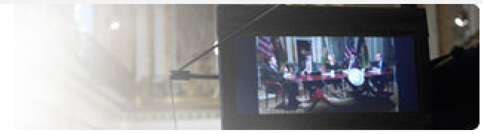

Testimony of Under Secretary for Domestic Finance Mary Miller before the Senate Banking Committee

2/14/2013

As prepared for delivery

WASHINGTON - Chairman Johnson, Ranking Member Crapo, and members of the Committee, thank you for the opportunity to appear here today to discuss progress implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act.

The Dodd-Frank Act represents the most comprehensive set of reforms to the financial system since the Great Depression. The package of reforms President Obama signed into law two-and-a-half years ago was a needed antidote for regulations that were too antiquated and weak to prevent or respond effectively to a financial crisis that inflicted devastating damage on the U.S. economy and American families. The inadequacy of our previous financial regulatory system was a major reason the crisis was so severe and why the recovery has taken so long.

Americans are already beginning to see benefits of the reforms implemented in the wake of the crisis reflected in a safer and stronger financial system and a broader economic recovery. Although the financial markets have recovered more vigorously than the overall economy, with the stock market near its October 2007 all-time high, the economic recovery is gaining traction. Private-sector payrolls have increased by more than 6 million jobs from the low point in February 2010, marking the 35th consecutive month of private-sector job growth. The unemployment rate, while still too high at 7.9 percent, has fallen more than two percentage points since its October 2009 peak of 10.0 percent. The recovery in the housing market also still has further to go, but it appears to be taking firmer hold as measured by rising home prices, stronger sales, and declining numbers of delinquencies and defaults.

The financial regulators represented here today have been making significant progress implementing Dodd-Frank Act reforms. Consumers have access to better information about financial products and are benefiting from new protections. Financial markets and companies have become more transparent. Regulators have become better equipped to monitor, mitigate, and respond to threats to the financial system.

Our financial system has also become smaller as a share of the economy and significantly less leveraged, reducing our vulnerability to a future crisis. Capital requirements for the largest banks have increased substantially, and U.S. banks have raised their capital levels to approximately $1 trillion, up 75 percent from three years ago. We have a new framework in place for protecting the financial system, the economy, and taxpayers from the consequences of the failure of a large financial company.

Eleven of the largest bank holding companies have already submitted their living wills to the Federal Reserve and Federal Deposit Insurance Corporation, and the other firms required to submit living wills will follow suit by the end of this year, providing their regulators with a roadmap to wind them down should they fail. The costs of resolving a failed financial company will not be borne by taxpayers, but by the company’s stockholders, creditors, and culpable management – and if necessary by the financial services industry.

The newly created Consumer Financial Protection Bureau (CFPB) has taken important steps to provide clarity on consumer financial products for ordinary Americans. The CFPB is cracking down on abusive practices and helping to level the playing field between banks and nonbanks, so that they play by the same rules when dealing with customers.

Expanded enforcement authorities at the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC), along with their new whistleblower rules, are providing investors with increased protections, and the agencies’ vigorous enforcement efforts should serve as a greater deterrent to misconduct. Investors in thousands of publicly traded companies have exercised new rights to vote on executive compensation packages as a result of Dodd-Frank’s say-on-pay provisions.

A new framework for regulatory oversight of the over-the-counter (OTC) derivatives market is largely in place. It will significantly reduce the risks associated with these products and will provide much-needed transparency for both market participants and regulators. As a result of trade-reporting requirements, the price and volume of certain swap transactions are now available to regulators and the public, at no charge, and reporting for additional asset classes will begin at the end of this month. Swap dealers now have to register with the CFTC and adhere to new standards for business conduct and recordkeeping. Beginning next month, certain types of financial institutions transacting in clearable interest-rate or credit-index swaps must move those transactions to central clearinghouses, reducing overall risk to the financial system.

Treasury's responsibilities under the Dodd-Frank Act include standing up new organizations to strengthen coordination of financial regulation both domestically and internationally, improve information sharing, and better identify and respond to potential risks to the financial system. Over the past 30 months, we have focused considerable effort on creating the Financial Stability Oversight Council, the Office of Financial Research, and the Federal Insurance Office and making them effective and efficient organizations that fulfill the objectives established in the Dodd-Frank Act.

The Financial Stability Oversight Council

The Financial Stability Oversight Council (FSOC) has become a valuable forum for collaboration among financial regulators and, despite its relative youth, has become a central figure in the implementation of financial regulatory reform and in addressing risks to the financial system.

Although FSOC members by law are required to meet only quarterly, the FSOC has been far more active than that. In 2012, FSOC principals met 12 times to conduct their regular business and respond to specific market developments. Additionally, the FSOC facilitates significant collaboration and information-sharing at the staff level through regular meetings of its Deputies Committee, which meets on a bi-weekly basis, and its Systemic Risk Committee, which meets monthly.

These are key forums for coordination among regulators. There is steady and understandable demand from the financial industry for enhanced regulatory coordination. Given the different statutory mandates and supervisory responsibilities of the various independent financial regulators, they are not always able to achieve as much alignment as regulated entities and market participants might desire. However, by having a regular forum available for frank discussion and early identification of areas of mutual or potentially overlapping interests, the financial regulatory community has been able to better identify issues that would benefit from enhanced coordination. On the international front, for example, the U.S. representatives to groups such as the Financial Stability Board and the International Association of Insurance Supervisors are able to use the FSOC as a means of sharing information and collaborating with a broader group of domestic colleagues on international efforts.

The benefits of strengthened coordination go beyond regulatory implementation. One of the strongest attributes of the FSOC has been its ability to quickly bring the key regulators together to respond to events such as the failure of MF Global and the disruption to financial markets caused by Superstorm Sandy.

In addition to the FSOC's coordination role, it has certain authority to provide for more stringent regulation of a financial activity by issuing recommendations to the responsible regulatory agencies. An example along these lines is vulnerability in the short-term funding markets, which the FSOC first addressed in its 2011 annual report and then again in 2012. The focus on this exposure ultimately led to the FSOC's issuance for public comment of proposed recommendations on money market mutual fund reforms. The comment period on those proposed recommendations closes tomorrow, February 15.

The FSOC has also taken significant steps to designate and increase oversight of financial companies whose failure or distress could negatively impact financial markets or the financial stability of the United States. In July 2012, the FSOC designated eight financial market utilities, companies that play important roles in our clearing, payment, and settlement systems, as systemically important. These companies are now subject to higher risk-management standards and coordinated oversight by the Federal Reserve, the SEC, and the CFTC. The FSOC is also in the final stages of evaluating an initial set of nonbank financial companies for potential designation, and completing that work is an important priority for 2013. Designated nonbank financial companies will be subject to enhanced prudential standards and supervision by the Federal Reserve, closing an important regulatory gap.

The Office of Financial Research

Treasury has made significant progress in establishing the Office of Financial Research (OFR), which has been further strengthened with the confirmation of Richard Berner early this year as its first Director.

The OFR provides important support for the FSOC, including data for the FSOC annual report as well as data and analysis relating to the designation of nonbank financial companies. In collaboration with FSOC members, the OFR is also developing new dashboards of financial stability metrics and indicators for use by the FSOC's Systemic Risk Committee.

A key part of the OFR mission is to fill the gaps in existing data and analysis. The OFR has accordingly completed an initial inventory of purchased and collected data among FSOC member agencies and an inventory of internally developed data is underway. To improve the quality and scope of data available to policymakers, the OFR has established data-sharing agreements with a number of FSOC member agencies and continues to work on new ones as needed.

The OFR plays a leadership role in the international initiative to establish a global Legal Entity Identifier (LEI), a code that uniquely identifies parties to financial transactions. The OFR's chief counsel was recently named Chair of the LEI Regulatory Oversight Committee. With the planned launch of the global system next month, the goal of standardizing the identification of these entities will become a reality. Financial companies and financial regulators worldwide will gain a better view of true exposures and counterparty risks across the global financial system.

In July 2012, the OFR issued its first annual report assessing the state of the U.S. financial system, the status of the efforts by the OFR to meet its mission, and key findings of the OFR's research and analysis. We have also established the Financial Research Advisory Committee, composed of 30 distinguished professionals in economics, finance, financial services, data management, risk management, and information technology to provide advice and recommendations to the OFR.

Federal Insurance Office

Treasury has also worked to establish the Federal Insurance Office (FIO) and develop its ability to serve as the federal voice on insurance issues, both domestically and internationally.

FIO is responsible for monitoring all aspects of the insurance industry, including identifying issues or gaps in regulation that could contribute to a systemic crisis in the insurance industry or financial system. FIO coordinates and develops federal policy on prudential aspects of international insurance matters; represents the United States at the International Association of Insurance Supervisors (IAIS); and, along with the independent insurance expert and a state insurance commissioner, the FIO Director contributes insurance expertise to the FSOC as a non-voting member. FIO also monitors the accessibility and affordability of non-health insurance products to traditionally underserved communities.

Until the establishment of FIO, the United States was not represented by a single, unified federal voice in the development of international insurance supervisory standards. FIO now provides important leadership in developing international insurance policy. In 2012, FIO was elected to serve on the IAIS Executive Committee and as Chair of its Technical Committee. FIO is involved with the IAIS's development of the methodology to identify global systemically important insurers and the policy measures to be applied to any designated firm. Apart from its work with the IAIS, FIO established and has provided leadership in the European Union-United States insurance project regarding matters such as group supervision, capital requirements, reinsurance, and financial reporting. FIO has worked and will continue to work closely and consult with state insurance regulators and other federal agencies in this work.

FIO will soon release its first annual report on the insurance industry and its report on how to modernize and improve the system of insurance regulation in the United States. FIO is working diligently to release these and several other reports in the coming months.

Coordination

In the year ahead, Treasury will continue to build on the FSOC's existing strengths as a key forum for information-sharing and collaboration among regulators and continue to develop the expertise and capacity of the OFR and FIO.

Although we are not a rulemaking agency for either the Dodd-Frank Act's Volcker rule or risk-retention rule, the Treasury Secretary, in his capacity as Chairperson of the FSOC, has an explicit statutory coordination role with respect to both of those rulemakings. We take that role very seriously and will continue to work with the respective rulemaking agencies as they finalize those rules.

Another area where we continue to engage in significant coordination with other agencies is with respect to the Dodd-Frank Act's new orderly liquidation authority. We have participated in extensive planning exercises and preparations with the Federal Reserve and FDIC to be fully prepared to wind down a company whose failure could have serious adverse effects on U.S. financial stability.

International

Our progress on domestic implementation is mirrored by our work internationally to support efforts to make financial regulations more consistent worldwide through the G-20 and the Financial Stability Board (FSB). By moving early with the passage and implementation of the Dodd-Frank Act, we have been able to lead from a position of strength in setting the international reform agenda and elevating the world's standards to our own. We remain attentive to the inevitable inconsistencies and lags on implementation and continue to emphasize that successful implementation of global financial regulatory reforms is essential for promoting U.S. financial sector competitiveness; building a stable, secure, and more resilient financial system; and avoiding regulatory arbitrage and a race to the bottom.

We are pursuing a comprehensive reform agenda internationally spanning bank capital and liquidity, resolution, and OTC derivatives markets.

On capital and liquidity, the Basel III standards raise the quality and quantity of capital and strengthen liquidity requirements so that banks can better protect themselves against losses of the magnitude seen in the crisis. These form the bulwark of core reforms that will enhance the stability of the international banking system. In June 2012, the federal banking agencies issued proposed rules and currently are working to adopt final rules to implement the Basel III standards in 2013. It is critical that our international partners implement Basel III faithfully as soon as possible. In fact, the majority of the largest U.S. banks already meet Basel III capital targets – well ahead of schedule.

On resolution, we have reached an important agreement that key financial jurisdictions should have the tools to resolve large cross-border financial firms without the risk of severe disruption or taxpayer exposure to loss. The FSB is working actively to see that this international commitment by regulators will drive major global banks to develop cross-border recovery and resolution plans; develop criteria to improve the “resolvability” of systemically important institutions; and negotiate institution-specific cross-border resolution cooperation arrangements.

On derivatives, U.S. regulators have led with implementation of reforms to centrally clear derivatives and require transaction reporting. We have also led the call for the development of a global margin standard for OTC derivatives that are not centrally cleared, and the G-20 and the FSB are making steady progress in their efforts to develop such a standard.

We have made real progress internationally on all of these fronts and must continue to do so. As the global economy heals from the devastation of the crisis, the urgency for reform may wane. Progress remains uneven internationally and significant work remains. We must redouble efforts domestically and urge our partners internationally to continue this essential work. In particular, we must be careful to avoid a fragmentation in financial regulation internationally, which can lead to uneven regulation, unequal treatment, constrained capital flows, and increased uncertainty. Treasury will continue to work with our partners around the world to achieve global regulatory convergence.

Conclusion

Financial regulatory reform implementation has presented one of the most challenging sets of responsibilities for regulators in nearly 80 years. We have a highly complex, international financial system with many intricately linked parts. While the demand for simple rules has a superficial appeal, simple rules do not suffice to address the nuances of a complex financial system. Also, as the work of regulatory reform implementation proceeds, issues inevitably arise such as MF Global’s failure, the so-called “London Whale” trading losses, and LIBOR manipulation that inform the work of regulators in important ways but that also require significant attention in and of themselves.

As we move forward, it is critical to strike the appropriate balance of measures to protect the strength and stability of the U.S. financial system while preserving liquid and efficient markets that promote access to capital and economic growth. Rules must also be properly calibrated to risks, taking into account, for example, the reduced risks that community banks pose compared to large, complex financial institutions.

Finally, we cannot afford to succumb to complacency now as the financial markets and economy slowly continue to recover. Efforts to repeal the Dodd-Frank Act in whole or piecemeal or to starve regulators by underfunding them will hamper growth, allow uncertainty to fester, and be corrosive to the strength and stability of our financial system. The progress we have made so far is because of the reforms that we are putting in place, not in spite of them. Completion of these reforms provides the best path to building a sounder foundation for continued economic growth and prosperity.

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