

## U.S. DEPARTMENT OF THE TREASURY

## Press Center



## Testimony of Deputy Assistant Secretary Patrick Pinschmidt before the Senate Subcommittee on Securities, Insurance, and Investment

7/22/2015

Chairman Crapo, Ranking Member Warner, and members of the Subcommittee, thank you for inviting me here today to discuss the Financial Stability Oversight Council's (Council) process for nonbank financial company designations.

The financial crisis taught us that we need clear accountability for the overall stability of the financial system. Five years ago this month, Congress responded with the Dodd-Frank Wall Street Reform and Consumer Protection Act (Wall Street Reform), which established the Council. The creation of the Council brought together, for the first time, the entire financial regulatory community with a collective responsibility to work together to identify and respond to potential threats to financial stability. This new mission required regulators to break out of their silos to strengthen the stability of the U.S. financial system.

Over the past five years, the Council has demonstrated a sustained commitment to working collaboratively to fulfill its statutory mission in a transparent and accountable manner. We built a new organization and developed strong working relationships among Council members and their staffs to provide a forum for candid conversations; share confidential, market-sensitive information; and ask tough questions that will help make our financial system safer.

Today, the Council convenes regularly to monitor market developments, to consider a wide range of potential risks to financial stability, and, when necessary, to take action to protect the American people against potential threats to the financial system. Our approach from day one has been data-driven and deliberative, while providing the public with considerable information regarding the Council's actions and views. The Council fosters interagency engagement on a daily basis, including through staff-level committees that discuss financial market developments, regulatory policy developments, and emerging risk topics. The Council has published five annual reports that describe its past work and future priorities in great detail; regularly opened its meetings to the public; published minutes of all of its meetings that include a record of every vote the Council has ever taken; and solicited public input both on areas of potential risk and on its procedures for evaluating potential risks.

As Secretary Lew has made clear, Council members recognize that the Council should be open to adapting its procedures when stakeholders raise good ideas. Just since last year, the Council has demonstrated this commitment by enhancing its transparency policy, strengthening its internal governance, adopting supplemental procedures to its nonbank financial company designations process, and soliciting public comment on potential risks from asset management products and activities.

One of the duties Wall Street Reform gave to the Council is to designate a nonbank financial company for enhanced prudential standards and supervision by the Board of Governors of the Federal Reserve System (Federal Reserve), if the Council determines that the company's material financial distress or activities could pose a threat to U.S. financial stability. The Council's nonbank designations address a key weakness brought to light by the financial crisis: that large, complex, and interconnected nonbank financial companies, without appropriate supervision, could contribute to bringing our financial system to a halt.

Since Wall Street Reform was enacted, the Council has designated four nonbank financial companies following a thorough, rigorous, and fact-based process with extensive engagement directly with each company and its regulators. Before considering any company for designation, the Council voluntarily adopted a rule and interpretive guidance in 2012, after soliciting three separate rounds of public comment, to provide as much transparency as possible regarding how the Council would evaluate companies. That guidance explains both the process that the Council follows for designations and the substantive framework for how it assesses risks.

As a result of these efforts, each designated company had extensive opportunities to engage with the Council and its staff during the process and the opportunity to understand and respond to the factors underpinning the Council's analysis before the Council's vote on a final designation. These designated companies are now subject to consolidated supervision by the Federal Reserve, which is currently working to develop enhanced prudential standards for these companies, taking into account their specific businesses, risks, and existing regulation.

Designating a firm is not a decision the Council takes lightly. Before making a final decision about any designation, the Council goes through a lengthy, multi-stage, in-depth analysis, during which it reviews every aspect of a company — including a company's financial statements, business activities, market dynamics, and existing regulation — and works with the company and its regulators to understand how the firm's financial distress could affect the broader financial system. The most recent designation followed a year and a half of engagement with the company. Most of the companies the Council has considered so far have not met the standard for designation. But in four cases, after considerable and thoughtful deliberation, the Council has found that a firm needs to be held to a higher standard to protect the U.S. financial system. Of the four firms the Council has designated, none were designated for a single reason — they are all large, interconnected, and complex firms.

The Council's recent adoption of changes to the nonbank financial company designations process is a prime example of the way the Council should go about supplementing its processes without compromising its fundamental ability to conduct its work. Last year, before making any changes, the Council conducted extensive outreach with a wide range of stakeholders. The Council's Deputies Committee — senior staff who coordinate the Council's activities — hosted a series of meetings in November with more than 20 trade groups, companies, consumer advocates, and public interest organizations. The Council also solicited input from each of the three companies then subject to a designation. The Council discussed the findings from this outreach and proposed changes during a public meeting in January before subsequently adopting the procedures in February. Having the administrative flexibility for the Council to adapt its own procedures allowed us to respond quickly to stakeholder feedback.

The supplemental procedures address the areas that stakeholders were most interested in and formalize a number of existing Council practices regarding engagement with companies. Under the new procedures, companies will now know early in the process where they stand, and they will have earlier opportunities to engage with and provide input to the Council. For example, the Council will notify a company when it first comes under active review and provide it with the opportunity to meet with staff, review the Council's primary sources of public information regarding the company, and provide information relevant to the Council's review. If a company advances to the next stage of review, staff will meet with the company to explain the evaluation process and the framework for the Council's analysis, as well as any specific issues identified.

Regarding transparency, the changes will provide the public with more information about the process, while still allowing the Council to meet its obligation to protect sensitive, nonpublic company information. First, if a company publicly announces that it is under review by the Council, the Council intends, upon the request of a third party, to confirm the status of the company's review. Second, the Council will continue its recent practice of including more information in its public bases for designations, to provide the public with a deeper understanding of the Council's analysis. Third, the Council has started to publish more information in its annual reports about its designations work, including the numbers of companies

in each stage of the review process. And fourth, the Council last month published further details explaining how staff calculate the quantitative thresholds that the Council applies as a screening mechanism to identify companies for consideration.

The Council is also providing companies with a clearer and more robust annual review process. Company representatives are now provided an opportunity to discuss the scope and process for the review, and they can present information regarding any change that may be relevant, including a company restructuring, regulatory developments, market changes, or other factors.

If a company contests its designation in an annual review, the Council will vote and provide the company with a written explanation of any decision not to rescind the designation. In addition, the Council will provide each designated company an opportunity for an oral hearing to contest its designation every five years. These changes open the door to more engagement with the Council following a designation to make sure there is ample opportunity to discuss and address any issues that a company wants to put before the Council.

Altogether, the changes that the Council has made strengthen the Council while also addressing many of the suggestions made by stakeholders.

As Congress contemplates additional changes to the designations process, it is important that such changes do not compromise the Council's fundamental ability to conduct its work. We are particularly concerned with legislative proposals that would dramatically lengthen an already long and deliberative designation process, impose insurmountable practical hurdles on the Council's work, and prevent the Council from taking action to address potential threats to financial stability that it has identified. Such proposals ignore the lessons of the financial crisis and would impede the Council's ability to fulfill the duties Congress gave it. As the President and Secretary Lew have made clear, we will not support legislation that weakens the important taxpayer, investor, and consumer protections by impeding the ability of regulators to identify and respond to threats to financial stability. U.S. markets and financial institutions are constantly evolving, and we must remain alert and responsive to new challenges in our dynamic system, toward the ultimate goal of maintaining the safety, soundness, and resiliency of our financial system.

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