultative process in consumer financial protection rulemaking since the Act mandates prior consultation by the Bureau with the FDIC in many provisions (such as sections 1022(b), 1031(e), and 1015, as well as in various specific sections of consumer laws). It will be critically important for the FDIC to communicate to the Bureau regarding how proposed rules could impact the FDIC's supervisory program and the affected FDIC supervised institutions. The information will be based on a variety of sources, including extensive research, supervisory experience, and outreach efforts. As a result, it will be a priority for the FDIC to provide input on proposed rules to the Consumer Financial Protection Bureau so that the Bureau has the benefit of the FDIC's long experience in supervising community banks.

Q.2. What infrastructure will the Fed and FDIC develop to ensure the coordination and sharing of information with the Bureau in cases in which the rule writing and examination and enforcement authority is split among agencies?

A.2. Under the Dodd-Frank Act, an infrastructure will be in place to ensure coordination and information sharing at the agency principal and staff levels, as well as through the interagency process.

First, the Director of the Consumer Financial Protection Bureau will be a member of the FDIC's Board. In this role, there will be opportunities to communicate on rule writing, examinations, and enforcement authority at the highest levels between the two agencies.

Second, following enactment of the Dodd-Frank Act, the FDIC approved the establishment of a new division—the Division of Depositor and Consumer Protection. One of the key reasons for creating this division was to ensure that the FDIC has a strong infrastructure in place to conduct ongoing dialogue with the new Consumer Financial Protection Bureau at the staff level in order to provide the FDIC's perspective as the supervisor of community banks.

Finally, the Consumer Compliance Task Force of the Federal Financial Institutions Examination Council (FFIEC) has long coordinated the development of examination procedures, and rule writing when appropriate, among the Federal banking regulators. As a result, the Federal banking agencies already have standard operating procedures in place for when we need to jointly develop examination procedures or regulations. In the future, the Director of the Bureau will also be a member of the FFIEC. We expect that although the Bureau will have sole rulemaking authority for many consumer protection regulations, all of the agencies that examine for and enforce these laws will continue to jointly develop examination procedures through our existing collaborative process, which will include the Bureau.

Q.3. The Dodd-Frank bill included provisions requiring the FDIC to change its insurance assessment based from domestic deposits to total assets less tangible equity. What is the FDIC's timeframe for implementing this change, including the publishing of the proposed rule, comment period and implementation date of the new assessment base for financial institutions?

A.3. As a result of the Dodd-Frank Act, an insured depository institution's (IDI's) assessment base will be calculated using average consolidated total assets less average tangible equity (with the possible exception of banker's banks and custodial banks, which the Dodd-Frank Act allows the FDIC to treat differently). This change constitutes a substantial revision to the deposit assessment system, which, by statute, can only be made after notice and opportunity for comment. Accordingly, on November 9, 2010, the FDIC's Board of Directors adopted a notice for proposed rulemaking with request for comment on changes to the assessment base and their anticipated effect. The proposed rulemaking has a 45 day comment period and proposes to make the changes effective April 1, 2011.

Q.4. Can you provide me an update on your agencies progress in implementing the property appraisal requirements of Title XIV of Dodd-Frank? What process will you use to develop and implement these requirements?

A.4. Title XIV contains several provisions pertaining to appraisals for transactions secured by a consumer's principal dwelling. Several provisions require joint rules to be promulgated, which includes drafting the joint proposed rules, soliciting public comments, and finalizing those rules. Therefore, the FDIC is working closely with the Federal Reserve Board, the Office of the Comptroller of the Currency, the National Credit Union Administration, the U.S. Department of Housing and Urban Development, and the Federal

Housing Finance Agency to address these provisions and rulemakings, as appropriate. In addition, once the Consumer Financial Protection Bureau becomes operational, this agency also will participate in interagency efforts relating to the implementation of many of these provisions.

In September 2010, the FDIC, along with the other agencies, established interagency working groups which are meeting to study and discuss key implementation issues. These groups now are identifying specific appraisal-related issues relative to transactions secured by a consumer's principal dwelling that will need to be addressed by proposed rules or interpretive guidance.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR KOHL FROM SHEILA C. BAIR

Q.1. In February 2008, the FDIC began a two-year pilot project to review affordable and responsible small-dollar loan programs in financial institutions. Title XII of the Dodd Frank Act calls for the establishment of a small dollar loan program within the Department of Treasury's Community Development Financial Institutions Fund. What has the FDIC learned from its pilot program that would be helpful for Treasury to consider as it implements its own small dollar loan program?

A.1. The FDIC's Small-Dollar Loan pilot was a two-year case study designed to illustrate the feasibility of banks offering small-dollar loans as an alternative to high-cost credit products, like payday loans or fee-based overdraft programs. The pilot ran from February 2008 to February 2010, and concluded with 28 participating banks ranging in asset size from $28 million to $10 billion. Cumulatively, during the pilot, banks made more than 34,400 loans with a principal balance of about $40.2 million. While delinquencies for loans made under the pilot were much higher than for personal unsecured loans in general, the loans had similar default rates to the general population. This fact—that loans made under the pilot are no more likely to default than other similar loans—is an important takeaway from the pilot that might be helpful to the Treasury as it implements its program.

Regarding other important lessons learned, a key point was that, as an overall program, most of the bankers did not view the small-dollar loans as a stand-alone profit generator. Rather, they indicated that long-term relationship building was the primary goal for their small dollar loan program. The bankers are seeking to generate long-term profits by using the small dollar product to build or retain multiproduct relationships.

In terms of actual product elements, bankers indicated that loan terms longer than just a few pay periods were critical for loan performance in that they gave consumers more time to recover from financial emergencies. While some banks experimented with shorter loan terms, in all but one rather specialized case, 90 days emerged as the bare minimum with averages hovering much longer, at 9 months or more. Streamlined, but solid underwriting, also was considered important for mitigating defaults.

The pilot also found that in general, small-dollar loan programs that emphasized savings linked to credit and delivery of financial education tended to have lower default rates than those that did not. Given the limited sample size and differences in program features, it is difficult to determine whether and the extent to which linked savings or formal financial education directly affected performance, however, there were some indications that these could be factors. Another interesting finding in this area was the difference of opinion among pilot bankers about mandating linked savings and financial education. Some bankers believed that these items had to be hardwired into the small-dollar lending process to break the cycle of high-cost lending. Others believed that adding features for a loan complicates the small-dollar loan product and drives stressed consumers into the ease of the payday process.

The best practices and lessons learned from the pilot resulted in the following model template of product design and delivery elements for small-dollar loans that might be of use to the Treasury. The template is simple and it is replicable in that it requires no particular technology or infrastructure investment. It also could help banks adhere to existing regulatory guidance that requires banks to monitor excessive overdraft use and offer available alternatives to qualified consumers.

A Safe, Affordable, and Feasible Template for Small-Dollar Loans

Product Element	Parameters
Amount	$2,500 or less
Term	90 days or more
Annual Percentage Rate (APR)	36 percent or less
Fees	Low or none; origination and other upfront fees plus interest charged equate to APR of 36 percent or less
Underwriting	Streamlined with proof of identity, address, and income, and a credit report to determine loan amount and repayment ability; loan decision within 24 hours
Optional Features	Mandatory savings and financial education

Source: FDIC.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MERKLEY FROM SHEILA C. BAIR

Q.1. *Regulatory Structure for Volcker Rule.* As you know, the objectives of the Merkley-Levin Volcker Rule are two-fold: (1) to address the specific risks to our financial stability caused by proprietary trades gone bad, and (2) to take on the conflicts of interests in proprietary trading.

Ensuring effective oversight will be challenging, because the issues are complicated. As you could see from the exchange at the hearing between Senator Reed and Chairman Bernanke, with interjections by Chairman Shapiro and Mr. Walsh, I and others are beginning to come of the view that there will have to be oversight at two levels. First, there will need to be real-time (or as close as practicable) monitoring and enforcement at the individual trade-by-trade level, which looks to whether any given transaction is proprietary trading. This will be necessary to ensure that the permitted activities are not abused. Second, there will need to be macro-level reviews of policies and procedures, and overall portfolio holdings. This will be necessary to ensure that proprietary positions and conflicts of interest are not cropping up despite the restrictions. In addition to monitoring and enforcing the proprietary trading and conflicts of interest restrictions, regulators are also tasked with setting appropriate capital charges, both for permitted activities, and, in the instances of nonbank financial companies supervised by the Board, capital charges for all covered activities.

Your agencies appear to have somewhat different strengths in these areas, with perhaps the SEC and CFTC having greater experience policing the securities and derivatives markets for trading violations, and the banking regulators having greater experience evaluating the safety and soundness of firms and setting appropriate capital charges and levels.

Share with me your view about the strengths you believe your agency brings to the oversight and enforcement of the Merkley-Levin Volcker Rule? Are you committed to working with your fellow regulators to best use your agency's strengths in the effort to keep our financial system safe?

A.1. As you indicated, the FDIC has significant experience in evaluating the safety and soundness of financial firms and specific investments, as well as setting appropriate regulatory capital requirements. We are prepared to work closely with our fellow regulators and use the skills and abilities of the FDIC to keep the financial system safe. We view the implementation of a strong Volcker Rule as a vital tool in this effort.

Q.2. *Data Collection.* The Dodd-Frank Act requires a significant amount of new data collection and storage, particularly in the derivatives arena. The SEC and CFTC have made a priority of new data collection in a number of areas. Collection and the ability to automate reviews of the data will be critical to enforcing a wide range of mandates under Dodd-Frank, including derivatives position limits, the Volcker Rule provisions, and other parts of the bill. At a minimum, your staffs will need to know who's making trades, the prices, how long firms hold onto their positions, and whether and how their positions are hedged.

Where is your agency in terms of thinking through the relevant data you will need to collect?

A.2. Although the CFTC and SEC are responsible for establishing data collection requirements, the FDIC staff has developed a list of the relevant data fields and is in the process of communicating these data needs directly to these agencies. As you indicate in your question, these revolve around the volume of positions and the purpose of the trade (hedge, speculate, make a market). As deposit insurer, the FDIC needs to be able to identify potential risks that are building within the financial system as a result of derivatives concentrations. Moreover, the FDIC has a specific mission regarding the disposition of over-the-counter (OTC) derivatives in the event of the failure of an insured depository or systemically significant market participant. In an earlier rulemaking, the FDIC developed data maintenance and reporting standards for the OTC derivatives in troubled banks; we refer to this as the "QFC Rule." Because the FDIC must make a decision on the disposition of the qualifying financial contracts (QFCs) one day after the appointment of the FDIC as receiver of the failed bank, an orderly resolution demands that a full understanding of the positions and the purpose of the trades be known in advance.

Q.3. Are there any major challenges you see in being able to collect and analyze that data in real-time, so as to ensure compliance with these various restrictions?

A.3. It is not clear that all of the analysis would need to be done in real time. Certainly, real time analysis would be needed to assure markets are functioning in an orderly manner and that violation of SEC or CFTC rules are not occurring. In general, the positions that banking organizations put on their books are not reversed during the course of one day. Moreover, data integrity is very important; therefore, using data that have been confirmed by both parties, or so-called "paired trades," should be the cornerstone of data accuracy for data being housed in the data repositories. For accuracy and as it pertains to the ultimate use, position reporting may not need to be in real time.

In terms of challenges, the greatest challenge likely may be obtaining accurate prices of positions in the repositories. Unlike the exchange-traded markets, where prices are generally set through a transparent market, the OTC contract values are usually marked-to-model rather than marked-to-market. Particularly for the FDIC's receivership responsibilities, knowledge of the market value of the contracts aggregated by exposure to a given counterparty (and the family of affiliates) and the value of collateral (and the jurisdiction in which it is being held) is critical.

Q.4. How do you see the newly created Office of Financial Research playing into this process?

A.4. The Office of Financial Research (OFR) will be very important for the analysis of the data and fostering data reporting infrastructure standardization. The OFR may be able to provide assistance to regulators by developing data standards. Recent public discussions by senior Treasury officials have emphasized the need to create standardized identifiers for counterparties, trade types, *etc.,* to be able to analyze meaningfully the volume of information that will be housed in multiple repositories. For example, the trade repositories likely will be based on asset classes, such as interest rates, foreign exchange, equities, *etc.* Without standardized identifiers, the ability to aggregate positions across trade repositories for a given banking organization will be limited.

Q.5. *Cross-border Resolution.* I know FDIC and to some extent others have been working very diligently to implement the new resolution authority for our Nation's large complex financial institutions—which owes so much to my colleagues on this Committee from Virginia and Tennessee.

But one of the areas I want to keep an eye on—and on which I offered an amendment during financial reform to provide additional oversight of—is how to make that resolution work for large firms operating across multiple national borders.

Where are we in terms of making the Dodd-Frank resolution authority work for large, systemically significant financial firms operating across borders? How cooperative have our international partners been in this effort?

A.5. We have received good cooperation from international supervisors regarding the development of resolution plans for cross-border firms. In January and in July of this year, multiple day meetings were held with international supervisors related to crisis management planning, specifically including resolution challenges facing the FDIC. Staff-level meetings have been ongoing with the United Kingdom, in furtherance of and pursuant to a Memorandum of Understanding (MOU) with the Bank of England specifically related to resolutions and crisis management. The FDIC continues work with other international regulators as well to develop resolution and crisis management MOUs.

Various challenges to cross-border implementation of resolutions have been identified and continue to exist. These relate to different insolvency regimes in national jurisdictions, which cause legal impediments to effectuating a cross-border resolution (*e.g.,* differences in creditor rights, contractual termination rights, impediments to transferring assets and liabilities, data protection and disclosure rules), as well as operational challenges (*e.g.,* continued access to payment and settlement systems, functioning of operations cross time zones around the world). These concerns are being discussed bilaterally, as well as at the multilateral level, with organizations such as the FSB, the International Monetary Fund and the Basel Committee.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR BUNNING FROM SHEILA C. BAIR

Q.1. Chairman Bair, I cannot tell you how many times I have heard community banks complain about how their regulators will not allow them to make good, solid, small-business loans. Congress responded to the lending crisis by creating another TARP-like structure for small business lending, which I believe was a terrible idea. To what extent is the FDIC guilty of smothering even solid loans, and is the Fed or other regulators to blame?

A.1. The FDIC is profoundly concerned about the availability of small business credit. Clearly, the recession and real estate crisis have caused banks to curtail loan originations as they seek to preserve capital and workout an increasing level of nonperforming assets. In addition, rapid collateral value depreciation is influencing banks' small business lending and loan restructuring decisions as loan-to-value ratios, in certain instances, have deteriorated beyond lenders' internal underwriting standards. We have attempted to address these issues and have taken actions internally to ensure our supervisory practices encourage, rather than hinder, the availability of small business credit. As you know, small businesses are a key driver of growth in our economy and likely will be the first enterprises to create jobs and spur an expansion.

In response to the great public concern over small business credit availability, the regulators issued the *Interagency Statement on Meeting the Credit Needs of Creditworthy Small Business Borrowers* on February 5, 2010, to encourage prudent small business lending and emphasize that examiners will apply a balanced approach in evaluating loans. The guidance states that examiners will not discourage prudent small business lending or criticize loans solely due to a decline in collateral value. This guidance was issued subsequent to the October 30, 2009, *Policy Statement on Prudent Commercial Real Estate Workouts* that encourages banks to restructure loans for commercial real estate mortgage customers experiencing difficulties making payments. This Statement applies appropriate and long-standing supervisory principles in a manner that recognizes pragmatic actions by lenders and borrowers are necessary to weather this difficult economic period. The FDIC believes these Statements have helped banks become more comfortable extending and restructuring soundly underwritten small business loans.

The FDIC has not changed its expectations for prudent small business lending. We provide banks with considerable flexibility in dealing with customer relationships and managing loan portfolios, and will continue to advocate for an expansion of prudent small business lending at the institutions we supervise.

Q.2. What is the total number of bank failures over the past 3 years, and have the failures of smaller institutions contributed to the growing trend of financial concentration in large banks?

A.2. Since the beginning of 2008 there have been 311 insured depository institution failures (as of November 15, 2010). There were 25 in 2008, 140 in 2009 and 146 as of November 15.

The failure of small insured depository institutions has not contributed to significant financial concentrations among large banks. Of the 311 failures over the past 3 years, 302 have been small institutions, defined as those with total assets of less than $10 billion. These smaller institutions amount to only 3.9 percent of the more than 7,800 insured depository institutions in existence today. The top 50 insured depository institutions hold 72 percent of total banking assets. But the top 50 institutions accounted for the acquisition of only 29 of the small failed institutions since 2008, or less than 10 percent of the total number. The trend toward increased financial concentration over the past several years has been driven mainly by the acquisition by the largest financial companies of other large companies, in many cases involving the acquisition of a troubled financial company without FDIC assistance.

Q.3. Is there anything in the Dodd-Frank law that will prevent the concentration of big banks, or will the fact that "too-big-to-fail" institutions will get both special Fed regulation and access to a new FDIC resolution process (with unlimited ability to get loans from the Treasury) actually encourage investors to leave smaller institutions and flock to the ones that are too big to fail?

A.3. Section 622 of the Dodd-Frank Act specifically restricts mergers of large financial firms that would result in their total liabilities exceeding 10 percent of the industry's total liabilities. The Council is required to complete a study on the concentration limit by late January 2011. There is currently in place a similar restriction on bank mergers based on domestic deposit concentrations.

The Dodd-Frank Title II orderly liquidation authority allowing the FDIC to resolve large nonbank financial firms is specifically designed to impose losses on the stockholders and bond holders of Systemically Important Nonbank Financial Companies or Bank Holding Companies with no cost to the American taxpayer. These new authorities will level the playing field by putting large financial firm investors at risk.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CRAPO FROM SHEILA C. BAIR

Q.1. Dodd-Frank requires that risk retention be jointly considered by the regulators for each different type of asset and includes a specific statutory mandate related to any potential reforms of the commercial mortgage-backed securities market to limit disruption. In light of the FDIC's unilateral decision to add an across the board risk retention requirement in the safe harbor rule, which the OCC opposed, how do you plan to coordinate and reconcile disagreements in the joint rulemaking?

A.1. The FDIC undertook to revise its original safe harbor rule (initially adopted in 2000) in light of accounting changes that came into effect for reporting periods after November 15, 2009. Nothing in this revised safe harbor rule (the Rule) is inconsistent with the Dodd-Frank Act. The provisions of the Dodd-Frank Act substantively address only the risk retention requirements and, pending further regulatory action, require 5 percent risk retention. This 5 percent level matches the level in the Rule (unless certain underwriting standards are met). Nonetheless, in order to assure consistency between the Rule as issued and any future interagency regulations that may be inconsistent, the Rule provides that automatically, upon the effective date of final regulations required by Section 941(b) of the Dodd-Frank Act, such final regulations shall exclusively govern the risk retention requirement under the Rule. Thus, there will not be disagreement to coordinate and reconcile because of this safe harbor rule.

Q.2. Market participants highlight uncertainty related to changing regulations, new accounting standards, and other mandates as an obstacle to a resurgence of these markets. What steps are your agencies currently taking to minimize these complications? What should be done collectively by regulators to limit this uncertainty as you look toward the joint rulemaking?

A.2. We believe that this safe harbor rule strikes a fair balance between protecting the FDIC's Deposit Insurance Fund and allowing participants to adjust to a safer, more transparent securitization market.

The FDIC advocates a reestablishment of the securitization market, but in a way that is characterized by strong disclosure requirements for investors, good loan quality, accurate documentation, better oversight of servicers, and incentives to assure that assets are managed in a way that maximizes value for investors as a whole. The FDIC has taken and is in the process of taking other steps to minimize market uncertainty.

In response to industry concerns, the FDIC did not delay, but took a measured evaluation of its original safe harbor rule. This evaluation has been in process for nearly a year, and we believe that the industry should have no problem adjusting. Even though the final regulations were adopted on September 30, 2010, application of the rule will not be effective until 2011, with the prior safe harbor rule extended through the end of the calendar year. All securitizations originated prior to January 1, 2011, will be grand fathered under the previous safe harbor rule.

While it is axiomatic that different regulatory agencies have different regulatory jurisdiction, and in exercising their different responsibilities, the agencies may have to adopt rules addressing the same issues within their regulatory mandate, the FDIC has made a conscious effort to harmonize its rules with other agencies, except where differences are appropriate to accomplish different regulatory missions. As noted in the response to the previous question, the FDIC, balancing requests from the industry for expedited revisions to the safe harbor rule with the pending financial reform legislation, issued its rule with a risk retention level that will automatically apply the risk retention levels established by the interagency regulations.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR HUTCHISON FROM SHEILA C. BAIR

Q.1. Since the passage of the Dodd-Frank Act, I have heard from a number of my small banks that are tremendously concerned about the onslaught of new regulations on the horizon, particularly because they are already drowning in a sea of regulatory burden. In fact, over the past few months, the vast majority of community banks in Texas State that they are much more concerned with future compliance exams than they are about safety and soundness exams. The reason for their concern lies simply in "missing something;" that is, not properly adhering to any of the new and unfamiliar regulations.

In addition to the amount of compliance that community banks will soon face, I am also hearing concern about the sheer cost, particularly for the smallest community banks with $250 million in assets or less. These banks will increasingly have more and more difficulty absorbing the additional costs to comply with the ever-expanding Government intervention into their business. These community banks will be forced to attract and pay for necessary staff, consultants, and lawyers as the regulations and new requirements keep piling on, something one of my bankers in Texas has described as "death by a thousand cuts." Many of these small community banks have indicated that they are simply waiting for the value of their banks to rise as the economy improves, so that they can sell their banks in the near future. In my assessment, this will leave a number of small communities without their local community bank, the primary driver of their local economy.

While it has been acknowledged over and over again throughout the debate on financial regulatory reform that community banks neither contributed to nor profited from the excesses that led to the financial crisis, community bankers in Texas, and across our country, feel that they're paying a very dear price.

What observations do you have? Is there a regulatory model that might allow these local institutions to operate in an environment where they can take deposits in from their communities, then lend out to local families and small businesses to foster economic growth and job creation in their respective communities, and do so without the economic and mental anguish of immense regulation that will only continue to increase as a result of the Dodd-Frank Act?

A.1. Congress has mandated a number of financial regulations to protect consumers and the FDIC recognizes that banks expend significant resources to comply with these laws. The FDIC is a strong advocate for consumer protection and we take our responsibility for ensuring compliance very seriously.

We agree with your constituents that this is an extremely challenging time for banks, and we applaud their efforts to maintain strong compliance programs while remediating credit quality and earnings issues associated with the economic downturn. Compliance with consumer protection laws requires considerable time and resources on the part of financial institutions, particularly during a period of stressed business conditions. Recent legislation should help level the playing field with nonbanks as they now will be required to meet the same standards as banking institutions, especially in the mortgage finance arena. However, it is clear that consumers have come to expect, and depend greatly on, insured depository institutions to design and offer fair and equitable financial services products. We believe the public's significant trust in banks has been fostered by banking institutions' diligence in maintaining effective consumer protection programs.

We understand your constituents' concerns and hope banks can continue to meet the public's expectations for delivering responsible consumer financial products. At the same time, the FDIC will strive to maintain a streamlined examination process to help ensure bankers can focus on their core banking business and serve consumers on Main Street.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM MARY L. SCHAPIRO

Q.1. Chairman Schapiro, a number of recent SEC initiatives have been approved by a split Commission.

Given the importance of implementing the Dodd-Frank legislation in a balanced manner, what steps are you taking to propose and adopt rules that have the support of all five Commissioners?

A.1. Since I have become Chairman, over 91 percent of the Commission's rulemaking actions have been approved by a unanimous vote. The Commission works hard to reach consensus on every matter, and I have rescheduled matters when additional time and further discussion may help us arrive at a decision that can be supported by all.

This is not to say, however, that unanimity is the only acceptable outcome. Sometimes, reasonable people—acting based on their own informed judgment—must ultimately agree to disagree. As our experience indicates, this happens relatively infrequently at the Commission. When it does occur, the matters are typically among the most controversial also from a public perspective. This is to be expected, as our Commission structure and public comment process is designed so that strongly held differences of opinion by external constituents are important factors that are considered by all Commissioners.

Q.2. Chairman Schapiro, the Dodd-Frank Act requires the SEC to adopt countless rules, establish new offices, and conduct a number of studies. A 10-page implementation schedule recently posted on the SEC's Web site gives an idea of what an undertaking this will be. These Dodd-Frank responsibilities must be balanced with the SEC's routine enforcement and oversight responsibilities. Needless to say, some more discretionary rulemaking by the SEC will have to be moved to the back burner in order to comply with the aggressive Dodd-Frank implementation schedule and address the serious problems with enforcement and compliance brought to light by the Madoff and Stanford cases.

How do you reconcile your decision to move forward with proxy access, a completely discretionary grant of authority in the Dodd-Frank legislation, with the need to move forward with the legislation's many other time-sensitive mandates?

What additional discretionary items do you intend to take up in the next year?

A.2. The Commission most recently proposed its "proxy access" rules on June 10, 2009, over a full year before the enactment of the Dodd-Frank Act. The comment period on these proposals was extended once, and ultimately closed in mid-January, 2010. Between that date and mid-July, 2010, the staff analyzed comments; developed a term sheet for adoption; considered Commission responses to that term sheet; and drafted an adopting release and regulatory text. Consistent with our internal processes, a fully developed adoption package was provided to Commissioners well before the Dodd-Frank Act was passed by Congress and signed into law by the President on July 21, 2010. Between that date and the Commission's adoption on August 25, 2010, the remaining staff work involved responding to Commissioners' questions, redrafting to address Commissioners' concerns, and revising the draft release to account for the statutory language on the topic included in the Dodd-Frank Act. Finalizing this regulatory action did not divert any resources that are or were necessary for implementing Dodd-Frank.

The timing was driven by a hope that new rules could be in place for most, if not all, of the 2011 proxy season.

As you note, Commission and staff resources are focused on meeting the obligations that Congress has created for us through Dodd-Frank as well as previous legislative actions. We believe, however, that certain "discretionary" rulemakings must continue to go forward—despite strained resources—to fulfill our overarching mandate of protecting investors, maintaining fair and orderly markets, and facilitating capital formation. At this time, while it is difficult to predict precisely which rulemaking efforts will go forward, non-Dodd-Frank issues I expect to bring before the Commission for consideration during the next year include: a variety of market structure rulemakings, consolidated audit trail, large trader reporting, broker-dealer financial responsibility, short-term borrowing disclosure, Regulation M, point of sale disclosure, proxy solicitation enhancements, target date funds, and 12b-1 fees. In addition, following review of the comments on our recent concept release on proxy "plumbing" issues, I expect to bring some related proposals before the Commission during the next year.

Q.3. Chairman Schapiro, Section 939G of the Dodd-Frank Act, which eliminated the expert liability exemption for credit rating agencies, shut down the already weakened securitization markets for a brief period upon enactment. A temporary fix by the SEC averted the problem, but a long-term solution still is needed. More generally, other regulatory changes in the securitization space could have unintended consequences, particularly if differences among asset classes are not taken into account.

What is the SEC doing to develop and implement a permanent solution to the credit rating agency issue?

What is the SEC doing to ensure that the securitization rules it adopts avoid creating further unintended consequences in any affected asset class?

A.3. With respect to the first question, Commission staff currently is discussing this issue with market participants and the credit rating agencies. In light of the significant revisions to the regulatory landscape currently being implemented for asset-backed securities and rating agencies, the staff is working on a solution that takes account of the new regulatory regime.

With respect to the second question, on April 7, 2010, the Commission published for public comment proposals to amend Regulation AB to enhance the disclosure investors receive when they purchase asset-backed securities. In addition, last month we issued two further proposals concerning asset-backed securities to implement Sections 932, 943, and 945 of the Dodd-Frank Act. Each of these proposals is subject to public comment, a critical step in the Commission's rulemaking process. We currently are working with our fellow regulators to propose risk retention requirements for asset-backed securities as required by Dodd-Frank, which also will be subject to notice and comment. As always, we will carefully consider all input we receive, including unintended consequences, as we formulate final rules. In addition, while we will make every effort to foresee and address unintended consequences in adopting final rules, whether in implementing Dodd-Frank or otherwise, the

Commission and its staff stand ready to act quickly to address any unintended consequences that may arise.

Q.4. Chairman Schapiro, last year you announced the creation of a new Division of Risk, Strategy, and Financial Innovation, which combined the Office of Economic Analysis and the Office of Risk Assessment, and you said "By combining economic, financial, and legal analysis in a single group, this new unit will foster a fresh approach to exchanging ideas and upgrading agency expertise."

This summer, both the Chief Economist and Deputy Chief Economist, along with some other economists, left the Commission. The former Chief Economist was quoted in a recent news article as saying that one of the reasons he left the SEC was because he felt the chief economist's role was diminished in importance under your chairmanship. In fact, prior to your chairmanship, the Chief Economist had reported directly to the Chairman. But, you insisted that the Chief Economist now report to the head of the Division of Risk, Strategy and Financial Innovation.

Why have you diminished the role of economic analysis at the Commission?

A.4. The importance of economic analysis to the SEC and its work is undiminished. Neither the creation of the new Division of Risk, Strategy, and Financial Innovation (RiskFin), nor our current need for a new Chief Economist should be viewed as reflecting any diminishment of the role of economic analysis at the SEC. On the contrary, as is clear in the portion of my statement quoted above, it was—and remains—my intention to strengthen the already significant role of economic analysis at the Commission by integrating it with other analytic disciplines and techniques into a single organization serving the entire Commission. In light of the SEC's broad responsibilities, I continue to believe that such a comprehensive, synergistic analytic capability makes far better sense than permitting economic analysis to remain isolated from other, complementary analytic disciplines that are useful in understanding emerging market conditions, trading practices, and their implications. Even so, the full benefits of combining these formerly separate or novel analytic functions cannot be realized overnight.

Vigorous and expert economic analysis under strong leadership is essential to support the Commission's work. As noted above, RiskFin was designed to combine and build upon our existing analytic capabilities. Nevertheless, as part of our ongoing search for the Chief Economist, I have made it explicit that, "the Chief Economist will report directly to me and, on economic matters, play the lead role in representing the Division of Risk, Strategy, and Financial Innovation before the Commission." I have made the Chief Economist's primary role equally clear: "I will look to the Chief Economist to assist me, my fellow Commissioners, and senior Commission staff in identifying and evaluating the economic implications of potential policy options."

Q.5. Chairman Schapiro, four SEC rulemakings in the past 5 years have been successfully challenged in court because of the Commission's failure to provide a sound economic justification for some of its arguments.

In light of these defeats, why do you insist on favoring unmeasurable, behavioral concepts like "investor confidence" as justifications for rulemakings over rigorous economic analysis based on sound theoretical arguments and solid empirical evidence?

A.5. Economic analysis is a critical component of the Commission's rulemaking process. It provides the Commission with a valuable framework to assist in the development of policies that best serve investors and the broader capital markets. For example, the Commission relies on principles of economic reasoning to understand and assess the likely responses of market participants to various regulatory alternatives. Similarly, the Commission relies on available empirical data and economic analysis to understand a potential rule's economic costs and benefits, as well as its likely effect on competition, efficiency, and capital formation.

Recognizing the importance of robust economic analysis in the rulemaking process, I established the Division of Risk, Strategy, and Financial Innovation in September 2009. A principal purpose of this new division is to elevate the role of economic analysis in the Commission's policymaking process and to strengthen the quality of the economic analysis underlying new Commission rules. As the Commission undertakes rulemaking in response to the Dodd-Frank Act and in other areas, this new division will continue to provide the Commission with sound economic analysis to inform our policy choices. The end result, I believe, will be Commission rules that rest on solid economic analyses that further our statutory mission.

Q.6. Chairman Schapiro and Chairman Gensler, the Dodd-Frank Act placed great emphasis on moving over-the-counter derivatives into clearinghouses for the purpose of reducing risk in the financial system. While this is a laudable goal, if not properly constructed, clearinghouses could be the too-big-to-fail entities at the center of the next crisis. The last thing the American people want to do is pay for another bailout.

What is each of you doing to ensure that the rules take seriously the potentially disastrous consequences of a misstep in the operation or oversight of clearinghouses?

A.6. The Commission has extensive experience with centralized clearance and settlement systems for securities. Since the 1975 amendments to the Exchange Act, the Commission has had direct regulatory authority over the clearinghouses and securities depository that serve as the infrastructure of the U.S. securities markets. To date, the Commission's authority over clearance and settlement in the security-based swap market has been much more limited. As a result of the Dodd-Frank Act, the Commission now has substantially greater authority to regulate this area.

In the coming months, I anticipate the Commission will use this new authority to consider rules designed to strengthen the risk management and governance practices of clearing agencies. The Commission staff also will continue its efforts to coordinate supervisory and oversight responsibilities in this area with the staff from the CFTC and the Federal Reserve, including under the payment, clearing, and settlement provisions of Title VIII of the Dodd-Frank Act. Both the Commission's rulemaking and its ongoing oversight of clearing agencies will continue to focus on the critical role that clearing agencies play in our financial system and the regulatory principles for those agencies set forth in the Exchange Act.

Q.7. Chairman Schapiro and Chairman Gensler, at a time when our economy is in terrible shape, we need to be particularly attentive to the unintended consequences of regulatory actions. Main Street businesses, large and small, have told us how imposing clearing and margin requirements on them will affect their ability to expand and hire. An effective, broad end user exemption is essential and completely consistent with the goals of transparency and mitigation of risk to the financial system.

Are you committed to crafting a broad end user exemption that allows our job creators to avoid costly clearing, margin, exchange trading, and other obligations under the Act?

A.7. As you note, with respect to clearing, an effective end-user exception is consistent with the policy goals of the Dodd-Frank Act. An end-user clearing exception that is appropriately implemented can facilitate the activities of end users. In the coming months, the Commission plans to propose rules relating to the end-user clearing exception, and will consider seriously the comments of all interested parties in order to help ensure appropriate implementation. With respect to margin, the Commission has not yet proposed rules under the Dodd-Frank Act provisions relating to margin requirements for noncleared security-based swaps transacted by security-based swap dealers and major security-based swap participants for which there is not a prudential regulator. I am sensitive to the concerns that have been expressed about the potential impact of these requirements—and other provisions of the Dodd-Frank Act—on end users. Accordingly, I expect that the Commission will carefully consider both the scope of its authority in this area and the potential effects of margin requirements on the markets and market participants, including the nature and extent to which such requirements could impact the business of end users. Public feedback through the notice and comment process—including input from end users—also will fully inform any final rule that the Commission may adopt.

Q.8. Chairman Schapiro and Chairman Gensler, Dodd-Frank mandates that both of your agencies adopt an unprecedented number of rules in a very short period of time. And, as you know, each of your agencies has a "statutory obligation to do what it can to apprise itself—and hence the public and the Congress—of the economic consequences of a proposed regulation before it decides whether to adopt the measure."

However, a recent news article pointed out that both the SEC and the CFTC have been without Chief Economists for months.

Chairman Schapiro and Chairman Gensler, why have your Chief Economist positions gone unfilled for so long?

How can you expect to adequately consider the economic consequences of all of your proposed rules with unfilled Chief Economist positions?

A.8. The SEC's need for sound economic analysis ranges across all three of its rule-writing divisions and includes the considerable litigation support our economists provide to the Division of Enforcement. Finding the strongest possible Chief Economist for the SEC is therefore a matter of considerable importance not only to me but to the SEC as a whole. We are conducting a broad search for the SEC's next Chief Economist and I actively have participated in that effort. I believe the additional effort we have taken to identify a range of strong candidates to meet our requirements is well worth the time inevitably entailed.

While we hope to recruit a Chief Economist soon, our economist staff in Risk Fin continues to analyze the economic implications of each proposed rule. The Chief Economist will provide strong and experienced leadership to this team of 25 PhD financial economists who routinely analyze the potential economic consequences of proposed regulatory actions and provide analytic support for SEC enforcement actions. They are also engaged in the more prospective and creative process of helping to identify the most appropriate regulatory approaches for new or evolving markets and products. Those activities continue unabated as we conduct a vigorous search for the SEC's next Chief Economist. We continue to hire experts in financial engineering and other analytic disciplines that complement our economists' analytic efforts. We are now in the midst of our annual effort to recruit new staff economists to the SEC. Attrition and replacement hiring within our staff of PhD-level financial economists is normal and can even assist in ensuring that our economist staff retains its familiarity with the latest analytic techniques and leading currents of thought in their fields.

Leading our team of professional financial economists, particularly during the present, exceptionally active period of rule writing, will require exceptional leadership and practical skills. In seeking candidates to serve as the SEC's next Chief Economist, I have, therefore, stressed that, "The Chief Economist will . . . play a special leadership role in guiding our staff economists and ensuring a uniformly high standard of analysis." I personally have sought the assistance of a wide variety of leaders outside the SEC, including each of the SEC's former Chief Economists, as we build the strongest possible list of candidates to fill this position.

Q.9. Chairman Schapiro and Chairman Gensler, the derivatives title of the Dodd-Frank Act establishes new entities called "swap execution facilities" and "security-based swap execution facilities," commonly referred to as "SEFs," as alternatives to exchanges. Ideally, multiple SEFs will compete to give market participants several different choices for trading particular types of swaps.

Given the SEC's experience in overseeing securities markets in which participants have the choice of several different trading venues, what is each of you doing to ensure that the CFTC has the benefit of the SEC's expertise in this area?

A.9. Members of SEC and CFTC staff have collaborated extensively and regularly exchanged information while working to create a framework for the regulation of the swap and security-based swap markets under the Dodd-Frank Act. In particular, the two teams working on SEFs have sought to make sure that each agency has the benefit of the other's expertise in regulating the financial markets.

Based on joint meetings with market participants and a joint roundtable on SEFs held by SEC and CFTC staff, I believe it is possible that multiple SEFs will trade the same swaps or security-based swaps. Trading on multiple markets is a hallmark of our equity and options markets, and competition among those markets helps investors and market professionals obtain the best price. We have shared with CFTC staff our experience in regulating multiple trading venues under the authority of the Exchange Act and the national market system.

Q.10. Chairman Schapiro and Chairman Gensler, Title VIII authorizes your agency to prescribe regulations for financial institutions engaged in designated activities for which each is the Supervisory Agency or the appropriate financial regulator governing the conduct of the designated activities.

What plans do you have for exercising this authority?

A.10. Commission staff has been working closely with the staffs from the Federal Reserve and the CFTC to develop a coordinated strategy for rulemaking and supervisory activities under Title VIII of the Dodd-Frank Act for financial market utilities designated as systemically important. In the coming months, I anticipate that the Commission will propose rules relating to standards for clearing agencies within its jurisdiction, including rules to implement the new "notice of material change" provisions applicable to designated financial market utilities under Title VIII.

Q.11. The Financial Stability Oversight Council is an important feature of Dodd-Frank. During the conference, my amendment was adopted to clarify the role of the Council and the Federal Reserve. My amendment gave the Council responsibility for financial stability regulation. Up to that point, the legislation had colocated this responsibility at the Fed and the Council. The Congressional intent is clear that you, as members of the Council, are responsible for all policy matters related to financial stability. After the Council acts, implementation of your policy determinations will fall to the individual Federal financial regulators, including, of course, the Fed.

With this in mind, I would like each of you to comment on your preparations to serve on the Council:

Have you directed your staff to examine and study all of the issues that will come before you?

Are you prepared to participate on the Council, not as a rubber stamp for the Chairman of the Council, but as a fully informed individual participant?

A.11. Yes. The Council and the staff of each agency (including the SEC) have formed a number of interagency working teams to establish the structure of the Council itself and address its substantive responsibilities. This includes teams establishing a process for designating systemically important nonbank financial companies and financial market utilities for heightened supervision and identifying potential risks and gaps in oversight and regulation.

The Council already has sought public comment regarding the Volcker Rule study (*http://www.treas.gov/FSOC/docs/2010-25320__PI.pdf*) and the proposed rulemaking for designating nonbank financial companies as systemically important (*http://www.treas.gov/FSOC/docs/2010-25321__PI.pdf*).

I appreciate that the Council was designed to bring together multiple independent perspectives to these and other issues that involve potential risks to the stability of our financial system. Indeed, I believe that this model is one of the Council's core strengths.

Q.12. Secretary Geithner has argued that there is a strong case to be made for continuing Government guarantees of mortgage-backed securities. Additionally, the Federal Reserve published a paper that proposes Government guarantees of a wide range of asset backed securities, including those backed by mortgages, credit cards, autos, student loans, commercial real estate, and covered bonds. While some may believe that the Government will charge fair prices for Government guarantees, the history of Government run insurance programs suggests that things will not go well.

Does anyone on the panel support extending or increasing Government insurance against losses on asset backed securities which, it seems to me, socializes risk, puts taxpayers on the hook for losses, and protects Wall Street against losses?

A.12. The mission of the SEC is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. In fulfilling this mission, the SEC's role traditionally has been to regulate the disclosure that public companies provide to their investors and to enforce the Federal securities laws, except where another role is specifically mandated or authorized by Congress,. Accordingly, I do not believe that this is a topic on which it would be appropriate for me to take a position.

Q.13. Please provide the Committee with an implementation schedule that includes:

(a) a list of the rules and studies that your agency is responsible for promulgating or conducting under Dodd-Frank and the date by which you intend to complete each rule or study; and

(b) a list of the reorganizational tasks your agency will undertake to fulfill the mandates of Dodd-Frank and the date by which you intend to complete each task.

A.13. Attached is a list containing the approximate dates of the rulemakings, studies and other actions the Commission will be undertaking pursuant to the Dodd-Frank Act in the 1 year period following its becoming law. The information contained in the list also can be found on our Web site at *http://www.sec.gov/spotlight/dodd-frank/dfactivity-upcoming.shtml#11-10*. This Web page is updated regularly. Currently, we have not yet set target dates beyond the 1-year time frame for other rulemaking actions and studies, but will make that information available on our Web site when those time frames have been developed. The Commission is on schedule to complete all of the required rulemakings, studies and other actions by the dates set forth in Dodd-Frank.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR BROWN FROM MARY L. SCHAPIRO

Q.1. As I've made clear before, I think the largest financial firms in this country are just too large, and that their massive size threatens our economic security and puts us at risk in future crises.

I think the rise of proprietary trading was one of the key drivers behind the massive growth in our largest financial institutions. Firms were taking on ever increasing prop trading positions, often with highly unstable short term financing, and when things froze up, the house of cards collapsed. The Volcker Rule looks to stop this risk.

I know that my colleagues, Senator Merkley and Senator Levin, drafted section 619 of the Dodd-Frank Act to ensure broad coverage of the prohibition on proprietary trading by banks, and meaningful restrictions on the largest nonbank financial firms. Nevertheless, one of the concerns I have is that firms may try to evade the restrictions. Particularly, I'm concerned that if the regulators set a definition of "trading account" that is too narrow, it might not capture all of the risks of proprietary trading. These evasions could only happen if the regulators ignore the clear direction of the law to stop proprietary trading.

Are you prepared to take a broad view on the definition of "trading account" and examine and prevent proprietary trading, wherever it occurs?

In short, are you prepared to use the full power of the Merkley-Levin provisions to cut the size and riskiness of our banks so they get back to the business of lending to families and businesses?

A.1. With respect to the first question, Commission staff is working closely with the staff of the bank regulators to study the definition of a "trading account" under Section 620 of the Dodd-Frank Act.[1] Commission staff is considering how the definition should be applied in the broker-dealer context to best meet the goals established by Section 619 of the Dodd-Frank Act. I am mindful—as is the Commission staff—that the results of the study currently being conducted by the Financial Stability Oversight Council (FSOC) under Section 619 also will help inform our approach to this important issue.

With respect to the second question, I must defer to our colleagues at the banking regulators, who are better-placed to address the size and riskiness of banks serving the vital function of lending to families and businesses. More broadly, however, there are parts of the Merkley-Levin provisions where our expertise can help further the goals of those provisions. For example, with respect to "proprietary trading" and "market making," Commission staff currently is sharing its expertise to inform the FSOC study, and I anticipate that this expertise will help reduce the risk that either activity is employed by firms to undercut the goals of Section 619 of the Dodd-Frank Act.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MERKLEY FROM MARY L. SCHAPIRO

Q.1. *Regulatory Structure for Volcker Rule.* As you know, the objectives of the Merkley-Levin Volcker Rule are two-fold: (1) to address the specific risks to our financial stability caused by proprietary

[1] While Section 619 establishes a broad definition of "trading account," the term historically has been used principally in a banking context because banks generally maintain separate investment accounts and trading books (as opposed to broker-dealers, who have no such separation).

trades gone bad, and (2) to take on the conflicts of interests in proprietary trading.

Ensuring effective oversight will be challenging, because the issues are complicated. As you could see from the exchange at the hearing between Senator Reed and Chairman Bernanke, with interjections by Chairman Shapiro and Mr. Walsh, I and others are beginning to come of the view that there will have to be oversight at two levels. First, there will need to be real-time (or as close as practicable) monitoring and enforcement at the individual trade-by-trade level, which looks to whether any given transaction is proprietary trading. This will be necessary to ensure that the permitted activities are not abused. Second, there will need to be macro-level reviews of policies and procedures, and overall portfolio holdings. This will be necessary to ensure that proprietary positions and conflicts of interest are not cropping up despite the restrictions. In addition to monitoring and enforcing the proprietary trading and conflicts of interest restrictions, regulators are also tasked with setting appropriate capital charges, both for permitted activities, and, in the instances of nonbank financial companies supervised by the Board, capital charges for all covered activities.

Your agencies appear to have somewhat different strengths in these areas, with perhaps the SEC and CFTC having greater experience policing the securities and derivatives markets for trading violations, and the banking regulators having greater experience evaluating the safety and soundness of firms and setting appropriate capital charges and levels.

Share with me your view about the strengths you believe your agency brings to the oversight and enforcement of the Merkley-Levin Volcker Rule? Are you committed to working with your fellow regulators to best use your agency's strengths in the effort to keep our financial system safe?

A.1. We are committed to working with our fellow regulators to develop a coordinated implementation of the Merkley-Levin Volcker Rule (Volcker Rule) that builds on each agency's relative strengths in regulating financial firms.

Among the strengths the Commission brings to the implementation of the Volcker Rule is our regulatory experience with securities trading activities, as well as with the concepts of "proprietary trading," "market making," and "hedging." For instance, the Commission staff has experience with activity that we consider to be bona fide market making in the equities markets. I look forward to the Commission and its staff using this experience as we consider—together with our fellow regulators—how "market making" should be viewed for purposes of the Volcker Rule. Another example is the Commission's experience in examining and sanctioning firms with respect to conflicts of interests—experience that will help inform our understanding and ability to address some of the misconduct the Volcker Rule seeks to prevent.

With respect to real-time collection of trade-by-trade data, given that a key goal of the Volcker Rule is addressing a firm's risk exposure, it may be necessary to focus on the nature and scope of a firm's principal trading and positions in the context of the type of market activity in which it is engaged. Collecting and analyzing trade-by-trade data on a real-time basis would require substantial new resources given both the volume of data that would need to be monitored and the current lack of regulatory infrastructure for collecting and surveilling such data on a real-time basis across all relevant asset classes and firms.

Q.2. *Data Collection.* The Dodd-Frank Act requires a significant amount of new data collection and storage, particularly in the derivatives arena. The SEC and CFTC have made a priority of new data collection in a number of areas. Collection and the ability to automate reviews of the data will be critical to enforcing a wide range of mandates under Dodd-Frank, including derivatives position limits, the Volcker Rule provisions, and other parts of the bill. At a minimum, your staffs will need to know who's making trades, the prices, how long firms hold onto their positions, and whether and how their positions are hedged.

Where is your agency in terms of thinking through the relevant data you will need to collect?

Are there any major challenges you see in being able to collect and analyze that data in real-time, so as to ensure compliance with these various restrictions?

How do you see the newly created Office of Financial Research playing into this process?

A.2. The Dodd-Frank Act not only creates new requirements for data collection and analysis of security-based swaps by the SEC, but also underscores similar needs for markets we have long regulated. Today, the SEC collects data after the fact through a series of manual requests that can take days or even weeks to fulfill. This is not acceptable. I therefore have sought to have the Commission take a holistic approach—addressing issues with our current data requirements while at the same time designing programs for our new requirements that take into consideration what we have learned from past efforts.

These requirements start with data collection and reporting. For the equities markets, challenges around data collection have led the Commission to propose new rules for large trader reporting and a consolidated audit trail. Both of these initiatives seek to address shortcomings in the agency's ability to collect and monitor data in an efficient and scalable manner. For derivatives, the Commission staff is in the midst of developing new rules and reporting requirements that are designed to facilitate data collection. The staff is considering a range of options and issues in the derivatives space, including the utility of standardized formats and data elements and the need for robust and automated Commission access to the data. In addition, the Commission staff is considering standardized counterparty names so that derivative ownership can be tracked.

A framework in which data is regularly collected on a daily basis and available to the SEC and other regulators would provide the Commission an opportunity for the timely analysis of specific issues as well as a framework for continuous, long-term study of the markets. In order to ensure any type of general or specific analysis accurately reflects the order and sequence of trading events, new systems we procure should be capable of receiving time stamps, and the Commission has proposed requiring data to be tagged with time stamps. Implementation of such initiatives would be a tremendous step forward.

Ensuring standardization of reporting is necessary, but not sufficient, to ensure a robust data analysis program. The Commission also needs to create an infrastructure for the scalable collection and timely analysis of such data. Again, we have started with existing requirements for the equities markets and are currently engaged in a Request for Information process with vendors who have proven track records in providing the types of specialized databases and analytical solutions required by the Commission. To help support and staff these initiatives with appropriate levels of expertise, the Division of Trading and Markets and the Division of Risk, Strategy, and Financial Innovation have been working, within the limitations of current budget constraints, to identify industry experts with the abilities, knowledge, and desire to help the Commission meet the new requirements under the Dodd-Frank Act.

In addition to internal programs, the Commission staff has been working with the CFTC staff whenever data standards are to be shared across similar products regulated by both agencies. The Commission staff also has been working with the newly created Office of Financial Research on their preliminary initiatives. In particular, OFR can be an excellent conduit for disseminating common data standards that can be used across all regulators and market participants. In this fashion, data can be sourced in a more efficient manner that benefits not only regulators of specific firms and markets, but also the OFR itself as it seeks to aggregate summary information from across the marketplace. I believe OFR will provide an excellent complement to the type of work underway at the Commission today and look forward to continuing our active participation as they expand their efforts.

With respect to "real-time" data collection and analysis, the collection of information on a regular, intraday basis would pose significant technical hurdles in markets where data is not generated in real-time. In addition, even if real-time collection of data may be feasible, it will require substantial new resources to achieve real-time analysis of the entire volume of the data that the Commission will seek to collect. Moreover, because much of the analysis likely to be performed will require careful reconstruction of events that also requires time, such analysis may best be accomplished in the context of end-of-day, or even longer, processing.

Q.3. *Cross-border Resolution.* I know FDIC and to some extent others have been working very diligently to implement the new resolution authority for our Nation's large complex financial institutions—which owes so much to my colleagues on this Committee from Virginia and Tennessee.

But one of the areas I want to keep an eye on—and on which I offered an amendment during financial reform to provide additional oversight of—is how to make that resolution work for large firms operating across multiple national borders.

Where are we in terms of making the Dodd-Frank resolution authority work for large, systemically significant financial firms operating across borders? How cooperative have our international partners been in this effort?

A.3. The challenge of resolving a large complex financial institution is compounded by different regulatory regimes that may apply to the same entity, or to affiliated entities, that operate across borders. The Commission and its staff participates in productive multilateral discussions among regulators in order to better understand the business practices and organizational aspects of global financial firms and how those practices and organizations can make resolution of international entities more challenging. The Commission plans to continue to work closely with the FDIC and other regulators to identify and address issues of mutual concern that arise in the context of the resolution of the Nation's large complex financial institutions.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR BUNNING FROM MARY L. SCHAPIRO

Q.1. Chairman Schapiro, this summer the *New York Times* reported on yet another AIG outrage. As part of the deal the New York Fed put together that paid off AIG's counterparties at par, AIG also waived its right to sue Goldman Sachs and other counterparties, even for fraud. It is interesting that you sued Goldman Sachs for fraud, but the New York Fed's deal did not allow AIG to sue Goldman Sachs or anyone else for fraud. If AIG had been able to sue, that could have helped recover shareholder value and made the massive bailout smaller. In your opinion, was it a mistake to force AIG to give up its right to sue, and do you plan to investigate this?

A.1. I understand your question to involve the actions of the Federal Reserve Bank of New York in November 2008 to restructure certain AIG credit-default swap contracts. I am not familiar with the considerations that factored into the decision-making process. As a result, I am not able to offer an opinion on particular components of the final agreements.

You also asked whether the Commission intends to investigate any issues related to these events. Although I am unable to comment on the existence or nonexistence of specific law-enforcement investigations, I can assure you that the Commission's Enforcement Division continues to examine the events surrounding the financial crisis and, where violations of the securities laws are uncovered, the Commission will vigorously pursue culpable entities and individuals.

Q.2. As you know, this Committee held an oversight hearing last week on the SEC's mishandling of the Stanford Ponzi scheme, which defrauded investors out of $5 billion. I asked the SEC Inspector General and witnesses from the SEC whether anyone had been fired over the Enforcement Division's disturbing actions, or more accurately, deliberate inaction in spite of examiners begging them over several years to do something. None of the witnesses were aware of any firing. And worse, after the hearing I was informed by the Stanford Victims Coalition that exactly the wrong people were rewarded and punished. I was told that many of the very people in the Enforcement Division who were guilty of malfeasance were actually promoted. And further, the one person from the Examinations Division who identified the problem and doggedly tried to get employees of the Enforcement Division to do their job has actually been demoted, possibly out of retaliation for blowing the whistle. Is this true, and if so, why does the SEC reward employees who are guilty of malfeasance and punish employees who do the right thing?

A.2. With respect to discipline of staff who worked on the Stanford matter, we have carefully reviewed the Inspector General's report and are in the final stages of determining what, if any, personnel actions are appropriate. Although the Inspector General's report generally is critical of the performance of Enforcement staff, it does not recommend discipline for any particular employee. The Inspector General's report also did not find that the failure to investigate Stanford more aggressively was related to any improper professional, social, or financial relationship on the part of any current or former Commission employee. Moreover, the conduct that the Inspector General investigated occurred over 5 years ago, some of it extending back well over a decade. Many of the Enforcement employees identified in the report no longer work at the Commission, including the most senior people who had final decision-making authority, such as the former District Administrator and two former Associate District Directors for Enforcement in the Fort Worth Office.

The Commission has not promoted or demoted any member of its Enforcement or Examination staff as a result of work performed on the Stanford matter during the time period reviewed by the Inspector General. Employees with varying degrees of involvement in the Stanford matter have been promoted in both programs, however, based on their contributions to the Commission's overall efforts.

You also inquire about a Fort Worth office employee who was allegedly demoted in retaliation for whistleblowing. The employee at issue currently is assigned to a position chairing our Southwest Regional Oil and Gas Task Force, which includes State and Federal regulators. The employee was not demoted and did not receive a decrease in pay or grade. The employee received a letter of reprimand based on conduct unrelated to Stanford that occurred prior to public criticism of the agency for its handling of the Stanford matter.

Q.3. Chairman Schapiro, I also learned at the Stanford Ponzi scheme hearing that the SEC Inspector General, who is supposed to be an independent watchdog, is not so independent after all. Apparently, the SEC can take as much time as it wants reviewing an IG report before it becomes public, redact whatever it wants from the report and call it "proprietary," and control the release date of the report. The SEC's release of the Inspector General's Stanford report looked suspicious because it was done on a day with other distracting SEC news. It is stunning that the SEC has so much control over the Inspector General. By contrast, I am told that the Treasury Department has only seven days to review reports of the Treasury Inspector General for Tax Administration (TIGTA). Treasury can recommend redactions for taxpayer confidentiality or other narrow reasons, but TIGTA makes the call about whether the information will be redacted and when the report is released. Why does the SEC not allow its Inspector General to be truly independent, and how many IG reports is the SEC currently sitting on?

A.3. The Commission's Inspector General has full independence in determining what matters to investigate, in conducting those investigations, in drawing its conclusions and in preparing its reports. The process described below does not impact that independence in any way.

As you may be aware, under the Inspector General Act, an Inspector General's reports are provided to the Commission. The Commission determines what redactions are needed prior to the dissemination of those reports. The Commission strives to make only limited redactions to the reports and seeks to perform its review function as expeditiously as is practicable. Examples of the types of information typically redacted from recent reports include:

- information the disclosure of which may harm ongoing law enforcement investigations or proceedings; and
- names and personal identifying information (generally of persons not employed by the Commission who played peripheral roles in the events under investigation and of lower-level Commission employees) to protect personal privacy (in instances where names are redacted, we overlay replacement text which generally describes the job/role of that individual so that the substance of the report is unaltered).

In certain instances, the Commission may disclose information even though it falls into a category listed above due to the public's interest in the information at issue. Prior to the Commission's approval of the release of a report, Commission staff solicits the input and feedback of the Inspector General's Office on the proposed redactions.

With regard to the timing of the Commission's release of the Inspector General's report in the Stanford investigation, the Inspector General found in a separate report that the act of redacting portions of the Stanford report "appeared to proceed independently of the timing of the SEC's . . . action" against Goldman Sachs & Co. and that it "did not find any concrete and tangible evidence" that the filing of the Commission's action against Goldman Sachs was "delayed to coincide with the issuance of the OIG Stanford Report."

There are two Inspector General reports that the Commission or its staff currently is reviewing. We will be making those available as soon as possible.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CRAPO FROM MARY L. SCHAPIRO

Q.1. Congress clearly intended, as Chairman Dodd and Chairman Lincoln set forth in a letter that: "The legislation does not authorize the regulators to impose margin on end-users, those exempt entities that use swaps to hedge or mitigate commercial risk . . . Again Congress clearly stated in this bill that the margin and capital requirements are not to be imposed on end-users."

Do you agree with the Congressional intent of the Dodd-Lincoln letter?

In setting capital requirements under Title VII, do you agree that increases in capital requirements will be linked to the risk associated with the swap, and not as a punitive mechanism to drive volume to central clearinghouses or exchanges?

Please describe any and all cost-benefit analysis, particularly with regard to end-users, that you will undertake prior to issuing rules.

A.1. The Commission has not yet proposed rules under the Dodd-Frank Act provisions relating to margin requirements for non-cleared security-based swaps transacted by security-based swap dealers and major security-based swap participants for which there is not a prudential regulator. I am sensitive to the concerns that have been expressed about the potential impact of these requirements—and other provisions of the Dodd-Frank Act—on end users. Accordingly, I expect that the Commission will carefully consider both the scope of its authority in this area and the potential effects of margin requirements on the markets and market participants, including the nature and extent to which such requirements could impact the business of end users. Public feedback through the notice and comment process—including input from end users—will also fully inform any final rule that the Commission may adopt.

The Commission also has not yet proposed rules establishing capital requirements for security-based swap dealers and major security-based swap participants. In establishing such capital requirements, the Dodd-Frank Act directs the Commission to consider whether they will help ensure the safety and soundness of the entity and whether the standards are appropriate for the risks associated with uncleared security-based swaps. These principles established by the statute—as well as input through the notice and comment process—will guide our consideration of capital requirements in this area.

The Commission conducts a cost-benefit analysis of proposed rules pursuant to specific statutory requirements, including those set forth in the Paperwork Reduction Act and the Small Business Regulatory Enforcement Fairness Act of 1996. Accordingly, any proposed rulemaking impacting end users and other market participants will include an analysis of any costs and benefits that may accrue to such end users and will be subject to public comment prior to any final action that may be taken.

Q.2. Dodd-Frank requires that risk retention be jointly considered by the regulators for each different type of asset and includes a specific statutory mandate related to any potential reforms of the commercial mortgage-backed securities market to limit disruption. In light of the FDIC's unilateral decision to add an across the board risk retention requirement in the safe harbor rule, which the OCC opposed, how do you plan to coordinate and reconcile disagreements in the joint rulemaking?

A.2. Under Section 941 of the Dodd-Frank Act, the Commission and the banking and other agencies will jointly write rules regarding risk retention, with the Department of Treasury—the Chairperson of the Financial Stability Oversight Council—coordinating all joint rulemaking required under the section. Staff from a number of Divisions and offices of the Commission have been meeting regularly and frequently with the staff from the other agencies and Treasury. Thus, we are working diligently with Treasury and the other agencies to jointly consider how best to prescribe risk retention rules for the various asset classes of asset-backed securities.

I also would note that the FDIC rule you referenced (12 C.F.R. 360.6) provides that upon the effective date of final regulations required by Section 941(b) of the Dodd-Frank Act, such final regulations shall exclusively govern the requirement to retain an economic interest in a portion of the credit risk of the financial assets under the FDIC rule.

Q.3. Market participants highlight uncertainty related to changing regulations, new accounting standards, and other mandates as an obstacle to a resurgence of these markets. What steps are your agencies currently taking to minimize these complications? What should be done collectively by regulators to limit this uncertainty as you look toward the joint rulemaking?

A.3. Given the breadth of the Dodd-Frank Act's implementation requirements, including many necessitating joint rulemakings, the SEC has significantly expanded its public outreach and is committed to an open and transparent notice and comment rulemaking process.

Specifically, we have enhanced our public consultative process by expanding the opportunity for public comment beyond what is required by law. To maximize the opportunity for public comment and to provide greater transparency, less than a week after Dodd-Frank became law, we made available to the public a series of e-mail boxes to which interested parties can send preliminary comments before the various rules are proposed and the official comment periods begin. We also are trying, given time constraints, to meet with anyone who seeks to meet with us on the various issues raised. In addition, staff is seeking to reach out as necessary to solicit views from affected stakeholders who do not appear to be fully represented by the developing public record on a particular issue. To further our public outreach effort, the Commission also is holding public roundtables and hearings on selected topics.

Commission staff also is meeting regularly on both a formal and informal basis with other financial regulators, and staff working groups frequently consult and coordinate with the staffs of the CFTC, Federal Reserve Board and other prudential financial regulators, as well as the Department of the Treasury, the Department of State, the Commerce Department, and the Comptroller General.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM GARY GENSLER

Q.1. Chairman Gensler, you have been very active in the CFTC's implementation of the derivatives title of the Dodd-Frank Act.

Recognizing that you are only one of five Commissioners at the CFTC, what steps are you taking to adopt balanced rules that can garner the support of all five Commissioners?

A.1. Throughout the rulemaking development process, Commission staff strives to ensure that each Commissioner is apprised of issues involved. Staff teams consult with all Commissioners and the comments and suggestions of each are often incorporated in staff recommendations.

Q.2. Chairman Gensler, the Dodd-Frank Act gives the CFTC new registrants such as major swap participants and swap dealers.

Does the CFTC intend to rely on a self regulatory organization to oversee these new entities, as it does for futures commission merchants?

A.2. Some tasks assigned to the Commission may be delegated in turn to Self Regulatory Organizations (SROs) where permitted, appropriate and where the SROs are ready to assume the new tasks.

Q.3. How will the CFTC coordinate its oversight of these entities with other regulators?

A.3. Coordination with the Securities and Exchange Commission and the banking regulators will be required to implement the Dodd-Frank Act in an efficient manner and to avoid unnecessary duplication on registrants. The Commission is striving to coordinate its rulemaking activities with its fellow regulators through staff to staff contacts, and it is contemplated that these coordination efforts will continue as the agencies move past the rule-writing process to administering the Dodd-Frank Act.

Q.4. Chairman Gensler, as one law firm's commentary noted, "major provisions of the Derivatives Legislation are either largely indeterminate or too broadly drafted to be implemented literally."

Chairman Gensler, how do you reconcile this assessment with your conclusion that the "Dodd-Frank Act is very detailed, addressing all of the key policy issues regarding regulation of the swaps marketplace"?

A.4. While the Dodd-Frank Act is detailed and comprehensive, it directs the financial regulatory agencies to write regulations to implement the policies Congress enacted. The rule-writing process will involve careful consideration of the insights of industry and other members of the public through meetings and written comments that may spotlight refinements that should be made before regulations are finalized.

Q.5. Should we be concerned that you are not paying sufficient attention to the potential unintended consequences of the legislation?

A.5. We are actively seeking participation in the rule-writing process from industry and other members of the public. As the rule-writing process goes forward, I am confident that concerns of industry and other members of the public about the consequences of rules, unintended or otherwise, will be brought to the attention of my fellow commissioners and myself.

Q.6. Chairman Gensler, you have set up 30 rulemaking teams for the Dodd-Frank Act. Some of those teams are headed by enforcement attorneys.

Please identify which teams are headed by enforcement attorneys and why enforcement attorneys are best suited to write the rules in the area assigned to each of those teams.

A.6. Four of the 30 rulemaking teams assigned to draft the rules required by the Dodd-Frank Act are led by Division of Enforcement Staff. Staff from the Division of Enforcement are leading groups drafting rules on manipulation, disruptive trading practices, whistleblowers, and business conduct with counter parties. The Division has 35 years experience investigating and litigating cases of manipulation, attempted manipulation, and false price reporting. Each of these areas is closely related to the mission of the Division. It should be noted that these teams are not limited to Division of Enforcement staff, but rather are composed of staff from several offices. Ultimately, the teams' recommendations must be approved by the Commissioners as proposals, exposed to comments from the public, and adopted by the Commissioners as final rules before they go into effect.

Q.7. Chairman Schapiro and Chairman Gensler, the Dodd-Frank Act placed great emphasis on moving over-the-counter derivatives into clearinghouses for the purpose of reducing risk in the financial system. While this is a laudable goal, if not properly constructed, clearinghouses could be the too-big-to-fail entities at the center of the next crisis. The last thing the American people want to do is pay for another bailout.

What is each of you doing to ensure that the rules take seriously the potentially disastrous consequences of a misstep in the operation or oversight of clearinghouses?

A.7. The Commission is in the process of proposing detailed rules for derivatives clearing organizations (DCOs). These proposals contain standards concerning financial resources, margin, and risk management with which DCOs will be required to comply. The Commission also conducts daily risk surveillance of DCOs, clearing members, and large traders and periodic reviews of DCO compliance with the Commodity Exchange Act and Commission regulations.

Q.8. Chairman Schapiro and Chairman Gensler, at a time when our economy is in terrible shape, we need to be particularly attentive to the unintended consequences of regulatory actions. Main Street businesses, large and small, have told us how imposing clearing and margin requirements on them will affect their ability to expand and hire. An effective, broad end user exemption is essential and completely consistent with the goals of transparency and mitigation of risk to the financial system.

Are you committed to crafting a broad end user exemption that allows our job creators to avoid costly clearing, margin, exchange trading, and other obligations under the Act?

A.8. The concerns of end users are being given a great deal of attention by the Commissioners and the staff. Their concerns will continue to be of great importance throughout the rulemaking process. The Dodd-Frank Act was enacted to reduce risk, increase transparency, and promote market integrity within the financial system. The rulemakings are intended to implement those goals, all of which will benefit customers, particularly end users, using the market. There is no intention to unnecessarily increase burdens on end users seeking to reduce their commercial risks.

Q.9. Chairman Schapiro and Chairman Gensler, Dodd-Frank mandates that both of your agencies adopt an unprecedented number of rules in a very short period of time. And, as you know, each of your agencies has a "statutory obligation to do what it can to apprise itself—and hence the public and the Congress—of the economic consequences of a proposed regulation before it decides whether to adopt the measure."

However, a recent news article pointed out that both the SEC and the CFTC have been without Chief Economists for months.

Chairman Schapiro and Chairman Gensler, why have your Chief Economist positions gone unfilled for so long?

How can you expect to adequately consider the economic consequences of all of your proposed rules with unfilled Chief Economist positions?

A.9. The CFTC recently announced the appointment of Dr. Andrei Kirilenko as Chief Economist. Dr. Kirilenko, who received his Ph.D. in Economics from the University of Pennsylvania, has been with the CFTC since 2008. Prior to joining the agency, he worked for 12 years at the IMF working on global capital markets issues. During the process of selecting a Chief Economist, the Commission's Acting Chief Economist, the other economists in the Office of the Chief Economist, and other economists on the Commission's staff took an active role in the Dodd-Frank rule-writing process.

Q.10 Chairman Schapiro and Chairman Gensler, the derivatives title of the Dodd-Frank Act establishes new entities called "swap execution facilities" and "security-based swap execution facilities," commonly referred to as "SEFs," as alternatives to exchanges. Ideally, multiple SEFs will compete to give market participants several different choices for trading particular types of swaps.

Given the SEC's experience in overseeing securities markets in which participants have the choice of several different trading venues, what is each of you doing to ensure that the CFTC has the benefit of the SEC's expertise in this area?

A.10. I have encouraged the CFTC staff to consult with and coordinate their rule-writing efforts with the SEC staff whenever appropriate in the implementation of the Dodd-Frank Act including the drafting of rules to govern SEFs. As part of ongoing communications, contacts between the two staffs have included more than 100 meetings.

Q.11. Chairman Schapiro and Chairman Gensler, Title VIII authorizes your agency to prescribe regulations for financial institutions engaged in designated activities for which each is the Supervisory Agency or the appropriate financial regulator governing the conduct of the designated activities.

What plans do you have for exercising this authority?

A.11. The Commission issued a proposed rule that was published in the Federal Register of October 14, 2010, addressing the financial resources of derivatives clearing organizations (DCOs) that might be designated as systemically important under Title VIII.

Q.12. The Financial Stability Oversight Council is an important feature of Dodd-Frank. During the conference, my amendment was adopted to clarify the role of the Council and the Federal Reserve. My amendment gave the Council responsibility for financial stability regulation. Up to that point, the legislation had colocated this responsibility at the Fed and the Council. The Congressional intent is clear that you, as members of the Council, are responsible for all policy matters related to financial stability. After the Council acts, implementation of your policy determinations will fall to the individual Federal financial regulators, including, of course, the Fed.

With this in mind, I would like each of you to comment on your preparations to serve on the Council:

Have you directed your staff to examine and study all of the issues that will come before you?

A.12. Yes.

Q.13. Are you prepared to participate on the Council, not as a rubber stamp for the Chairman of the Council, but as a fully informed individual participant?

A.13. Yes.

Q.14. Secretary Geithner has argued that there is a strong case to be made for continuing Government guarantees of mortgage-backed securities. Additionally, the Federal Reserve published a paper that proposes Government guarantees of a wide range of asset backed securities, including those backed by mortgages, credit cards, autos, student loans, commercial real estate, and covered bonds. While some may believe that the Government will charge fair prices for Government guarantees, the history of Government run insurance programs suggests that things will not go well.

Does anyone on the panel support extending or increasing Government insurance against losses on asset backed securities which, it seems to me, socializes risk, puts taxpayers on the hook for losses, and protects Wall Street against losses?

A.14. The Commission does not have a position on this issue.

Q.15. Please provide the Committee with an implementation schedule that includes:

A list of the rules and studies that your agency is responsible for promulgating or conducting under Dodd-Frank and the date by which you intend to complete each rule or study; and . . .

A.15. We identified 30 areas where rules will be necessary and assigned teams of staff to work on rulemakings for each of these areas.

Following each team on the list are found the date of the Commission meeting to consider the Advanced Notice of Proposed Rulemaking (ANPR) or Notice of Proposed Rulemaking (NPR), the Final Rule (FR) or the anticipated date of those meetings that have been scheduled.

I. Registration (NPR 11/10/10)

II. Definitions, such as Swap Dealer, Major Swap Participant, Security-Based Swap Dealer, and Major Security-Based Swap Participant, to be Written Jointly with SEC (NPR 12/1/10)

III. Business Conduct Standards with Counterparties (NPR 12/9/10)

IV. Internal Business Conduct Standards (NPR 11/10/10), (NPR 12/16/10), (NPR 1/13/11)

V. Capital & Margin for Nonbanks (NPR 1/20/11)

VI. Segregation & Bankruptcy for both Cleared and Uncleared Swaps (uncleared, NPR 11/19/10; cleared, ANPR 11/19/10) (NPR wk of 2/21/11)

Clearing:

VII. DCO Core Principle Rulemaking, Interpretation & Guidance (NPR 9/30/10), (NPR 12/1/10), (NPR 12/16/10)

VIII. Process for Review of Swaps for Mandatory Clearing (NPR 10/26/30)

IX. Governance & Possible Limits on Ownership & Control (NPR 9/30/10), (NPR 12/9/10)

X. Systemically Important DCO Rules Authorized Under Title VIII (NPR 16/10), (FR 1/19/11)

XI. End-user Exception (NPR 12/9/10)

Trading:

XII. DCM Core Principle Rulemaking, Interpretation & Guidance (NPR 12/1/10)

XIII. SEF Registration Requirements and Core Principle Rulemaking, Interpretation & Guidance (12/16/10)

XIV. New Registration Requirements for Foreign Boards of Trade (NPR 11/10/10)

XV. Rule Certification & Approval Procedures (applicable to DCMs, DCOs, SEFs) (NPR 10/26/10)

Data:

XVI. Swap Data Repositories Registration Standards and Core Principle Rulemaking, Interpretation & Guidance (Int. FR 9/30/10), (NPR 11/19/10)

XVII. Data Record Keeping & Reporting Requirements (NPR 11/19/10), XVIII. Real Time Reporting (NPR 11/19/10)

Particular Products:

XIX. Agricultural Swaps (ANPR 9/20/10), definitions (NPR 10/19/10), (FR 1/20/11)

XX. Foreign Currency (Retail Off Exchange) (FR 9/3/10)

XXI. Joint Rules with SEC, such as “Swap” and “Security-Based Swap” (NPR week of 2/7/11)

XXII. Portfolio Margining Procedures (combined with VI above and other rules)

Enforcement:

XXIII. Antimanipulation (NPR 10/26/10)

XXIV. Disruptive Trading Practices (ANPR 10/26/10), (NPR wk of 2/21/11)

XXV. Whistleblowers (NPR 11/10/10)

Position Limits:

XXVI. Position Limits, including Large Trader Reporting, Bona Fide Hedging Definition & Aggregate Limits (large trader reporting NPR 10/19/10), (NPR 12/16/10), (NPR 1/13/11)

Other Titles:

XXVII. Investment Adviser Reporting (NPR 1/20/11)

XXVIII. Volcker Rule (not scheduled)

XXIX. Reliance on Credit Ratings (NPR 10/26/10)

XXX. Fair Credit Reporting Act and Disclosure of Nonpublic Personal Information (NPR 10/19/10)

Recently an additional team was created and assigned the task of writing conforming rules.

A comprehensive schedule for the rulemaking process was set out with dates for technical conferences on many of the rules, dates to circulate drafts of rule proposals to Commissioners, dates for meetings to consider Advanced Notices of Proposed Rules and Notices of Proposed Rules and comment periods. The public, including the regulated industry, other businesses that may be affected, interest groups, and others, have been encouraged to participate in the process through filing writing comments. Schedules for the adoption of final rules have not been set because in large part the staff recommendations to the Commission and the views of the Commissioners themselves are expected to be significantly affected by the public comments.

Q.16. A list of the reorganizational tasks your agency will undertake to fulfill the mandates of Dodd-Frank and the date by which you intend to complete each task.

A.16. The Commission has discussed potential reorganizations; however, given uncertainties of funding, staffing, and other issues no final reorganization plans have been adopted.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR BROWN FROM GARY GENSLER

Q.1. Over the last 15 years, the 6 biggest banks grew from having assets equal to 17 percent of GDP to 63 percent of GDP. The four largest banks control about 48 percent of the total assets in the Nation's banking system. And the 5 largest dealer banks control 80 percent of the derivatives market and account for 96 percent of the exposure to credit derivatives.

Part of the Volcker Rule, section 622 of the Dodd-Frank Act, requires the Financial Stability Oversight Council (FSOC), of which your organizations are a member, to study and make recommendations concerning the effects of financial sector concentration on financial stability, moral hazard, efficiency, and competitiveness in the financial system. Subject to these recommendations, no company will be permitted to hold more than 10 percent of the liabilities held by all financial companies, with some significant exceptions.

What are effects does concentration in the financial industry have on financial stability, moral hazard, efficiency, and competitiveness?

Given that the six biggest banks alone have about $7.4 trillion in liabilities, almost 53 percent of GDP, do you think this provision will meaningfully restrict the size of financial institutions?

How should this rule be implemented to address financial stability, moral hazard, efficiency, and competitiveness?

Can you identify any potential loopholes in the existing provision?

As I've made clear before, I think the largest financial firms in this country are just too large, and that their massive size threatens our economic security and puts us at risk in future crises.

I think the rise of proprietary trading was one of the key drivers behind the massive growth in our largest financial institutions. Firms were taking on ever increasing prop trading positions, often with highly unstable short term financing, and when things froze up, the house of cards collapsed. The Volcker Rule looks to stop this risk.

I know that my colleagues, Senator Merkley and Senator Levin, drafted section 619 of the Dodd-Frank Act to ensure broad coverage of the prohibition on proprietary trading by banks, and meaningful restrictions on the largest nonbank financial firms. Nevertheless, one of the concerns I have is that firms may try to evade the restrictions. Particularly, I'm concerned that if the regulators set a definition of "trading account" that is too narrow, it might not capture all of the risks of proprietary trading. These evasions could only happen if the regulators ignore the clear direction of the law to stop proprietary trading.

Are you prepared to take a broad view on the definition of "trading account" and examine and prevent proprietary trading, wherever it occurs?

A.1. Section 619 of the Dodd-Frank Act defines "trading account" to mean any account used for acquiring or taking positions in the securities and instruments described in paragraph (4) principally for the purpose of selling in the near term (or otherwise with the intent to resell in order to profit from short-term price movements), and any such other accounts as the appropriate Federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission may, by rule, determine. The FSOC is currently conducting its study that will provide recommendations on the Volcker Rule, and whether the definition in this section is adequate to enforce the Volcker Rule; however, at this time because this study is still underway, I believe that it is too early to opine on the definition of "trading account."

Q.2. In short, are you prepared to use the full power of the Merkley-Levin provisions to cut the size and riskiness of our banks so they get back to the business of lending to families and businesses?

A.2. The CFTC is committed to using its resources to ensure that applicable CFTC regulated entities will be monitored to seek to ensure compliance of the CFTC promulgated rules relating to the Volcker Rule.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MERKLEY FROM GARY GENSLER

Q.1. *Regulatory Structure for Volcker Rule.* As you know, the objectives of the Merkley-Levin Volcker Rule are two-fold: (1) to address the specific risks to our financial stability caused by proprietary trades gone bad, and (2) to take on the conflicts of interests in proprietary trading.

Ensuring effective oversight will be challenging, because the issues are complicated. As you could see from the exchange at the hearing between Senator Reed and Chairman Bernanke, with interjections by Chairman Shapiro and Mr. Walsh, I and others are beginning to come of the view that there will have to be oversight at two levels. First, there will need to be real-time (or as close as practicable) monitoring and enforcement at the individual trade-by-trade level, which looks to whether any given transaction is proprietary trading. This will be necessary to ensure that the permitted activities are not abused. Second, there will need to be macro-level reviews of policies and procedures, and overall portfolio holdings. This will be necessary to ensure that proprietary positions and conflicts of interest are not cropping up despite the restrictions. In addition to monitoring and enforcing the proprietary trading and conflicts of interest restrictions, regulators are also tasked with setting appropriate capital charges, both for permitted activities, and, in the instances of nonbank financial companies supervised by the Board, capital charges for all covered activities.

Your agencies appear to have somewhat different strengths in these areas, with perhaps the SEC and CFTC having greater experience policing the securities and derivatives markets for trading violations, and the banking regulators having greater experience evaluating the safety and soundness of firms and setting appropriate capital charges and levels.

Share with me your view about the strengths you believe your agency brings to the oversight and enforcement of the Merkley-Levin Volcker Rule? Are you committed to working with your fellow regulators to best use your agency's strengths in the effort to keep our financial system safe?

A.1. The CFTC has the ability to collect and analyze trade data in regulating and supervising the futures markets. The agency also has capabilities for auditing and reviewing intermediaries. These tools would be available to the CFTC to help enforce all aspects of the Dodd-Frank Wall Street Reform and Consumer Protection Act. The CFTC is committed to keeping our financial system safe and to working with all other fellow financial regulatory agencies toward that objective.

Q.2. *Data Collection.* The Dodd-Frank Act requires a significant amount of new data collection and storage, particularly in the derivatives arena. The SEC and CFTC have made a priority of new data collection in a number of areas. Collection and the ability to automate reviews of the data will be critical to enforcing a wide range of mandates under Dodd-Frank, including derivatives position limits, the Volcker Rule provisions, and other parts of the bill. At a minimum, your staffs will need to know who's making trades, the prices, how long firms hold onto their positions, and whether and how their positions are hedged.

Where is your agency in terms of thinking through the relevant data you will need to collect?

Are there any major challenges you see in being able to collect and analyze that data in real-time, so as to ensure compliance with these various restrictions?

How do you see the newly created Office of Financial Research playing into this process?

A.2. On November 19th the Commission held an open meeting to consider, among other things, requirements and duties of swap data repositories; real time public reporting requirements of swap transactions; and record keeping and reporting requirements for swaps entities. These proposed rules were published in the Federal Register in December 2010.

The proposed rules specify minimum data fields and/or categories that must be reported to the public and to swap data repositories. The data reported to swap data repositories will allow the staff to identify parties involved in a trade, the prices, how long counterparties hold onto their position, among other things. The staff identified major categories of relevant data that needs to be collected based on the instrument type and asset-class underlying.

The proposal requires real time reporting for swap transaction and pricing data to occur as soon as technologically practicable for trades other than trades of large notional size or block trades.

The proposal implements the Dodd-Frank Act direction that regulators have direct access to information maintained by swap data repositories. We are currently in the public comment period and will be considering those comments before the Commission adopts and final rules in these areas.

Agency staffs are meeting to coordinate data collection and analysis and to efficiently identify market interconnectedness. To achieve that, the Commission staff is involved in numerous consultations with various Federal Government agencies including the Office of Financial Research.

Q.3. *Cross-border Resolution.* I know FDIC and to some extent others have been working very diligently to implement the new resolution authority for our Nation's large complex financial institutions—which owes so much to my colleagues on this Committee from Virginia and Tennessee.

But one of the areas I want to keep an eye on—and on which I offered an amendment during financial reform to provide additional oversight of—is how to make that resolution work for large firms operating across multiple national borders.

Where are we in terms of making the Dodd-Frank resolution authority work for large, systemically significant financial firms operating across borders? How cooperative have our international partners been in this effort?

A.3. Our role in responding to the insolvency of firms such as holding companies with a Futures Commission Merchant (FCM) subsidiary is somewhat limited, such as assisting in the transfer of customer funds and positions, advising the bankruptcy court with respect to the FCM, and exchanging information with foreign regulators concerning our respective regulated entities. We do not undertake the operational role envisioned under the Dodd-Frank Act for the FDIC.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR BUNNING FROM GARY GENSLER

Q.1. Mr. Gensler, I support the concept of regulating derivatives because they helped cause the problem. But I do understand that some businesses use derivatives to manage legitimate business risk. How will dealers be encouraged to not pass on additional capital and regulatory costs to businesses that are end users, and how will the regulators know whether a derivative is being used to manage commercial risk?

A.1. On December 9, 2010, the Commission issued proposed rules to implement the end user exception to mandatory clearing that was contained in Section 2(h)(7) of the Dodd-Frank Act, which were published in the Federal Register of December 23, 2010. This provision of the Dodd-Frank Act generally provides that a swap otherwise subject to mandatory clearing is subject to an elective exception from clearing if one party to the swap is not a financial entity, and is using swaps to hedge or mitigate commercial risk. A number of commercial end-users were concerned that mandatory clearing would require them to deposit cash in margin accounts. The Commission rule proposal also addresses the need to verify that swaps exempt from clearing and margining were entered into to mitigate commercial risk.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CRAPO FROM GARY GENSLER

Q.1. Congress clearly intended, as Chairman Dodd and Chairwoman Lincoln set forth in a letter that: "The legislation does not authorize the regulators to impose margin on end-users, those exempt entities that use swaps to hedge or mitigate commercial risk . . . Again Congress clearly stated in this bill that the margin and capital requirements are not to be imposed on end-users."

Do you agree with the Congressional intent of the Dodd-Lincoln letter?

In setting capital requirements under Title VII, do you agree that increases in capital requirements will be linked to the risk associated with the swap, and not as a punitive mechanism to drive volume to central clearinghouses or exchanges?

Please describe any and all cost-benefit analysis, particularly with regard to end-users, that you will undertake prior to issuing rules.

A.1. The Dodd-Frank Act was enacted to reduce risk, increase transparency, and promote market integrity within the financial system. At the Commission's open meeting on December 1, I stated that "my view is that uncleared swaps entered into between financial entities pose more risk to the financial system than those where one of the parties is a nonfinancial entity."

I further stated that "Interconnectedness among financial entities allows one entity's failure to cause uncertainty and possible runs on the funding of other financial entities, which can spread risk and economic harm throughout the economy. We know from the AIG debacle that the interconnectedness of financial entities through their swap books raises the risks of bailouts. Transactions involving nonfinancial entities, however, do not present the same risk to the financial system as those solely between financial entities. The risk of a crisis spreading throughout the financial system is greater the more interconnected financial companies are to each other. I think that Congress also recognized the different levels of risk posed by transactions between financial entities and those that involve nonfinancial entities, as reflected in the nonfinancial end-user exception to clearing. Consistent with this, I believe that proposed rules on margin requirements should focus only on transactions between financial entities rather than those transactions that involve nonfinancial end-users. I would be interested to hear views from the public on this issue."

RESPONSES TO WRITTEN QUESTIONS OF SENATOR SHELBY FROM JOHN WALSH

Q.1. Recent news reports have detailed disturbing information about servicers' foreclosure processes. Allegations have ranged from forged documents to the signing of eviction notices without review.

What evidence have your agencies found in regards to these charges? What actions have been undertaken by your agencies both to address this situation and to prevent future abuses?

A.1. To date, six large national bank servicers have publicly acknowledged procedural deficiencies in their foreclosure processes. The lapses that have been reported represent a serious operational breakdown in foreclosure governance and controls that national banks should maintain. These lapses are unacceptable, and we are taking aggressive actions to hold national banks accountable, and to get these problems fixed.

As soon as the problems at Ally Bank—which is not supervised by the OCC—came to light, the OCC directed the largest national bank mortgage servicers under our supervision to review their operations, to take corrective action to remedy identified problems, and to strengthen their foreclosure governance to prevent recurrences. At the same time, we initiated plans for intensive, onsite examinations of the eight largest national bank mortgage servicers. The Federal Reserve Board and the Federal Deposit Insurance Corporation (FDIC), are participating in these examinations.

Our examination objectives are to independently test and verify the adequacy and integrity of bank self-assessments and corrective actions; the adequacy and effectiveness of governance over servicer foreclosure processes to ensure foreclosures are completed in accordance with applicable legal requirements and that affidavits and claims are accurate; and to determine whether troubled borrowers were considered for loss mitigation alternatives such as loan modifications prior to foreclosure. The scope of work to assess governance is extensive and includes an assessment of each servicer's foreclosure policies and procedures, organizational structure and staffing, vendor management, quality control and audit, loan documentation including custodial document management, and foreclosure work flow processes. We also will test and validate the effectiveness of foreclosure governance and adequacy of the bank's self-assessment including corrective actions taken and/or planned.

Examiners will also be reviewing samples of individual borrower foreclosure files from judicial and nonjudicial States that include both in-process and completed foreclosures. In reviewing these files, examiners will determine whether foreclosed borrowers were appropriately considered for alternative loss mitigation actions such as a loan modification. Examiners will also check for the following:

- A documented audit trail that demonstrates that data and information (*e.g.,* amount of indebtedness and fees) in foreclosure affidavits and claims are accurate and comply with State laws;
- Possession and control over the underlying, critical loan documents such as original note, mortgage, and deed of trust to support legal foreclosure proceedings; and
- Evidence that the affidavit and documents were appropriately reviewed, and that proper signatures were obtained.

In addition to these loan file reviews, examiners will review the nature, volume, and resolution of foreclosure-related complaints. These will include complaints received by the OCC's Customer Assistance Group as well as complaints received by the banks.

Finally, examiners will assess the adequacy of each bank's analysis and financial reporting for the potential adverse impact on the bank's balance sheet and capital that may arise from the increased time and costs needed to correct any procedural errors; losses (if any) resulting from inability to access collateral; and expected litigation costs. We are directing banks to maintain adequate reserves for potential losses and other contingencies and to make appropriate disclosures, consistent with applicable Securities and Exchange Commission disclosure rules.

As our examination work proceeds, where we find errors or deficiencies, we are directing banks to take immediate corrective action. We are also responding to the concerns that have been raised about the so-called "dual track" foreclosure process when a borrower is in a trial loan modification. We recognize that the so-called "dual track" process is confusing for many consumers and risks consumers receiving mixed or contradictory information. As a result, we have directed the large national bank servicers, when they have the legal ability to do so, to suspend foreclosure proceedings for borrowers who are in a trial modification and are performing according to the terms of the modification agreement. This directive is modeled on provisions that the Treasury Department has adopted for trial modifications made under the HAMP program. It is important to note, however, that the terms and conditions for non-HAMP modifications, and the ability of servicers to suspend foreclosure processes, may be significantly affected—and limited—by requirements imposed by the GSEs and agreements with private investors.

Using our authority under the Bank Service Company Act, we also are conducting interagency examinations of two major nonbank mortgage service providers. In coordination with the Federal Reserve Board, FDIC and the Federal Housing Finance Administration, the OCC is leading an on-site examination of the Morlgage Electronic Registration System (MERS), which operates a system that electronically registers and tracks mortgage ownership interests and servicing rights and may serve as the mortgagee of record as a nominee/agent of the owner of a loan (the lender or subsequent investor). A key objective of the MERS examination is to assess MERS corporate governance, control systems, and accuracy and timeliness of information maintained in the MERS system.

We also are participating in an examination being led by the Federal Reserve Board of Lender Processing Services Inc. (LPS) which provides third party foreclosure services to banks.

The OCC is focused on identifying and rectifying problems so that the basic function and integrity of the foreclosure process is restored; the rights of all homeowners subject to the foreclosure process are protected; and the basic functioning of the U.S. mortgage market is stabilized. As we move forward we will continue to cooperate with the many inquiries and investigations that are taking place.

Q.2. What policies and procedures have your agencies put in place to ensure compliance with State laws, and when were they implemented?

A.2. The OCC's Mortgage Banking Handbook, which provides guidance to the industry and examiners on risks associated with mortgage banking activities, states that "a bank that originates and/or services mortgages is responsible for complying with applicable Fderal and State laws." As a general matter, we expect national banks to know what laws apply to their business activities, whether Federal or State, to have policies and procedures for complying with those laws, and to have ongoing quality controls and audits that test compliance with these procedures.

Q.3. Mr. Walsh, your testimony states that there appears to be an inconsistency in the duties assigned to the banking agencies and the CFPB with respect to fair lending, and that this creates confusion in responsibilities. Could you elaborate?

A.3. Fair lending compliance and reporting requirements are contained in provisions of the Fair Housing Act, Equal Credit Opportunity Act and the Home Mortgage Disclosure Act. The Dodd-Frank Act provides the Consumer Financial Protection Bureau (CFPB) with exclusive examination and enforcement authority over national banks (and other insured depository institutions) with assets greater than $10 billion with respect to the Equal Credit Opportunity Act and the Home Mortgage Disclosure Act (Secs. 1025, 1002(12)(D), 1002(12)(K)). However, the law does not transfer to the CFPB the authority to examine insured depository institutions with assets over $10 billion for compliance with the Fair Housing Act. *See,* Sec. 1002 (defining "enumerated consumer laws"); *see,* also Sec. 1027(s) (preserving current authorities under the Fair Housing Act).

Continuing the banking agencies' supervision of Fair Housing Act compliance for institutions over $10 billion in asset size will potentially result in duplication of, or overlap with, the CFPB's supervision and in inconsistencies in supervisory approach between the banking agencies and the CFPB. If Congress did not intend this jurisdictional split, amendments to Title X of the Dodd-Frank Act would be needed.

Q.4. Mr. Walsh, your testimony identifies that Dodd-Frank requires Federal banking agencies to make capital standards countercyclical. How will that be accomplished?

A.4. As you know, the OCC, along with the other U.S. banking agencies, are participating in the international efforts to revise and improve regulatory capital standards as part of the Basel III reform process. Throughout the development of these new standards, we have made a concerted effort to reduce the cyclicality of capital requirements. The countercyclical elements of Basel III operate both at the bankwide level, through the introduction of capital buffers and a new international leverage ratio, and at the exposure level, through the assignment of higher capital requirements to certain types of transactions and risks that proved most problematic during the crisis.

Basel III will create countercyclical bank-level capital requirements through the introduction of capital conservation buffers. These capital conservation buffers essentially raise the capital ratios at which banks will operate. If a bank dips into the capital conservation buffer range, it faces constraints on its capital distributions including constraints on dividends and discretionary bonuses. The capital buffers will reduce the cyclicality of capital requirements by creating incentives for banks to hold high levels of capital during good times that can then be drawn down during periods of economic stress. This additional capital cushion will also make it easier for banks to lend during a downturn without fear of broaching minimum capital requirements, which will help to reduce the likelihood of a credit crunch.

Basel III will also introduce an international leverage ratio that is intended to limit the build-up of excessive leverage and serve as a backstop to the risk-based capital requirements. While the United States already employs a leverage ratio, the international leverage ratio will also incorporate certain off-balance sheet elements, which will strengthen the ability of the leverage ratio to serve as a governor on excessive leverage.

At the individual exposure level, Basel III will reduce the cyclicality of capital requirements for trading book exposures by requiring banks to explicitly incorporate stress periods when assigning capital to these positions. In contrast, the existing capital requirements only require banks to make use of recent experience, which during benign periods led to capital requirements that proved to be too low. Similarly, Basel III reforms will also require banks to consider stress periods when assessing capital for counterparty credit risk. By using periods of stress to assign capital requirements for trading book positions and counterparty exposures, the amount of capital required will be less variable over the business cycle, and more capital will be required before a downturn instead of once the downturn occurs.

Basel III will also require more capital for bank exposures to certain other financial institutions, particularly large banks and highly leveraged firms such as hedge funds. By requiring more capital for exposures to other financial institutions, each bank under Basel III will be better able to withstand a negative shock to another financial institution, thereby reducing the likelihood of contagion that was clearly evident during the crisis.

Basel III will also significantly increase capital requirements under the Standardized Approach for certain bank exposures to asset-backed commercial paper (ABCP) programs. During the crisis, some banking organizations decided to support their ABCP programs and similar structures such as structured investment vehicles. This support required additional capital at the most inopportune time. By raising capital requirements for these programs, capital will be required to be held up front, resulting in a smoothing of capital requirements over the cycle.

The enhancements under Basel III described above represent significant progress in limiting the cyclicality of capital requirements; however, it is worth noting that there are limits with respect to the extent to which capital requirements can be made less cyclical. Capital requirements are meant to be reflective of risk, and if risk increases for a bank during a downturn, one would expect capital requirements to also rise during a downturn. Despite this limitation, we believe the Basel III changes noted above will reduce the cyclicality of regulatory capital standards, and we will continue to work to make capital requirements less cyclical and will consider cyclicality in every capital rulemaking we undertake, as required under Dodd-Frank.

Lastly, it is also important to note that the Basel Committee and the banking agencies are actively engaged in efforts to reduce procyclicality through changes in areas other than the capital rules, Specifically, the Committee and the agencies are advocating changes in domestic and international accounting standards that would promote stronger and less procyclical provisioning practices, Both the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) have proposed changes to the current "incurred loss model" of provisioning that would move the standards towards an expected loss (EL) approach. The OCC, along with the other agencies are providing input to both the FASB and IASB in their efforts to finalize an EL approach to provisioning to permit earlier-in-the-cycle provisioning that captures credit losses more transparently and results in a less procyclical regime than the current "incurred loss" approach.

Q.5. The Financial Stability Oversight Council is an important feature of Dodd-Frank. During the conference, my amendment was adopted to clarify the role of the Council and the Federal Reserve. My amendment gave the Council responsibility for financial stability regulation. Up to that point, the legislation had colocated this responsibility at the Fed and the Council. The Congressional intent is clear that you, as members of the Council, are responsible for all policy matters related to financial stability. After the Council acts, implementation of your policy determinations will fall to the individual Federal financial regulators, including, of course, the Fed.

With this in mind, I would like each of you to comment on your preparations to serve on the Council:

Have you directed your staff to examine and study all of the issues that will come before you? Are you to prepared to participate on the Council, not as a rubber stamp for the Chairman of the Council, but as a fully informed individual participant?

A.5. Yes, The OCC is fully committed to the independent exercise of its authority and judgment in tile Council's deliberations and actions, and there are statutory provisions that broadly protect the OCC's independence. These statutory independence provisions would cover matters that arise in connection with the OCC's membership on the Council.

Moreover, the OCC has put staffing arrangements in place to ensure that the OCC's participation on the Council is informed by careful staff review and analysis of the matters the Council considers. We have committed staff resources to the support of its Council responsibilities that are commensurate with scope and importance of the Council's work. For example, the OCC's Senior Deputy Comptroller/Chief National Bank Examiner serves on the Council's deputies' committee. He is supported by staff at the deputy comptroller level, specialists in various areas of supervisory policy, and, in the Law Department, by lawyers expressly assigned to support Council-related work.

Q.6. Secretary Geithner has argued that there is a strong case to be made for continuing Government guarantees of mortgage-backed securities. Additionally, the Federal Reserve published a paper that proposes Government guarantees of a wide range of asset-backed securities, including those backed by mortgages, credit cards, autos, student loans, commercial real estate, and covered bonds. While some may believe that the Government will charge fair prices for Government guarantees, the history of Government run insurance programs suggests that things will not go well.

Does anyone on the panel support extending or increasing Government insurance against losses on asset-backed securities which, it seems to me, socializes risk, puts taxpayers on the hook for losses, and protects Wall Street against losses?

A.6. We believe that this is a public policy issue that is for Congress to decide. Should the Congress determine that such guarantees are in the public interest, we would incorporate this into our supervision of the assets.

Q.7. Please provide the Committee with an implementation schedule that includes: A list of the rules and studies that your agency is responsible for promulgating or conducting under Dodd-Frank and the date by which you intend to complete each rule or study.

A.7. Please see the chart attached as Appendix A [Ed.: See Page 196], which details the rules and studies the OCC is responsible for under Dodd-Frank (either as primary drafter or in a consultative capacity) and the target dates for completion of each rule or study.

Q.8. Please provide the Committee with an implementation schedule that includes: A list of the reorganizational tasks your agency will undertake to fulfill the mandates of Dodd-Frank and the date by which you intend to complete each task.

A.8. The OCC is engaged in a number of tasks to plan for and accomplish the integration of the OTS's personnel and its supervision of Federal savings associations into the OCC; the establishment of our Office of Minority and Women Inclusion; and the transfer of certain OCC functions and personnel to the CFPB.

In addition to the list of items below, section 327(a) of the Dodd-Frank Act requires the OCC, the FDIC, the OTS, and the Board of Governors of the Federal Reserve System (FRB) to submit an Implementation Plan to the Committee on Banking, Housing, and Urban Affairs of the Senate, the Committee on Financial Services of the House of Representatives, and the Inspectors General of the Department of the Treasury, the FDIC, and the FRB. The Plan, which must be submitted by January 17, 2011, will provide additional details with respect to the integration of the OTS into the OCC.

OTS/OCC Integration

- The OCC has established a transition team, headed by the Senior Deputy Comptroller/Chief Financial Officer, to coordinate and supervise the implementation of all issues involving the integration of OTS functions and personnel.
- Pursuant to section 314 of the Dodd-Frank Act, we have designated a Deputy Comptroller for Thrift Supervision, who will lead the agency's planning process for integration of OTS examination and supervision functions and staff into the OCC. He will report to the Senior Deputy Comptroller for Midsize/ Community Bank Supervision.
- Pursuant to the Dodd-Frank Act, the Director of the OTS, the Comptroller of the Currency, and the Chairperson of the FDIC must jointly determine the number of OTS employees needed to perform the functions transferred and identify employees for transfer to the OCC or FDIC. While the final number of OTS employees who will transfer to the OCC has not yet been determined, senior managers from the OCC, OTS, and FDIC are meeting regularly to discuss the process and to identify and address mutual concerns and issues for resolution.
- We also have begun the process of integrating our examination workforce by developing plans to enroll recent OTS hires in OCC national bank examiner training courses. Pursuant to the statute, OTS personnel coming to the OCC will be transferred not later than 90 days after the transfer date.
- The OCC intends to integrate transferred employees into the agency's organizational structure and pay plan as soon as possible and to maintain existing OCC human resources policies.
- The transition team also is reviewing and comparing employee benefits and any related contracts, including those under the OTS's Financial Institutions Retirement Fund (FIRF), which covers some OTS employees, and other supplemental retirement benefits.
- OCC staff is now participating in OTS supervisory review committee presentations for problem banks, and sharing information on other institutions and supervisory strategies. The development of examination plans and supervisory strategies for national banks and Federal thrifts for fiscal year 2012 will be conducted jointly and is scheduled to begin in January 2011.
- The OCC is working closely with the OTS to review the status of leased office space supporting thrift supervision, including the leasing decisions required over the next 2 years. This re-

view includes an assessment of space needs to support thrift supervision staff throughout the country, as well as the continuing space requirements for more than 3,000 current OCC employees.

- We have posted on our internal Web site a number of frequently asked questions and answers regarding the OTS/OCC integration.

Establishment of the OCC's Office of Minority and Women Inclusion

- The OCC has moved promptly to fulfill the requirements of Section 342 of the Dodd-Frank Act. Shortly after passage of the Act, the agency's Human Resources office, in consultation with senior OCC leadership, developed a job description for the position of Director and advertised the position within the OCC in accordance with our policies and principles for merit promotion and internal placement. The process for evaluating eligible candidates is complete and a selection will be announced shortly.
- Once a selection is made, the Director will play an integral role in determining the orgranizational structure and the number of staff needed to successfully carry out his or her responsibilities. We expect to have the office organized and functioning on or before mid-January, 2011.

Transfer of OCC Functions and Personnel to the CFPB

- The OCC is coordinating with the Department of Treasury to identify personnel that could be transferred to the CFPB. This involves identifying those OCC employees who have both the skills needed by the CFPB and are interested in transferring to the CFPB.
- We also have solicited expressions of interest from employees who may be interested in moving to the CFPB. To help keep OCC employees informed, the OCC has posted on our internal Web site a number of frequently asked questions and answers regarding the CFPB. In addition, on November 10, the OCC held an agencywide teleconference to inform OCC employees about developments regarding the CFPB.
- Acting Comptroller Walsh and other senior managers at the OCC recently met with Treasury officials and Professor Warren to discuss issues related to the transfer of OCC personnel. To further the understanding of our current operations, we also have provided extensive materials to Treasury staff, including organizational charts describing our consumer protection functions, details about the national banks with more than $10 billion in assets that the CFPB will assume responsibility to examine, position descriptions, and FTE requirements for supervision.
- In addition to assist with the organization of the CFPB, we have detailed employees to the CFPB and provided technical assistance to CFPB organizers relating to bank supervision, consumer compliance and consumer complaint functions, and

internal systems and issues such as payroll, procurement, and benefits.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR BROWN FROM JOHN WALSH

Q.1. As I've made clear before, I think the largest financial firms in this country are just too large, and that their massive size threatens our economic security and puts us at risk in future crises.

I think the rise of proprietary trading was one of the key drivers behind the massive growth in our largest financial institutions. Firms were taking on ever increasing prop trading positions, often with highly unstable short term financing, and when things froze up, the house of cards collapsed. The Volcker Rule looks to stop this risk.

I know that my colleagues, Senator Merkley and Senator Levin, drafted section 619 of the Dodd-Frank Act to ensure broad coverage of the prohibition on proprietary trading by banks, and meaningful restrictions on the largest nonbank financial firms. Nevertheless, one of the concerns I have is that firms may try to evade the restrictions. Particularly, I'm concerned that if the regulators set a definition of "trading account" that is too narrow, it might not capture all of the risks of proprietary trading. These evasions could only happen if the regulators ignore the clear direction of the law to stop proprietary trading.

Are you prepared to take a broad view on the definition of "trading account" and examine and prevent proprietary trading, wherever it occurs? In short, are you prepared to use the full power of the Merkley-Levin provisions to cut the size and riskiness of our banks so they get back to the business of lending to families and businesses?

A.1. The OCC is fully committed to ensuring that national banks comply with the requirements of section 619, including the statute's restrictions on proprietary trading. The statute requires, as a first step, that the Financial Stability Oversight Council conduct a study and make recommendations about implementation of the provision. The statute prescribes certain implementation objectives, including protecting banks' safety and soundness, protecting taxpayers and consumers, enhancing financial stability, limiting the inappropriate transfer of Federal subsidies to unregulated entities, reducing conflicts of interest between banks and their customers, limiting activities that have caused or might reasonably be expected to create undue risk or loss at banks, appropriately accommodating the business of insurance, and appropriately timing the divestiture of illiquid assets that will be affected by the restrictions of section 619(a). It further provides that the study must be completed not later than 6 months after the enactment of the Dodd-Frank Act, that is, in January 2011.

The Council sought public input for the required study by publishing a notice in the Federal Register on October 6, 2010. The public comment period closed on November 5, 2010; the Council received more than 8,000 comments in total, approximately 1,450 of which were unique (that is, individualized, rather than form, letters).[1] An interagency staff group currently is developing a draft study for consideration and final action by the Council at its next meeting, in January 2011. As a member of the Council, the Acting Comptroller has been fully engaged in these implementation efforts, and OCC are actively participating in the interagency group that is conducting the staff work.

Section 619 directs the OCC, the Federal Reserve Board, and the Federal Deposit Insurance Corporation to issue joint regulations implementing section 619 for banks after carefully considering the findings of the Council's study, and after consultation and coordination with the Securities Exchange Commission and the Commodity Futures Trading Commission. These regulations are due 9 months after the study is completed, that is, in October 2011. We will proceed as directed by the statute, and will consider the findings in the Council's study and the views of the other regulatory agencies in defining statutory terms and implementing the important proscriptions in the statute on proprietary trading.

With particular respect to the size of financial firms, section 622 of the Dodd-Frank Act imposes a concentration limit that prevents a financial company from acquiring, merging or consolidating with another company if the resulting company's total consolidated liabilities would exceed 10 percent of the aggregate consolidated liabilities of all financial companies. Congress directed the Council to study the effects of imposing this concentration limit, specifically the extent to which the concentration limit would affect financial stability, moral hazard in the financial system, the efficiency and competitiveness of the U.S. financial firms and financial markets, and the cost and availability of credit and financial services to U.S. households and businesses. In January, 2011, the Council must issue recommendations regarding modifications to the concentration limit that the Council determines would more effectively implement section 622. Following the Council's study and recommendations, the Federal Reserve Board will issue implementing regulations. The OCC is actively participating in the interagency staff group that is drafting the study, which we expect the Council also will consider and act on at its January, 2011, meeting.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR TESTER FROM JOHN WALSH

Q.1. Can you provide me an update on your agencies progress in implementing the property appraisal requirements of Title XIV of Dodd-Frank? What process will you use to develop and implement these requirements?

A.1. Title XIV provides that the appraisal rules are to be developed jointly by a group of agencies that includes the OCC, the FDIC, the Federal Reserve Board, the National Credit Union Administration (NCUA) the Federal Housing Finance Administration (FHFA), and the CFPB. Title XIV provides, in general, that the regulations it requires must be prescribed in final form before the end of the 18-month period beginning on the designated CFPB transfer date

[1] For the Council's Federal Register notice, *see,* 75 Fed. Reg. 61758 (Oct. 6, 2010). Comments received may be viewed on Regulations.gov at *http://www.regulations.gov/search/Regs/home.html#docketDetail?R=FSOC-2010-0002.*

which will be in July, 2011, and take effect 12 months following issuance of the final regulations. Since the CFPB does not yet have a director or permanent staff, the rulemakings in which it is required to participate have not yet commenced. Pending initiation of the rulemakings, OCC staff have primarily focused on evaluating the changes required by the legislation.

In addition, the OCC, together with the Federal Reserve Board, the FDIC, the OTS, and the NCUA recently issued revisions to their joint “Interagency Appraisal and Evaluation Guidelines.” The revised Guidelines update the agencies’ supervisory guidance and clarify their expectations for institutions’ appraisal and evaluation programs to conduct real estate lending safety and soundly. The revised Guidelines were published in the Federal Register on December 10, 2010.

Finally, Title XIV required that within 90 days of the enactment of the Dodd-Frank Act, the Federal Reserve Board issue an interim final rule specifiying acts or practices that violate appraisal independence requirements. Pursuant to this provision, the Board issued its interim final rule for comment on October 18, 2010, with a mandatory compliance date of April 1, 2011.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MERKLEY FROM JOHN WALSH

Q.1. *Regulatory Structure for Volcker Rule.* As you know, the objectives of the Merkley-Levin Volcker Rule are two-fold: (1) to address the specific risks to our financial stability caused by proprietary trades gone bad, and (2) to take on the conflicts of interests in proprietary trading.

Ensuring effective oversight will be challenging, because the issues are complicated. As you could see from the exchange at the hearing between Senator Reed and Chairman Bernanke, with interjections by Chairman Shapiro and Mr. Walsh, I and others are beginning to come of the view that there will have to be oversight at two levels. First, there will need to be real-time (or as close as practicable) monitoring and enforcement at the individual trade-by-trade level, which looks to whether any given transaction is proprietary trading. This will be necessary to ensure that the permitted activities are not abused. Second, there will need to be macrolevel reviews of policies and procedures, and overall portfolio holdings. This will be necessary to ensure that proprietary positions and conflicts of interest are not cropping up despite the restrictions. In addition to monitoring and enforcing the proprietary trading and conflicts of interest restrictions, regulators are also tasked with setting appropriate capital charges, both for permitted activities, and, in the instances of nonbank financial companies supervised by the Board, capital charges for all covered activities.

Your agencies appear to have somewhat different strengths in these areas, with perhaps the SEC and CFTC having greater experience policing the securities and derivatives markets for trading violations, and the banking regulators having greater experience evaluating the safety and soundness of firms and setting appropriate capital charges and levels.

Share with me your view about the strengths you believe your agency brings to the oversight and enforcement of the Merkley-Levin Volcker Rule? Are you committed to working with your fellow regulators to best use your agency's strengths in the effort to keep our financial system safe?

A.1. The OCC is unequivocally committed to working with our fellow regulators to promote the safety of our financial system. The strengths we bring to this challenge include, first, a comprehensive and detailed knowledge about the securities and derivatives activities of the national banks we supervise and the risks presented by those activities. The OCC's knowledge derives from our examination activity, which is conducted through the continuous presence of examiners on-site at the largest institutions. (Smaller institutions are examined on-site on a 12–18 month schedule, consistent with requirements for the frequency of bank examinations established by statute). The on-site examination process is complemented by extensive off-site monitoring and analyses done not only by examiners but also by experienced supervisory staff and economists. Finally, the OCC has an extensive array of supervisory tools that it can use to remedy problems or weaknesses that we identify. These tools include broad administrative enforcement authority to impose cease-and-desist remedies and assess civil money penalties. But, unlike some other regulators, the OCC is not solely reliant on formal administrative or judicial proceedings, where remedies may be applied only after lengthy proceedings are concluded. The OCC also can use its supervisory process to direct bank management to correct deficiencies identified in an examination report as "matters requiring attention" or MRAs—an approach that is especially effective because it requires a bank to fix a problem right away.

Q.2. *Data Collection.* The Dodd-Frank Act requires a significant amount of new data collection and storage, particularly in the derivatives arena. The SEC and CFTC have made a priority of new data collection in a number of areas. Collection and the ability to automate reviews of the data will be critical to enforcing a wide range of mandates under Dodd-Frank, including derivatives position limits, the Volcker Rule provisions, and other parts of the bill. At a minimum, your staffs will need to know who's making trades, the prices, how long firms hold onto their positions, and whether and how their positions are hedged.

Where is your agency in terms of thinking through the relevant data you will need to collect?

Are there any major challenges you see in being able to collect and analyze that data in real-time, so as to ensure compliance with these various restrictions?

How do you see the newly created Office of Financial Research playing into this process?

A.2. As directed by Congress, the Financial Stability Oversight Council is currently conducting a study on how to implement the Volcker Rule. As a member agency of the Council, the OCC is working closely with the Department of the Treasury and other member agencies on the study, and will carefully consider the study's findings and recommendations in the Volcker Rule's implementing regulations. We will be better positioned to ascertain what data might be required once the study and implementing regulations are finalized.

We do not foresee major challenges in acquiring this data. The OCC's supervisory authorities, as well as the Dodd-Frank Act and other banking statutes, provide tools adequate to collect any data needed to monitor compliance with the proprietary trading restrictions.

The Office of Financial Research is still in formation, so it is too soon to determine how it will fulfill its duties under the Dodd-Frank Act. We expect the Office will support the Council and its constituent agencies in carrying out their respective responsibilities under the Volcker Rule, including, as appropriate, through data collection and related services.

Q.3. *Cross-border Resolution.* I know FDIC and to some extent others have been working very diligently to implement the new resolution authority for our Nation's large complex financial institutions—which owes so much to my colleagues on this Committee from Virginia and Tennessee.

But one of the areas I want to keep an eye on—and on which I offered an amendment during financial reform to provide additional oversight of—is how to make that resolution work for large firms operating across multiple national borders.

Where are we in terms of making the Dodd-Frank resolution authority work for large, systemically significant financial firms operating across borders? How cooperative have our international partners been in this effort?

A.3. On an interagency basis with the FRB and FDIC, the OCC has been working as a home regulator on recovery and resolution planning for large, U.S.-owned, cross-border firms. Significant international partners (*i.e.,* host supervisors) have been cooperative in seeking answers to difficult resolution issues for both U.S. and foreign owned cross-border firms. The U.S. agencies have conducted vertical (*i.e.,* firm specific plans) and horizontal (*i.e.,* issues across firms) reviews of recovery plans prepared by the U.S. firms. The FRB and OCC are preparing feedback to the firms on their detailed recovery plans. This is an iterative process which will require further work by the firms.

As home supervisors, the OCC, FRB, and FDIC have hosted crisis management group (CMG) meetings with significant host supervisors of the large, U.S.-owned, cross-border firms. The SEC was also invited to participate in these meetings. The CMG meetings served to identify resolution issues which are being researched by both home and host supervisors (*e.g.,* recognition of U.S. bridge bank, licensing processes, *etc.*). Follow up meetings are being planned for early 2011. CMG meetings are in addition to the supervisory colleges held for these firms.

As the host supervisor of foreign-owned U.S. banks/branches, the OCC has participated in supervisory colleges and CMG meetings of foreign firms with significant global operations. As with the meetings for the U.S. firms, there are many resolution issues that require further research.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CRAPO FROM JOHN WALSH

Q.1. Dodd-Frank requires that risk retention be jointly considered by the regulators for each different type of asset and includes a specific statutory mandate related to any potential reforms of the commercial mortgage-backed securities market to limit disruption. In light of the FDIC's unilateral decision to add an across the board risk retention requirement in the safe harbor rule, which the OCC opposed, how do you plan to coordinate and reconcile disagreements in the joint rulemaking?

A.1. The OCC believes that it is essential to set policy for U.S. securitization markets on a comprehensive, interagency basis as mandated by the Dodd-Frank Act. Dodd-Frank assigns several different aspects of the credit risk retention rule writing that it requires to several different combinations of agencies and assigns a coordination role to the Secretary of the Treasury as Chairman of the Financial Stability Oversight Council. Through an interagency group coordinated by the Treasury Department, the respective staffs of the OCC, the FDIC, the Federal Reserve Board, the SEC, the FHFA, and HUD are currently working cooperatively to draft the various sets of risk retention rules mandated under the Dodd-Frank Act. Differences among the agencies are negotiated the staff level with guidance from agency principals. If necessary, agency principals will hold direct discussions to reach closure on any unresolved issues.

This interagency process is unaffected by the OCC's views on the proposed or final FDIC safe harbor rule. At both stages of the rulemaking process, the OCC took the position that FDIC action was premature in light of legislation—the provisions ultimately enacted in section 941 of Dodd-Frank—that addressed securitizations and risk retention on a comprehensive basis. The FDIC final rule acknowledges that the joint agency rules promulgated pursuant to Dodd-Frank will "exclusively govern" the requirement to obtain an economic interest in a portion of the credit risk of the financial assets that are subject to its rule.

Q.2. Market participants highlight uncertainty related to changing regulations, new accounting standards, and other mandates as an obstacle to a resurgence of these markets. What steps are your agencies currently taking to minimize these complications? What should be done collectively by regulators to limit this uncertainty as you look toward the joint rulemaking?

A.2. We recognize that the uncertainty that has been created by the scope and magnitude of regulatory and accounting changes facing the financial industry can, by itself, create obstacles for bankers, their accountants, auditors, and other market participants as they try to make strategic business decisions. The OCC's Senior Deputy Comptroller and Chief National Bank Examiner, Tim Long, highlighted these issues in his recent speech before the AICPA National Conference on Banks and Savings Institutions. [1] As Mr. Long noted in his speech, we believe it is important that regulators and

[1] A copy of Mr. Long's speech is available at: *http://www.occ.gov/news-issuances/speeches/2010/pub-speech-2010-108.pdf.*

accounting standard-setters move as quickly as possible to give the industry the clarity it needs to move ahead, at a time when a strong and competitive financial sector is more important than ever to our economy. At the same time, however, we must ensure that our decisions are governed by a process that is deliberate, transparent, and inclusive. To that end, we believe it will be important to provide the industry and other interested parties sufficient time to review and comment on proposed rules and standards and, to the extent practical, allow appropriate transition periods and mechanisms to assess the impact of rule changes before they take full effect. The phased-in approach for strengthening capital and liquidity standards that the Basel Committee has recently announced is one example of such an approach.

The myriad of rules required under the Dodd-Frank Act will also place a premium on interagency coordination and communication. As I noted in my written testimony, the Dodd-Frank Act wisely requires other financial regulatory agencies to consult with primary supervisors as those agencies draft studies or develop regulations or standards, since there may be implications for the safety and soundness of depository institutions. To help facilitate this collaboration, we have designated OCC experts to advise the other financial regulatory agencies about the potential impact on the institutions we supervise and their customers.

APPENDIX A: OCC RULES AND STUDIES

The OCC is participating in a total of 46 rules and 26 studies, reports or other items. Of the 46 rules, the OCC is the writer of 26 and consults with the other agencies or FSOC in the remaining 20.

Action Required	Section No.	Description	Deadline after Enactment[1]
OCC rulemaking	165(i)(2)	**Self-Stress Tests** – Regulations to implement the requirement that 1) each designated nonbank financial company and bank holding company with over $50 billion in assets conduct its own semiannual stress test and 2) all other financial companies with total assets of more than $10 billion conduct annual stress tests. Each federal primary financial regulatory agency, in co-ordination with the FRB and Federal Insurance Office "shall issue consistent and comparable regulations to implement" this requirement.	None, but the FRB may assert that an 18-month deadline applies at least to it[2]
OCC rulemaking (but joint action likely)	171	**Minimum Capital Requirements** – The federal banking agencies must establish minimum leverage and risk based capital requirements for insured depository institutions, depository institution holding companies and designated nonbank financial companies. Subject to recommendations of the Council in accordance with section 120 (Council recommendations for heightened standards for financial activities and practices), the appropriate federal banking agencies must also develop capital regulations to address risks that the activities of depository institutions, depository institution holding companies and designated nonbank financial companies pose to the financial system.	None, but the FRB may assert that an 18-month deadline (Jan. 2012) applies at least to it[3]

[1] The date of enactment of the Dodd-Frank Act was July 21, 2010.
[2] Section 168 generally authorizes the Board to issue regulations to implement Subtitle C of Title I of the Dodd-Frank Act, which contains section 165. "Except as otherwise specified," an 18-month deadline applies to the Board's exercise of this authority. Since the Board is a Federal PFRA, it may conclude that its implementation of section 165(i)(2) must occur by that 18-month deadline.
[3] *See* supra note 5.

OCC Rulemaking	171(b)(7)	**Recommend Capital Requirements to Address Activities that Pose Risks to the Financial System** – Subject to the recommendations of the Council, in accordance with section 120, the Federal banking agencies shall develop capital requirements applicable to insured depository institutions, depository institution holding companies, and nonbank financial companies supervised by FRB that address the risks that the activities of such institutions pose, not only to the institution engaging in the activity, but to other public and private stakeholders in the event of adverse performance, disruption, or failure of the institution or the activity.	None
OCC joint rulemaking	210(c)(8)(H)	**QFC Recordkeeping** – Joint rules by banking agencies, SEC, CFTC, FHFA requiring that financial companies maintain such records with respect to qualified financial contracts (including market valuations) as the agency determines necessary or appropriate to assist the FDIC as receiver for a covered financial company.	24 months (July, 2012)
OCC identification of OTS rules; FDIC identification of OTS rules	316(b)(2), 316(b)(3)	**Identification of OTS Regulations** – OCC, in consultation with FDIC, to identify OTS regulations to be continued and enforced by the OCC. **Identification of the OTS Regulations to be Continued and Enforced by the FDIC**	OTS Transfer Date (July 2011 – Jan. 2012)
OCC rulemaking – agency matters	318, 605, 314(c)	**Revision to 12 CFR Part 8** – Revise assessments regulation to incorporate assessments for Federal savings associations. **Backup Examination Authority – Cost Recovery** – Section 605 authorizes appropriate Federal banking agency of "lead insured depository institution" ("LIDI") in a BHC or S&LHC to perform backup examination and enforcement authority; and authorizes LIDI to assess fees to cover backup exam or enforcement costs. OCC may wish to revise assessment rules to address cost recovery. **Revision to OCC Ethics Rules** – The OCC's ethics rules will need to be revised to reflect the OCC's supervision of Federal savings associations (e.g., Comptroller and Deputy Comptrollers will be prohibited from holding an interest in Federal savings associations). **Revision to 12 CFR 4.5** – Revisions needed to describe the OCC's District offices after the integration with OTS	None, but practical need to do concurrent with transfer date

OCC joint standards and procedures	322(k)	**OTS Employees** – Develop procedures and safeguards designed to ensure equitable treatment of transferred OTS employees (rulemaking not required); conduct a study detailing the position assignments and implementation safeguards of transferred OTS employees and report to Congress.	12 months after OTS Transfer Date (July 2012 – Jan. 2013)
Joint implementation plan	327	**Implementation Plan** – Submit a joint Implementation Plan regarding sections 301-326 to Congress and the IGs of Treasury, FDIC, and FRB.	180 days (Jan. 2011)
OCC rulemaking – national bank activities	341, 603, 612, 335. 939	**Revision to 12 CFR Part 5** – Revisions need to be made to Subpart A, (e.g., § 5.4 will need to be amended to incorporate filing of applications by Federal savings associations). **Revision of 12 CFR 5.50(f)(5)** -- Revise 12 C.F.R. 5.50(f)(5) to incorporate moratorium on certain changes in control of certain insured trust banks and CEBA credit card banks. **Revision of Conversion Regulation – 12 CFR 5.24** – Revise conversion regulation, 12 C.F.R. 5.24, to include new denial standards under section 612 for banks subject to enforcement proceedings and orders, and incorporate new procedures. **Revision to 12 CFR 28.16** – Revise regulation to reflect the permanent increase in the SMDIA to $250,000. **Ratings Requirements for Fin Subs** – Revise regulations to conform to statutory change in 12 U.S.C. § 24a, which revises requirements for minimum credit ratings applicable to banks seeking to control financial subsidiaries.	None
OCC rulemaking	610	**Rule Implementing Amendments to 12 USC 84** – Revise Part 32 to reflect new lending limit categories for derivatives.	None, but section 610 is effective 1 year after enactment (July 2011)
Consider counter-cyclicality in capital rulemakings	616	**Counter-Cyclical Capital Requirements** – In establishing capital requirements under BHCA, HOLA, and ILSA, agencies shall seek to make capital standards for holding companies and insured depository institutions counter-cyclical. No requirement for joint rulemaking, but the OCC has typically proceeded jointly in capital rulemakings.	None; provisions effective day after enactment
OCC joint rulemaking	616(d)	**Source of Strength Requirement** – Joint appropriate Federal banking agency rules implementing source of strength requirement.	One year after OTS Transfer Date (July 2012 – Jan. 2013)

OCC joint rulemaking	619	**"Volcker Rule" – Restrictions on Proprietary Trading/Hedge Funds** – Implement restrictions on proprietary trading and investment in or sponsorship of hedge funds and private equity funds by insured depository institutions. **Additional Capital for Hedge Fund Risks** – Imposition of additional capital or other restrictions on nonbank financial companies supervised by the FRB to address risks to and conflicts of interest of banking entities created by their relationships with hedge funds and private equity funds.	15 months (Oct. 2011)
OCC joint report	620	**Joint Report on Banking Activities** – Joint appropriate Federal banking agency report on activities that a "banking entity" may engage in under federal and state law, associated risks, risk mitigation activities; make recommendations re: any negative effect on safety and soundness, and restrictions needed.	20 months (Mar. 2012)
OCC rulemaking	625	**Waived Dividends upon Final Conversion of Thrift Subsidiaries** – Revisions to regulations (particularly OTS rule 12 C.F.R. 575.11(d)) requiring appropriate Federal banking agency of thrift subsidiary of mutual S&L holding company to consider waived dividends upon final conversion.	None; effective date of the statutory provision is the OTS Transfer Date
[Request input from KS]	716	**Prohibition Against Federal Government Bailouts of Swaps Entities** – Section 716 requires, among other things, that a bank swap entity conduct its swap activities in compliance with minimum standards for safety and soundness and mitigation of systemic risk. The text presumes prudential regulators (*e.g.* the OCC) will impose these standards by regulation, but section 716 does not require a rulemaking, or any consultation as to the minimum standards.	None
OCC joint rulemaking	731	**Margin and Capital (Prudential Regulator Rules)** – The prudential regulators (e.g., OCC, FRB) shall jointly adopt rules with the other prudential regulators, in consultation with the SEC and CFTC, for swap dealers and major swap participants for which there is a prudential regulator, imposing capital requirements and margin requirements on swaps that are not cleared. (Annual consultations with the SEC, CFTC, and other prudential regulators on minimum capital and margin requirements are also mandated.)	None
OCC rulemaking	742	**Retail Commodity Transactions** – Per amendment to the CEA, a person subject to the jurisdiction of a "Federal regulatory agency" (*e.g.*, OCC, FRB, CFTC, and SEC) is prohibited from offering to, or entering into with, a person that is not an eligible contract participant, any agreement, contract, or transaction in foreign currency except pursuant to a rule or regulation of the Federal regulatory agency with jurisdiction over the person. The rules are not required to be issued jointly.	360 days (July 16, 2011)

OCC joint rulemaking	764	**Margin and Capital (Prudential Regulator Rules)** – The OCC shall jointly adopt rules with the other prudential regulators (e.g., FRB, FDIC), in consultation with the SEC and CFTC, for security-based swap dealers and major security-based swap participants for which there is a prudential regulator, imposing capital requirements and margin requirements on swaps that are not cleared.	None
OCC rulemaking	806(e)	**FMU Notice of Material Changes** – Each Supervisory Agency (OCC, FDIC, SEC, CFTC), with FRB consultation, issues regs defining standards for determining when a Council-designated Financial Market Utility must provide advance notice to the SA of changes to the designated FMU's rules, procedures or operations that could materially affect the nature or level of risks presented by the designated FMU.	None; Title VIII is effective upon enactment
OCC rulemaking	810	**General Rulemaking Authority** – Each Supervisory Agency, the Council, and the FRB may prescribe rules and orders necessary to administer and carry out Title VIII, which regulates financial payment, clearing, and settlement functions. Section 808(c) may mean that the FRB must consult with the SAs if the FRB issues rules under section 810.	None; Title VIII is effective upon enactment
OCC review, modification of regulations; report to Congress (but joint action likely)	939A	**Remove Reliance on Credit Ratings from Regulations** – Review all regulations that require the use of an assessment of creditworthiness of a security or money market instrument, and remove any reference to or requirement of reliance on credit ratings and to substitute such standard of credit-worthiness as appropriate.	1 year for completion of the review (July 2011); report to Congress is due "upon completion" of the review
OCC joint rulemaking	941(b)	**Regulations on Credit Risk Retention by Securitizers** – Rules requiring securitizers to retain an economic interest in "a portion of the credit risk" for any asset securitized.	9 months (Apr. 2011)
OCC joint rulemaking	941(b)	**Regulations on Credit Risk Retention for Securitized Residential Mortgages** – Rules requiring securitizers to retain an economic interest in "a portion of the credit risk" for any residential mortgage asset securitized. **Exemption of Certain Qualified Residential Mortgages from Risk Retention Regulations** – Regulation to define "qualified residential mortgage."	9 months (Apr. 2011)

OCC joint rulemaking	941(b)	**Establishment of Asset Classes and Underwriting Standards for Risk Retention Regulations** – Requires risk retention regulations: (1) to establish asset classes with separate rules for different classes of assets; and (2) for each asset class so established, to include underwriting standards established by the Federal banking agencies specifying loan characteristics indicative of low credit risk.	9 months (Apr. 2011)
OCC joint rulemaking	956	**No Excessive Incentive-Based Compensation** – Regulations or guidelines comparable to FDIA section 39 guidelines, prohibiting incentive-based compensation that is excessive or may lead to material financial loss, taking into account the compensation provisions of section 39. **Compensation Structure Disclosure** – Regulations or guidelines comparable to FDIA section 39 guidelines, requiring disclosure to Federal regulators of compensation structures.	9 months (Apr. 2011)
OCC rulemaking	1025	**Prohibition Against Retaliation** – Prescribe rules to provide safeguards from retaliation against insured depository institutions and officers and employees that institute an appeal asserting the BCFP and the prudential regulator issued inconsistent supervisory guidance.	None
OCC review	1044, 1045	**Preemption and Visitorial Powers Rules** – Review regulations to determine what modifications are needed in light of the new statute.	None, but procedural standards changes are effective on BCFP Transfer Date. (July 21, 2011)
OCC joint rulemaking	1471	**Full Written Appraisal Requirement** – Implementing rules for new TILA requirement that higher-cost mortgages be supported by a full written appraisal of the property. Implementing rules may include exemptions for classes of mortgages.	18 months after BCFP transfer date (July 2011); effective date 12 months thereafter
OCC joint rulemaking	1472	**Appraiser Influence and Conflicts Prohibitions** – Optional authority of the agencies to issue joint regulations, interpretive guidelines, and policy statements implementing section 1472's prohibitions on improperly influencing an appraiser and appraiser conflicts of interest, appraisal report portability between lenders, and customary and reasonable compensation for fee appraisers.	None

OCC joint rulemaking	1473(a) 1473(f)(2)	**Reporting to Appraisal Subcommittee** – Issue joint regulations for reporting of the activities of appraisal management companies to the Appraisal Subcommittee for purposes of determining the annual registry fee. **Appraisal Management Company Registration Requirements** – Establish minimum requirements to be applied by states in registering appraisal management companies, and to be applied by appraisal management committee op subs of financial institutions.	18 months after BCFP transfer date (July 2011); effective date 12 months thereafter
OCC joint rulemaking	1473(a), (c)	**Appraisal Threshold and Standards** – Affects appraisal regulations issued by each Federal banking agency under Title 11 of FIRREA indentifying threshold for residential mortgages requiring a full written appraisal. OCC rules are at 12 C.F.R. Part 34, Subpart C. Requires banking agencies to obtain concurrence of the BCFP that the threshold provides reasonable protection for consumers.	18 months after BCFP transfer date (July 2011); effective date 12 months thereafter
OCC joint rulemaking	1473(q)	**Automated Valuation Model Quality Control Standards** – Establish quality control standards for AVMs to ensure confidence in estimates produced.	18 months after BCFP transfer date (July 2011); effective date 12 months thereafter