U.S. DEPARTMENT OF THE TREASURY

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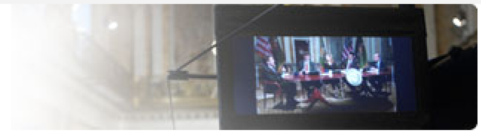

Remarks of Secretary Lew at Pew Charitable Trusts

12/5/2013

As prepared for delivery

WASHINGTON - I want to thank Sheila for that kind introduction and for all the work she continues to do advancing the cause of financial reform. I would also like to thank Pew for the work you do and for hosting me here today. I want to spend a few minutes discussing how far we have come to repair the weaknesses that shook our financial system to its core just a few years ago, the progress we have made reshaping our financial architecture, and what we need to do to remain vigilant to make sure our financial system is safe in the future.

Five years ago, the U.S. economy was reeling from a devastating financial crisis that helped trigger the worst recession since the Great Depression. In late 2008, our businesses were shedding more than 700,000 jobs a month, our economy was shrinking at an 8.3 percent annual rate, credit was frozen, our auto industry was sliding toward the abyss, and millions of Americans were losing their homes and their life savings.

To make matters worse, to contain the damage and keep our economy from melting down completely, American taxpayers were forced to provide extraordinary assistance to financial institutions and other companies, many of which had taken risks that contributed to the economic crisis.

The President faced an economy teetering on the edge. In response, he quickly moved to put out the financial fires, restore growth, and get people back to work. But he was also determined to make sure that a financial crisis like this never happens again.

This effort produced the most comprehensive overhaul of our financial system since the Great Depression, bringing our financial system into the 21st century and creating tools to address a complex and ever-changing markets and institutions. These reforms created the strongest new financial safeguards for consumers and investors in nearly a century. And as a matter of law, they state clearly that no financial institution is “too big to fail.”

Now, five years later, our economy has steadily grown. Our businesses have created nearly 8 million jobs over the past 44 months. Our housing market is recovering. And our financial system is stronger and once again an engine for economic growth.

A lot of progress has been made—and one of the main drivers has been the extensive work of agencies and regulators to repair a badly damaged financial system.

As regulators complete the remaining core elements of Wall Street Reform, there are four things we must keep in mind. First, the rules of the road must be effective and designed to address the modern financial markets. Second, we must make sure regulators have the resources necessary to get the job done and that they are held accountable. Third, other countries need comparably strong standards and mechanisms to address risks that reach across borders. And finally, we must remain vigilant to potential new threats, constantly monitoring the way that risks change and evolve and pursuing reforms to reduce risks stemming from both traditional banking and the shadow banking system.

While the process of putting these reforms in place has taken longer than we hoped, much has been done, and much is being completed. And we are committed to finishing the job. But as I have said before, this is not about writing a set of rules, and then walking off the field. This will require ongoing attention—ongoing fact-finding, review, analysis, and action. Ultimately, the measure of our success will not hinge on how fast regulations were put in place, but whether we strike the right balance. That is, maintaining deep, liquid financial markets that promote strong credit creation and lending, and protecting our economy and the American taxpayer from excessive risk-taking.

RULES OF THE ROAD

With the completion of the Volcker Rule, resolution authority, and stronger capital and liquidity requirements, the tools of financial reform are being used to make our financial system safer and to hold financial institutions responsible for bearing their own risk without the backstop of public support. Regulators have worked hard to find the right balance that protects our economy and taxpayers while also leaving room for well-functioning financial markets that fuel growth and help the private sector create jobs.

The Dodd-Frank rules of the road address the root causes of the financial crisis and meet the challenge of regulating today’s financial markets: a premium on consumer financial protection; curbs on excessive risk taking; transparency and oversight in the massive over-the-counter derivatives market; and, the necessary tools to prevent large financial institutions from threatening the financial system.

These reforms are transforming the way Wall Street operates.

As we know, some of the greatest damage to both ordinary individuals and major financial firms began with deceptive and harmful practices that left millions of Americans owing more than they could ever realistically repay. Dodd-Frank created the Consumer Financial Protection Bureau to increase transparency and choice, and to prevent unfair, deceptive, or abusive practices. And since opening its doors in 2011, the CFPB has already taken bold and decisive action.

The CFPB moved quickly to strengthen consumer protections in the mortgage market, bring payday lenders and debt collectors under federal supervision for the first time, and to provide extra help to those like the elderly and military families who were targeted by unscrupulous lenders. The CFPB’s new Qualified Mortgage standards, which help protect against risky loan features that harmed homeowners during the financial crisis, will go into effect in a few weeks. And just a few weeks ago, the CFPB created new mortgage disclosure forms. These new forms replace several complicated, overlapping documents and disclosure requirements with two clear, easy-to-understand forms to make home buying simpler and more understandable for all Americans.

Five years ago, most Americans did not even know what the enormous over-the-counter derivatives market was. But its lack of transparency and lax oversight put all of them, our economy, and our financial system at risk. Dodd-Frank set forth comprehensive requirements for this previously unregulated market, and the Commodity Futures Trading Commission and the Securities and Exchange Commission have been working hard to implement rules of the road. Earlier this year, requirements for trading platforms, central counter-party clearing, and trade reporting went into effect, reducing risk from derivatives by creating transparency and moving towards more standardized transactions. In September, G-20 leaders agreed to a U.S.-initiated proposal that establishes global margin standards for uncleared swaps. Now, regulators—both here and abroad—will make sure that consistent safeguards across borders protect the financial system from external shocks.

Part of ensuring that financial institutions bear their own risk is to make certain they have sufficient capital to absorb losses they may face.

Tough capital standards were put in place this summer, and banks will begin compliance next month. Rules requiring the largest firms to decrease leverage were proposed this year and will soon be finalized.

Under Dodd-Frank, bank regulators conduct annual stress tests to determine if the largest and most complex U.S. banks have sufficient capital to withstand severely adverse economic and financial conditions. For banks that do not pass these rigorous tests, change is required, including raising capital or suspending dividends. And the Federal Reserve will finalize new enhanced prudential standards very soon that go beyond capital and liquidity to impose tougher risk management standards and reduce interconnectedness for the largest and most complex financial companies. And there is measurable progress: the largest banks are now better capitalized and less leveraged—adding more than $450 billion of capital since the first quarter of 2009.

On top of that, Dodd-Frank restricts the types of high-risk activities in which banks can participate. Next week, regulators will begin voting on the Volcker Rule, putting in place tough restrictions on proprietary trading and investment in private funds by banks. Rule-writers will soon put forward a tough Volcker Rule that I expect to be true to President Obama's vision and the statute's intent. The rule now before regulators for a vote is the product of much intensive work and analysis—and, needless to say, years of effort. It prohibits risky proprietary trading while protecting economically essential activities like market making, such as when a firm facilitates selling bonds for a mutual fund. The rule prohibits risky trading bets like the "London Whale" that are masked as risk-mitigating hedges. And it puts in place strong compliance requirements that require those in charge of financial institutions to make sure that the "tone at the top" sends the right signal to the whole firm.

Now, in order to make sure that taxpayers are truly protected, it is critical to have an effective resolution process so that individual failing firms do not jeopardize the entire financial system or leave taxpayers at risk. Dodd-Frank prohibits the use of taxpayer dollars to bail out any financial firm. Yet ending "too big to fail" requires us to be confident that in a future crisis, we can and will use the tools that the law provides.

The largest financial companies have already submitted "living wills"—or blueprints—for how to unwind firms if they fail. Regulators will require firms to rework these plans if they are not credible. And if firms are unable to provide a credible plan, regulators can impose remedies, including requiring firms to divest or realign their businesses.

Also, regulators have already issued rules that make clear how they will implement the orderly liquidation authority, which allows the Federal Deposit Insurance Corporation to take over a failing firm and wind it down safely over time. And they are continuing to develop strategies and guidance for resolving major financial institutions with minimum disruption to the financial system. There is still more work to do—particularly to make certain international rules mesh with our own, since, as we know too well, financial crises do not respect national borders.

While we will not know how well these tools work for certain until they are tested by a true crisis, several things are clear. Dodd-Frank ended "too big to fail" as a matter of law; tough rules are now in place to make sure banks have the capital to absorb their own losses; monitoring through stress tests is underway; and resolution authorities and plans are in place. There is a growing recognition of these changes, and market analysts are now factoring them into their assumptions.

Put simply, the reforms we are putting in place raise the cost for a bank to be large, requiring firms to internalize their risks, and together, with resolution authority and living wills, make clear that shareholders, creditors, and executives—not taxpayers—will be responsible if a large financial institution fails. Earlier this year, I said if we could not with a straight face say we ended "too big to fail," we would have to look at other options. Based on the totality of reforms we are putting in place, I believe we will meet that test, but to be clear, there is no precise point at which you can prove with certainty that we have done enough. If, in the future, we need to take further action, we will not hesitate.

ACCOUNTABILITY

An essential part of meeting that test will be to make sure regulators have the resources necessary to police markets and financial institutions effectively. Even with the best rules, illegal behavior or excessive risk taking will go unchecked unless regulators have the resources to conduct regular examinations, monitor suspect behavior, and go after those who break the law. The point is, this is not an either/or proposition. The best rules will fall short without effective supervision and enforcement. And effective supervision and enforcement are only possible with sufficient resources.

After failing in efforts to block or rollback reforms, some in Congress would now simply starve the regulatory agencies of funding so they lack the resources to do their job. Failing to fund supervision and enforcement of the new rules amounts to virtual deregulation. And it puts Americans at risk that financial threats will go unchecked.

Even in tight budgetary times, this is not a budget-driven choice, and we must provide regulators with sufficient resources to make the financial regulatory system work and protect working families from financial harm. How could any of us say to someone who lost their job, home, or retirement security because of lax oversight that a safe financial system was a luxury we could not afford? We saw what that wrought in 2008 – and it cost Americans trillions of dollars and untold human misery. We cannot let that happen again.

The work these agencies do is money well spent. For example, in fiscal year 2013 alone, the CFTC imposed more than $1.7 billion in sanctions, including almost $1.3 billion for abusive actions related to manipulation of LIBOR and other financial benchmarks. These sanctions made our system safer and provide a disincentive for firms to engage in behavior that undermines market integrity and American's faith in our financial system.

In the near term, it is essential that Congress provide adequate funding for our regulators. But if annual funding does not meet this goal, Congress should consider moving the market regulator budgets out of the current budget process, as the President has proposed, and treat them like our banking agencies, which are self-funded through industry fees. That way, instead of unpredictable funding that shifts from year to year, oversight of our markets and institutions will be guaranteed. Political winds may shift, but the government's ability to focus on safe markets must be constant.

There are also ongoing efforts to strip the Consumer Financial Protection Bureau of its independence and undermine its ability to protect consumers. In only two years, the CFPB has already proven itself an effective enforcer, pushing back on predatory practices and abusive tactics. Already the CFPB has taken enforcement actions that have resulted in companies refunding hundreds of millions of dollars to consumers. And we must make sure that this new consumer agency is able to continue its vital work. You can understand why some out there would want to rein in this agency – it is now harder to profit from unfair, deceptive, and abusive practices. And it needs to stay that way.

As we fund and support our regulatory agencies, we also need to hold them accountable. The Dodd-Frank Act sets high expectations for regulators and gives them the tools they need to protect ordinary Americans and the broader financial system. There has been and will be ongoing debate on what are the right levels for capital and liquidity, the size of banks, and the structure of markets. And in a few moments, I will discuss some of the areas regulators need to keep their eyes on—including the money market fund industry and the tri-party repurchase agreement market. But one thing is clear: the regulators that Congress charged with these duties continue to use the tools at their disposal to reduce excessive risks in the system. And if necessary, regulators can and should do more.

Regulators must understand risk exposures, demand strong compliance and reporting, and promote effective risk-management systems. When regulators see failures in internal controls—like the failures that occurred during the events involving the "London Whale" and MF Global—it is critical that they hold those responsible to account. Regulators, like everyone else, must be held to the highest standards. The stakes are high and the standard for performance needs to be just as high.

INTERNATIONAL COORDINATION

The U.S. responded to the financial crisis aggressively and on a bipartisan basis to make our domestic system safer and more secure. But given the global nature of our financial system, we must continue working with other regulators to forge compatible rules so that reforms in other jurisdictions are as strong as our own.

From the outset of the crisis, the time and energy we put in to domestic regulatory reform have been paired with international efforts to promote high-quality standards, build a level playing field, and reduce risk.

We have made considerable progress through the G-20 and the Financial Stability Board in designing a more stable and resilient global financial system. But design is not sufficient. Implementation and follow-through are key. And we must avoid a race to the bottom.

Next February, I will meet with G-20 finance ministers in Australia, and I will use this opportunity to call on the world's biggest economies to bear down even more forcefully on implementation.

Our 2014 agenda is this: We will take steps to make sure that global banks meet the high standards we have set. That means moving swiftly to build strong and high-quality capital, properly weight risk assets, curb leverage, and build strong liquidity buffers to protect themselves in times of crisis.

Several years ago, the G-20 recommended that trading, reporting, and clearing of over-the-counter derivatives be in place by now. As I noted earlier, the United States has forged ahead in getting that done. We need to make sure these recommendations are put in place around the globe. There will be difficult cross-border issues to manage, and these are made more complex because other nations are moving far more slowly than the U.S.

Major financial institutions work globally, and for resolution of these firms to work fully, cross-border resolution must be part of it. The failure of Lehman Brothers demonstrated that the absence of cooperation between domestic and foreign authorities to resolve a financial company can endanger the global financial system—and underscored that, in the future, new resolution tools will need to work across borders.

Our agenda in the coming year will focus heavily on completing the work underway on international arrangements that establish how home and host authorities will cooperate to wind down a globally active firm in an orderly way. The failure to work out such arrangements now could pose a significant future risk to our financial system. Treasury is emphasizing this as a priority, and we are working with our domestic regulatory partners and international counterparts to get this in place.

The U.S. is also working closely with our colleagues internationally to reform financial benchmarks like LIBOR and make sure that alternatives are developed and available. As we have seen with LIBOR and circumstances around foreign exchange rates, we must guard against the potential for market manipulation both domestically and internationally.

We will also prioritize our work with international partners on ways to address the risks from short-term wholesale funding markets and shadow banking, complementing our domestic efforts.

In short, we are leaders in the international efforts to develop enhanced measures for all types of financial institutions, and working to align these approaches with the strong U.S. frameworks. Our aim is clear—we want a global race to the top.

While finishing high standard free trade agreements presents real opportunities to drive growth and create jobs, we will not allow these agreements to serve as an opportunity to water down domestic financial regulatory standards. And let me be clear: We will press other jurisdictions to match our robust standards—including in Europe and across Asia. And we will do so by continuing to pursue our international regulatory agenda in the bilateral and multilateral forums that have been and will continue to be at the forefront of advancing global financial reforms, such as the FSB and G-20. This will help prevent gaps in oversight and protect taxpayers from financial risk.

REMAINING VIGILANT TO EMERGING THREATS

Implementing the Dodd-Frank Act and internationally agreed-upon Basel standards, and encouraging global alignment with our strong reforms, are all necessary steps towards a safer and sounder financial system. But as we take these steps, it is also essential to remember that the crisis revealed that regulation and oversight failed to keep up with a rapidly evolving financial system. The fact is, we must remain vigilant as emerging threats appear on the horizon.

Dodd-Frank created two new organizations to help combat potential new risks—the Financial Stability Oversight Council and the Office of Financial Research. The Council brings the regulatory community together and charges them to look across their areas of responsibility, whether it is banks or markets or other financial institutions, and to identify risks that may emerge in the future. And the Office of Financial Research is working to understand what data we need to better track risks in the system and what we can learn from that data. They are leading efforts to create international data standards, so that we can anticipate the next crisis with information that is accessible and usable.

Part of the current focus of these new organizations is nonbank financial companies and shadow banking activities. In many ways, these firms act like banks and fill similar roles in the financial system, but without the comprehensive oversight or safeguards that banks are subject to. It is essential that we better understand and address the risks that these firms and activities present.

The tri-party repurchase agreement market is a critical source of short-term funding, but one with identified structural vulnerabilities, particularly the reliance on intra-day credit. The Federal Reserve has taken important steps to reduce this vulnerability and improve risk management practices for both borrowers and lenders.

And while the money market fund industry plays an important role in the everyday financial needs of many Americans, it is not without risk. As we saw in the financial crisis, some funds were susceptible to runs and new protections were needed. The Council made recommendations for additional reforms, to supplement changes made by the SEC in 2010. The SEC has proposed additional reforms and is working to finalize them. Having strong new protections for the money fund industry goes hand in hand with the broader work we are doing to safeguard the financial system. The Council will continue to work closely with the SEC, advocating for strong reforms to this core financial product.

The Council and the Office of Financial Research are fulfilling their charge to look across the financial system and evaluate risks that may pose a threat to financial stability. For instance, at the Council's request, the OFR recently put forward a study of the asset management industry to inform the Council's understanding of risk in this sector. This report provides the Council with important analysis as it begins to look at whether the asset management industry and its activities present risks to the broader financial system.

We also cannot forget the importance of reforming the housing finance system to enhance financial stability and working with Congress on bipartisan legislation to get this done. As the Council noted in its most recent annual report, significant housing finance reform is still needed to add clarity to the market and attract more private capital.

Going forward, we cannot be afraid to ask tough questions, with an open mind and without preconceived judgments. And informed by data and analysis, we should act as necessary to promote stability across our financial system.

We knew from the start that reforming our financial system could not happen overnight. Perhaps if we were building our regulatory regime from scratch or if our financial system were less complex, it may have happened faster. Our financial system is an elaborate engine that fuels economic growth. It provides credit for homes, cars, and education, it helps small businesses buy inventory and meet payroll, and it helps the largest employers hedge risks so that sudden changes do not mean layoffs or shutdowns.

We have made tough choices, and very significant progress toward reforming our financial system. Every day more change comes, not just on paper, but in the way banks, private funds, exchanges, and clearing houses do business. As we move forward, and as new, higher standards are phased in, the changes will be even more apparent. And our financial system will be even more secure. Because our financial system is always evolving, this is work that, by its basic nature, is never finished and it is our ongoing obligation to remain vigilant and responsive to a dynamic and changing financial system.

Thank you.

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