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WALL STREET REFORM: ASSESSING AND ENHANCING THE FINANCIAL REGULATORY SYSTEM

HEARING

BEFORE THE

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

ONE HUNDRED THIRTEENTH CONGRESS

SECOND SESSION

ON

EXAMINING THE PROGRESS FINANCIAL REGULATORY AGENCIES ARE MAKING TOWARD COMPLETING RULES THAT IMPLEMENT THE DODD–FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT

SEPTEMBER 9, 2014

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C O N T E N T S

TUESDAY, SEPTEMBER 9, 2014

	Page
Opening statement of Chairman Johnson	1
Opening statements, comments, or prepared statements of:	
Senator Crapo	2
WITNESSES	
Daniel K. Tarullo, Governor, Board of Governors of the Federal Reserve System	4
Prepared statement	41
Responses to written questions of:	
Chairman Johnson	101
Senator Crapo	101
Senator Merkley	104
Senator Toomey	110
Senator Kirk	117
Martin J. Gruenberg, Chairman, Federal Deposit Insurance Corporation	5
Prepared statement	47
Thomas J. Curry, Comptroller of the Currency, Office of the Comptroller of the Currency	7
Prepared statement	60
Responses to written questions of:	
Senator Crapo	119
Senator Merkley	121
Senator Hagan	126
Senator Toomey	127
Senator Kirk	129
Senator Heller	131
Richard Cordray, Director, Consumer Financial Protection Bureau	8
Prepared statement	69
Responses to written questions of:	
Chairman Johnson	132
Senator Crapo	134
Senator Toomey	137
Senator Kirk	139
Senator Heller	141
Mary Jo White, Chair, Securities and Exchange Commission	10
Prepared statement	72
Responses to written questions of:	
Senator Crapo	141
Senator Tester	146
Senator Merkley	147
Senator Warren	155
Senator Kirk	162
Senator Heller	164
Timothy G. Massad, Chairman, U.S. Commodity Futures Trading Commission	12
Prepared statement	95
Responses to written questions of:	
Senator Crapo	164
Senator Merkley	168
Senator Kirk	170
Senator Moran	171
Senator Heller	172

WALL STREET REFORM: ASSESSING AND ENHANCING THE FINANCIAL REGULATORY SYSTEM

TUESDAY, SEPTEMBER 9, 2014

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

The Committee met at 10:01 a.m., in room SD–538, Dirksen Senate Office Building, Hon. Tim Johnson, Chairman of the Committee, presiding.

OPENING STATEMENT OF CHAIRMAN TIM JOHNSON

Chairman JOHNSON. I call this hearing to order.

Today, I welcome back the financial regulators for another one of our many Wall Street Reform oversight hearings in this Committee since the enactment of the law. You all have been busy over August as you continue to make progress in completing rulemakings to implement Wall Street Reform. I thank you and your staffs for your hard work.

I strongly believe today, as I did in 2010, that Wall Street Reform was the appropriate response at the time to the financial crisis. We can already see the benefits. We have an enhanced system of regulation for our largest banks and nonbank financial companies. We have greater transparency and oversight for derivatives. We have a dedicated and accountable watchdog focused on better protecting consumers. We have strengthened coordination between regulators. And, we have new ways to monitor threats to financial stability.

As we all know, the road to implementing Wall Street Reform has been long and it has not always been easy. This is especially true for regulators trying to work together to write effective rules for an increasingly complex and global financial system. For some, this work has been done while Congress has not provided adequate funding. Proposed rules have not always been met with open arms from Congress, industry, or consumer groups. However, through robust and constant oversight, Members of this Committee have had the opportunity to express their views, and each of you and your agencies have listened. Because of it, the finalized rules are stronger.

Going forward, as we get farther away from the crisis and calls to water down Wall Street Reform grow louder, policymakers cannot forget the lessons from the crisis and how costly a weak regulatory system can be. Our financial system is strongest when we

have tough, but fair, oversight to provide a level playing field for all financial firms to better serve their clients.

Today, I look forward to hearing from the witnesses their next steps to complete the remaining Wall Street Reform rulemakings. Because of your diligent work, our financial institutions are stronger, our economy is more stable, and the rest of the world is looking to us when it comes to strong financial regulation. This is a vast improvement from where our country was before and during the financial crisis.

I now turn to Senator Crapo for his opening statement.

STATEMENT OF SENATOR MIKE CRAPO

Senator CRAPO. Thank you, Mr. Chairman.

Dodd-Frank requires about 400 new rules to be written and approved by the Federal financial regulators, and to date, slightly more than 50 percent of these rules have been finalized, and nearly 25 percent are still in the proposed stage. The remaining 25 percent are yet to be written.

With some 220 rulemakings finalized, we still have no idea what the cumulative cost of Dodd-Frank is or will be. The Volcker Rule and the conflict minerals rule alone will add approximately 4.6 million paperwork burden hours and over one billion for services of outside professionals, according to the regulators' own Paperwork Reduction Act estimates, and that is just for 2 of the 220 rules finalized.

We cannot pretend that these additional costs are not passed on to consumers. Without a cumulative analysis of the true costs and burdens of the rules, we cannot understand their overall impact on the regulated entities, consumers, and the markets.

For example, while Dodd-Frank was intended to exempt small institutions from some regulations, what I hear back in Idaho is that regulatory demands are trickling down even to the smaller banks and entities. Community banks are disproportionately affected because they are less able to absorb additional costs. Out of concern about what new regulations may be imposed next, financial institutions keep money for compliance costs set aside rather than investing it in local communities.

We can and should make commonsense changes to lessen the regulatory burden. In past hearings, the regulators have supported several Dodd-Frank fixes, including the end-user fix, the swaps push-out rule, and giving the Fed flexibility to tailor the capital standards it places on insurance companies. Regarding the latter, the Senate passed by unanimous consent a fix so that insurance companies are not subject to bank-like capital requirements contrary to their business model.

I look forward to hearing from the witnesses what specific fixes should be made so that traditional banking services do not become so complicated or expensive that banks like those in Idaho and other rural communities can no longer offer such services.

I appreciate that some of your agencies have commenced the statutorily mandated interagency review of existing regulations to identify outdated, unnecessary, or unduly burdensome regulations. A similar review led to the 2006 Regulatory Relief law, and I encourage the remaining agencies to join in this effort. I urge all of

you to make this review a priority, to set up outreach meetings and with community banks and others, and to provide a list of recommendations to Congress. For example, several of our witnesses have discussed eliminating a paper version of the Annual Privacy Notice, a measure that has passed the House by a voice vote and currently has more than 70 cosponsors in the Senate.

In addition to Dodd-Frank regulatory mandates, the law also established the Financial Stability Oversight Council. At the July FSOC hearing, I reiterated my concerns to Secretary Lew about the lack of transparency of FSOC's designation process. Last week's action by FSOC on Met Life only reinforces those concerns and threatens to disrupt a carefully forged regulatory balance for an industry that has been traditionally under the purview of State regulators. The U.S. financial system and capital markets cannot remain the preferred destination for investors throughout the world if our regulators operate under a cloak of secrecy.

Secretary Lew stated that each of the designated nonbank SIFIs was given detailed explanations as to why they were designated, but this information was provided only after the designations were made. This is not how our regulatory framework should operate. I urge you to publish indicator-based SIFI designation criteria in the *Federal Register* for public comment, and I urge you to impose a moratorium on new designations until there are objective metrics and increased transparency. Only then can we restore accountability to the FSOC designation process. All of your agencies should recognize the benefit in having an open and transparent regulatory process. Transparency does not weaken rulemakings, it gives them much-needed legitimacy.

Mr. Chairman, the issues we are discussing today are very important, especially as they relate to our smaller financial institutions. I know that the Committee will be looking at the small business issues in the near future, and I thank you for that.

Chairman JOHNSON. Thank you, Senator Crapo.

This morning, opening statements will be limited to the Chairman and Ranking Member to allow more time for questions from the Committee Members. I want to remind my colleagues that the record will be open for the next 7 days for opening statements and any other materials you would like to submit.

Now, I would like to introduce our witnesses. Daniel Tarullo is a member of the Board of Governors of the Federal Reserve System.

Martin Gruenberg is the Chairman of the Federal Deposit Insurance Corporation.

Tom Curry is the Comptroller of the Currency.

Rich Cordray is the Director of the Consumer Financial Protection Bureau.

Mary Jo White is the Chair of the Securities and Exchange Commission.

Tim Massad is Chairman of the Commodities Futures Trading Commission. Tim, welcome back to the Committee.

Mr. MASSAD. Thank you.

Chairman JOHNSON. I thank you all for being here today. I would like to ask the witnesses to please keep your remarks to 5 minutes. Your full written statements will be included in the hearing record.

Governor Tarullo, you may begin your testimony.

STATEMENT OF DANIEL K. TARULLO, GOVERNOR, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. TARULLO. Thank you, Mr. Chairman and Senator Crapo and other Members of the Committee.

Senator Johnson, I understand that this may be the last time that this group of six appears before you in your time as Chairman of the Committee, and I just want to say before I begin that I think everybody appreciates the care and even-handedness with which you have approached the substance of these important issues of financial regulation. And, speaking as one who has testified before you over the years, I also want to thank you for the patience and courtesy that you have extended to all witnesses in your time as Chair. I think it is something that we have all appreciated and that people have broadly admired, and we obviously will miss your presence on this Committee.

In appearing before this Committee in February, I noted my hope and expectation that this year would be the beginning of the end of our implementation of the major provisions of the Dodd-Frank Act. Seven years later, we are on track to fulfill that expectation, as detailed in my written testimony. To be clear, though, this is the beginning of the end, not the end itself. The agencies still have some work to do in adopting some regulations specifically required by Dodd-Frank. Moreover, the Fed has some additional work to do in filling out a regime of additional prudential requirements for systemically important financial firms.

Let me mention here two priorities. First, we will be proposing capital surcharges for the eight U.S. banks that have been identified as of global systemic importance. By increasing above Basel III levels the amount of common equity required to be held by these firms, we look to improve their resiliency to take account of the impact their failure would have on the financial system. While we will use the risk-based capital surcharge framework developed by the Basel Committee as a starting point, we will strengthen that framework in two respects.

First, the surcharge levels for the U.S. institutions will extend higher than the Basel Committee range, which will mean higher applicable surcharges for most U.S. firms—most of the eight U.S. firms, noticeably so in some cases.

Second, the surcharge formula will directly take into account each U.S. G–SIB's reliance on short-term wholesale funding, which we believe to be a very important indicator of systemic importance because of the potential for funding runs and contagion under stress.

I would note that while some other countries have also applied higher surcharges on their G–SIBs than required by the Basel Committee, none has explicitly taken account of short-term wholesale funding vulnerabilities.

Second, we are developing a proposal for these same eight banks to maintain a minimum amount of long-term unsecured debt. Should one of these firms ever go into resolution or bankruptcy, this structurally subordinated debt would have been previously identified as available for conversion into loss absorbing equity.

The presence of a substantial tranche of such long-term unsecured debt should reduce run risk by clarifying the position of other creditors in an orderly liquidation or bankruptcy process. It should also have the benefit of improving market discipline, since the holders of that debt would know they face the prospect of loss should the firm become insolvent.

You will note I mentioned short-term wholesale funding a couple of times in connection with the most systemically important institutions. We are also mindful of the risks that runnable funding can pose more generally. We have been working with our international counterparts on a proposal for minimum margins for security financing transactions, such as repos, that would extend to lending of this sort to all market actors.

While there is more to be done with respect to the largest institutions and vulnerable wholesale funding markets, I would close by suggesting it may be time to consider raising some thresholds or eliminating altogether the application of some Dodd-Frank provisions to other banks. The three banking agencies before you today have all been working on ways to reduce regulatory and supervisory burdens on smaller- and mid-sized banks. There would also be benefit, I think, from some statutory changes. One would be to raise the current $50 billion asset threshold that determines which banks are in the systemic category.

A second would be to exempt community banks entirely from provisions such as the Volcker Rule and the incentive compensation provision of Dodd-Frank, which are really both directed at practices in larger institutions.

Thank you for your attention. I would be pleased to answer any questions you may have.

Chairman JOHNSON. Thank you.

Chairman Gruenberg, please proceed.

STATEMENT OF MARTIN J. GRUENBERG, CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. GRUENBERG. Thank you, Chairman Johnson, Ranking Member Crapo, and Members of the Committee, for the opportunity to testify today on the FDIC's implementation of the Dodd-Frank Act.

If I may, like Governor Tarullo, I would like to begin by thanking Chairman Johnson for his strong personal support and encouragement to me, both during my service on the staff of this Committee as well as since I have been at the FDIC. I am very grateful for the support and encouragement you have given me and will greatly miss your steady, thoughtful leadership of this Committee.

The recent actions by the banking agencies to adopt a supplementary leverage capital ratio, a final rule on the liquidity coverage ratio, and a proposed rule on margin requirements for derivatives address three key areas of systemic risk that, taken together, are an important step forward in addressing the risks posed, particularly by the largest, most systemically important financial institutions.

In April of this year, the banking agencies finalized an enhanced supplementary leverage ratio final rule for the eight largest and most systemically important bank holding companies and their insured banks. This rule strengthens the supplementary leverage

capital requirements well beyond the levels required in the Basel III Accord. The enhanced supplementary leverage standards will help achieve one of the most important objectives of capital reforms, addressing the buildup of excessive leverage that contributes to systemic risk.

Just last week, the Federal banking agencies issued a joint interagency final rule implementing a liquidity coverage ratio. During the recent financial crisis, many banks had insufficient liquid assets and could not borrow to meet their liquidity needs, which greatly exacerbated the depth of the crisis. The liquidity coverage ratio standard will be the first quantitative liquidity requirement in the United States and is an important step toward bolstering the liquidity position of large internationally active banking organizations.

And, finally, establishing margin requirements for over-the-counter derivatives is one of the most important reforms of the Dodd-Frank Act. Before the crisis, some institutions entered into large OTC derivative positions without the prudent exchange of collateral, or margin, to support those positions. The margin requirements required by the proposed rule should promote financial stability by reducing systemic leverage in the derivatives marketplace.

The FDIC and the Federal Reserve have completed their reviews of the 2013 Resolution Plans submitted to the agencies by the 11 largest, most complex bank holding companies as required by Title I of the Dodd-Frank Act. On August 5, the agencies issued letters to each of these firms detailing the specific shortcomings of each firm's plan and the requirements for the 2015 submission. While the shortcomings of the plans varied across the firms, the agencies identified several common features of the plans' shortcomings, including unrealistic or inadequately supported assumptions and the failure to make or even to identify the necessary changes in firm structure and practices to enhance the prospects for orderly resolution.

The agencies will work closely with the companies to implement required improvements in the resolution plans, including simplifying their legal structures, amending derivative contracts to provide for a stay of early termination rights, ensuring continuity of critical operations during bankruptcy, and demonstrating operational capabilities to produce reliable information in a timely manner. The agencies are also committed to finding an appropriate balance between transparency and confidentiality for proprietary and supervisory information in the resolution plans.

Finally, in its role as supervisor of the majority of the community banks in the United States, the FDIC has been engaged in a sustained effort to better understand the issues related to community banks, those institutions that provide traditional relationship-based banking services in their local communities. Since the beginning of this year, FDIC analysts have published new papers dealing with consolidation among community banks, the effects of long-term rural depopulation on community banks, and the efforts of minority depository institutions to provide essential banking services in the communities they serve. We have also instituted a new section of the Quarterly Banking Profile that focuses specifically on commu-

nity banks and are providing technical assistance to them, including assisting with critical cyber risks.

Mr. Chairman, that concludes my remarks. I would be glad to respond to your questions.

Chairman JOHNSON. Thank you.

Comptroller Curry, please proceed.

STATEMENT OF THOMAS J. CURRY, COMPTROLLER OF THE CURRENCY, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Mr. CURRY. Chairman Johnson, Ranking Member Crapo, and Members of the Committee, I am pleased to appear here today to provide an update on the steps the OCC has recently taken to further enhance the effectiveness of our bank supervision and to provide a status report on the completed and current projects required by the Dodd-Frank Act.

Like my colleagues, I, too, however, would like to first thank Chairman Johnson for his guidance and steady leadership over the years. I have been in public service for a long time and learned early on that when Congressman Johnson or Senator Johnson had something to say on a financial matter, it was worth listening to. I thank you for your years of service and wisdom and wish you well in your retirement.

In the 4 years since passage of the Dodd-Frank Act, new tools have been developed and new rules have been put in place to address regulatory gaps and to create a stronger financial system. For our part, we at the OCC have completed all of the Dodd-Frank rulemakings for which we have sole responsibility. For those interagency rulemakings that remain to be completed, I believe we have made good progress to date and anticipate finalizing many of them in the near term.

Since the crisis, we have also seen steady improvements in the overall financial condition of the banking system. Despite the improving strength and health of banks, however, I am keenly aware of the need for supervisors to remain vigilant.

Last week, I was pleased to sign a new rule that not only memorializes the heightened standards we have applied to large, complex banks since 2010, but provides also an enforcement mechanism to compel compliance when necessary. Requiring higher supervisory standards for the largest and most complex banks we oversee is consistent with the Dodd-Frank Act's broad objective of strengthening the stability of the financial system. These heightened standards address the need for comprehensive and effective risk management, an engaged board of directors that exercises independent judgment, a more robust audit function, talent management recruitment and succession planning, and a compensation structure that does not encourage inappropriate risk taking.

Consistent with the heightened standards we are requiring of the largest banks, we are holding ourselves accountable to supervisory improvements, as well. Last year, I asked a team of international regulators to provide a broad, candid, and independent assessment of our supervision of mid-sized and large banks. The review identified a number of areas where we performed really well, but also highlighted areas where we need to improve. The OCC has em-

braced the team's findings and taken steps to execute recommendations that include transformational improvements.

One key improvement includes expanding our Lead Expert Program, which will allow us to better compare the operations of the institutions we regulate to identify trends, best practices, and weaknesses. Another change will improve our ability to identify systemic risk by enhancing our risk monitoring processes and reporting, and that fits squarely with the semi-annual public reports by our National Risk Committee. Those reports highlight emerging industry trends and identify those risk areas where we will focus our resources.

While the OCC has taken many steps to improve our supervision of large banks, we also recognize the impact of our activities on community banks. While we are focused on strong and effective supervision, we are always mindful of the need to avoid unnecessary burden on community banks. We have responded by tailoring our supervisory programs to the risks and complexity of a bank's activities. In each rulemaking, the OCC has sought and listened to the concerns of community banks. As an example, the lending limits rule provides a simpler option for small banks to use for measuring credit exposures, and the final domestic capital rules address concerns of small banks with respect to the treatment of TruPS, accumulated other comprehensive income, and residential mortgages.

My written statement includes a full status report on the many Dodd-Frank Act rulemakings the OCC has been involved in and our efforts to better coordinate with other domestic and international regulators. My statement concludes with an update of our activities to shore up the industry's defenses against cyberthreats, which I regard as one of the most significant emerging issues facing the industry.

Thank you again, and I would be happy to answer the Committee's questions.

Chairman JOHNSON. Thank you.

Director Cordray, please proceed.

STATEMENT OF RICHARD CORDRAY, DIRECTOR, CONSUMER FINANCIAL PROTECTION BUREAU

Mr. CORDRAY. Chairman Johnson, Ranking Member Crapo, Members of the Committee, thank you for the opportunity to testify today about implementation of the Dodd-Frank Act.

It will surprise nobody to learn that I will join my colleagues in expressing our respect and admiration for your leadership on financial reform and in this body. Your obvious commitment to fair consumer financial markets set an example for this Bureau in our work that, I think, is improving the lives of so many people across your State and this country. And, I will always remember your personal kindness and your family in welcoming me to South Dakota and having me hear from your constituents about these issues, and your personal kindness, in particular, in advising me that if I pronounced the State capital as "Pierre" rather than "Pier," that would make me a dude.

[Laughter.]

Mr. CORDRAY. The Consumer Financial Protection Bureau, as you know, is the Nation's first financial agency whose sole focus is

on protecting consumers in the financial marketplace, and over the past 3 years, we have made considerable progress in fulfilling our rulemaking, supervisory, and enforcement responsibilities to protect people across this country.

Our initial focus, as directed by Congress, by all of you, was to address deep problems in the mortgage market that helped precipitate the financial crisis. We began by issuing a series of mortgage rules that took effect early this year. They require creditors to make reasonable good faith assessments that borrowers are able to repay their loans, address pervasive problems in mortgage servicing that caused so many homeowners to end up in foreclosure, and regulate compensation practices for loan originators, among others. We have worked closely with industry housing counselors and other stakeholders to ensure the rules are implemented smoothly and timely.

Last fall, we also issued another mortgage rule to accompany a goal long urged in the Congress, which was to consolidate and streamline Federal mortgage disclosures under various laws. The new "Know Before You Owe" mortgage forms are streamlined and simplified to help consumers understand their options, choose the deal that is best for them, and avoid costly surprises at the closing table.

This summer, we also issued a proposed rule required by Congress to implement changes made to the Home Mortgage Disclosure Act. As with the redesign of the mortgage disclosure forms, we believe this rulemaking presents an opportunity to reduce unwarranted regulatory burdens.

As each of these initiatives proceeds, we are working diligently to monitor the effects of our rules on the mortgage market and make clarifications and adjustments to our rules where warranted. Right now, for instance, we are pursuing further research to determine how best to define the scope of statutory provisions for small creditors that operate predominately in rural or underserved areas in order to promote access to credit in those areas.

We are also addressing pressing issues in nonmortgage markets, including the first consumer protections ever for remittance transfers—international money transfers, that is—and a series of larger participant rules to supervise operations and activities in other markets. And, we are currently in the process of developing proposed rules on prepaid cards, debt collection, and payday lending.

Another key task for the Bureau has been to build effective supervision and enforcement programs to ensure compliance with Federal consumer financial laws. For the first time ever, we have the authority to supervise not only the larger banks, but also a broad range of nonbank financial companies, including mortgage lenders and servicers, payday lenders, student loan originators and servicers, debt collectors, and credit reporting companies.

We made it a priority to coordinate the timing and substance of examination activities with our Federal and State regulatory partners. Our supervision program is helping to drive cultural change within financial institutions that places more emphasis on treating customers fairly. Our work has strengthened compliance management at the large banks and caused many large nonbank firms to implement such systems for the first time.

Consistent enforcement of the laws under our jurisdiction benefits consumers, honest businesses, and the economy as a whole. To date, our enforcement actions have resulted in $4.7 billion in relief for 15 million consumers who were harmed by illegal practices.

For example, with officials in 49 States, we took action against the Nation's largest nonbank mortgage loan servicer for misconduct at every stage in the mortgage servicing process. With 13 State Attorneys General, we obtained $92 million in debt relief for 17,000 servicemembers and others harmed by a company's predatory lending scheme that inflated prices for electronics.

We worked with the Department of Justice to order a large auto lender to pay $80 million in damages to 235,000 Hispanic, African American, and Asian and Pacific Islander borrowers because of discriminatory practices, the largest amount the Federal Government has ever secured in an auto lending discrimination case. And, we took action against two of the Nation's largest payday lenders for various violations of the law, including the Military Lending Act.

The core of our mission is to stand on the side of consumers and make sure they are treated fairly in the financial marketplace. We have now handled 440,000 consumer complaints and counting and secured monetary and nonmonetary relief on their behalf, including many people in each of your States. We are working on other resources for consumers to help them better understand the choices they make in the marketplace.

I would like to say that my outstanding colleagues at the Bureau, as well as the leaders of our Federal agencies represented on this panel, are strongly dedicated to a shared vision of a healthy financial marketplace and we are working together well to achieve this goal.

Thank you, and I look forward to your questions.

Chairman JOHNSON. Thank you.

Chair White, please proceed.

STATEMENT OF MARY JO WHITE, CHAIR, SECURITIES AND EXCHANGE COMMISSION

Ms. WHITE. Thank you. Chairman Johnson, Ranking Member Crapo, and Members of the Committee, thank you for inviting me to testify about the SEC's ongoing implementation of the Dodd-Frank Act and our efforts to reduce systemic risk, close regulatory gaps, and better protect investors.

Chairman Johnson, I am a relative newcomer to this Committee, but I certainly want to add my admiration for you, your professionalism, your leadership of this Committee, and your support, really, for all of our efforts. So, thank you very much.

As you know, the Dodd-Frank Act gave the SEC significant new responsibilities and included some 90 provisions that require complex SEC rulemaking. The SEC has made quite substantial progress implementing our Congressionally mandated rulemaking agenda as we have simultaneously continued our broader core responsibilities of pursuing securities violations, important discretionary rulemaking, reviewing public company disclosures, inspecting the activities of regulated entities, and maintaining fair and efficient markets, which has included a continuing review and initia-

tives to enhance the quality of our equity and fixed income markets.

Since I became Chair in April of last year, we have focused on eight key areas of SEC responsibility mandated by the Dodd-Frank Act: Credit rating agencies, asset-backed securities, municipal advisors, asset management including regulation of private fund advisers, over-the-counter derivatives, clearance and settlement, proprietary activities by financial institutions, and executive compensation.

Specifically, in furtherance of these regulatory objectives, the Commission has to date created a new regulatory framework for municipal advisors, advanced significant new standards for the clearing agencies that stand at the center of our financial system, along with our fellow regulators implemented new restrictions on the proprietary activities of financial institutions through the Volcker Rule, finalized rules intended to strengthen the integrity of credit ratings by reducing conflicts of interest in ratings and improving their transparency. These rules were adopted on August 27 and implemented actually 14 credit rating agency rulemakings.

We have adopted significantly enhanced disclosures of asset-backed securitizations, also adopted last month. We completed reforms in July to address risks of investor runs in money market funds, a systemic vulnerability in the financial crisis, pushed forward new rules for previously unregulated derivatives, begun implementing additional executive compensation disclosures, put in place strong new controls on broker-dealers that hold customer assets, reduced reliance on credit ratings, and barred bad actors from private securities offerings.

Since April 2013, the SEC has proposed or adopted nearly 20 significant Dodd-Frank Act rules and thus far has proposed or adopted in total rules to address about 90 percent of all the provisions of the Dodd-Frank Act that mandate Commission rulemaking.

In the eight categories of mandated rulemaking that I have identified, the bulk of our work is completed or nearing completion. Our focus now is on finishing our Title VII and executive compensation rules as required by Dodd-Frank.

We have also worked closely with our fellow financial regulators to ensure that our financial regulatory system works overall to protect against risks, both by promoting financial stability and supporting a sensible and integrated financial regulatory framework that works effectively for market participants. The Financial Stability Oversight Council established by the Dodd-Frank Act, on which I participate as a member, serves a critical role in that effort.

While the SEC has made significant progress on both our Dodd-Frank and JOBS Act rulemakings, more remains to be done, and we must continue our work with intensity. As we do so, we must be deliberate as we consider and prioritize our remaining mandates and deploy our broadened regulatory authority, supported by robust economic analysis. Progress ultimately will be measured based on whether we have implemented rules that create a strong and effective regulatory framework and stand the test of time under intense scrutiny in rapidly changing financial markets. We must be

focused on fundamental and lasting reform that will protect investors and our markets and safeguard our financial system.

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

Chairman JOHNSON. Thank you.

Chairman Massad, please proceed.

STATEMENT OF TIMOTHY G. MASSAD, CHAIRMAN, U.S. COMMODITY FUTURES TRADING COMMISSION

Mr. MASSAD. Thank you, Chairman Johnson and Ranking Member Crapo and Members of the Committee. I am pleased to testify before you today on behalf of the Commission.

While this is my first appearance as CFTC Chair, I also want to add my thanks to you, Chairman Johnson, particularly with respect to my prior role at Treasury overseeing the TARP program. It was very unfortunate, of course, that we ever had to implement TARP, but I appreciate your support for all of our efforts to stabilize the system.

Before I begin, I would also like to note that my fellow Commissioner, Chris Giancarlo, is here. He, like me, is a new member of the Commission and I am pleased that he is here today.

I would like to review our progress in implementing the Dodd-Frank Act, Congress's response to the worst financial crisis since the Great Depression. We must never forget that this crisis imposed terrible costs on all Americans—millions of jobs lost, homes foreclosed, many businesses shuttered, and many retirements and college educations deferred. And, that is why implementation is so important.

In Dodd-Frank, Congress enacted four basic reforms of the swap market: Increased oversight of major market players; clearing of standardized transactions on central clearinghouses; transparent trading of standardized transactions on regulated platforms; and regular reporting for increased market transparency.

The CFTC has made substantial progress in implementing these reforms. First, we have put in place a framework for the oversight of swap dealers and major swap participants. Today, 104 swap dealers and 2 major swap participants are provisionally registered, and we require them to observe strong risk management practices and business conduct standards.

Second, standardized swaps must now be cleared with a registered clearinghouse so that risk can be better monitored and mitigated. In December 2007, only 16 percent of outstanding transactions measured by notional value were cleared, according to industry estimates. Last month, 60 percent were cleared. In addition, last month, an estimated 85 percent of index credit default swaps were cleared.

Third, standardized swaps must also be traded on a regulated platform. There are currently 22 swap execution facilities temporarily registered and volumes are growing.

And, fourth, rules for data reporting are in place. All swaps, whether cleared or uncleared, must be reported to swap data repositories. We have four SDRs provisionally registered and operating.

And, in getting us where we are today, no group deserves more credit than the hard working staff of the agency, and I want to publicly thank them for their extraordinary contributions.

But, much work remains to be done. Let me highlight a few priorities. First, as we gain experience with new regulations, we will likely make adjustments to the rules. With reforms as significant as these, this is to be expected. And, in particular, we want to make sure the new rules do not place undue burdens on commercial end users that were not responsible for the crisis and that depend on these markets to hedge risk. We will also be mindful of their interest as we complete the small number of remaining rules required by Dodd-Frank.

To that end, I have scheduled a public meeting on September 17 where we will consider a rule governing special entities, like public power companies. The Commission will also consider at that time a proposed rule on margin for uncleared swaps similar to the rules put forward last week by my banking regulator colleagues here today.

Second, for reforms to succeed, global regulators must work together to harmonize rules as much as possible. I have been very focused on this effort since the day I took office.

Third, we must make sure that market participants comply with the rules. Strong enforcement and compliance efforts are vital to maintaining public confidence and participation in our markets.

And, fourth, technology and data management are priorities. The CFTC is leading an international effort to establish consistent standards for reporting, and we will also make sure the SDRs and market participants report data accurately and promptly, as this is critical to effective market oversight and transparency.

All of these tasks require resources. While the agency staff is excellent and we will do all we can with what we have, I believe the CFTC's current financial resources are insufficient to fulfill our increased responsibilities. I hope to work with Congress to address this need.

The United States has the best financial markets in the world, the most dynamic, innovative, competitive, and transparent, and they have been an engine of our economic growth and prosperity. Effective oversight is vital to maintaining those strong financial markets.

Thank you again for inviting me today and I look forward to your questions.

Chairman JOHNSON. Thank you all.

I will now ask the Clerk to put 5 minutes on the clock for each Member's questions.

My first question is for each of the panelists. What Wall Street Reform rules will be finalized before the end of the year by your agency? For example, should we expect a final risk retention rule or rule on long-term debt to facilitate an orderly resolution? Governor Tarullo, let us begin with you and go down the line.

Mr. TARULLO. Senator, I would expect that we will finalize the financial sector concentration rule. And, with respect to risk retention, I am interested, actually, to hear what some of my colleagues say. I do not know whether I would say by the end of the year, but I think we are definitely in the home stretch.

Mr. GRUENBERG. Mr. Chairman, the agencies have been working hard on the risk retention rule and I think we are in the end game. And, I would hope, without making predictions, that we could complete that rulemaking by the end of the year.

And, you mentioned the long-term debt rule. As you know, the FDIC has been working cooperatively with the Fed on that rule and I am hopeful the Fed will be able to move forward on that area, as well.

Mr. CURRY. I, too, would hope to complete the risk retention rule by the end of the year. The OCC is certainly committed to devoting the appropriate resources to get it done, and I hope to be able to work cooperatively with both the Federal banking agencies and the housing-related agencies, as well.

Mr. CORDRAY. Mr. Chairman, we are not directly involved in the risk retention rule, but we take an interest in it as it overlaps with our qualified mortgage rule to some significant degree.

We continue to work on the HMDA implementation and the mortgage rules implementation, generally. We will have other larger participant rules that allow us to supervise other financial markets before the end of the year. And, we continue to work, as I said, on a number of other issues that are not mandated by Dodd-Frank but are an important part of implementing its goals.

Ms. WHITE. With respect to the Dodd-Frank Act, as I mentioned in my oral testimony, we expect to focus on Title VII and the executive compensation rules. I do not say they will be finished by year end, but we will be focusing on those. I do expect to work with our fellow regulators in completing the credit risk retention rule.

Outside of Dodd-Frank, we expect to pursue by the end of the year Regulation SCI, which is Systems Compliance and Integrity, as well as other initiatives in the equity market structure area.

Mr. MASSAD. Mr. Chairman, we are not part of the risk retention rule, but we will, as I noted, be acting on a rule for special entities next week which addresses some of the smaller end-user concerns. We will also be acting on a reproposal of the margin rule. Of course, with the public comment period, we may not quite get that finalized by the end of the year.

Most of our rules are done, so, again, we are very focused on looking at them and making sure we have addressed some of the end-user concerns.

Chairman JOHNSON. Thank you.

Governor Tarullo, your staff has indicated that the Fed is taking a two-track approach with capital rules for insurance companies, including one approach the Fed could use if Congress enacts legislation that the Senate passed unanimously months ago to provide the Fed with more flexibility to tailor rules for insurance companies. Is it important for Congress to enact that law soon to provide for more appropriate rules for insurance companies?

Mr. TARULLO. Senator, it would be very welcome if the House would follow your lead and enact that to give us the kind of flexibility in making an assessment on liability vulnerabilities of insurance companies that are unique to insurance companies. We will continue with our two tracks of planning. We are going to conduct a quantitative impact study to try to develop some more informa-

tion on insurance industry specific products, but it would be very helpful. Thank you.

Chairman JOHNSON. Chairman Gruenberg, in August, you announced that the living wills for the 11 largest banking organizations contain important shortcomings. You have given each of these banking organizations until July 1 of 2015 to submit a resolution plan that addresses the shortcomings. What will your agency be doing in the next year to monitor these banks and their efforts to address their living will shortcomings?

Mr. GRUENBERG. Mr. Chairman, as I indicated in my opening statement, we have, in effect, now given each of the 11 firms a detailed road map of changes they need to make to improve the resolvability of their firms. We anticipate—by "we," I mean the FDIC and the Federal Reserve, which worked together jointly on these letters—to give the firms direction and guidance to follow through on compliance and implementation of the directions contained in those 11 letters.

Chairman JOHNSON. Senator Crapo.

Senator CRAPO. Thank you, Mr. Chairman.

I, too, in my first question, want to talk to each of the agencies, but I am going to do it in segments. I am focusing in this question on EGRPRA, the Economic Growth and Regulatory Paperwork Reduction Act, which, as you know, has requirements in it for reviews that are statutorily mandated to evaluate existing regulations to identify outdated, unnecessary, or unduly burdensome regulations. It was actually this Act that we used some years back when we made some very good progress working with many of you to pass a significant Regulatory Relief Act.

I understand that the Federal Reserve, the FDIC, and the OCC are already well into and have been going—well underway and are going down the road of doing this, and so my first question is to the three of you, which is, will you commit that your agencies will provide us with a list of—or a table of regulations that fit this category that we could evaluate for regulatory reform purposes, and specifically with focus on community banks?

Mr. CURRY. Mr. Chairman, I am currently the Chairman of the FFIEC, which is overseeing the EGRPRA process, and I think our objectives are totally in tune with your objectives that you stated today. The focus of our review of unnecessary or burdensome rules is really focused on community banks.

Senator CRAPO. Good.

Mr. CURRY. We are also looking to make sure that we get adequate input from community bankers directly, so we will be holding a series of outreach sessions throughout the country to take in that information. And then, ultimately, we do intend to do two things: One, to make changes that we have complete control over in terms of regulations and policy statements, but also to file a report with Congress in which we would make recommendations for appropriate statutory changes.

Senator CRAPO. Thank you.

Mr. GRUENBERG. I would simply add that I agree with everything the Comptroller said. The EGRPRA process actually offers the agencies a nice opportunity to take an overview of the regulatory compliance issue and identify opportunities both for addressing

unneeded regulatory requirements, as well as opportunities for any statutory change. This has been a focus of attention and priority, certainly for our three agencies. As the Comptroller indicated, we are planning a series of public hearings around the country. We will be participating directly in some of those hearings and we view it as a good opportunity to take a broad overview of this.

Senator CRAPO. Thank you.

Governor Tarullo.

Mr. TARULLO. Tom gave a good summary, Senator, I think, of where the three banking agencies are and I agree with him.

Senator CRAPO. All right. Thank you very much.

And then to the other three, as I understand it, the CFPB is covered by this law, also, but the timing is not necessarily kicking in at the same timeframe for the CFPB, and the CFTC and SEC are not technically under the law. But, my question to the three of you is that, regardless of that, will you pursue the same process and help to provide us with your evaluation of the kind of unnecessary or unduly regulatory burdensome regulations that we have, and in particular with regard to community banks?

Mr. CORDRAY. I will simply say, I am part of the FFIEC. We are following, as the Comptroller indicated as Chairman of that body, his lead on regulatory burden review. We have our own statutory provision that requires a 5-year look-back on all rules that the CFPB promulgates. We have been actively involved with industry looking at the mortgage rules to see if there are tweaks that are needed as we go, and we have made a number of those to assist compliance. We also have had our own streamlining initiative, which led to work on the ATM sticker issue, which Congress ultimately resolved, and we provided technical assistance on that, and relief on the Annual Privacy Notices, which is coming very soon in final form.

Senator CRAPO. Thank you.

Ms. WHITE. And, I think, Senator Crapo, you are correct. I do not think the statute applies to us, but I am very much committed to reviewing our rules in that fashion. We also are obviously in constant contact with those who our rules impact. Our rules do not generally have as much impact on community banks.

One of the other things that I have tried to do since I became Chair is also to review our major rules, both JOBS Act and Dodd-Frank and others, as they come out the door so that we are making changes, making them more efficient, stronger, as we go.

Senator CRAPO. Thank you.

And, Mr. Massad, could you be real fast, because I have got to get one more question in here.

Mr. MASSAD. Certainly. We agree with the goal, Senator, and will be happy to work with your office on it.

Senator CRAPO. Thank you. I appreciate that.

My next question is for Governor Tarullo, and, Governor, in your testimony and in your speech at the Federal Reserve Bank of Chicago's Annual Bank Structure Conference, you called for raising the trigger when a bank is systemically important from $50 billion. I would like you, if you would for us, please, to just expand on your thinking there, because I agree with you very strongly and I hope we can make progress in this area.

Mr. TARULLO. Senator, I think we have had the benefit now of several years of stress testing under both Dodd-Frank and also our capital requirements assessment process, and I think we have just concluded that, given the intensity and the complexity of the work around the really good stress testing which we believe is necessary for the largest firms, we have not felt that the additional safety and soundness benefits of that really aren't substantial enough to warrant the kinds of expenditures that banks above $50 billion but well below the largest systemically important institutions have to expend. Their balance sheets are pretty easily investigated by us, and their lending falls in a fairly discrete number of forms. So, in thinking about it, we just thought that having some experience put us in a better position to make that judgment, and that is why I mentioned it in the Chicago speech.

Senator CRAPO. Well, thank you. I think your observation is very well taken and is one of those examples of what I am talking about here today, as well, where we need to find places where we can resolve some of these unnecessary burdens that are causing difficulty. Thank you.

Chairman JOHNSON. Senator Schumer.

Senator SCHUMER. Thank you, Mr. Chairman. I thank the witnesses.

Now, as we speak, the Treasury Secretary and Secretary of Transportation are holding a summit with leaders across the country to encourage greater investment in infrastructure projects. But, unfortunately, the Administration's effort to promote greater investment in infrastructure fly in the face of rulemaking finalized last week by the Fed, the OCC, and the FDIC. By excluding municipal bonds from being considered as high-quality liquid assets, Federal regulators have run the risk of limiting the scope of financial institutions willing to take on investment-grade municipal securities, which we know are the lifeblood of development in this country.

My city and State, New York City and State, rely on this financing to pave roads, bridges, and start construction in new schools, but it is not just New York. Any city or State that have made tough decisions to protect their credit ratings—Chicago, Philadelphia, California—are susceptible to the impact of this rule. Investment-grade municipal bonds not only serve as the mechanism through which we are able to create bonds and finance critical infrastructure, but the securities service high-quality assets that adequately cover liquidity outflows in periods of stress.

I certainly support regulatory efforts to ensure the banking section is able to absorb shocks in times of financial and economic stress, as well as enhanced liquidity, but I have not yet heard a convincing argument why, for instance, corporate debt can be considered a high-quality asset but investment-grade municipal securities cannot. Investment-grade municipal bonds have comparable, if not better, trade, volume, and price volatility, and they performed well through the financial crisis. In fact, in 2008 and 2009, price declines on AAA corporate bonds were greater than the price declines on both AA municipal general bonds and revenue bonds. And, this does not even touch on the fact the new rule permits for-

eign sovereign debt to be qualified as HQLA while these municipal bonds are not.

And, the exclusion of this type of debt from counting toward liquidity coverage for banking institutions has the potential for States and municipalities to both increase the cost of interest payments and decrease investment by the largest banking institutions in infrastructure. Now, more than ever, we should be wary of blunt policies that have the potential to negatively impact the municipal bond market and, ultimately jobs.

The debt issuances from certain States and local municipalities are considered high-quality liquid assets by markets and should be treated as such by the rule. Developing criteria to assess liquidity and performance of various municipal bond offerings is a more narrowly tailored approach that was absent from the rule finalized last Wednesday. I hope all three agencies will reassess the finalized rule and issue supplemental rules that appropriately account for these instruments.

So, here are my questions. First, Governor Tarullo, I know this rule is something you have looked at closely. I was particularly struck by your comments last week in which you acknowledged that, quote, "Staff analysis suggests that the liquidity of some State and municipal bonds is comparable to that of the very liquidity of corporate bonds that can qualify as HQLA," and indicated the staff has been working on some idea for determining criteria for such bonds which might be considered for inclusion. Would you mind discussing what types of ideas do you believe are appropriate, and specifically, whether these ideas would allow for greater flexibility so that certain investment-grade municipal bonds could be considered high-quality liquid assets.

And, then, after you opine, I would like to ask Chairman Gruenberg and Comptroller Curry if they think a rule that provides greater flexibility in this area would be something that is important to look into.

Governor Tarullo.

Mr. TARULLO. Thank you, Senator. As you noted, we, the Board, asked the staff to prepare a proposal that would allow for recognition as high-quality liquid assets those State and municipal bonds which are in the same league with very liquid corporates, and what we have asked the staff to do is an analysis of the liquidity characteristics of State and munis, taking into account daily trading volumes. There are some differences in those markets, but our analysis during the course of the comment period suggested that there ought to be a way of identifying the more liquid State and munis, because if they are really liquid, we really do want banks to be able to take that into account in thinking about their maturity lengths.

Senator SCHUMER. Right. So, you want some comparability here and you do not want to lump all municipal bonds in one pot.

Mr. TARULLO. That is correct, Senator.

Senator SCHUMER. OK. Chairman Gruenberg.

Mr. GRUENBERG. Senator, I——

Senator SCHUMER. The question to you is, would you consider revising this rule if the analysis shows that the liquidity levels are similar.

Mr. GRUENBERG. The short answer is yes, Senator——

Senator SCHUMER. Good.

Mr. GRUENBERG. ——and I indicated in my remarks at our Board meeting that we would monitor carefully the impact on the market, and if there was reason to make adjustments, we would consider adjustments.

Senator SCHUMER. Yes. We have loads of our mayors and our finance directors, as well as Governors, are howling about this, and so they really think it will impact their markets and they are experienced to know.

How about Comptroller Curry.

Mr. CURRY. Senator, we are certainly looking forward to discussing with the Fed any additional research or thoughts that they may have in this area. If there is a possibility to calibrate a standard that differentiates certain municipal securities from the broader characteristics, we would look forward to talking to the Fed about it.

Senator SCHUMER. Would you be open to changing—to modifying the rule——

Mr. CURRY. Based on——

Senator SCHUMER. ——as Mr. Gruenberg and Mr. Tarullo have said they would be?

Mr. CURRY. Certainly, based on supporting research or thoughts from the Fed.

Senator SCHUMER. What does that mean?

Mr. CURRY. I——

Senator SCHUMER. Would you be open to revising the rule?

Mr. CURRY. We are open, but we need to talk with our colleagues.

Senator SCHUMER. OK. Thank you, Mr. Chairman, and I thank you. If all three of you are open to it, and two of you seemed pretty favorable toward it, I hope you will go ahead and do it, because it is really important.

Chairman JOHNSON. Senator Corker.

Senator CORKER. Thank you, Mr. Chairman. I appreciate it. I appreciate all of you being here and the job that you do.

Back when Dodd-Frank was being created, each of us were assigned certain areas to work on, and our friend Mark Warner and I worked on Title I and II, and Amy Friend changed it a little bit, but still pretty good. And, I want to focus on those two areas. I actually think it was some of the strongest pieces of the Dodd-Frank bill. And, I noticed that the FDIC and the Fed had a joint letter relative to the living wills. I will say, in fairness, Senator Warner was far more focused on the living wills, and I appreciate his efforts in that regard.

But, I noticed that you had a joint statement, and then what happened after that is the Fed backed away from that and wrote something separate from the joint letter that really watered down, if you will, your concern about living wills, which created a concern for me, because I know that there is a process that gets put in place if both of you agree that they are inadequate, and, therefore, by stepping away, that has been watered down to a big degree. And, I am just curious as to why that took place, and both of you might want to respond to that.

Mr. TARULLO. Senator, I did not see any watering down of the impact of the letters that we agreed on and jointly sent out. What we jointly agreed on were the measures that we actually want the banks to take in order to become more resolvable, which, I think, is the object of this entire exercise. And, so far as I could determine, there was substantial convergence, certainly at the staff and principal levels, on those areas where we expect to see progress.

I think the difference was that the FDIC made a determination of noncredibility of the letters that had been submitted already. The feeling at the Board was that there are obviously shortcomings—that is why we wanted to get these specifics out—but, we also thought that it was important to go through another stage of the iterative process that had been laid out in our reg, and I think is contemplated by the statute, because that, after all, is the object here, to get us to the point where the firms are resolvable in bankruptcy as well as under Title II. And, as you will note in our statement, the Fed statement and also in the letters, if the firms are not able to take the steps that we have jointly indicated they need to take by next July, the agencies will be prepared to take action under Dodd-Frank in order to enforce those provisions.

And, so, I think by doing that, by being as specific as we were, I think we should put to rest any complaints that there was not enough guidance from the agencies along the way. I think the guidance is out there now and it is actually quite explicit.

Senator CORKER. But, it does have the effect, does it not, of really slowing down and putting off the institutions taking the steps they need to take to simplify—there is an iterative process, as you mentioned, and, I think, by doing what the Fed did, you added a step to that, did you not?

Mr. TARULLO. Well, I think, actually, what we did was we focused on what we actually want them to change, and we made it pretty clear we want a change in the next year. So, I hope there is no slow-down here. We are certainly not expecting a slow-down. On the contrary. We are expecting acceleration in their planning and them to do it with more realistic assumptions than they did in their prior submissions.

Senator CORKER. One of the things that I think there have been concerns about is you have been—the FSOC has been given tremendous powers to deal with these entities if you feel like there, in fact, is any possibility that because of their size or complexity, they could create a risk to the system. I just want to ask the two of you, I know we have asked in letter form, several of us, we have gotten back, as we might expect, semi-nebulous responses. But, is it a fact or is it not that will you use the powers that are given to you if these firms—if you find themselves after this year process not in a place to be resolved appropriately through bankruptcy, will you take the measures that you have—many people are trying to pass legislation, but you already have powers within the organizations to take steps and force them to be less complex. Will you do that?

Mr. TARULLO. Sure, Senator. That is, I think, again, the object of the process, is to try to get them to the point of resolvability, but as we indicated, we are prepared to use the powers granted in Dodd-Frank if, in fact, they do not get there.

I might also add that the things I mentioned this morning—the higher level of surcharges for the most systemically important institutions, the attention to the short-term wholesale funding vulnerabilities, and the requirement for a substantial amount of subdebt that could be convertible—are all measures that are actually intended in the same direction, which is to ensure both the resiliency and the resolvability of these institutions.

Mr. GRUENBERG. Senator, if I could just add, I think the answer to your question is yes, we will be prepared to use the authorities of the statute. We have laid down a clear marker at the Fed and the FDIC for these firms in terms of the kinds of changes that need to be made.

And, if I may, I would underscore the agreement between the two agencies on the substance of the letters, which, I think, was really very solid and meaningful. Think the firms are clearly on notice that there is an expectation of compliance with the directions in the letters, and there is a joint commitment by the two agencies to follow through on that.

Senator CORKER. Well, I thank you, and Mr. Chairman, I appreciate the time. I will say that a big part of the concerns that were expressed during that time in the passage of the bill was about the extraordinary actions that we and the American people had to take during that time. And, unless you, especially the two of you, are willing to take the steps that are necessary to ensure that these organizations are not too complex to be resolved through bankruptcy, then all is for naught. So, I hope you will. I thank you for your work, and I appreciate the time, Mr. Chairman.

And, by the way, thank you for creating a bipartisan atmosphere on the Committee, too, since everybody is apparently thinking you are going to be Chairman of the Universe after this——

[Laughter.]

Chairman JOHNSON. Senator Menendez.

Senator MENENDEZ. Thank you, Mr. Chairman.

Madam Chair, you and I have on previous occasions discussed the CEO pay ratio provision I offered in the Wall Street Reform law, which requires companies to disclose the ratio of compensation of their chief executive with the pay of median workers. This measure focuses investors' attention on the relative value a CEO creates in order to facilitate better checks and balances against insiders paying themselves runaway compensation packages.

And, while CEOs undoubtedly can create value for companies, so can ordinary workers across an organization. So, when a CEO asks for a raise while giving other employees a pay cut, investors should have this information so they can ask whether this is a value creation or simply value capture by insiders, especially in an environment in which incomes for the top 1 percent have grown by more than 86 percent over the last 20 years, while incomes for everyone else has grown by less than 7 percent.

As you know from my letters of support, I was pleased to see the SEC's proposed rule last year to implement this provision, which, in my view, accurately reflects the legislative intent that I and others intended. Can you please give us an update on the status of this rulemaking, and when does the SEC expect to finalize it?

Ms. WHITE. Essentially, as I think I said in my oral testimony, we are focused for the balance of this year in terms of our Dodd-Frank mandated rulemakings on Title VII and executive compensation. Pay ratio is one of those that has been proposed, but not adopted. It is certainly a priority to complete it this year.

Senator MENENDEZ. So, it is your expectation that you would complete it this year?

Ms. WHITE. It is my hope and expectation to complete it this year. The staff is still going through the comments, which were extensive, and formulating a final recommendation, but that is my expectation.

Senator MENENDEZ. OK. I hope there will be more expectation and less hope.

Now, let me turn to, Chair White, this summer, the SEC received its record one-millionth public comment supporting a rule to require public issuer companies to disclose their political campaign spending to investors. Supporters include leading academics in the field of corporate governance, Vanguard founder John Bogle, investment managers and advisors, and the investing public. Without disclosure, corporate insiders may be spending company funds to support candidates or causes that are directly adverse to shareholders' interests without shareholders having any knowledge of it. The amounts being spent may be small or large, but shareholders have no way of knowing. And, even where the amounts are small relative to the overall size of the company, the impact on an election, and, therefore, on shareholders, can still be very large.

If corporate political spending is material to investors, as the leading experts in the field and over one million members and the investing public believe it is, why is not the SEC requiring public issuer companies to disclose this information? Do you have any plans to engage in a rulemaking on this issue any time soon?

Ms. WHITE. As you know, we have two petitions actually still pending before the SEC to require such disclosure. If, in fact, in a particular company the political spending is material under the law, that would be required to be disclosed now. The petition is broader than that.

Again, as, I believe, the Senator and others are aware, we are very focused on our mandated rulemakings under Dodd-Frank and the JOBS Act and the staff is currently not working on a proposal in that area. I do note that a number of companies have voluntarily made those disclosures and that subject can also be, and often is, a subject of a proxy proposal.

Senator MENENDEZ. Well, I appreciate where you said your focus is, but when one million—I think it is very rare that you get one million public comments in support of a proposal. And, even if you look at Justice Kennedy's majority opinion in *Citizens United,* which opened the floodgates for corporate election spending and that presumed that shareholders should have transparency—it presumed, in his opinion, that shareholders would have transparency in order to enforce accountability over executives. So, how is it that investors have control, have that transparency, if they cannot even get basic information about what is being spent?

Ms. WHITE. I appreciate the intense interest of investors and others in this issue. The comment letters, of which there have been

many, have been on both sides. And, it is an area that I am quite sensitive to. It is of high interest. But, as I said earlier, at this point in time, it is not part of our current regulatory agenda. We are focused on the mandated rulemakings.

Senator MENENDEZ. Well, I appreciate that, as someone who was here and helped not only devise Dodd-Frank, but also supported it. I will just close on this comment. You know, I would hope that—this is true across the spectrum—that all of you realize that while you may ultimately deal with significant corporations in this country, that at the end of the day, it is the public who we collectively seek to serve. And, that is best served by transparency and openness and an opportunity to understand what companies are doing, whether that is CEO pay to worker pay, or whether that is using potentially millions of dollars of corporate funds to maybe the disadvantage of the very investors who are investing in that company.

And, so, I hope that the hallmark of what we can expect from all of you, but certainly in this case where you have some particular unique jurisdiction, is a push toward greater transparency so that investors really understand what choices they are making and whether the company is best serving them.

Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Johanns.

Senator JOHANNS. Thank you, Mr. Chairman.

Governor Tarullo, let me go back to the question that the Chairman asked you about capital standards relative to insurance companies. I fear we have kind of left you folks in a difficult position. This bill, as you know, has moved through the Senate by unanimous consent, and I thank my colleague, Senator Brown, for his help on this bill. So, I think, on the Senate side, we are in pretty good shape. It is even kind of rarer that things would move by unanimous consent, but this did.

On the House side, it has not happened yet. We hope it will. In fact, my sincere desire is that that will happen very quickly, certainly by the end of the year, but we do not know if that is going to happen, and there you are. You are caught in this kind of limbo situation of what do you do here.

So, let me ask you, how are you folks handling this? Is there a track for this law passing and a separate track for this law not passing and you having to cobble something together that, hopefully, complies with Dodd-Frank? How are you dealing with this in this interim period of time?

Mr. TARULLO. Senator, you have intuited correctly. We are trying to think about it under both alternatives. Under one alternative, we would be able to take account of the different liability structure of core insurance kinds of activities, and that would allow us to shape capital requirements at the consolidated holding company level in a way that fully took account of those differences in business models.

In the absence of the legislation, we will still be able to do some things, because there are insurance products that do not resemble existing bank products. And, so, in some cases, we can, and we are already planning to, assign different risk weights to those based upon our assessment of the actual risk associated with those assets. But, that is where the two-tracking is actually taking place.

I mentioned a little while back the quantitative impact study that we are doing. By getting more information from the insurance companies, we hope to actually find a few other areas where, consistent with existing statutory requirements, we could still make some adjustments.

But in the end, Senator, it does all come down to core insurance activities and the different kind of liability risks that are associated with them. The assets are often the same. It is really on that liability side of the balance sheet that you feel a difference in what a property and casualty insurer does as opposed to what a bank does, and that is what we would like to be able to take into account.

Senator JOHANNS. Your comments lead me to another kind of whole other area of inquiry that we are not going to be able to get too far into with the limited time, but let me just throw out a question, and this probably impacts other panel members, too. There is so much about the insurance industry that you are telling us you want more information on. You want—you have got the quantitative impact study, and there are probably some other areas where you are seeking additional information. And, yet, we have three insurance companies—Met Life, AIG, Prudential—who have been designated systemically risky or whatever. How do you do that? How do you get so far down the road and identify these folks as being that when, by your own testimony, you acknowledge that there are things about the insurance industry that you want more information on?

Mr. TARULLO. So, Senator, I guess I would draw a distinction between the creation of capital standards for traditional or current insurance activities, on the one hand, and an assessment of systemic risk on the other. My own reading of the FSOC process with respect to Prudential and AIG is that there is not a lot of concern about the core insurance activities of those companies. The concerns were with respect to some nontraditional insurance activities where runnability is more of a concern, and also with respect to things that are not insurance activities of any sort. I think that is where the analysis would allow one to conclude there is systemic importance.

I personally do not think that the issue of whether there is systemic importance in traditional insurance activities has really been broached, and I am personally not sure we need to broach it. I mean, my pretty strong presumption would be that there is not.

Senator JOHANNS. OK. Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Brown.

Senator BROWN. Thank you, Mr. Chairman.

Chair White, I sent you a letter on the SEC's waiver policies. I appreciate your response. We received it yesterday, and we will follow up with you. Thank you for that.

Governor Tarullo, I appreciate especially your comments and your discussion, and Mr. Gruenberg's, with Senator Corker. I thought that was helpful. You say that capital surcharges to the largest banks could be a good deal higher than the 2.5 percent Basel rules. An unnamed Fed official told the *Wall Street Journal* they could be as high as 4.5 percent. Not surprisingly, the industry tells us that those additional requirements would be costly, would

put them at a competitive disadvantage. Tell the Committee why they are important for financial stability.

Mr. TARULLO. Senator, I would say several things. First, as some of you may recall, a few years ago, when we were beginning this exercise on capital surcharges, we did quite a bit of analysis. And, while we did not think that we could come up with a point estimate of exactly, precisely what was an appropriate surcharge given the additional risks to the system and the impact on the system of the failure of one of these firms, we did come up with a range. And, in all honesty, the one to 2.5 percent that the Basel Committee concluded, while an important step forward, was at the low end of that range. And, I think we will feel more comfortable to be somewhat closer to the middle of the range of estimates of the kind of additional resiliency that is needed.

The second point I would make is that a few other countries have already come to similar conclusions. Switzerland has on its own applied higher surcharges than the Basel approach calls for for its two large globally active institutions. Sweden and the Netherlands—each has one globally systemically important institution—they have done the same, and I think at least one or two other countries are thinking of it. I think we are all trying to come to grips with what we really need in order to provide more assurance that these firms do not threaten the financial system.

And, the third point I would make, which I alluded to in the written testimony, is the whole idea of these being increasingly strict surcharges, higher surcharges as the systemic importance of the entity increases, is grounded in, the very sound principle embodied in Dodd-Frank that the stringency of these additional prudential standards should increase as the systemic importance of the firm increases.

Now, why is that important? Well, it is important because of the potential harm to society if the firm gets in trouble. But, it also provides the firm with a kind of tradeoff. You know, if the firm really thinks that it has to be this big and this complicated to engage in a certain set of activities or to have a certain size balance sheet, then it can do so, but it has to have very high levels of capital. If, on the other hand, those highest levels of capital appear to not be worth it, then it has the option of changing what people have called its systemic footprint.

So, I think, for all of those reasons, this is really a quite important step forward globally, for everybody to do surcharges, but, for us and some other countries to recognize that we need to go a little further than the minimums that have been provided in Basel.

Senator BROWN. Thank you, and I would note that under these estimates, it could take the largest banks to a 14 percent requirement. There is a great deal of support in this Committee and, I think, throughout the House and Senate on stronger capital standards like that.

Comptroller Curry, thank you for your—the OCC finalizing rules for heightened expectations for—just because of lack of time, I will not ask you a question, but thank you for that. I think that you have taken major steps toward changing the culture in board rooms. I think we are obviously not there yet—I know you think that, too—changing the culture in terms of risk management and

elevating risk management to a particularly important part of large banks' and holding companies' decision-making process. Thank you.

For my final question, Chair White, at your confirmation hearing, I asked you about Industry Guide 3, the SEC's disclosure rules for bank holding companies. You responded that you agreed that a review of these rules, which an SEC staff report says have not been updated since 1986, that a review was warranted. When can we expect the SEC to update its Guide 3 disclosures to help make the largest banks that have increased measurably and dramatically in both size and complexity in this three-decade time period, when can we expect you to come forward to make them more transparent?

Ms. WHITE. As part of our disclosure effectiveness review, the Industry Guide 3 is currently under review by the staff. The staff is in the process of actually preparing recommendations to update Guide 3, including whether to bring the requirements as they ultimately end up into Regulation SK. If we change our disclosure requirements, they would also be put out for notice and comment. We have opened a window in connection with this initiative where we have also been receiving some public comments on that. And, so, it is moving along.

In terms of the "when" question, I mean, I cannot answer it precisely, but it is something that we are actively engaged on now. I actually reached out, I think, in August to Governor Tarullo to invite the Fed's input into that, too, because, obviously, of their role over bank holding companies.

Senator BROWN. Thank you. Thanks, Mr. Chairman.

Chairman JOHNSON. Senator Shelby.

Senator SHELBY. Thank you, Mr. Chairman.

You know, we have wrestled with this right here with most of you for years. Capital—what is adequate capital? What is good capital? What is liquidity, which, I guess, goes to the basis of what we are talking about.

In the insurance field, have you shared with the Committee, the Chairman or the Ranking Member, the methodology of how you designated some of these big insurance companies, like Met Life and Prudential and others, as systemically risky? Do you furnish any of the information to the Committee, or would you be willing to do that, because this is a topic of more than passing interest right now. Governor Tarullo?

Mr. TARULLO. So, I have to confess, Senator, that I do not know the answer to that question. Treasury, as you know, chairs the FSOC——

Senator SHELBY. OK.

Mr. TARULLO. I do not know whether any of my colleagues know whether there is a formal submission process to the Committee.

Mr. GRUENBERG. Senator——

Senator SHELBY. Chairman.

Mr. GRUENBERG. ——I do not know if there is a specific submission for the Committee. After a final decision is reached, I believe there is a public document that is released laying out the basis for the action in some detail, not disclosing proprietary information.

But, I do not know that there has been a specific communication to the Committee apart from that.

Senator SHELBY. I know a lot of the people, participants and CEOs and board members in the insurance company, are really concerned, because they do not know what direction. I think they see the direction, but do not know what is happening next in the field. Is there any way you can give them some certainty there, or is it just a work in progress as far as you are concerned? You have designated, what, three big insurance companies? How many? As systemically risky.

Mr. TARULLO. Oh, there have been final determinations on two——

Senator SHELBY. Two.

Mr. TARULLO. ——Senator. There has been a news report on a third.

Senator SHELBY. News.

Mr. TARULLO. But, that is not a complete administrative determination yet. The third already designated is GE Capital, which is not insurance.

Senator SHELBY. OK.

Mr. CURRY. Senator——

Senator SHELBY. Yes, sir.

Mr. CURRY. The FSOC has adopted procedures to outline how we approach our determinations. I do believe, to answer your question, that we could probably do a better job in explaining and informing affected institutions as to how that process works and making sure that we get the most relevant information possible to make our decision.

Senator SHELBY. Let me get into the surcharge a minute. Some of our large foreign banks that do business here, will they be subject to the surcharge, too, above three, what, 3 percent or whatever, 2.5—three percent, 3.5—above Basel III? Governor.

Mr. TARULLO. Senator, that is not our current intention, although as I mentioned a moment ago, a number of the home authorities of countries have already at a consolidated level imposed higher than Basel levels on their own institutions.

Senator SHELBY. As high as what you are doing here?

Mr. TARULLO. I am not sure anybody would go as high, but that is probably because those three countries do not have anybody who is currently in the so-called top buckets.

Senator SHELBY. OK. Well, but do you basically believe, as a matter of public policy, that large foreign banks doing business in the U.S. should be subject to—they are—to our regulatory authority and also capital standards?

Mr. TARULLO. Well, yes. That, is, of course, why we——

Senator SHELBY. That is what we did——

Mr. TARULLO. ——adopted the intermediate holding company regulatory requirement and made sure that all the operations of the big foreign banks are brought under one umbrella and they are subject to capital standards, liquidity standard, and, if need be, resolution standards here in the U.S.

Senator SHELBY. Chairman Gruenberg, do you agree with that?

Mr. GRUENBERG. I do, Senator.

Senator SHELBY. Comptroller?

Mr. CURRY. Yes, Senator.

Senator SHELBY. OK. That is all. Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Warner.

Senator WARNER. Thank you, Mr. Chairman.

I am going to make a couple quick editorial comments before I get to a question, actually, for Chairman White. First of all, I want to follow up on what Senator Corker said. We did struggle through on Title I and II, and the living wills concept or funeral plans, it was a new idea. There were others, Senator Brown and others, who had a more clearly defined cap on too big to fail. A fair debate took place. I think that debate continues to be revisited. And, I would simply say that—or urge, again, I understand this iterative process, but we really need to keep a fire lit underneath this, and if at some point the FSOC does not act to start using some of these tools that were given, then I really do question whether we, as well intentioned as we were, whether we got it right in Title I and Title II in terms of ending the too big to fail.

So, my editorial comment would be, let us speed up this iterative process. The fact that we are now going into many, many years of getting these plans right, we have got to get it right, but I would also like to see it come to a conclusion, and, I think, some evidence that some of these tools that were broad in grant would actually be used.

Second, and Governor Tarullo, I was pleased to hear your comments at the outset. I would like to follow up with you both, one, on looking at the asset cap size of $50 billion may not be the right number. I think we need to acknowledge, again, that historically, Congress never gets it 100 percent right. You have got to come back and do fix-it bills, and I think it is time for a fix-it bill around Dodd-Frank.

I also hope, echoing what Senator Crapo emphasized, that we tried to put in restrictions on smaller enterprises, community banks. One part that Senator Crapo raised which I would love to echo, as well, is the regulatory creep. But, we tried to be explicit on community banks not falling into some of the more burdensome regulatory requirements of Dodd-Frank. My fear is that while we put that in as a legislated exclusion under, I believe $10 billion cap, that kind of best practices creep has kind of come into that, and I find repeatedly from smaller institutions enormous additional marginal cost added. So, I hope you will come back with some specific suggestions there on how we might look at that.

Chairman White, I cannot get in front of a public session without echoing once again, urging you to continue to move forward on JOBS Act. I sent you another letter last Friday. I am again looking at what is happening, or not happening, for that matter, around the country on equity fundraising. I still think it is a tool we may not, again, get 100 percent right, but we have got to try to use that tool, the sooner the better.

I would like to get to a question. I have been spending some time looking at the excess complexity in equity trading that, I think, sometimes allows entrenched firms advantages over smaller firms. For example, Direct Edge, EDGX, as just one example, has a hundred different ways a share stock can be billed. They have 12 different tiers, seven of which pay customers to trade. And, for some

certain select customers, the rebate per share fee is greater than the take fee. I know we have talked about maker taker and some of these areas. This is a level of complexity further down.

Do you have any specific plans to address complexity in the marketplace? For example, would the SEC support ensuring transparency for market participants by providing them the ability to audit the fees or rebates, or even looking at potentially banning some of these practices? How far down the trail are you at looking at this issue?

Ms. WHITE. We have a number of initiatives, as actually discussed publicly in June, with respect to enhancing the transparency of the equity markets, and particularly on the fees. Also we are talking about initiatives on the conflicts of interest in terms of complexity of order types. I mean, that is of concern on a number of fronts. One of the things that I mentioned in that speech, and then followed up on, is to have the exchanges basically do an audit of all of those and report back to the SEC. I expect that to be completed in the fall. It is underway.

We are also looking at, really, across the board a number of other near-term initiatives and then a broader review of the structural issues, as well. Our markets are very strong and very reliable, but that does not mean that enhancements and more level playing field initiatives cannot and should not be undertaken.

Senator WARNER. I would be very interested in continuing to work with you on that.

And then, finally—and you may not get a chance to address it since my time is running out—I am concerned about the increased leverage ratios among some of the broker-dealers. My understanding from your own data, that firms like Barclays are up toward 30-to-1 on their leverage ratios. That is getting close to where Lehman and Bear Stearns and others were. I hope this is a subject of some concerns——

Ms. WHITE. Yes, and I probably should get back to you in the interest of time, but certainly, that is an area that is monitored by us, and FINRA, as well. We can talk about what our net capital rule does, as well as some initiatives we have to enhance some of our financial responsibility oversight of broker-dealers, including a possible rulemaking on leverage.

Senator WARNER. Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Reed.

Senator REED. Well, thank you, Mr. Chairman.

Thank you for this excellent testimony. We have all been sort of thinking back to some of the challenges of Dodd-Frank. One of the challenges on derivatives was to have a regime which would be able to be effective, given that there were two different agencies that had jurisdiction over derivatives, dictated more by history than logic. And, my understanding—and, what we did is we insisted upon some joint rulemaking in critical areas, and I understand that this joint rulemaking has been completed. Is that the case, Chair White, Chairman Massad?

Mr. MASSAD. Yes, that is generally true, and I would just say on the point of making sure that we work together well, I think that is certainly a priority of mine. I believe Chair White shares that

feeling, and we have been in touch on a number of issues already and our staffs are working together.

Senator REED. Well, let me commend you on that, because as you understood—as we understood—trying to sort out the lines and create different agencies, to do different things—what we tried to do is basically take the existing structure and make it cooperate and work more congruently, for want of a better term.

But, let me shift to the SEC. Throughout the course of the testimony, you have pointed out the huge issues that you still have to face. My calculation is roughly 18 rules left the SEC has to complete with respect to the swaps, including securities-based swaps, execution facilities, rules governing registered security-based swap repositories, to rules regarding conflict of interest. And, you have pointed out that you are prioritizing Dodd-Frank rules. Can you give us the assurance that these derivatives rules are at the very top of your list to get done very quickly?

Ms. WHITE. I can assure you of that. We have a number to complete, as you have pointed out. It is a very high priority of mine to get them done as quickly as we can, but also as well as we can. And, one of the areas which you also touched on is making sure that they are workable for this global market as well as strong and robust, working not only with Chairman Massad on these—I have the benefit of his rulemaking in a number of those areas—but also our international counterparts. But, totally committed to getting them done.

Senator REED. And, Chairman Massad made the point that the resources are getting pretty thin. Is that the same case in the SEC, Madam Chair?

Ms. WHITE. It is absolutely the case, Senator.

Senator REED. So, we can talk the talk here about how you have got to get things done, how it is important and so critical, et cetera, but if we do not—the Congress—provide you the resources, you cannot get it done.

Ms. WHITE. I very much appreciate that. And also, I think we all have to be focused on, the fact that once these rules are finished, we have to implement them and enforce them, and that takes resources.

Senator REED. Thank you. Let me just quickly shift gears because we have been talking about what is already on the table that you have to get done. Some of my colleagues have suggested other things that you should be interested in. One of the issues, really, is cybersecurity, Madam Chair. You have public companies that have been reporting significant problems, which leads me to believe that they are not alone and that the SEC has to start thinking seriously about routine disclosure for two reasons.

One is the investing public should know very quickly that there is something amiss, but also it is like that old line in the Army. What people inspect and evaluate, they tend to do more of, and I think this would be an action-forcing device for companies now that either feel they are free riders or they are too small, et cetera, to really begin to think and take seriously their responsibilities to their shareholders, ultimately, in this area. Are you thinking along these lines?

Ms. WHITE. Certainly, in terms of the priority of cyber- and the long-term risk it is to not only investors, but the country. No question about that. As you know, Senator, we issued guidance, disclosure guidance, in 2011. We also, in our Division of Corporation Finance, continued to review the filings of the companies under that guidance and get comments on that. I have recently also formed an interdivisional cyber working group within the SEC to bring all of the expertise and information together, and that is one of the things that we will look at, among others. I mean, we also, obviously, have cyber responsibilities for our registrants——

Senator REED. Right——

Ms. WHITE. ——systems and so forth.

Senator REED. You are moving fast. I suggest we all have to move faster.

Chairman Cordray, thank you for extraordinary work, particularly with the Military Lending Act. Can you explain why it is important to finalize some of the rules that are pending, and update the rules to protect these servicemen and women.

Mr. CORDRAY. I think it is obvious on its face, and Congress, of course, intervened very helpfully about a year and a half ago to require a review and revision of the rules that did not implement that law as intended by Congress. The statute, as you know, indicated that the CFPB was to consult with the Department of Defense. We have worked closely with them, and organized a larger group that included colleagues from the other agencies. Department of Treasury took a lead role. These rules are well along. They are at OMB at this point, and my understanding is that they are now moving. I think that your efforts to prod that along have been helpful, fruitful, and I believe that we will see action very quickly at this point, and I am pleased to be able to say that.

Senator REED. Well, thank you very much, Mr. Chairman. I had the opportunity to mention that to Secretary of Defense Hagel, who gets it from the E5 level, which he was in Vietnam, to the SECDEF level, and we talked, again, a lot about what we owe to our servicemen and women. We certainly owe, as a minimum, fair dealing in the marketplace.

Mr. CORDRAY. Thank you for that, and I think this will go a long way to getting us where we should be.

Senator REED. Thank you, Mr. Chairman. Thank you.

Chairman JOHNSON. Senator Manchin.

Senator MANCHIN. Thank you, Mr. Chairman, and I thank all of you for being here today.

I would like to first say that my little State of West Virginia depends an awful lot on community banks, so I am going to be talking about cybersecurity here and the need for reform with cybersecurity. We just learned about Home Depot's data breach, which might be the largest retailer breach and is just on the heels of the Target breach.

According to one report, U.S. banks had to reissue 8 percent of all debit cards and 4 percent of all credit cards, on average. For small community banks, reissuing those cards cost just over $11 per debit card and $12.75 per credit card, including production, mailing, and staff time. That is what the report said. This is not simply a drop in the bucket for these community banks, as I am

sure you all know. These hacks could prove the difference between being in the black and bleeding red for the bottom lines and make all of them very vulnerable.

So, even if your agency is not directly responsible—which I know it is not—for cybersecurity, it has an effect on the banks you regulate. What is your opinion about the need for the reform and how it is affecting the financial markets today? Mr. Tarullo, I will start with you, over at that end.

Mr. TARULLO. Senator, you are raising an issue that we have discussed in this Committee—I think, somewhat ironically, the last hearing was right after the Target breach, I believe. And, I think, again, you have just noted that even though there is work to do in the banking sector—and there surely is, and I think Tom, in a moment, will probably explain some of what we have been trying to do together in the FFIEC. I do think, for all of us as bank regulators, when we see the asymmetry in the requirements of nonbank companies, or the absence of requirements for nonbank companies to take measures to protect personal information, it is frustrating, particularly for the smaller banks, but to be honest, for banks of all sizes, and I think we feel, to some degree, we have all got one hand tied behind our back.

So, among the many other things that need to be done in this area one is to get a set of expectations as to what nonfinancial companies that are not subject to the regulation of those of us sitting at this table are expected to do in protecting the very same kinds of information that our institutions hold.

Senator MANCHIN. I think what I am trying to get to is the cost that, basically, small community banks are incurring, especially in States such as West Virginia, that depends on them, basically, for our banking community, if you will. And, you add anything else to that from Dodd-Frank that trickles down to the community banks, you are just adding more on their vulnerability. So, if you would like to——

Mr. CURRY. Yes. I would like to add, as Governor Tarullo mentioned, this has been an issue that we are coordinating through the FFIEC in terms of making sure that community banks, in particular, are appropriately responding to cyberthreats, and we see this as actually a much larger issue——

Senator MANCHIN. Sure.

Mr. CURRY. ——than just the financial costs of reissuing cards, because it really goes to the trust between a customer and the security of their deposit or other banking relationship.

But, as Governor Tarullo mentioned, it is really an issue of leveling the playing field in terms of the regulatory requirements between banks and nonbanks, and in this case, retailers. Banks really have, clearly, longstanding over a decade, expectations in terms of maintaining the security of account information, including electronic access to it. We actually assess, as part of our regulatory function, their capabilities from an IT standpoint. And, we have clear rules on customer notification and notification to law enforcement and regulatory authorities. I think it is important that Governor Tarullo mentioned, that similar requirements need to be in place for the nonbank participants in our payment system.

Senator MANCHIN. OK. Thank you. If I could—I have one more question, sir, and I am so sorry, but I wanted to get to Ms. White.

Chairman White, the *Wall Street Journal* recently reported that two firms are working to create a fund for Bitcoin to allow investors to speculate on Bitcoin's worth. As you know, I wrote a letter describing my concern that the regulators have not yet issued rules on Bitcoin. And, this is especially troubling since Bitcoin is wildly speculative, as you know, and is especially subject to electronic theft and scams.

I know your agency is taking a particularly long period of time to approve a Bitcoin exchange traded fund and I would applaud your caution. However, I want to convey my concern with this virtual currency again and hope that the other regulators will help you to fill in the gaps so that you can protect all of our American consumers. So, if you can just give me a quick update—I know my time is running out here—on——

Ms. WHITE. I will be quick. Basically, this is an evolving area for all the regulators——

Senator MANCHIN. Yes.

Ms. WHITE. ——as you know. We have taken enforcement actions, actually, in Bitcoin-involved Ponzi schemes some time ago. We have issued, I think, two separate investor alerts, and as you mentioned, we are also reviewing a filing very carefully——

Senator MANCHIN. Yes.

Ms. WHITE. ——that is key to Bitcoin. At this point, there is not a conclusion by our staff that the currency itself is a security, so there is not that kind of regulation that flows at this point, but we continue to look at it very, very carefully and work with our fellow regulators on it, as well.

Senator MANCHIN. Do you think you will be having a rule——

Ms. WHITE. Well, I think, at this stage, there is not a planned rulemaking. As I say, at this stage, we have not concluded that it is a security that would be subject to that kind of regulation by us. But, it is something we are still very focused on.

Senator MANCHIN. Thank you.

Chairman JOHNSON. Senator Heitkamp.

Senator HEITKAMP. Mr. Chairman, first, let me thank my good friend, Senator Warren from Massachusetts, for letting me bump in line. I have to go preside at noon.

But, I want to make the point, in case you guys have not figured that out from my letters and my discussions with you, I really care about small community banks. They are the lifeblood, the capital lifeblood for the many, many people in the great State of North Dakota. I know we consistently talk about the need for reform, the need for look-back, the need to have a very directed discussion about the regulatory responsibilities and how that is affecting community banks.

I would like to be able to go back to my independent community banks and tell them when there is going to be regulatory relief enacted, and I know there is always a lot of swirl and a lot of talk, but I share Senator Crapo's discussion, and so I am curious about timeframe, because they are making decisions today. And, what started out to be too big to fail has become for many of these community banks too small to succeed. They are moving out of lending

in certain areas as a result of what they perceive to be massive regulatory burden.

And, so, if we are going to stem the tide of dissolution of that portion of their business because of compliance burdens, we need to offer a timeframe, and so I am curious to anyone who can tell me when we will actually get an answer to small community banks on regulatory relief.

Mr. CURRY. Senator, from an FFIEC perspective, where we are coordinating the Federal banking agencies' EGRPRA process, that is already underway. We have put out for comment a series of rules and regulations. That comment period closed. There will be two more. So, we are programmatically reviewing the regulations that are under our authority to make those judgments that you are asking us to do to recommend or to eliminate those rules and regulations under our control.

An important part of this process, as I mentioned earlier, we are going to have direct input from community bankers. We have asked them to identify those areas where they are most pressing in need of a change and how we can go about doing that.

Senator HEITKAMP. That does not answer the question about time. Maybe——

Mr. CURRY. The statute requires a fairly lengthy review process, but we intend to do it as quickly as possible and to have either action taken under our own independent rulemaking or to make recommendations to Congress.

Senator HEITKAMP. Mr. Tarullo.

Mr. TARULLO. Senator, I would just comment. Sometimes, people, when they talk about regulatory burden, they lump together two sets of things. One is actual legislative or regulatory requirements, called the *Federal Register* type requirements.

The second thing, which Senator Manchin and maybe Senator Warner, several of you have referred to already today, is the—somebody called it, quite aptly, the trickle down effect of supervisory practices, and we do not have to wait for a formal process to do something about that. I think Tom met with the same group yesterday of small bankers. They were a very good group, and the reason I thought they were a particularly good group is they came in with specifics. They came in with specifics and they said, look, here is a way in which some articulated supervisory expectation is, we think, not appropriate for us, creating a problem for us, and we think it is trickling down. In some cases, I think they were right. It was good for our staff to be there to hear it, as we have done with groups of small community bankers in the past. We got a list of action items to follow up on.

So, although the EGRPRA process is kind of formalized, I think—and I suspect the same thing is going on at the OCC and the FDIC—that we can be constantly in a process of trying to change current practices, and, you know, if you do it even at the request of a small number of smaller banks, the benefits of that can proliferate.

I do think, in the end, we have this problem of we have got thousands of examiners and it is hard to get them all coordinated without bringing all the decisions to Washington, which none of us wants to do.

Senator HEITKAMP. And, I am running out of time. I have a couple more questions I will submit for the record, with the agreement of the Chairman.

But, just back to this, there is nothing like certainty. I mean, there can be promises that this is how supervise—you know, what is going to happen in a bank audit, and do not worry about this, but they will worry about it, and they will worry about compliance burdens because the cost of not being in compliance is so high that just the risk will cause those banks to retreat from the market. And, I do not think that is in the best interest of this country, and it certainly is not in the best interest of my State.

And, so, thank you for elevating this to one of your top concerns. I understand all of the great burdens that you all have in making sure that we do not have systemic failure, but, again, what was too big to fail has become too small to succeed and we need to fix that problem.

Chairman JOHNSON. Senator Warren.

Senator WARREN. Thank you, Mr. Chairman.

In the past year, the three largest banks in this country—JPMorgan Chase, Citigroup, and Bank of America—have admitted to breaking the law and have settled with the Government for a combined $35 billion. Now, as Judge Rakoff of the Southern District of New York has noted, the law on this is clear. No corporation can break the law unless an individual within that corporation broke the law. Yet, despite the misconduct at these banks that generated tens of billions of dollars in settlement payments by the companies, not a single senior executive at these banks has been criminally prosecuted.

Now, I know that your agencies cannot bring prosecutions directly, but you are supposed to refer cases to the Justice Department when you think individuals should be prosecuted. So, can you tell me how many senior executives at these three banks you have referred to the Justice Department for prosecution?

Mr. TARULLO. Well, Senator, I do not know the answer to that question, but I want to pick up on something you just said, because I think it is actually quite important, that although failures of the sort that have resulted in these big fines, criminal and civil, almost always result from problems in organizations, because there are many ways to catch these——

Senator WARREN. Governor Tarullo——

Mr. TARULLO. Hold on, Senator, if I could. There often are individuals who can clearly be identified as responsible, and although, as you know, we do not have criminal prosecutorial power, what we do have is the power to insist that firms either discharge current employees who have been implicated in this, even if they have not been criminally prosecuted—which we have done in the past couple of cases—or, as we are doing now, conducting investigations under the authorities that are already in the law that would allow us to ban these people from working for——

Senator WARREN. So, I take it what you are saying, Governor Tarullo, is that you do not know of any criminal prosecutions in these three banks that the Fed has recommended.

Mr. TARULLO. Well, we have——

Senator WARREN. You have investigated enough to know that——

Mr. TARULLO. We shared all——

Senator WARREN. ——that these banks are responsible. They have given—they have admitted to wrongdoing. They have signed up for $35 billion in a settlement. And no one has been referred?

Mr. TARULLO. Well, Senator, we have shared all the information that the Department of Justice needed, and I think the Justice Department has probably made its own assessment on both sets of criminal and civil——

Senator WARREN. So, you are saying you have referred people for criminal prosecution?

Mr. TARULLO. No. We have provided information to——

Senator WARREN. But, you have not actually referred someone for criminal prosecution. You know, I just——

Mr. TARULLO. Well, we——

Senator WARREN. I want to be clear about the contrast here. After the savings and loan crisis in the 1970s and the 1980s, the Government brought over a thousand criminal prosecutions and got over 800 convictions. The FBI opened nearly 5,500 criminal investigations because of referrals from banking investigators and regulators.

So, if we did not even limit it to these three banks, how many prosecutions have you all regulated [sic]? What we have to remember here is the main reason that we punish illegal behavior is for deterrence, you know, to make sure that the next banker who is thinking about breaking the law remembers that a guy down the hall was hauled out of here in handcuffs when he did that. These civil settlements do not provide deterrence. The shareholders for the companies pay the settlement. Senior management does not pay a dime.

And, in fact, if you are like Jamie Dimon, the CEO of JPMorgan Chase, you might even get an $8.5 million raise for the settlement of negotiating such a great settlement when your company breaks the law. So, without criminal prosecutions, the message to every Wall Street banker is loud and clear. If you break the law, you are not going to jail, but you might end up with a much bigger paycheck.

So, no one should be above the law. If you steal a hundred bucks on Main Street, you are probably going to jail. If you steal a billion bucks on Wall Street, you darn well better go to jail, too.

So, I have another question I want to ask about, and that is about living wills, that is, the plans that big banks are supposed to submit now so that if they start to fail, they could be liquidated without bringing down the economy or needing a taxpayer bailout. Last month, the FDIC and the Fed, as we talked about earlier, sent letters to 11 of the country's biggest banks, telling them that their living wills did not cut it. You said that if these banks failed, either they would need a Government bailout or they would bring down the economy. These letters confirmed quite literally that 6 years after the financial crisis, all of our biggest banks remain too big to fail.

Now, in your joint statement, you said—and I want to get this right—that by next July, the 11 banks must demonstrate, quote,

"significant progress to address all the shortcomings identified in the letter," and if the banks do not address significant progress, you told Senator Corker earlier in this hearing, you have tools to force the banks to make changes, and I just want to underline that means higher capital standards, higher liquidity standards, restrict bank growth, limit bank operations. But, these actions take place only if there is not significant progress on the part of the banks.

So, I just would like the two of you, FDIC and the Fed, just to speak briefly to the question—because I realize I am out of time here, Mr. Chairman—what constitutes "significant" in this case? What is it you want to see the too big to fail banks do, and if they do not do it, the action you are going to take? Chairman Gruenberg, maybe we could start with you, and then Governor Tarullo.

Mr. GRUENBERG. Senator, we laid out in these letters a pretty specific set of markers for the institutions to meet that goes to some of the key obstacles to orderly resolution of these firms. We directed them in the letters to simplify their legal structures so that they put their business lines in line with their legal entity so that in resolution, you can sort the firm out and figure out how to manage the failure.

A critical issue is their derivatives contracts. Those contracts provide for automatic termination in the event at the beginning of an insolvency proceeding. Those contracts need to be changed in order to avoid the contagion consequences that we saw in 2008 from a disorderly termination of those contracts. We direct in the letters the firms to change those contracts.

Critical operations—a firm has got to be able, during the course of a resolution process, to maintain its IT and other critical operations so the whole operation does not fall apart. You may have an IT operation in a foreign jurisdiction that could get taken out or not made available as a result of problems by the institution. The institution has to develop back-up capabilities to sustain its critical operations. Otherwise, the public ends up having to pick up the slack.

Information—the institutions have to be able to produce critical, timely information that is essential to managing a resolution process. The firms right now do not have that capability.

These are specific, measurable actions that we have directed the firms to take, and we are going to be looking for these firms to take specific, measurable actions to address these. And, they have got a year now. They are on notice. We are going to be working closely with these firms so there is clarity of guidance, and we are going to be expecting action, and that is really the whole purpose of this effort.

Senator WARREN. Thank you, Chairman.

Mr. TARULLO. If I could just underscore that last point that Marty made, Senator. None of us wants to be in the situation where, next July or August, there is this issue of, well, we made this progress. Is this significant or is this not significant?

Senator WARREN. Right.

Mr. TARULLO. And, so, what Marty just alluded to is the point I was going to make and I will now underscore, that we have our supervisors from the Fed and the FDIC in the institutions right

now and this will be a process of what are you going to do about this and wanting to hear in very tangible terms what it is they are doing. And, I know at the Fed, I suspect at the FDIC, the boards will be regularly briefed on this so that we will be in a position to be giving indications that this is what we expected or you guys are already falling short, because I think what lay behind your question was the concern that, next July, we get into this palaver of whether progress has been significant or not.

Senator WARREN. So, we are not going to be back here a year from now having this same conversation again. You are prepared to demand that they take these measurable steps, and if they fail to do so, you are going to use your tools to take them for them——

Mr. TARULLO. Correct.

Senator WARREN. ——is that right? Good. Thank you.

Thank you for your indulgence, Mr. Chairman.

Chairman JOHNSON. Senator Shelby.

Senator SHELBY. Thank you, Mr. Chairman.

I want to follow up on Senator Warren's observations regarding the Justice Department and criminal activity in financial institutions or whatever. I realize that you are regulators. You are not prosecutors. But, if there is $35 billion, more or less, in fines or settlements because of criminal conduct, and there is no justice—justice is important for the big and the well-being and also small—something is wrong with the Justice Department. People should not be able, whoever they are, not just financial institutions, should be able to buy their way out of culpability, especially when it is so strong, it defies rationality. You know, I agree with her on that.

But, I think, Senator Warren, that it goes to the Justice Department, because I am not defending my regulators, because I call them to task at times, but they can make recommendations, they can send things over, but, ultimately, it seems like the Justice Department seems bent on money rather than justice, you know, and that is a mistake and the American people pick up on that.

Having said that, Governor, I want to get back on the insurance regulation, if I could. Have you or others, have you consulted with any of the State regulators in making the SIFI designations for the insurers, and if you have, what did they say? For years, we all know this, the States have regulated insurance. We know the story of AIG. We have hashed it out here many times. But, AIG was not running an insurance company. They had visions. But, they got out of their basic stuff and it caused them great harm, as we all know, and caused headaches right here in this Committee and with you guys.

But, Met Life and Prudential, to my knowledge, they have not been involved in credit default swaps and everything, other than managing their own risk. I do not know. You might have a better feel for this. But, have you consulted or dealt, had a dialog with some of the State regulators before you make these designations, and if you have, what have they said, and if you have not, why have you not?

Mr. TARULLO. I would say first, Senator, as I am sure you know, that on the FSOC, there is a slot reserved for a representative of the National Association of Insurance Commissioners——

Senator SHELBY. I know. We know.

Mr. TARULLO. ——and there is also, by statute, the independent insurance person, who also brings to bear expertise and experience——

Senator SHELBY. Sure.

Mr. TARULLO. ——and they, obviously, have both been fully involved. I certainly would be a little reluctant to speak for them here, but they are fully involved and other commissioners in the NAIC have been, as well.

Senator SHELBY. Is this—you know, the States have regulated these insurance companies for years, and this is new for the Federal Government and for you. Is this the beginning of a preemption of the Federal over the State in the regulation of insurance? Some people would argue that.

Mr. TARULLO. Yes. Certainly not from the Fed's point of view.

Senator SHELBY. Uh-huh.

Mr. TARULLO. There are two ways that we get supervision of entities that are either owned by or include insurance firms. One, if the entity also owns a depository institution, because that is when the Holding Company Act requirements come in.

Senator SHELBY. Uh-huh.

Mr. TARULLO. Or, two, if they are designated by the FSOC. When they are designated by the FSOC, it is because of their systemic importance, and our supervision and oversight and regulation of those institutions is directed toward the containment of systemic risk, not their insurance business. As I said earlier, I, at least, do not regard generally traditional insurance activities as posing systemic risk.

It is the nontraditional, the more runnable things, the new things where we see similarities that are more toward contagion and runnable assets and the like, the sort of thing that we are regulating in the banking arena, but we do not want to be in the business of regulating insurance companies the way State insurance commissioners do, which is trying to preserve the franchise for the benefit of the policy holders. Our purpose is a different one, which is assuring on a consolidated basis the safety and soundness of a——

Senator SHELBY. Sure.

Mr. TARULLO. ——large financial institution.

Senator SHELBY. Let me ask you a question, if I could——

Chairman JOHNSON. One more question.

Senator SHELBY. I have to ask a long question, then——

[Laughter.]

Senator SHELBY. Would a big insurance company—we will just use Met Life or Prudential or anybody—that was managing their own risk through derivatives and so forth, would they be considered, for the most part, an end user?

Mr. MASSAD. Well, generally, our consideration of end users applies to companies that are not primarily financial in nature.

Senator SHELBY. Uh-huh, like steel and all this?

Mr. MASSAD. Exactly. Exactly.

Senator SHELBY. Hard commodities.

Mr. MASSAD. So, large insurance companies who have a lot of swap activity, we would not consider——

Senator SHELBY. OK.

Mr. MASSAD. ——as end users.

Senator SHELBY. Thank you. Thank you, Mr. Chairman.

Chairman JOHNSON. I want to thank today's witnesses, again, for their testimony.

This hearing is adjourned.

[Whereupon, at 12:10 p.m., the hearing was adjourned.]

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

PREPARED STATEMENT OF DANIEL K. TARULLO

GOVERNOR, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

SEPTEMBER 9, 2014

Chairman Johnson, Ranking Member Crapo, and other Members of the Committee, thank you for the opportunity to testify on the Federal Reserve's activities in mitigating systemic risk and implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). In testifying before this Committee in February, I noted my hope and expectation that this year would be the beginning of the end of our implementation of the major provisions of the Dodd-Frank Act. Seven months later, we are on track to fulfill that expectation. The Federal Reserve and other banking supervisors have continued to make progress in implementing the congressional mandates in the Dodd-Frank Act, promoting a stable financial system, and strengthening the resilience of banking organizations. In today's testimony, I will provide an update on the Federal Reserve's implementation of the Dodd-Frank Act and describe key upcoming regulatory and supervisory priorities to address the problems of "too big to fail" and systemic risk. The Federal Reserve is committed to continuing to work with our fellow banking agencies and with the market regulators to help ensure that the organizations we supervise operate in a safe and sound manner and are able to support activity in other sectors of the economy.

As we complete our revisions to the financial regulatory architecture, we are cognizant that regulatory compliance can impose a disproportionate burden on smaller financial institutions. In addition to overseeing large banking firms, the Federal Reserve supervises approximately 800 State-chartered community banks that are members of the Federal Reserve System, as well as several thousand small bank holding companies. In my testimony, I also will describe how the Federal Reserve is seeking to ensure that its regulations and supervisory framework are not unnecessarily burdensome for community banking organizations so they can continue their important function of safe and sound lending to local communities.

Recent Dodd-Frank Act Implementation Milestones

Since the passage of the Dodd-Frank Act more than 4 years ago, the Federal Reserve and the other agencies represented at this hearing have completed wide-ranging financial regulatory reforms that have remade the regulatory landscape for financial firms and markets. Internationally, at the Basel Committee on Banking Supervision (BCBS), we have helped develop new standards for global banks on risk-based capital, leverage, liquidity, single-counterparty credit limits, and margin requirements for over-the-counter derivatives. We have also worked with the Financial Stability Board (FSB) to reach global agreements on resolution regimes for systemic financial firms and on a set of shadow banking regulatory reforms.

Domestically, we have completed many important measures. We approved final rules implementing the Basel III capital framework, which help ensure that U.S. banking organizations maintain strong capital positions and are able to continue lending to creditworthy households and businesses even during economic downturns. We implemented the Dodd-Frank Act's stress testing requirements, which are complemented by the Federal Reserve's annual Comprehensive Capital Analysis and Review. Together, these supervisory exercises provide a forward-looking assessment of the capital adequacy of the largest U.S. banking firms. Pursuant to section 165 of the Dodd-Frank Act, we established a set of enhanced standards for large U.S. banking organizations to help increase the resiliency of their operations and thus promote financial stability. In addition, the Federal Reserve implemented a rule requiring foreign banking organizations with a significant U.S. presence to establish U.S. intermediate holding companies over their U.S. subsidiaries and subjecting such companies to substantially the same prudential standards applicable to U.S. bank holding companies. We finalized the Volcker rule to implement section 619 of the Dodd-Frank Act and prohibit banking organizations from engaging in short-term proprietary trading of certain securities and derivatives. These and other measures have already created a financial regulatory architecture that is much stronger and much more focused on financial stability than the framework in existence at the advent of the financial crisis.

More recently, the Federal Reserve, often in tandem with some or all of the other agencies represented at this hearing, has made progress on a number of other important regulatory reforms. I will discuss those steps in more detail.

Liquidity Rules for Large Banking Firms

Last week, the Federal Reserve and the other U.S. banking agencies approved a final rule, consistent with the enhanced prudential standards requirements in sec-

tion 165 of the Dodd-Frank Act, which implements the first broadly applicable quantitative liquidity requirement for U.S. banking firms. Liquidity standards for large U.S. banking firms are a key contributor to financial stability, as they work in concert with capital standards, stress testing, and other enhanced prudential standards to help ensure that large banking firms manage liquidity in a manner that mitigates the risk of creditor and counterparty runs.

The rule's liquidity coverage ratio, or LCR, requires covered banking firms to hold minimum amounts of high-quality liquid assets—such as central bank reserves and high-quality Government and corporate debt—that can be converted quickly and easily into cash sufficient to meet expected net cash outflows over a short-term stress period. The LCR applies to bank holding companies and savings and loan holding companies with $250 billion or more in total consolidated assets or $10 billion or more in on-balance-sheet foreign exposures. The rule also applies a less stringent, modified LCR to bank holding companies and savings and loan holding companies that are below these thresholds but with more than $50 billion in total assets. The rule does not apply to bank holding companies or savings and loan holding companies with less than $50 billion in total assets, nor to nonbank financial companies designated by the Financial Stability Oversight Council (FSOC). The Federal Reserve will apply enhanced liquidity standards to designated nonbank financial companies through a subsequently issued order or rule following an evaluation of each of their business models, capital structures, and risk profiles.

The rule's LCR is based on a liquidity standard agreed to by the BCBS but is more stringent than the BCBS standard in several areas, including the range of assets that qualify as high-quality liquid assets and the assumed rate of outflows for certain kinds of funding. In addition, the rule's transition period is shorter than that in the BCBS standard. The accelerated phase-in of the U.S. LCR reflects our objective that large U.S. banking firms maintain the improved liquidity positions they have already built following the financial crisis, in part because of our supervisory oversight. We believe the LCR will help ensure that these improved liquidity positions will not weaken as memories of the financial crisis fade.

The final rule is largely identical to the proposed rule, with a few key adjustments made in response to comments from the public. Those adjustments include changing the scope of corporate debt securities and publicly traded equities qualifying as high-quality liquid assets, phasing in reporting requirements, and modifying the stress period and reporting frequency for firms subject to the modified LCR.

Swap Margin Reproposal

Sections 731 and 764 of the Dodd-Frank Act require the establishment of initial and variation margin requirements for swap dealers and major swap participants (swap entities) on swaps that are not centrally cleared. These requirements are intended to ensure that the counterparty risks inherent in swaps are prudently limited and not allowed to build to unsustainable levels that could pose risks to the financial system. In addition, requiring all uncleared swaps to be subject to robust margin requirements will remove economic incentives for market participants to shift activity away from contracts that are centrally cleared.

The Federal Reserve and four other U.S. agencies originally issued a proposed rule to implement these provisions of the Dodd-Frank Act in April 2011. Following the release of the original proposal, the BCBS and the International Organization of Securities Commissions began working to establish a consistent global framework for imposing margin requirements on uncleared swaps. This global framework was finalized last September. After considering the comments that were received on the April 2011 U.S. proposal and the recently established global standards, the agencies issued a reproposal last week. Under the reproposal, swap entities would be required to collect and post initial and variation margin on uncleared swaps with another swap entity and other financial end-user counterparties. The requirements are intended to result in higher initial margin requirements than would be required for cleared swaps, which is meant to reflect the more complex and less liquid nature of uncleared swaps.

In accordance with the statutory requirement to establish margin requirements regardless of counterparty type, the reproposal would require swap entities to collect and post margin in connection with any uncleared swaps they have with nonfinancial end users. These requirements, however, are quantitatively and qualitatively different from the margin requirements for swaps with financial end users. Specifically, swaps with nonfinancial end users would not be subject to specific, numerical margin requirements but would only be subject to initial and variation margin requirements at such times, in such forms, and in such amounts, if any, that the swap entity determines is necessary to address the credit risk posed by the counterparty and the transaction. There are currently cases where a swap entity

does not collect initial or variation margin from nonfinancial end users because it has determined that margin is not needed to address the credit risk posed by the counterparty or the transaction. In such cases, the reproposal would not require a change in current practice. The agencies believe that these requirements are consistent with the Dodd-Frank Act and appropriately reflect the low level of risk presented by most nonfinancial end users.

The agencies in the reproposal have taken several steps to help mitigate any impact to the liquidity of the financial system that could result from the swap margin requirements. These steps include incorporating an initial margin requirement threshold below which exchanges of initial margin are not required, allowing for a wider range of assets to serve as eligible collateral, and providing smaller swap entities with an extended timeline to come into compliance. We look forward to receiving comments on the reproposal.

Modifications to the Supplementary Leverage Ratio and Adoption of the Enhanced Supplementary Leverage Ratio

Also last week, the Federal Reserve and the other U.S. banking agencies approved a final rule that modifies the denominator calculation of the supplementary leverage ratio in a manner consistent with the changes agreed to earlier this year by the BCBS. The revised supplementary leverage ratio will apply to all banking organizations subject to the advanced approaches risk-based capital rule starting in 2018. These modifications to the supplementary leverage ratio will result in a more appropriately measured set of leverage capital requirements and, in the aggregate, are expected to modestly increase the stringency of these requirements across the covered banking organizations.

This rule complements the agencies' adoption in April of a rule that strengthens the internationally agreed-upon Basel III leverage ratio as applied to U.S.-based global systemically important banks (G–SIBs). This enhanced supplementary leverage ratio, which will be effective in January 2018, requires U.S. G–SIBs to maintain a tier 1 capital buffer of at least 2 percent above the minimum Basel III supplementary leverage ratio of 3 percent, for a total of 5 percent, to avoid restrictions on capital distributions and discretionary bonus payments. In light of the significantly higher risk-based capital rules for G–SIBs under Basel III, imposing a stricter leverage requirement on these firms is appropriate to help ensure that the leverage ratio remains a relevant backstop for these firms.

Key Regulatory Priorities

As we near the completion of the implementation of the major provisions of the Dodd-Frank Act, some key regulatory reforms remain unfinished. To that end, the Federal Reserve contemplates near- to medium-term measures to enhance the resiliency and resolvability of U.S. G–SIBs and address the risks posed to financial stability from reliance by financial firms on short-term wholesale funding.

The financial crisis made clear that policymakers must devote significant attention to the potential threat to financial stability posed by our most systemic financial firms. Accordingly, the Federal Reserve has been working to develop regulations that are designed to reduce the probability of failure of a G–SIB to levels that are meaningfully below those for less systemically important firms and to materially reduce the potential adverse impact on the broader financial system and economy in the event of a failure of a G–SIB.

G–SIB Risk-Based Capital Surcharges

An important remaining Federal Reserve initiative to improve G–SIB resiliency is our forthcoming proposal to impose graduated common equity risk-based capital surcharges on U.S. G–SIBs. The proposal will be consistent with the standard in section 165 of the Dodd-Frank Act that capital requirements be progressively more stringent as the systemic importance of a firm increases. It will build on the G–SIB capital surcharge framework developed by the BCBS, under which the size of the surcharge for an individual G–SIB is a function of the firm's systemic importance. By further increasing the amount of the most loss-absorbing form of capital that is required to be held by firms that potentially pose the greatest risk to financial stability, we intend to improve the resiliency of these firms. This measure might also create incentives for them to reduce their systemic footprint and risk profile.

While our proposal will use the G–SIB risk-based capital surcharge framework developed by the BCBS as a starting point, it will strengthen the BCBS framework in two important respects. First, the surcharge levels for U.S. G–SIBs will be higher than the levels required by the BCBS, noticeably so for some firms. Second, the surcharge formula will directly take into account each U.S. G–SIB's reliance on short-term wholesale funding. We believe the case for including short-term wholesale funding in the surcharge calculation is compelling, given that reliance on this type

of funding can leave firms vulnerable to runs that threaten the firm's solvency and impose externalities on the broader financial system.

Resolvability of G–SIBs

Our enhanced regulation of G–SIBs also includes efforts to improve their resolvability. Most recently, in August, the Federal Reserve and the Federal Deposit Insurance Corporation (FDIC) completed reviews of the second round of resolution plans submitted to the agencies in October 2013 by 11 U.S. bank holding companies and foreign banks. Section 165(d) of the Dodd-Frank Act requires banking organizations with total consolidated assets of $50 billion or more and nonbank financial companies designated by the FSOC to submit resolution plans to the Federal Reserve and the FDIC. Each plan must describe the organization's strategy for rapid and orderly resolution in the event of material financial distress or failure. In completing the second round reviews of these banking organizations' resolution plans, the FDIC and the Federal Reserve noted certain shortcomings in the resolution plans that the firms must address to improve their resolvability in bankruptcy. Both agencies also indicated the expectation that the firms make significant progress in addressing these issues in their 2015 resolution plans.

In addition, the Federal Reserve has been working with the FDIC to develop a proposal that would require the U.S. G–SIBs to maintain a minimum amount of long-term unsecured debt at the parent holding company level. While minimum capital requirements are designed to cover losses up to a certain statistical probability, in the even less likely event that the equity of a financial firm is wiped out, successful resolution without taxpayer assistance would be most effectively accomplished if a firm has sufficient long-term unsecured debt to absorb additional losses and to recapitalize the business transferred to a bridge operating company. The presence of a substantial tranche of long-term unsecured debt that is subject to bail-in during a resolution and is structurally subordinated to the firm's other creditors should reduce run risk by clarifying the position of those other creditors in an orderly liquidation process. A requirement for long-term debt also should have the benefit of improving market discipline, since the holders of that debt would know they faced the prospect of loss should the firm enter resolution.

The Federal Reserve is working with global regulators, under the auspices of the FSB, to develop a proposal that would require the largest, most complex global banking firms to maintain a minimum amount of loss absorbency capacity beyond the levels mandated in the Basel III capital requirements.

Another element of our efforts to promote resolvability of large banking organizations involves the early termination rights of derivative counterparties to G–SIBs. Some of the material operating subsidiaries of G–SIBs are counterparties to large volumes of over-the-counter derivatives and other qualifying financial contracts that provide for an event of default based solely on the insolvency or receivership of the parent holding company. Although the Dodd-Frank Act created an orderly liquidation authority (OLA) to better enable the Government to resolve a failed systemically important financial firm—and the OLA's stay and transfer provisions can prevent exercise of such contractual rights by counterparties to contracts under U.S. law—the OLA provisions may not apply to contracts under foreign law. Accordingly, counterparties of the foreign subsidiaries and branches of G–SIBs may have contractual rights and substantial economic incentives to accelerate or terminate those contracts as soon as the U.S. parent G–SIB enters OLA. This could render a resolution unworkable by resulting in the disorderly unwind of an otherwise viable foreign subsidiary and the disruption of critical intra-affiliate activities that rely on the failing subsidiary. The challenge would be compounded in a bankruptcy resolution because derivatives and other qualifying financial contracts are exempt from the automatic stay under bankruptcy law, regardless of whether the contracts are governed by U.S. or foreign law.

The international regulatory community is working to mitigate this risk as well. The Federal Reserve is working with the FDIC and global regulators, financial firms, and other financial market actors to develop a protocol to the International Swaps and Derivatives Association (ISDA) Master Agreement to address the impediments to resolvability generated by these early termination rights. The FSB will be reporting progress on this effort in the fall.

Short-Term Wholesale Funding

As I have noted in prior testimony before this Committee, short-term wholesale funding plays a critical role in the financial system. During normal times, it helps to satisfy investor demand for safe and liquid investments, lowers funding costs for borrowers, and supports the functioning of important markets, including those in which monetary policy is executed. During periods of stress, however, runs by pro-

viders of short-term wholesale funding and associated asset liquidations can result in large fire sale externalities and otherwise undermine financial stability. A dynamic of this type engulfed the financial system in 2008.

Since the crisis, the Federal Reserve has taken several steps to address short-term wholesale funding risks. The Basel III capital framework and the Federal Reserve's stress testing regime have significantly increased the quantity and quality of required capital in the banking system, particularly for those banking organizations that are the most active participants in short-term wholesale funding markets. Similarly, the implementation of liquidity regulations such as the LCR, together with related efforts by bank supervisors, will help to limit the amount of liquidity risk in the banking system.

We have also taken steps to reduce risks posed by the use of short-term wholesale funding by actors outside the banking system. These include leading an effort to reduce reliance by borrowers in the triparty repo market on intraday credit from clearing banks and increasing the regulatory charges on key forms of credit and liquidity support that banks provide to shadow banks. In part because of these actions and in part because of market adjustments, there is less risk embedded in short-term wholesale funding markets today than in the period immediately preceding the financial crisis. The short-term wholesale funding markets are generally smaller, the average maturity of short-term funding arrangements is moderately greater, and collateral haircuts are more conservative. In addition, the banking organizations that are the major intermediaries in short-term wholesale funding markets are much more resilient based on the measures I discussed earlier.

Nevertheless, we believe that more needs to be done to guard against short-term wholesale funding risks. While the total amount of short-term wholesale funding is lower today than immediately before the crisis, volumes are still large relative to the size of the financial system. Furthermore, some of the factors that account for the reduction in short-term wholesale funding volumes, such as the unusually flat yield curve environment and lingering risk aversion from the crisis, are likely to prove transitory.

Federal Reserve staff is currently working on three sets of initiatives to address residual short-term wholesale funding risks. As discussed above, the first is a proposal to incorporate the use of short-term wholesale funding into the risk-based capital surcharge applicable to U.S. G–SIBs. The second involves proposed modifications to the BCBS's net stable funding ratio (NSFR) standard to strengthen liquidity requirements that apply when a bank acts as a provider of short-term funding to other market participants. The third is numerical floors for collateral haircuts in securities financing transactions (SFTs)—including repos and reverse repos, securities lending and borrowing, and securities margin lending.

Modifications to the NSFR could be designed to help address the types of concerns described in my previous testimony regarding SFT matched book activity. In the classic fact pattern, a matched book dealer uses SFTs to borrow on a short-term basis from a cash investor, such as a money market mutual fund, to finance a short-term SFT loan to a client, such as a leveraged investment fund. The regulatory requirements on SFT matched books are generally low despite the fact that matched books can pose significant microprudential and macroprudential risks. Neither the BCBS LCR nor the NSFR originally finalized by the Basel Committee would have imposed a material charge on matched book activity.

In January, the BCBS proposed a revised NSFR that would require banks to hold a material amount of stable funding against short-term SFT loans, as well as other short-term credit extensions, to nonbank financial entities. By requiring banks that make short-term loans to hold stable funding, such a charge would help limit the liquidity risk that a dealer would face if it experiences a run on its SFT liabilities but is unable to liquidate corresponding SFT assets. In addition, by making it more expensive for the dealer to provide short-term credit, the charge could help lean against excessive short-term borrowing by the dealer's clients.

Turning to numerical floors for SFT haircuts, the appeal of this policy measure is that it would help address the risk that post-crisis reforms targeted at banking organizations will drive systemically risky activity toward places in the financial system where prudential standards do not apply. In its universal form, a system of numerical haircut floors for SFTs would require any entity that wants to borrow against a security to post a minimum amount of excess margin to its lender that would vary depending on the asset class of the collateral. Like minimum margin requirements for derivatives, numerical floors for SFT haircuts would serve as a mechanism for limiting the build-up of leverage at the transaction level and could mitigate the risk of procyclical margin calls.

Last August, the FSB issued a consultative document that represented an initial step toward the development of a framework of numerical floors. However, the

FSB's proposal contained some significant limitations, including that its scope was limited to transactions in which a bank or broker-dealer extends credit to an unregulated entity and that the calibration of the numerical floor levels was relatively low. Since then, the FSB has been actively considering whether to strengthen the proposal along both of these dimensions.

Financial Sector Concentration Limits

In May, the Federal Reserve proposed a rule to implement section 622 of the Dodd-Frank Act, which prohibits a financial company from combining with another company if the resulting financial company's liabilities exceed 10 percent of the aggregate consolidated liabilities of all financial companies. Under the proposal, financial companies subject to the concentration limit would include insured depository institutions, bank holding companies, savings and loan holding companies, foreign banking organizations, companies that control insured depository institutions, and nonbank financial companies designated by the FSOC for Federal Reserve supervision. Consistent with section 622, the proposal generally defines liabilities of a financial company as the difference between its risk-weighted assets, as adjusted to reflect exposures deducted from regulatory capital, and its total regulatory capital. Firms not subject to consolidated risk-based capital rules would measure liabilities using generally accepted accounting standards. We anticipate finalizing this rule in the near term.

Credit Risk Retention

Section 941 of the Dodd-Frank Act requires firms generally to retain credit risk in securitization transactions they sponsor. Retaining credit risk creates incentives for securitizers to monitor closely the quality of the assets underlying a securitization transaction and discourages unsafe and unsound underwriting practices by originators. In August 2013, the Federal Reserve, along with several other agencies, revised a proposal from 2011 to implement section 941. The Federal Reserve is working with the other agencies charged by the Dodd-Frank Act with implementing this rule to complete it in the coming months.

Rationalizing the Regulatory Framework for Community Banks

Before closing, I would like to discuss the Federal Reserve's ongoing efforts to minimize regulatory burden consistent with the effective implementation of our statutory responsibilities for community banks, given the important role they play within our communities. Over the past few decades, community banks have substantially reduced their presence in lines of businesses such as consumer lending in the face of competition from larger banks benefiting from economies of scale. Today, as a group, their most important forms of lending are to small- and medium-sized businesses. Smaller community banks—those with less than $1 billion in assets—account for nearly one-fourth of commercial and industrial lending, and nearly 40 percent of commercial real estate lending, to small- and medium-sized businesses, despite their having less than 10 percent of total commercial banking assets. These figures reveal the importance of community banks to local economies and the damage that could result if these banks were unable to continue operating within their communities.

Banking regulators have taken many steps to try to avoid unnecessary regulatory costs for community banks, such as fashioning more basic supervisory expectations for smaller, less complex banks and identifying which provisions of new regulations are relevant to smaller banks. In this regard, the Federal Reserve has worked to communicate clearly the extent to which new rules and policies apply to smaller banks and to tailor them as appropriate. We also work closely with our colleagues at the Federal and State banking regulatory agencies to ensure that supervisory approaches and methodologies are consistently applied to community banks.

But several new statutory provisions apply explicitly to some smaller banks or, by failing to exclude any bank from coverage, apply to all banks. The Federal Reserve is supportive of considering areas where the exclusion of community banks from statutory provisions that are less relevant to community bank practice may be appropriate. For example, we believe it would be worthwhile to consider whether community banks should be excluded from the scope of the Volcker rule and from the incentive compensation requirements of section 956 of the Dodd-Frank Act. The concerns addressed by statutory provisions like these are substantially greater at larger institutions and, even where a practice at a smaller bank might raise concerns, the supervisory process remains available to address what would likely be unusual circumstances.

Another area in which the Federal Reserve has made efforts to right-size our supervisory approach with regard to community banks is to improve our off-site monitoring processes so that we can better target higher risk institutions and activities.

Research conducted for a 2013 conference sponsored by the Federal Reserve System and the Conference of State Bank Supervisors addressed the resilience of the community bank model and showed how some banks performed better than others during the recent crisis. Building on this research, we are updating our off-site monitoring screens to reflect experience gained during the crisis and recalibrating our examination scoping process for community banks to focus our testing on higher-risk banks and activities, and whenever possible reduce procedures for banks of lower risk.

Recognizing the burden that the on-site presence of many examiners can place on the day-to-day business of a community bank, we are also working to increase our level of off-site supervisory activities. Responding to on-site examinations and inspections is of course a cost for community banks, but this cost must be weighed against the supervisory benefit of face-to-face interactions with bank examiners to explore and resolve institution-specific concerns. The Federal Reserve aims to strike the appropriate balance of off-site and on-site supervisory activities to ensure that the quality of community bank supervision is maintained without creating an overly burdensome process. To that end, last year we completed a pilot on conducting parts of the labor-intensive loan review off-site using electronic records from banks. Based on good results with the pilot, we are planning to continue using this approach in future reviews at banks where bank management is supportive of the process and where electronic records are available. We are also exploring whether other examination procedures can be conducted off-site without compromising the ability of examiners to accurately assess the safety and soundness of supervised banks.

Conclusion

The Federal Reserve has made significant progress in implementing the Dodd-Frank Act and other measures designed to improve the resiliency of banking organizations and reduce systemic risk. We are committed to working with the other U.S. financial regulatory agencies to promote a stable financial system in a manner that does not impose a disproportionate burden on smaller institutions. To help us achieve these goals, we will continue to seek the views of the institutions we supervise and the public as we further develop regulatory and supervisory programs to preserve financial stability at the least cost to credit availability and economic growth.

Thank you for your attention. I would be pleased to answer any questions you might have.

PREPARED STATEMENT OF MARTIN J. GRUENBERG

CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

SEPTEMBER 9, 2014

Chairman Johnson, Ranking Member Crapo, and Members of the Committee, thank you for the opportunity to testify today on the Federal Deposit Insurance Corporation's (FDIC) actions to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

My written testimony will address several key topics. First, I will discuss capital and liquidity rules that the bank regulatory agencies recently finalized, as well as a recently proposed margin rule on derivatives. Second, I will provide an update on our progress in implementing the authorities provided the FDIC relating to the resolution of systemically important financial institutions (SIFIs). I will then discuss an updated proposed risk retention rule for securitizations and implementation of the Volcker Rule. Finally, I will discuss our supervision of community banks, including the FDIC's efforts to address emerging cybersecurity and technology issues.

Capital, Liquidity, and Derivative Margin Requirements

The new regulatory framework established under the Dodd-Frank Act augments and complements the banking agencies' existing authorities to require banking organizations to maintain capital and liquidity well above the minimum requirements for safety and soundness purposes, as well as to establish margin requirements on derivatives. The recent actions by the agencies to adopt a final rule on the leverage capital ratio, a final rule on the liquidity coverage ratio, and a proposed rule on margin requirements for derivatives address three key areas of systemic risk and, taken together, are an important step forward in addressing the risks posed particularly by the largest, most systemically important financial institutions.

Supplementary Leverage Ratio

In April 2014, the FDIC published a final rule that, in part, revises minimum capital requirements and, for advanced approaches banks,[1] introduces the supplementary leverage ratio requirement. The Office of the Comptroller of the Currency (OCC) and the Federal Reserve adopted a final rule in October 2013 that is substantially identical to the FDIC's final rule. Collectively, these rules are referred to as the Basel III capital rules.

The Basel III rulemaking includes a new supplementary leverage ratio requirement—an important enhancement to the international capital framework. Prior to this rule, there was no international leverage ratio requirement. For the first time, the Basel III accord included an international minimum leverage ratio, and consistent with the agreement, the Basel III rulemaking includes a 3 percent minimum supplementary leverage ratio. This ratio, which takes effect in 2018, applies to large, internationally active banking organizations, and requires them to maintain a minimum supplementary leverage ratio of 3 percent (in addition to meeting other capital ratio requirements, including the agencies' long-standing Tier 1 leverage ratio).

In April 2014, the FDIC, the OCC and the Federal Reserve also finalized an Enhanced Supplementary Leverage Ratio final rule for the largest and most systemically important bank holding companies (BHCs) and their insured banks. This rule strengthens the supplementary leverage capital requirements beyond the levels required in the Basel III accord. Eight banking organizations are covered by these Enhanced Supplementary Leverage standards based on the thresholds in the final rule.

The agencies' analysis suggests that the 3 percent minimum supplementary leverage ratio contained in the international Basel III accord would not have appreciably mitigated the growth in leverage among SIFIs in the years leading up to the crisis. Accordingly, the Enhanced Supplementary Leverage standards that the agencies finalized in April will help achieve one of the most important objectives of the capital reforms: addressing the buildup of excessive leverage that contributes to systemic risk.

Under the Enhanced Supplementary Leverage standards, covered insured depository institutions (IDIs) will need to satisfy a 6 percent supplementary leverage ratio to be considered well capitalized for prompt corrective action (PCA) purposes. The supplementary leverage ratio includes off-balance sheet exposures in its denominator, unlike the longstanding U.S. leverage ratio which requires capital only for balance sheet assets. This means that more capital is needed to satisfy the supplementary leverage ratio than to satisfy the U.S. leverage ratio if both ratios were set at the same level. For example, based on recent supervisory estimates of the off-balance sheet exposures of these banks, a 6 percent supplementary leverage ratio would correspond to roughly an 8.6 percent U.S. leverage requirement. Covered BHCs will need to maintain a supplementary leverage ratio of at least 5 percent (a 3 percent minimum plus a 2 percent buffer) to avoid restrictions on capital distributions and executive compensation. This corresponds to roughly a 7.2 percent U.S. leverage ratio.

An important consideration in calibrating the Enhanced Supplementary Leverage ratio was the idea that the increase in stringency of the leverage requirements and the risk-based requirements should be balanced. Leverage capital requirements and risk-based capital requirements are complementary, with each type of requirement offsetting potential weaknesses of the other. In this regard, the Basel III rules strengthened risk-based capital requirements to a much greater extent than they strengthened leverage requirements. The Enhanced Supplementary Leverage ratio standard will ensure that the leverage requirement continues to serve as an effective complement to the risk-based capital requirements of the largest, most systemically important banking organizations, thereby strengthening the capital base and the stability of the U.S. banking system.

Maintaining a strong capital base at the largest, most systemically important financial institutions (SIFIs) is particularly important because capital shortfalls at these institutions can contribute to systemic distress and lead to material adverse

[1] An advanced approaches bank is an insured depository institution (IDI) that is an advanced approaches national bank or Federal savings association under 12 CFR 3.100(b)(1), an advanced approaches Board-regulated institution under 12 CFR 217.100(b)(1), or an advanced approaches FDIC-supervised institution under 12 CFR 324.100(b)(1). In general, an IDI is an advanced approaches bank if it has total consolidated assets of $250 billion or more, has total consolidated on-balance sheet foreign exposures of $10 billion or more, or elects to use or is a subsidiary of an IDI, bank holding company, or savings and loan holding company that uses the advanced approaches to calculate risk-weighted assets.

economic effects. These higher capital requirements will also put additional private capital at risk before the Deposit Insurance Fund (DIF) and the Federal Government's resolution mechanisms would be called upon. The final Enhanced Supplementary Leverage ratio rule is one of the most important steps the banking agencies have taken to strengthen the safety and soundness of the U.S. banking and financial systems.

On September 3, 2014, the FDIC Board also finalized a rule originally proposed in April 2014 that revises the denominator measure for the supplementary leverage ratio and introduced related public disclosure requirements. The changes in this rule apply to all advanced approaches banking organizations, including the eight covered companies that would be subject to the Enhanced Supplementary Leverage standards. The denominator changes are consistent with those agreed upon by the Basel Committee on Banking Supervision and would, in the aggregate, result in a modest further strengthening of the supplementary leverage ratio requirement as compared to the capital rules finalized in April.

Liquidity Coverage Ratio

On September 3, 2014, the FDIC issued a joint interagency final rule with the Federal Reserve Board and the OCC implementing a liquidity coverage ratio (LCR). During the recent financial crisis, many banks had insufficient liquid assets and could not borrow to meet their liquidity needs. The LCR final rule is designed to strengthen the liquidity positon of our largest financial institutions, thereby promoting safety and soundness and the stability of the U.S. financial system.

This final rule applies to the largest, internationally active banking organizations: U.S. banking organizations with $250 billion or more in total consolidated assets or $10 billion or more in on-balance sheet foreign exposure and their subsidiary depository institutions with $10 billion or more in total assets. The Federal Reserve also finalized a separate rule that would apply a modified LCR requirement to BHCs with between $50 billion and $250 billion in total consolidated assets. Other insured banks are not subject to the rule.

The LCR final rule establishes a quantitative minimum liquidity coverage ratio that builds upon approaches already used by a number of large banking organizations to manage liquidity risk. It requires a covered company to maintain an amount of unencumbered high-quality liquid assets (HQLA) sufficient to meet the total stressed net cash outflows over a prospective 30 calendar-day period. A covered company's total net cash outflow amount is determined by applying outflow and inflow rates described in the rule, which reflect certain stressed assumptions, against the balances of a covered company's funding sources, obligations, and assets over a 30 calendar-day period.

A number of commenters have expressed concern about the exclusion of municipal securities from HQLA in the final rule. It is our understanding that banks do not generally hold municipal securities for liquidity purposes, but rather for longer term investment and other objectives. We will monitor closely the impact of the rule on municipal securities and consider adjustments if necessary.

Margin Rule for Derivatives

Before the passage of the Dodd-Frank Act, the derivatives activities of financial institutions were largely unregulated. One of the issues observed in the crisis was that some financial institutions had entered into large over-the-counter (OTC) derivatives positions with other institutions without the prudent initial exchange of collateral—a basic safety-and-soundness practice known as margin—in support of the positions. Title VII addressed this situation in part by requiring the use of central clearinghouses for certain standardized derivatives contracts, and by requiring the exchange of collateral, i.e., margin, for derivatives that are not centrally cleared.

Central clearinghouses for derivatives routinely manage their risks by requiring counterparties to post collateral at the inception of a trade. This practice is known as initial margin, in effect a type of security deposit or performance bond. Moreover, central clearinghouses routinely require a counterparty to post additional collateral if the market value of the position moves against that counterparty, greatly reducing the likelihood the clearinghouse will be unable to collect amounts due from counterparties. This type of collateral is known as variation margin.

Sections 731 and 764 of the Dodd Frank Act requires the large dealers in swaps to adopt certain prudent margining practices for their OTC derivatives activities that clearinghouses use, namely the posting and collecting of initial and variation margin. The exchange of margin between parties to a trade on OTC derivatives is an important check on the buildup of counterparty risk that can occur with OTC derivatives without margin. More generally, the appropriate exchange of margin promotes financial stability by reducing systemic leverage in the derivatives market-

place and promotes the safety and soundness of banks by discouraging the excessive growth of risky OTC derivatives positions.

The FDIC recently approved an interagency proposed rule to establish minimum margin requirements for the swaps of an insured depository institution or other entity that: (1) is supervised by the FDIC, Federal Reserve, OCC, Federal Housing Finance Administration (FHFA), or Farm Credit Administration (FCA); and (2) is also registered with the Commodity Futures Trading Commission (CFTC) or the Securities and Exchange Commission (SEC) as a dealer or major participant in swaps. The proposed rule will be published in the *Federal Register* with a 60-day public comment period.

In developing this proposal, the FDIC, along with the other banking agencies, worked closely with the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) to develop a proposed framework for margin requirements on noncleared swaps (the "international margin framework") with the goal of creating an international standard for margin requirements on noncleared swaps. After considering numerous comments, BCBS and IOSCO issued a final international margin framework in September 2013. The agencies' 2014 proposed rule is closely aligned with the principles and standards from the 2013 international framework. The E.U. and other jurisdictions also have issued similar proposals.

The proposed rule would require a covered swap entity (a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant) to exchange initial margin with counterparties that are: (1) registered with the CFTC or SEC as swap entities; or (2) financial end users with material swaps exposure—that is, with more than $3 billion in notional exposure of OTC derivatives that are not cleared. The rule would not require a covered swap entity to collect initial margin from commercial end users. The agencies intend to maintain the status quo with respect to the way that banks interact with commercial end users.

The proposed rule would also require a covered swap entity to exchange variation margin on swaps with all counterparties that are: (1) swap entities; or (2) financial end users (regardless of whether the financial end user has a material swaps exposure). There is no requirement that a covered swap entity must collect or post variation margin with commercial end users.

Because community banks typically do not have more than $3 billion in notional exposure of OTC derivatives that are not cleared, the agencies expect that the proposed rule will not result in community banks being required to post initial margin. Community banks that do engage in OTC derivatives that are not cleared are likely already posting variation margin in the normal course of business, or in amounts too small to fall within the scope of the rule. As a result, the margin rule likely will have little, if any, impact on the vast majority of community banks.

Resolution of Systemically Important Financial Institutions

Resolution Plans—"Living Wills"

Under the framework of the Dodd-Frank Act, bankruptcy is the preferred option in the event of a SIFI's failure. To make this objective achievable, Title I of the Dodd-Frank Act requires that all BHCs with total consolidated assets of $50 billion or more, and nonbank financial companies that the Financial Stability Oversight Council (FSOC) determines could pose a threat to the financial stability of the United States, prepare resolution plans, or "living wills," to demonstrate how the company could be resolved in a rapid and orderly manner under the Bankruptcy Code in the event of the company's financial distress or failure. The living will process is an important new tool to enhance the resolvability of large financial institutions through the bankruptcy process.

In 2011, the FDIC and the FRB jointly issued a final rule (the 165(d) rule) implementing the resolution plan requirements of Section 165(d) of the Dodd-Frank Act. The 165(d) rule provided for staggered annual submission deadlines for resolution plans based on the size and complexity of the companies. Eleven of the largest, most complex institutions (collectively referred to as "first wave filers") submitted initial plans in 2012 and revised plans in 2013.

During 2013, the remaining 120 institutions submitted their initial resolution plans under the 165(d) rule. The FSOC also designated three nonbank financial institutions for Federal Reserve supervision that year. In July 2014, 13 firms that previously had submitted at least one resolution plan submitted revised resolution plans, and the 3 nonbank financial companies designated by the FSOC submitted their initial resolution plans. The Federal Reserve and the FDIC granted requests for extensions to two firms whose second resolution plan submissions would have been due July 1. Those plans are now due to the agencies by October 1, 2014. The

remaining 116 firms are expected to submit their second submission revised resolution plans in December 2014.

Following the review of the initial resolution plans submitted in 2012, the Federal Reserve and the FDIC issued joint guidance in April 2013 to provide clarification and direction for developing 2013 resolution plan submissions. The Federal Reserve and the FDIC identified an initial set of obstacles to a rapid and orderly resolution that covered companies were expected to address in the plans. The five obstacles identified in the guidance—multiple competing insolvencies, potential lack of global cooperation, operational interconnectedness, counterparty actions, and funding and liquidity—represent the key impediments to an orderly resolution. The 2013 plans should have included the actions or steps the companies have taken or propose to take to remediate or otherwise mitigate each obstacle and a timeline for any proposed actions. The agencies also extended the deadline for submitting revised plans from July 1, 2013, to October 1, 2013, to give the firms additional time to develop resolution plan submissions that addressed the agencies' instructions.

Section 165(d) of the Dodd-Frank Act and the jointly issued implementing regulation[2] require the FDIC and the Federal Reserve to review the 165(d) plans. If the agencies jointly determine that a plan is not credible or would not facilitate an orderly resolution under the U.S. Bankruptcy Code, the FDIC and the Federal Reserve must notify the filer of the areas in which the plan is deficient. The filer must resubmit a revised plan that addresses the deficiencies within 90 days (or other specified timeframe).

The FDIC and the Federal Reserve have completed their reviews of the 2013 resolution plans submitted to the agencies by the 11 bank holding companies that submitted their revised resolution plans in October 2013. On August 5, 2014, the agencies issued letters to each of these first wave filers detailing the specific shortcomings of each firm's plan and the requirements for the 2015 submission.

While the shortcomings of the plans varied across the first wave firms, the agencies have identified several common features of the plans' shortcomings, including: (1) assumptions that the agencies regard as unrealistic or inadequately supported, such as assumptions about the likely behavior of customers, counterparties, investors, central clearing facilities, and regulators; and (2) the failure to make, or even to identify, the kinds of changes in firm structure and practices that would be necessary to enhance the prospects for orderly resolution. The agencies will require that the annual plans submitted by the first wave filers on July 1, 2015, demonstrate that those firms are making significant progress to address all the shortcomings identified in the letters, and are taking actions to improve their resolvability under the U.S. Bankruptcy Code. These actions include:

- establishing a rational and less complex legal structure which would take into account the best alignment of legal entities and business lines to improve the firm's resolvability;
- developing a holding company structure that supports resolvability, including maintaining sufficient longer term debt;
- amending, on an industrywide and firm-specific basis, financial contracts to provide for a stay of certain early termination rights of counterparties triggered by insolvency proceedings;
- ensuring the continuity of shared services that support critical operations and core business lines throughout the resolution process; and
- demonstrating operational capabilities for resolution preparedness, such as the ability to produce reliable information in a timely manner.

Agency staff will work with each of the first wave filers to discuss required improvements in its resolution plan and the efforts, both proposed and in progress, to facilitate each firm's preferred resolution strategy. The agencies are also committed to finding an appropriate balance between transparency and confidentiality of proprietary and supervisory information in the resolution plans. As such, the agencies will be working with these firms to explore ways to enhance public transparency of future plan submissions.

Based upon its review of submissions by first wave filers, the FDIC Board of Directors determined, pursuant to section 165(d) of the Dodd-Frank Act, that the plans submitted by the first wave filers are not credible and do not facilitate an orderly resolution under the U.S. Bankruptcy Code. The FDIC and the Federal Reserve agreed that in the event that a first wave filer has not, by July 1, 2015, submitted a plan responsive to the shortcomings identified in the letter sent to that firm, the

[2] 12 CFR Part 243 and 12 CFR Part 381.

agencies expect to use their authority under section 165(d) to determine that a resolution plan does not meet the requirements of the Dodd-Frank Act.

Improvements to Bankruptcy

At the December 2013 meeting of the FDIC's Systemic Resolution Advisory Committee, the FDIC heard how the existing bankruptcy process could be improved to better apply to SIFIs. The current provisions of the U.S. Bankruptcy Code do not expressly take into account certain features of SIFIs that distinguish these firms from other entities that are typically resolvable under bankruptcy without posing risk to the U.S. financial system. Issues such as the authority to impose a stay on qualified financial contracts and the ability to move part of a bankrupt firm into a bridge entity in an expeditious and efficient fashion are left unaddressed in current law. It also is unclear whether traditional debtor-in-possession financing, which is available under bankruptcy, would be sufficient to address the significant liquidity needs arising from the failure of a SIFI. A further challenge in a U.S. bankruptcy proceeding would be how it could foster global cooperation with foreign authorities, courts, creditors, or other pertinent parties, including U.S. financial regulatory officials, to ensure that their interests will be protected.

Additionally, a number of scholars, policy analysts, and public officials have made helpful proposals for changes to the U.S. Bankruptcy Code that would facilitate the resolution of a SIFI in bankruptcy. The FDIC has been reaching out to those in the bankruptcy community to discuss ways to enhance the U.S. Bankruptcy Code to facilitate an orderly failure of a SIFI. In addition, the FDIC has been working with foreign authorities to encourage the International Swaps and Derivatives Association (ISDA) to modify its standard-form contracts to facilitate resolution in bankruptcy. The FDIC supports these efforts and is prepared to work with Congress on modifications to the U.S. Bankruptcy Code for the treatment of SIFIs in bankruptcy.

Implementation of Title II

Congress also recognized that there may be circumstances in which the resolution of a SIFI under the U.S. Bankruptcy Code would have serious adverse effects on financial stability in the U.S. Accordingly, in Title II of the Dodd-Frank Act, Congress provided the FDIC with orderly liquidation authority to resolve a failing SIFI as a last resort in the event that resolution under the U.S. Bankruptcy Code would result in systemic disruption of the financial system. This Orderly Liquidation Authority serves as a backstop to protect against the risk of systemic disruption to the U.S. financial system and allows for resolution in a manner that results in shareholders losing their investment, creditors taking a loss and management responsible for the failure being replaced, resulting in an orderly unwinding of the firm without cost to U.S. taxpayers.

In my February testimony before this Committee, I described how the FDIC is developing a strategic approach, referred to as Single Point of Entry (SPOE) strategy, to carry out its Orderly Liquidation Authority for resolving a SIFI in the event it is determined that a firm cannot be resolved under bankruptcy without posing a risk to the U.S. financial system. Under the SPOE strategy, the FDIC would be appointed receiver of the top-tier parent holding company of the financial group following the company's failure and the completion of the recommendation, determination, and expedited judicial review process set forth in Title II of the Act. For the SPOE strategy to be successful, it is critical that the top-tier holding company maintain a sufficient amount of unsecured debt that would be available to provide capital to manage the orderly unwinding of the failed firm. In a resolution, the holding company's debt would be used to absorb losses and keep the operating subsidiaries open and operating until an orderly wind-down could be achieved.

In support of the SPOE strategy, the Federal Reserve, in consultation with the FDIC, is considering the merits of a regulatory requirement that the largest, most complex U.S. banking firms maintain a minimum amount of unsecured debt at the holding company level, in addition to the regulatory capital those companies already are required to maintain. Such a requirement would ensure that there is sufficient debt at the holding company level to absorb losses at the failed firm.

Cross-Border Issues

Advance planning and cross-border coordination for the resolution of globally active SIFIs (G–SIFIs) will be essential to minimizing disruptions to global financial markets. Recognizing that G–SIFIs create complex international legal and operational concerns, the FDIC continues to reach out to foreign regulators to establish frameworks for effective cross-border cooperation.

As part of our bilateral efforts, the FDIC and the Bank of England, in conjunction with the prudential regulators in our respective jurisdictions, have been developing contingency plans for the failure of a G–SIFI that has operations in the United

States and the United Kingdom. Of the 28 G–SIFIs identified by the Financial Stability Board (FSB) in the G20 countries, four are headquartered in the United Kingdom, and eight in the United States. Moreover, more than 70 percent of the reported foreign activities of the eight U.S. G–SIFIs originate in the United Kingdom. The magnitude of the cross-border financial relationships and local activity of G–SIFIs in the United States and the United Kingdom makes the U.S.–UK bilateral relationship by far the most significant with regard to the resolution of G–SIFIs. Therefore, our two countries have a strong mutual interest in ensuring that the failure of such an institution could be resolved at no cost to taxpayers and without placing the financial system at risk.

The FDIC and UK authorities are continuing to work together to address the cross-border issues raised in the December 2012 joint paper on resolution strategies and the December 2013 tabletop exercise between staffs at the FDIC, the Bank of England (including the Prudential Regulation Authority), the Federal Reserve, and the Federal Reserve Bank of New York. This work is intended to identify actions that could be taken by each regulator to implement the SPOE resolution strategy in the event of a resolution.

The FDIC also has continued to coordinate with representatives from other European authorities to discuss issues of mutual interest, including the resolution of European G–SIFIs and ways in which we can harmonize receivership actions. The FDIC and the European Commission (E.C.) continue to work collaboratively through a joint Working Group composed of senior executives from the FDIC and the E.C., focusing on both resolution and deposit insurance issues. The Working Group meets twice a year, in addition to less formal meetings and exchanges of detailees. In 2014, the Working Group convened in May, and there has been ongoing collaboration at the staff level. The FDIC and the E.C. have had in-depth discussions regarding the FDIC's experience with resolution as well as the FDIC's SPOE strategy.

The E.U. recently adopted important legislation related to the resolution of global SIFIs, such as the E.U.-wide Credit Institution and Investment Firm Recovery and Resolution Directive, amendments that further harmonize deposit guarantee schemes E.U.-wide, and a Single Resolution Mechanism for Euro-area Member States and others that opt-in. The E.U. is now working to implement that legislation through secondary legislation, in the form of guidelines and standards, and by establishing the organizational capacity necessary to support the work of the Single Resolution Board under the Single Resolution Mechanism. FDIC and E.C. staffs continue to collaborate in exchanging information related to this implementation work. In June 2014, at the request of the E.C., the FDIC conducted a 2-day seminar on resolutions for resolution authorities and a broad audience of E.C. staff involved in resolutions-related matters.

The FDIC continues to foster relationships with other jurisdictions that regulate G–SIFIs, including Switzerland, Germany, France and Japan. So far in 2014, the FDIC has had significant principal and staff-level engagements with these countries to discuss cross-border issues and potential impediments that would affect the resolution of a G–SIFI. We will continue this work during the remainder of 2014 and in 2015 and plan to host tabletop exercises with staff from these authorities. We also held preliminary discussions on developing joint resolution strategy papers, similar to the one with the United Kingdom, as well as possible exchanges of detailees.

In a significant demonstration of cross-border cooperation on resolution issues, the FDIC signed a November 2013 joint letter with the Bank of England, the Swiss Financial Market Supervisory Authority and the German Federal Financial Supervisory Authority to ISDA. This letter encouraged ISDA to develop provisions in derivatives contracts that would provide for short-term suspension of early termination rights and other remedies in the event of a G–SIFI resolution. The authorities are now providing comments on proposed draft ISDA protocols that would contractually implement these provisions during a resolution under bankruptcy or under a special resolution regime. The adoption of the provisions would allow derivatives contracts to remain in effect throughout the resolution process under a number of potential resolution strategies. The FDIC believes that the development of a contractual solution has the potential to remove a key impediment to cross-border resolution.

We anticipate continuation of our international coordination and outreach and will continue to work to resolve impediments to an orderly resolution of a G–SIFI.

Risk Retention

On August 28, 2013, the FDIC approved an NPR issued jointly with five other Federal agencies to implement the credit risk retention requirement in Section 941 of the Dodd-Frank Act. The proposed rule seeks to ensure that securitization spon-

sors have appropriate incentives to monitor and ensure the underwriting and quality of assets being securitized. The proposed rule generally requires that the sponsor of any asset-backed security (ABS) retain an economic interest equal to at least 5 percent of the aggregate credit risk of the collateral. This was the second proposal under Section 941; the first was issued in April 2011.

The FDIC reviewed approximately 240 comments on the August 2013 NPR. Many comments addressed the proposed definition of a "qualified residential mortgage" (QRM), which is a mortgage that is statutorily exempt from risk retention requirements under the Dodd-Frank Act. The NPR proposed to align the definition of QRM with the definition of "qualified mortgage" (QM) adopted by the Consumer Financial Protection Bureau (CFPB) in 2013. The NPR also included a request for public comment on an alternative QRM definition that would add certain underwriting standards to the existing QM definition. The August 2013 proposal also sets forth criteria for securitizations of commercial real estate loans, commercial loans, and automobile loans that meet specific conservative credit quality standards to be exempt from risk retention requirements.

The issuing agencies have reviewed the comments, met with interested groups to discuss their concerns and have given careful consideration to all the issues raised. The agencies have made significant progress toward finalizing the rule and expect to complete the rule in the near term.

Volcker Rule Implementation

In adopting the Volcker Rule, the agencies recognized that clear and consistent application of the final rule across all banking entities would be extremely important. To help ensure this consistency, the five agencies formed an interagency Volcker Rule Implementation Working Group. The Working Group has been meeting on a weekly basis and has been able to make meaningful progress on coordinating implementation. The Working Group has been able to agree on a number of interpretive issues and has published several Frequently Asked Questions. In addition, the Working Group has been able to successfully develop a standardized metrics reporting template, which has been provided to and tested by the industry. In addition, the Working Group is developing a collaborative supervisory approach by the agencies.

Community Banks

Focus of Research

Since 2011, the FDIC has been engaged in a sustained research effort to better understand the issues related to community banks—those institutions that provide traditional, relationship-based banking services in their local communities. Our initial findings were presented in a comprehensive study published in December 2012. The study covered topics such as structural change, geography, financial performance, lending strategies and capital formation, and it highlighted the critical importance of community banks to our economy and our banking system. While the study found that community banks account for about 14 percent of the banking assets in the U.S., they also account for around 45 percent of all the small loans to businesses and farms made by all banks in the U.S. In addition, the study found that, of the more than 3,100 U.S. counties, nearly 20 percent (more than 600 counties)—including small towns, rural communities and urban neighborhoods—would have no physical banking presence if not for the community banks operating there.

The study also showed that community banks' core business model—defined around careful relationship lending, funded by stable core deposits, and focused on the local geographic community that the bank knows well—performed comparatively well during the recent banking crisis. Among the more than 500 banks that have failed since 2007, the highest rates of failure were observed among noncommunity banks and among community banks that departed from the traditional model and tried to grow with risky assets often funded by volatile brokered deposits.

Our community bank research agenda remains active. Since the beginning of the year, FDIC analysts have published new papers dealing with consolidation among community banks, the effects of long-term rural depopulation on community banks, and the efforts of Minority Depository Institutions to provide essential banking services in the communities they serve.

We have also instituted a new section in the FDIC Quarterly Banking Profile, or QBP, that focuses specifically on community banks. Although some 93 percent of FDIC-insured institutions met our community bank definition in the first quarter, they hold a relatively small portion of industry assets; as a result, larger bank trends tend to obscure community bank trends. This new quarterly report on the structure, activities and performance of community banks should help smaller institutions compare their results with those of other community banks as well as those

of larger institutions. Introducing this regular quarterly report is one example of the FDICs commitment to maintain an active program of research and analysis on community banking issues in the years to come.

Subchapter S

The Basel III capital rules introduce a capital conservation buffer for all banks (separate from the supplementary leverage ratio buffer applicable to the largest and most systemically important BHCs and their insured banks). If a bank's risk-based capital ratios fall below specified thresholds, dividends and discretionary bonus payments become subject to limits. The buffer is meant to conserve capital in banks whose capital ratios are close to the minimums and encourage banks to remain well-capitalized.

In July 2014, the FDIC issued guidance clarifying how it will evaluate requests by S corporation banks to make dividend payments that would otherwise be prohibited under the capital conservation buffer. S corporation banks have expressed concern about the capital conservation buffer because of a unique tax issue their shareholders face. Federal income taxes of S corporation banks are paid by their investors. If an S corporation bank has income, but is limited or prohibited from paying dividends, its shareholders may have to pay taxes on their pass-through share of the S corporation's income from their own resources. Relatively few S corporation banks are likely to be affected by this issue, and in any case not for several years. The buffer is phased-in starting in 2016 and is not fully in place until 2019.

As described in the guidance, if an S corporation bank faces this tax issue, the Basel III capital rules allow it (like any other bank) to request an exception from the dividend restriction that the buffer would otherwise impose. The primary regulator can approve such a request if consistent with safety and soundness. Absent significant safety and soundness concerns about the requesting bank, the FDIC expects to approve on a timely basis exception requests by well-rated S corporations to pay dividends of up to 40 percent of net income to shareholders to cover taxes on their pass-through share of the bank's earnings.

Cybersecurity

In its role as supervisor of State-chartered financial institutions that are not members of the Federal Reserve System, the FDIC works with other bank regulators to analyze emerging cyberthreats, bank security breaches, and other technology incidents. An important initiative of the FFIEC is a project to assess the level of cybersecurity readiness at banks, technology service providers and our own supervisory policies. The agencies plan to review any identified gaps to enhance supervisory policies to address cyberthreats.

Recognizing that addressing cyber risks can be especially challenging for community banks, the FDIC has taken a number of actions in addition to those taken by the FFIEC to further improve awareness of cyber risks and encourage practices to protect against threats. In April, the FDIC issued a press release urging financial institutions to utilize available cyber resources to identify and help mitigate potential threats. During the first quarter of 2014, the FDIC distributed a package to all FDIC supervised banks that included a variety of tools to assist them in developing cyber readiness. As part of this kit, the FDIC developed a "Cyber Challenge" resource for community banks to use in assessing their preparedness for a cyber-related incident, and videos and simulation exercises were made available on *www.FDIC.gov* and mailed to all FDIC-supervised banks. The Cyber Challenge is intended to assist banks in beginning a discussion of the potential impact of IT disruptions on important banking functions. In April, the FDIC also reissued three documents on technology outsourcing that contain practical ideas for community banks to consider when they engage in technology outsourcing. The documents are: *Effective Practices for Selecting a Service Provider; Tools To Manage Technology Providers' Performance Risk: Service Level Agreements; and Techniques for Managing Multiple Service Providers.*

In addition to the FDIC's operations and technology examination program, the FDIC monitors cybersecurity issues in the banking industry on a regular basis through on-site examinations, regulatory reports, and intelligence reports. The FDIC also works with a number of groups, including the Finance and Banking Information Infrastructure Committee, the Financial Services Sector Coordinating Council for Critical Infrastructure Protection and Homeland Security, the Financial Services Information Sharing and Analysis Center, other regulatory agencies and law enforcement to share information on emerging issues.

Conclusion

Thank you for the opportunity to share with the Committee the work that the FDIC has been doing to address systemic risk in the aftermath of the financial crisis. I would be glad to respond to your questions.

Status of FDIC Dodd-Frank Act Rulemakings
August 2014

Completed FDIC-only Rulemakings
FDIC has met all applicable deadlines in issuing those required regulations in the Dodd-Frank Wall Street Reform and Consumer Protection Act for which it is solely responsible. These include:

- Orderly Liquidation Authority (OLA) Regulations
  - Inflation adjustment for wage claims against financial company in receivership;
  - Executive compensation clawbacks and definition of compensation;
  - Definition of 'predominantly engaged in activities financial in nature' for title II purposes; and
  - Rules governing asset purchaser eligibility.
- Deposit Insurance Fund Management Regulations
  - Regulations establishing an asset-based assessment base;
  - Regulations implementing permanent $250,000 coverage;
  - Elimination of pro-cyclical assessments; dividend regulations;
  - Restoration plan to increase the minimum reserve ratio from 1.15 to 1.35% by Sept. 30, 2020; and
  - Regulations implementing temporary full Deposit Insurance coverage for non-interest bearing transaction accounts (Program expired 12/31/12).

The FDIC has also issued several optional rules, including the following OLA rules:

- Rules governing payment of post-insolvency interest to creditors;
- Rules establishing the proper measure of actual, direct, compensatory damages caused by repudiation of contingent claims;
- Rules governing the priority of creditors and the treatment of secured creditors;
- Rules governing the administrative claims process;
- Rules governing the treatment of mutual insurance holding companies; and
- Rules providing for enforcement of contracts of subsidiaries or affiliates of a covered financial company.

Completed Interagency Rules:
FDIC and its fellow agencies have issued a number of joint or interagency regulations. These include:

- Title I resolution plan requirements;
- Regulations implementing self-administered stress tests for financial companies;
- Minimum leverage capital requirements for IDIs (Collins §171(b)(1));
- Minimum risk-based capital requirements (Collins §171(b)(2));
- Capital requirements for activities that pose risks to the financial system (Collins §171(b)(7)) (as of July 9, 2013);
- Rules providing for calculation of the "maximum obligation limitation";
- Regulations on foreign currency futures;

- Removing regulatory references to credit ratings;
- Property appraisal requirements for higher cost mortgages;
- Appraisals for higher priced mortgages supplemental rule;
- Appraisal independence requirements;
- Volcker Rule Prohibition on Proprietary Trading and Investments in Covered Funds; and
- Interim final rule authorizing Retention of Interests in CDOs backed by Bank-Issued Trust Preferred Securities

Rulemakings in process—FDIC-only:

- Annual Stress Test – revisions to "as-of" dates for financial data;
- Integration and Streamlining of adopted OTS regulations.

Interagency Rulemakings in process:

- Additional OLA Rules:
  - Orderly liquidation of covered brokers and dealers;
  - Regulations regarding treatment of officers and directors of companies resolved under Title II; and
  - QFC recordkeeping rules;
- Regulations implementing the credit exposure reporting requirement for large BHCs and nonbank financial companies supervised by the FRB;
- Regulations implementing the "source of strength" requirement for BHCs, S&LHCs, and other companies that control IDIs;
- Capital and margin requirements for derivatives that are not cleared OTC;
- Regulations governing credit risk retention in asset-backed securitizations, including ABS backed by residential mortgages;
- Regulations governing enhanced compensation structure reporting and prohibiting inappropriate incentive-based payment arrangements;
- Rulemaking prohibiting retaliation against an IDI or other covered person that institutes an appeal of conflicting supervisory determinations by the CFPB and the appropriate prudential regulator; and
- Additional appraisals and related regulations:
  - Minimum requirements for registration of appraisal management companies and for the reporting of the activities of appraisal management companies to Appraisal Subcommittee;
  - Regulations to implement quality controls standards for automated valuation models; and
  - Regulations providing for appropriate appraisal review.

Other DFA Regulations and Guidance:

- OMWI – Proposed Standards for Assessing Diversity in Regulated Entities;
- Stress Testing Guidance, including:
  - Economic Scenarios for 2014 Stress Testing;
  - Policy Statement on the Principles for Development and Distribution of Annual Stress Test Scenarios (FDIC-supervised institutions); and

- Interagency Supervisory Guidance on Implementing Dodd-Frank Act Company-Run Stress Tests for Banking Organizations With Total Consolidated Assets of More Than $10 Billion But Less Than $50 Billion; and
- Interagency Statement on Supervisory Approach for Qualified and Non-Qualified Mortgage Loans

PREPARED STATEMENT OF THOMAS J. CURRY

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

SEPTEMBER 9, 2014

Chairman Johnson, Ranking Member Crapo, and Members of the Committee, thank you for the opportunity to update you on steps the Office of the Comptroller of the Currency (OCC) has taken to enhance the effectiveness of our supervision and the status of our efforts to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act or Act).* The OCC is the primary regulator of nearly 1,650 national banks and Federal savings associations with approximately $10.5 trillion in assets, which represents 68 percent of all bank and thrift assets insured by the Federal Deposit Insurance Corporation (FDIC).[1] OCC-supervised banks and thrifts hold the majority of FDIC-insured deposits and range from small, community banks with assets of less than $100 million to some of the largest and most complex financial institutions.

Our Nation's economic and financial condition has steadily improved since the financial crisis, and the strength and health of our Federal banking system reflect this progress. As a bank supervisor, I take comfort in these improvements. I am keenly aware, however, that we need to remain vigilant, and I am instituting new measures to ensure we do so. Specifically, the OCC is recalibrating the way we supervise large, complex financial institutions based on the lessons we have learned since the financial crisis. Importantly, we are strengthening our capacity to take a broad, horizontal view across the institutions we regulate to identify emerging trends and red flags, while enhancing our traditional hands-on supervision of individual institutions. In addition, we are requiring our largest institutions to improve risk management and corporate governance.

In my testimony today, I will address recent OCC initiatives that are central to the effective and vigilant oversight of national banks and Federal savings associations. Additionally, in response to the Committee's letter of invitation, I will discuss the OCC's progress in issuing and implementing the rules required by the Dodd-Frank Act, as well as the OCC's efforts to coordinate our supervision with other domestic and international regulators. Finally, my testimony will touch on emerging issues related to cybersecurity.

I. State of the National Banking and Federal Thrift System

The condition of the national banks and Federal savings associations that the OCC supervises (collectively referred to here as "banks") has steadily improved over the past 4 years, as the economy has slowly recovered from the severe 2008–2009 credit crisis and recession. Banks have increased their total lending volume during this period, although this increase is at a pace below the long-term average rate of growth. Total credit growth has been subdued, primarily due to an extended contraction in residential mortgage activity, with only recent signs of emerging loan growth in this area. Private residential mortgage securitization has yet to recover.

Although housing credit has continued to struggle, other areas of loan growth have shown more resilience. For example, commercial and industrial loan growth has averaged 10 percent per year during the past 4 years, triple its average pace in the decade before the financial crisis. Auto sales and lending also have rebounded from the lows of the recession and are fast approaching precrisis levels. Credit quality has significantly improved. Charge-off rates for all major loan categories are at or below the 25-year average and, as a result, the Federal banking system's total loan charge-off rate is now 0.6 percent, 40 percent below the 25-year average of 1 percent. The ratio of loan loss reserves to total loans, a measure of a bank's expectation of future loan losses, has returned to its 1984–2006 average of below 2 percent, after peaking at 4 percent in 2010. That said, concerns have begun to emerge related to subprime auto lending outside the banking system and to loan terms more generally. Leveraged lending also has grown rapidly, and the OCC, along with the other Federal banking agencies, issued guidance aimed at preventing overheating in this area.

Given the gradual recovery in lending and improved credit performance, the profitability of the Federal banking system has steadily improved, from a 7 percent return on equity in 2010 to approximately 10 percent today. However, the return on assets is approximately 1.1 percent, and profitability levels remain subdued relative to the precrisis period. This is due in part to a continued low level of loans to total

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*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.

[1] All data are as of June 30, 2014.

assets and the narrow lending margins that result from persistently low interest rates, as well as elevated expenses tied to enhanced compliance and ongoing litigation costs. Even so, the proportion of unprofitable banks is at 8.9 percent, just above the 8 percent average in the decade prior to the crisis and well down from a peak of nearly one-in-three at the height of the crisis.

The number of troubled institutions supervised by the OCC (CAMELS 4 or 5 rated) has decreased significantly, from a high of 196 in December 2010, to 77 in June of this year. Bank balance sheets also reflect stronger capital and improved liquidity. Tier 1 common equity stands at nearly 13 percent of risk-weighted assets, up from a low of 9 percent in the fall of 2008. The current capital leverage ratio is now at 9.3 percent, 40 percent above the ratio in 2008. Liquid assets have achieved a 30-year high of 15 percent of total assets.

II. Enhancing Supervision

The financial crisis underscored the critical role of supervision in ensuring a safe and sound global banking system as well as the need to change supervisory approaches that may not have kept pace with developments in the industry. Key lessons from both the crisis and the international supervisory peer review study that we commissioned prompted the OCC to reassess and revise our supervisory approach for all banks, particularly larger banks. Below, I describe OCC initiatives in this area that will transform how we supervise both larger institutions and the small institutions whose vitality is critical to so many communities across our country.

A. New Supervisory Initiatives

In 2013, I asked a team of international regulators (referred to here as the "peer review team") to provide the OCC with a candid and independent assessment of our supervision of midsize and large banks. The scope of the assessment was broad: it included how we go about the business of supervision; our agency culture and approach to risk identification; and any gaps in our supervisory approach or systems.

While the peer review team complimented many areas of OCC supervision, it also identified areas where the OCC can improve: enhancing systemic risk monitoring and the processes that support supervisory responses; improving the consistency of supervisory practices within and across business lines; and strengthening the standards we use to supervise. In the months since the peer review team's report,[2] the OCC has taken steps to improve our supervisory processes and execute plans based on the report's findings that include a number of transformational improvements, which I describe below.

Remaking the Large Bank Lead Expert Program

We are expanding and restructuring the organization, functions, and responsibilities of our Large Bank Lead Expert Program in which an expert, independent of the dedicated examination staff, is assigned to each key risk area. This expansion will allow us to compare the operations of the institutions we regulate and improve our ability to identify systemic risk. It will also enhance the quality control of our exam processes and enable us to allocate our resources more effectively. In addition, we are making a number of changes to our dedicated examiner program and implementing a rotation policy to enhance the skills and broaden the perspectives of our examination teams.

Enhancing Risk Monitoring

The OCC's supervisory program includes our National Risk Committee (NRC), which monitors the condition of the Federal banking system and emerging threats to the system's safety and soundness. The NRC meets quarterly and issues guidance to examiners providing important perspectives on industry trends and highlighting issues requiring supervisory attention. This information allows the OCC to react more quickly to emerging risks and trends and to allocate our resources in a manner that matches the challenges we are likely to face going forward.

In addition, using midyear and year-end data, the NRC publishes the Semiannual Risk Perspective report, which informs the development of our supervisory strategies and processes. We make this report available to the public. The broad dissemination of this information is part of our continuing efforts to provide greater transparency to both the public and industry regarding the issues to which we are devoting increased supervisory attention. In June 2014, the report also began outlining our key supervisory priorities for the next twelve months both for large bank supervision and for midsize and community bank supervision.

[2] *http://www.occ.gov/news-issuances/news-releases/2013/nr-occ-2013-184.html*

Other analytical groups that focus on specific risk areas, such as retail and commercial credit and conditions across our districts, support the work of the NRC. We recently augmented the existing risk committees with a Large Bank Supervision Risk Committee (LBSRC). The LBSRC will further enhance our ability to identify and respond quickly to emerging risk issues across large, complex institutions, ensure consistency in our supervisory activities, and assist the NRC in its risk monitoring activities.

Improving Management Information Systems and Data Analytics

The OCC has unique and secure access to substantial and comprehensive banking system data, and it is imperative that we have strong data analytics. Our goal is to transition to a shared services environment across functions within the agency to improve the ability of our supervisory staff to use this data and enhance the integrity and consistency of our data analytics. These changes will improve the consistency, reliability, and efficiency of our supervision of the institutions that we oversee.

Formalizing an Enterprise Risk Management Framework

The OCC sets a high bar for the institutions we supervise, and we must ask no less of ourselves. To this end, we are developing and formalizing an enterprise risk management framework for the OCC, including a risk appetite statement, to better define, measure, and control the risks that we accept in pursuit of our mission, vision, and strategic goals. A working group will soon conduct an initial enterprisewide risk assessment and inventory existing risk management practices.

B. Heightened Standards for Large Banks

Due to their size, activities, and implications for the U.S. financial system, large institutions require more rigorous regulation and supervision than less systemically significant institutions. Since the crisis, we have applied heightened standards to large institutions. These standards address comprehensive and effective risk management; the need for an engaged board of directors that exercises independent judgment; the need for a robust audit function; the importance of talent development, recruitment, and succession planning; and a compensation structure that does not encourage inappropriate risk taking.

Last week, we issued final guidelines refining and formalizing these standards and making them enforceable. These standards provide important additional supervisory tools to examiners and focus bank management and boards of directors on strengthening their institutions' risk management practices and governance. The standards are generally applicable to insured national banks, insured Federal savings associations, and insured Federal branches of foreign banks with average total consolidated assets of $50 billion or greater (referred to in this subsection as "banks").

The final guidelines set forth minimum standards for the design and implementation of a bank's risk governance framework and provide minimum standards for the board's oversight of the framework. The standards make clear that the framework should address all risks to a bank's earnings, capital, and liquidity that arise from the bank's activities.

The standards also set out roles and responsibilities for the organizational units that are fundamental to the design and implementation of the risk governance framework. These units, often referred to as a bank's three lines of defense, are front line business units, independent risk management, and internal audit. The standards state that, together, these units should establish an appropriate system to control risk taking. The standards also provide that banks should develop a risk appetite statement that articulates the aggregate level and types of risk a bank is willing to assume to achieve its strategic objectives, consistent with applicable capital, liquidity, and other regulatory requirements.

In addition, the final guidelines contain standards for boards of directors regarding oversight of the design and implementation of a bank's risk governance framework. They note that it is vitally important for each director to be engaged in order to understand the risks that his or her institution is taking and to ensure that those risks are well-managed. Directors should be in a position to present a credible challenge to bank management with the goal of preserving the sanctity of the bank's charter. That is, a bank should not be treated merely as a booking entity for a holding company. The Federal bank charter is a special corporate franchise that provides a gateway to Federal deposit insurance and access to the discount window. Accordingly, management and independent directors must see that the bank operates in a safe and sound manner.

We issued the final standards as a new appendix to Part 30 of our regulations. Part 30 codifies an enforcement process set out in the Federal Deposit Insurance

Act that authorizes the OCC to prescribe operational and managerial standards. If a bank fails to satisfy a standard, the OCC may require it to submit a compliance plan detailing how it will correct the deficiencies and how long it will take. The OCC can issue an enforceable order if the bank fails to submit an acceptable compliance plan or fails in any material way to implement an OCC-approved plan.

Higher supervisory standards for the large banks we oversee, such as those in the final guidelines, along with bank management's implementation of these standards, are consistent with the Dodd-Frank Act's broad objective of strengthening the stability of the financial system. We believe that this increased focus on strong risk management and corporate governance will help banks maintain the balance sheet improvements achieved since the financial crisis and make them better able to withstand the impact of future crises.

C. Supervision of Community Banks

The OCC is the supervisor of approximately 1,400 institutions with assets under $1 billion, of which approximately 870 have less than $250 million in assets. These small institutions play a vital role in our country's financial system by providing essential products and services to our communities and businesses, including credit that is critical to economic growth and job creation.

The OCC is a resource to these community banks through our more than 60 offices throughout the United States. Our examiners are part of the communities in which they work and are empowered to make most supervisory decisions at the local level. In addition, the entire agency works to support these examiners and small banks and provides them with easy access to licensing specialists, lawyers, compliance and information technology specialists, and a variety of other subject matter experts.

Small banks face unique challenges, and the OCC has been sensitive to this in our implementation of the Dodd-Frank Act and in our approach to supervising these institutions. Throughout the rulemaking process, the agency has sought and listened to comments and concerns from community banks. We have heard—and we agree—that a one-size-fits-all approach to bank supervision is not appropriate. Accordingly, we tailor our supervisory programs to the risk and complexity of a bank's activities and have separate lines of business for community and midsize banks and large banks. When developing regulations, the OCC works to avoid unnecessary regulatory and compliance burden on small banks.

Our commitment to this principle is evident in many of the rules we have issued. For example, the lending limits rule we issued under the Dodd-Frank Act provides a simpler option that small banks may use for measuring the credit exposure of derivative and securities financing transactions. The final domestic capital rules, issued on an interagency basis, also accommodate concerns of small banks with respect to the treatment of trust preferred securities (TruPS), accumulated other comprehensive income, and residential mortgages. Finally, with our interagency counterparts, we revised the treatment of certain collateralized debt obligations (CDOs) backed primarily by TruPS under the Volcker Rule largely to address concerns raised by community banks.

The OCC, along with the other Federal banking agencies, is also engaged in a review of regulatory burden pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA). This statute requires the OCC, as well as the FDIC and Board of Governors of the Federal Reserve System (FRB), to seek public comment at least once every 10 years to identify outdated, unnecessary, or unduly burdensome regulations. The EGRPRA review provides the public with an opportunity to recommend to the agencies how to reduce burden through targeted regulatory changes.

In connection with the EGRPRA process, the agencies published a *Federal Register* notice this past June asking for comment on three categories of rules. The comment period on this first notice ended 1 week ago, and the agencies are reviewing the comments received. Over the next 2 years, the agencies will issue three more *Federal Register* notices that will invite public comment on the remaining rules. In each notice, we will specifically ask the public, including small institutions, to identify ways to reduce unnecessary burden associated with our regulations.

The OCC also has taken steps to communicate more effectively with the small banks we supervise. Certain provisions of the Dodd-Frank Act apply to institutions of all sizes, but many apply only to larger banks. Therefore, in each bulletin transmitting a new regulation or supervisory guidance to our banks, we include both a "highlights section" that succinctly summarizes the major provisions of the issuance and an easy-to-see box written in plain English that allows community banks to assess quickly whether the issuance applies to them. We have also developed other methods for distilling complex requirements, such as summaries and guides that

highlight aspects of rules that are relevant to small institutions. We have received positive feedback on these communication tools, and we will continue to work to make the regulatory process manageable for small banks.

III. Dodd-Frank Act: Regulatory Milestones Achieved

Congress enacted the Dodd-Frank Act to address regulatory gaps, create a stronger financial system, and address systemic issues that contributed to, or that accentuated and amplified the effects of, the financial crisis. To achieve these objectives, the Act provided the Federal financial regulators, including the OCC, with new tools to address risk and to mitigate future financial crises.

The implementation of the Dodd-Frank Act presented challenges on an unprecedented scale, as many of these new tools required, among other things, the Federal financial regulators to write or revise a number of highly complex regulations. In the 4 years since the Act became law, the OCC has worked tirelessly to fulfill this mandate. I am pleased to report that the OCC has completed all rules that we have independent authority to issue. Furthermore, the OCC has finalized many of the regulations that the Dodd-Frank Act required the OCC to issue jointly or on a coordinated basis with other Federal financial regulators. For those rulemakings that remain, we have made good progress and, in many cases, we have seen meaningful improvements in industry practices in anticipation of the finalized rules. Below, I will discuss the completed rulemakings followed by a description of the rulemakings that are in-process.

A. Finalized Rules

OCC/OTS Integration

The Dodd-Frank Act transferred to the OCC all the functions of the Office of Thrift Supervision (OTS) relating to Federal savings associations, as well as the responsibility for the examination, supervision, and regulation of Federal savings associations. We have previously reported on the successful transfer of these functions, including the integration into the OCC of former OTS employees and systems and the development of an aggressive cross-credentialing program that qualifies examiners to lead examinations of both national banks and Federal savings associations.

We are committed to continuing to improve and refine our new responsibilities. For example, we are undertaking a comprehensive, multiphase review of our regulations and those of the former OTS to reduce regulatory burden and duplication, promote fairness in supervision, and create efficiencies for both types of institutions. We have begun this process and, in June of this year, we issued a proposal to integrate national bank and Federal saving association rules relating to corporate activities and transactions.

In addition, as we have gained experience in our supervision of Federal savings associations, I have come to recognize that the current legal framework limits the ability of these institutions to adapt their business strategies to changing economic and business environments unless they change their charter or business plans. More specifically, Federal savings associations that want to move from a mortgage lending business model to providing a mix of business loans and consumer credit would need to change charters. I believe that the thrift charter should be flexible enough to accommodate either strategy.

When I was a regulator in Massachusetts, we made State bank and thrift powers and investment authorities, as well as supervisory requirements, the same or comparable regardless of charters, and we allowed the institutions to exercise those powers while retaining their own corporate structure. Congress may wish to consider authorizing a similar system at the Federal level. This flexibility will improve the ability of thrifts to meet the financial needs of their communities.

The "Volcker Rule"

On December 10, 2013, the OCC, jointly with the FDIC, FRB, and the Securities and Exchange Commission (SEC), adopted final regulations implementing the requirements of section 619, also known as the "Volcker Rule".[3] Section 619 prohibits a banking entity from engaging in short-term proprietary trading of financial instruments and from owning, sponsoring, or having certain relationships with hedge funds or private equity funds (referred to here and in the final regulations as "covered funds"). Notwithstanding these prohibitions, section 619 permits certain financial activities, including market making, underwriting, risk-mitigating hedging, trading in Government obligations, and organizing and offering a covered fund.

[3] The Commodity Futures Trading Commission (CFTC) issued a separate rule adopting the same common rule text and a substantially similar preamble.

In accordance with the statute, the final regulations prohibit banking entities from engaging in impermissible proprietary trading and strictly limit their ability to invest in covered funds. At the same time, the regulations are designed to preserve market liquidity and allow banks to continue to provide important client-oriented services. As discussed later in this testimony, the OCC and the other agencies are currently working together to implement this rulemaking.

The agencies followed this rulemaking with an interagency interim final rule to permit banking entities to retain interests in certain CDOs backed primarily by TruPS. We issued this interim rule because of, and in response to, concerns expressed primarily by small institutions that they would otherwise have to divest instruments that the Dodd-Frank Act expressly allows for capital-raising purposes.

Annual Stress Tests

This OCC-only rule, issued on October 9, 2012, implements section 165(i)(2) of the Act by requiring banks with average total consolidated assets of $10 billion or greater to conduct annual "stress tests." The rule, which is consistent with and comparable to the stress test rules issued by the other Federal banking agencies, establishes methods for conducting stress tests, requiring that the tests be based on at least three different economic scenarios (baseline, adverse, and severely adverse). The rule also sets forth the form and content for reporting the test results and requires banks to publish a summary of the results. In addition, the rule divides banks into two categories, based on asset size, so that those with total consolidated assets between $10 and $50 billion and those with assets over $50 billion are subject to different test requirements, as well as reporting and disclosure deadlines.

Lending Limits

The OCC issued a final rule on June 25, 2013, implementing section 610 of the Act, which amended the national bank statutory lending limit at 12 U.S.C. 84. The rule revises the lending limits applicable to banks to include credit exposures arising from derivative transactions, as well as repurchase agreements, reverse repurchase agreements, securities lending transactions, and securities borrowing transactions.

Appraisals for Higher-Priced Mortgage Loans

On January 18, 2013, the OCC participated in the issuance of an interagency rule concerning appraisals for "higher-priced mortgage loans," which are loans secured by a consumer's home with interest rates above certain thresholds. The rule requires that creditors for higher-priced loans obtain appraisals that meet certain standards, notify loan applicants of the purpose of the appraisal, and give applicants for certain higher-priced mortgages a copy of the appraisal before advancing credit. In addition, if the seller acquired the property for a lower price during the 6 months before the sale and the price difference exceeds a certain threshold, a creditor must obtain a second appraisal at no cost to the consumer. This requirement for higher-priced home-purchase mortgage loans seeks to address fraudulent property flipping by ensuring that the property value increase was legitimate.

Collins Amendment

The OCC participated with the FDIC and FRB in issuing an interagency rule on June 11, 2011, that established a floor for the risk-based capital requirements applicable to the largest, internationally active banking organizations. This rule amended the advanced risk-based capital adequacy standards (the "advanced approaches rules") consistent with section 171(b) of the Act, known as the "Collins Amendment". Under the rule, a banking organization that has received approval to use the advanced approaches rules is required to meet the higher of the minimum requirements under the general risk-based capital rules or the minimum requirements under the advanced approaches rules.

Alternatives to External Credit Ratings

On June 13, 2012, the OCC published a rule implementing sections 939 and 939A of the Act. This rule removes references to external credit ratings from the OCC's noncapital regulations, including its regulation that sets forth the types of investment securities that banks may purchase, sell, deal in, underwrite, and hold. Banks must conduct their own analysis of whether a security is investment grade. In addition, the OCC, together with the other Federal banking agencies, removed all references to external credit ratings from their risk-based capital rules when we finalized the enhanced capital rule on October 11, 2013 (discussed below). For example, for securitization positions, the enhanced capital rule replaced a ratings-based approach with a non-ratings-based supervisory formula for determining risk-based capital requirements.

B. Rules In-Process

Swaps Margin Rule

The OCC, jointly with the FDIC, FRB, Federal Housing Finance Agency (FHFA), and Farm Credit Administration, published a proposal in 2011 to implement sections 731 and 764 of the Act by requiring covered swap entities to collect margin for their noncleared swaps and noncleared security-based swaps. Subsequently, the OCC, FDIC, and FRB participated in international efforts to coordinate the implementation of margin requirements among the G20 Nations. Following extensive public review and comment, the Basel Committee on Bank Supervision (Basel Committee) and the International Organization of Securities Commissions finalized an international framework in September of last year.

After considering the international framework and the comments we received on the U.S. proposal, the agencies decided to repropose the U.S. swaps margin rule. I am happy to report that last week I signed an interagency reproposal that imposes minimum initial margin and variation requirements for certain noncleared swaps and security-based swaps. The reproposal specifically seeks to avoid unnecessarily burdening both nonfinancial entities that use swap contracts to hedge commercial costs and smaller financial companies whose activities do not pose a risk to the financial system. The rule would reduce risk, increase transparency, and promote market integrity within the financial system by addressing the weaknesses in the regulation and structure of the swaps markets that the financial crisis revealed. The comment period on this reproposal is open for 60 days but, as previously noted in the OCC's Quarterly Report on Bank Trading and Derivatives Activities, we have already seen improvements in the overall collateralization rates for industry derivative exposures.

Credit Risk Retention

The OCC participated in the issuance of an interagency proposal in 2011 that established asset-backed securities requirements designed to motivate sponsors of securitization transactions to exercise due diligence regarding the quality of the loans they securitize. Under this proposal, a securitizer would have to retain a material economic interest in the credit risk of any asset that it transferred, sold, or conveyed to a third party. The agencies received over 10,000 comments on the proposal and concluded that the rulemaking would benefit from a second round of public review and comment.

In September 2013, the interagency group issued a reproposal. Although the reproposal includes significant changes from the original, its focus is the same—to ensure that sponsors are held accountable for the performance of the assets they securitize. The OCC and the other participating agencies expect to approve the final rule in the near future.

Incentive-Based Compensation Arrangements

The OCC, together with the FRB, FDIC, OTS, National Credit Union Administration, SEC, and FHFA, published a proposal on April 14, 2011, designed to ensure that certain financial institutions with more than $1 billion in assets structure their incentive compensation arrangements: (1) to balance risk and financial rewards; (2) to be compatible with effective controls and risk management; and (3) to be supported by strong corporate governance. Specifically, the proposal, which would implement section 956 of the Act, would require these institutions to report incentive-based compensation arrangements and prohibit arrangements that either provide excessive compensation or could expose an institution to inappropriate risks that could lead to material financial loss. In light of the thousands of comments that the agencies received on the proposal, as well as significant industry and international developments related to incentive-based compensation, the agencies continue to work on the rule. The completion of this rule is an OCC priority because of the impact that poorly structured incentive compensation can have on risk-taking behaviors and the overall safety and soundness of an institution. Finalizing this rule will reinforce and complement the risk management principles and heightened standards that we are implementing.

Retail Foreign Exchange Transactions

On July 14, 2011, the OCC issued a final retail foreign exchange transactions rule for OCC-regulated entities that engage in off-exchange transactions in foreign currency with retail customers, implementing section 742(c)(2) of the Act. The rule contains a variety of consumer protections, including margin requirements, required disclosures, and business conduct standards, on foreign exchange options, futures, and futures-like transactions with certain retail customers. To promote regulatory comparability, the OCC worked closely with the CFTC, SEC, FDIC, and FRB in de-

veloping this rule. On October 12, 2012, the OCC issued a proposal to amend this final rule in light of related CFTC and SEC rules, and we continue to work on finalizing this proposal.

Appraisal Management Companies

In April 2014, the OCC joined in the issuance of an interagency proposal to implement section 1473 of the Act, which sets forth minimum requirements for State registration and supervision of appraisal management companies (AMCs). (AMCs serve as intermediaries between appraisers and lenders and provide appraisal management services). The proposal: (1) provides that AMC-coordinated appraisals must adhere to applicable quality control standards; (2) facilitates State oversight of AMCs; and (3) ensures that States report to the Federal Financial Institutions Examination Council's (FFIEC) Appraisal Subcommittee the information needed to administer a national AMC registry. The agencies plan to issue a final rule in the near term.

Source of Strength

The OCC, FRB, and FDIC continue to work on an interagency basis to draft a proposal to implement section 616(d) of the Act to require bank and savings and loan holding companies, as well as other companies that control depository institutions, to serve as a "source of strength" for their subsidiary depository institutions. As we saw during the crisis, too often banks served as a source of strength for nonbank subsidiaries of their holding companies. This rulemaking will complement actions we have taken elsewhere to preserve the federally insured bank's financial health.

IV. Other Significant OCC Rulemaking Projects

The OCC, together with the FRB and FDIC, has proposed or finalized a number of other significant rules over the past 4 years. Many of these rules, although not mandated by the Dodd-Frank Act, share the same broad objectives and address many of the same concerns as the Act. Several of these rules result from international initiatives by groups such as the Basel Committee and, consistent with the Dodd-Frank Act, are intended to strengthen global capital and liquidity requirements and promote a more resilient banking sector. I describe these rules below.

Enhanced Liquidity Standards

On September 3, 2014, the OCC, FDIC, and FRB approved a final rule to implement the Basel Committee's liquidity coverage ratio in the United States. These standards address banking organizations' maintenance of sufficient liquidity during periods of acute short-term financial distress. Under the rule, large, internationally active banking organizations[4] are required to hold an amount of high quality liquid assets to cover 100 percent of their total net cash outflows over a prospective 30 calendar-day period.

The agencies are also working with the Basel Committee to develop a net stable funding ratio, which is intended to complement the liquidity funding ratio by enhancing long-term structural funding. It is expected that these liquidity standards, once fully implemented, will accompany the existing liquidity risk guidance and enhanced liquidity standards (issued by the FRB in consultation with the OCC and the FDIC) that are part of the heightened prudential standards required by section 165 of the Dodd-Frank Act.

Enhanced Capital Rule

Last year, the OCC, FDIC, and FRB issued a rule that comprehensively revises U.S. capital standards. Most revisions, including the narrowing of instruments that count as regulatory capital, will be phased in over several years. For large, internationally active banking organizations, this phase-in has already begun. For all other banks, the phase-in will begin in 2015.

The Basel Committee's efforts to revise the international capital framework shared many of the goals of the Dodd-Frank Act and addressed many of the same issues. For example, both the agencies' enhanced capital rule and the Dodd-Frank Act focus increased attention on efforts to address the excessive interconnectedness of financial sector exposures and to create incentives for the use of central clearing houses for over-the-counter derivatives. This capital rule and the Dodd-Frank Act require an improvement in the quality and consistency of regulatory capital by narrowing the instruments that count as regulatory capital. Furthermore, the enhanced capital rule establishes conservative, stringent capital standards, especially for large

[4] This category of institutions is defined as those with $250 billion or more in total consolidated assets or $10 billion or more in foreign financial exposure.

banking organizations, by increasing overall risk-based capital requirements and refining the methodologies for determining risk-weighted assets to better capture risk.

Supplementary Leverage Ratio

Regulatory capital standards in the U.S. have long included both risk-based capital and leverage ratio requirements. The Basel Committee's revisions to the international capital framework introduced a new leverage ratio requirement for large, internationally active banking organizations. The Federal banking agencies' supplementary leverage ratio implements this additional and stricter leverage requirement. Unlike the more broadly applicable leverage ratio, this supplementary leverage ratio adds off-balance sheet exposures into the measure of total leverage exposure (the denominator of the leverage ratio). The supplementary leverage ratio is a more demanding standard because large banking organizations often have significant off-balance sheet exposures arising from different types of commitments, derivatives, and other activities.

Earlier this year, to further strengthen the resilience of the banking sector, the Federal banking agencies finalized a rule that enhances the supplementary leverage ratio requirement for the largest, most systemically important U.S. banking organizations (those with $700 billion or more in total consolidated assets or $10 trillion or more in assets under custody). Under this rule, these banking organizations will be required to maintain even more Tier 1 capital for every dollar of exposure in order to be deemed "well capitalized."

Last week, the OCC and other Federal banking agencies approved a final rule that further strengthens the supplementary leverage ratio by more appropriately capturing a banking organization's potential exposures. In particular, the revisions contained in this final rule will better capture leverage embedded in a bank's buying and selling of credit protection through credit derivatives. This should further improve our assessment of leverage at the largest banks that are the most involved in the credit derivatives business.

V. Coordination With Domestic and International Regulators

The Committee has also asked us to report on the OCC's efforts to better coordinate with other domestic and international regulators. The OCC, FDIC, and FRB have a long history of cooperative and productive relationships, through a combination of formal agreements, informal working groups, and the FFIEC. For example, although the OCC, FDIC, and FRB each has its own infrastructure, focus, and responsibilities, we work together to foster a coordinated and cohesive supervisory approach that minimizes overlaps and avoids supervisory gaps. This allows each agency to deploy its resources effectively and leverage supervisory work products. It also allows for the timely communication of supervisory risks, concerns, priorities, and systemic information, while reducing the supervisory burden on our institutions and the agencies. In addition, I am very pleased to report that the OCC and SEC recently signed a Memorandum of Understanding to facilitate sharing and coordination between our two agencies.

We have extended this network to include collaboration with the Bureau of Consumer Financial Protection (CFPB) and State banking regulators. For example, we have protocols in place to share information with the CFPB, and we work together to schedule exams and coordinate other supervisory activities. In addition, the OCC is engaged in the Financial Stability Oversight Council, which the Dodd-Frank Act established to help identify and respond to emerging risks across the financial system. Together, these relationships allow agencies to share and compare insights and expertise and to reduce duplication.

Implementation of the Volcker Rule is another important area where we are working together with other agencies to coordinate our supervisory strategies and our interpretive approaches. An informal, interagency staff-level working group meets regularly to discuss interpretive issues common to all of the agencies with a goal of developing and publishing uniform answers to frequently asked questions. The agencies published the first set of "Frequently Asked Questions" on their respective Web sites on June 10, 2014. In addition, the agencies are discussing how the collaborative approach to supervision in use among the banking agencies could be expanded to include the SEC and the CFTC for purposes of Volcker compliance supervision. I strongly support a supervisory approach that promotes orderly, coherent supervision by the agencies involved in implementing the Volcker Rule, and I look forward to our ongoing cooperation toward that end.

The interconnectedness of the global financial system has also increased the importance of effective international supervisory coordination and collaboration. As members of the Basel Committee, the OCC and the other U.S. Federal banking agencies played a critical role in developing international standards incorporating

many lessons learned since the financial crisis, such as those reflected in the agencies' enhanced capital rule. In addition, OCC staff serves on numerous Basel Committee working groups and chairs its Supervision and Implementation Group (SIG). The SIG has overseen the Basel Committee's recent work disseminating good practices on stress testing and business model analysis, as well as updating principles for bank governance, risk data aggregation, and the management of supervisory colleges.

The OCC, along with the FDIC and FRB, also regularly enters into arrangements with foreign regulators that broadly govern information access and sharing. The purpose of these arrangements, which include Memoranda of Understanding, statements of cooperation, and exchanges of letters, is to assist each regulator in obtaining the information necessary to carry out its respective supervisory responsibilities. They address issues including cooperation during the licensing process, the supervision of ongoing activities, and the handling of problem banks.

The OCC also plays an important role in international discussions concerning cross-border resolutions including through the Financial Stability Board's Cross-Border Crisis Management Group and the Legal Experts Group of the Resolutions Steering Group. In addition, the OCC participates in such discussions in firm-specific Crisis Management Groups and Supervisory Colleges and on a bilateral basis with prudential supervisors. For example, we have been working with the FDIC, FRB, SEC, and numerous foreign jurisdictions to develop agreements to facilitate coordination in future crises that affect significant, cross-border financial institutions.

VI. Emerging Issues: Cybersecurity

While it is essential that we learn lessons from history, it is unlikely that the challenges of tomorrow will take the same form as those of the past. The now regular and wide-scale reports of cyberattacks underscore the importance of cybersecurity and preparedness. It is clear that some of these attacks use increasingly sophisticated malware and tactics. With this in mind, I want to share with you what the OCC and our colleagues in the banking regulatory community are doing to address one of the most pressing concerns facing the financial services industry today—the operational risks posed by cyberattacks. There are few issues more important to me, to the OCC, and to our country's economic and national security than shoring up the industry's and our own defenses against cyberthreats.

In June 2013, the FFIEC, which I currently chair, announced the creation of the Cybersecurity and Critical Infrastructure Working Group (CCIWG). This group coordinates with intelligence, law enforcement, the Department of Homeland Security, and industry officials to provide member agencies with accurate and timely threat information. Within its first year, this working group released joint statements on the risks associated with "distributed denial of service" attacks, automated teller machine "cash-outs," and the wide-scale "Heartbleed" vulnerability. They held an industry webinar for over 5,000 community bankers and conducted a cybersecurity assessment of over 500 community institutions. The information from this assessment will help FFIEC members identify and prioritize actions that can enhance the effectiveness of cybersecurity-related guidance to community financial institutions.

The CCIWG is also working to identify gaps in the regulators' examination procedures and examiner training to further strengthen the banking industry's cybersecurity readiness and its ability to address the evolving and increasing cybersecurity threats. The OCC will continue to work with the institutions we supervise, our Federal financial regulatory colleagues, and others within Federal, State, and local governments as we address this ongoing threat to our financial system.

Conclusion

Thank you again for the opportunity to appear before you and to update the Committee on the OCC's continued efforts to implement the Dodd-Frank Act and other initiatives at the agency.

PREPARED STATEMENT OF RICHARD CORDRAY

ADIRECTOR, CONSUMER FINANCIAL PROTECTION BUREAU

SEPTEMBER 9, 2014

Chairman Johnson, Ranking Member Crapo, and Members of the Committee, thank you for the opportunity to testify today about the implementation of the Dodd-Frank Act. We appreciate your oversight and leadership as we all work to strengthen our financial system and to ensure that it serves both consumers and the long-term foundations of the American economy.

As you know, the Consumer Financial Protection Bureau is the Nation's first Federal agency whose sole focus is protecting consumers in the financial marketplace. The effects of the financial crisis—with millions of lost jobs, millions of lost homes, and tremendous declines in household wealth amounting to trillions of dollars—remain vivid in our collective experience. Although the damage done to individuals and communities was substantial, our country is finally recovering.

In passing the Dodd-Frank Act, Congress vested in this new Bureau the responsibility to stand on the side of consumers and to help restore their trust in the financial marketplace. Over the past 3 years, we have made considerable progress in fulfilling our rulemaking, supervisory, and enforcement responsibilities to protect people all across this country.

Our initial focus, as directed by Congress, was to address deep problems in the mortgage market that helped precipitate the financial crisis. We began by issuing a series of mortgage rules that took effect earlier this year. They require creditors to make reasonable, good faith assessments that borrowers are able to repay their loans; address pervasive problems in mortgage servicing that caused many homeowners to end up in foreclosure; regulate compensation practices for loan originators; and address various other practices that contributed to the housing crisis and ensuing financial meltdown. We have spent much of the last 20 months working intensively with industry, housing counselors, and other stakeholders to ensure that these rules are implemented smoothly according to the timelines established by Congress.

Last fall, we also issued another mortgage rule to accomplish a goal long urged in the Congress, which was to consolidate Federal mortgage disclosures under various laws. The new "Know Before You Owe" mortgage forms are streamlined and simplified to help consumers understand their options, choose the deal that is best for them, and avoid costly surprises at the closing table. We conducted extensive testing of the new forms before issuing a proposal and later to validate the results. The testing showed that consumers at very different levels of experience were able to understand the new forms better than the current forms. This rule takes effect about a year from now, and we again are working intensively to help industry implement the rule and to prepare educational materials that help consumers understand and use the new forms.

This summer, we also issued a proposed rule to implement changes Congress made to the Home Mortgage Disclosure Act. The point is to improve the quality of data available to monitor compliance with fair lending laws, public and private investment to meet housing needs, and general developments in the mortgage market. As with the redesign of the mortgage disclosure forms, we believe this rulemaking presents an opportunity to reduce unwarranted regulatory burdens. So we are looking closely at how to clarify existing requirements and streamline the processes and infrastructure for reporting this data. We have conducted detailed discussions with a group of small creditors to focus on their particular concerns, and we are now seeking broad public comment from all stakeholders on the proposed rule through the end of October.

As each of these initiatives proceeds, we are working diligently to monitor the effects of our rules on the mortgage market; make clarifications and adjustments to our rules where warranted; provide compliance guides, webinars, and other tools to facilitate the implementation process; and work closely with our fellow agencies to support their own regulatory initiatives. We are intent on making sure that these statutory and regulatory provisions achieve their intended goals. Right now, for instance, we are pursuing further research to determine how best to define the scope of statutory provisions for small creditors that operate predominantly in "rural or underserved" areas in order to promote access to credit in those areas.

We are also intensifying our focus on nonmortgage markets to address other pressing consumer financial protection issues. For example, we adopted a rule specified by Congress that fashioned the first comprehensive Federal consumer protections for international money transfers, often called remittances. We have also issued a series of rules defining the parameters of the Bureau's supervision authority over larger participants in certain financial markets, which enables us to impose supervisory oversight over their operations and activities. More of those rules are on their way. We are well into the process of developing proposed rules in several other areas, including prepaid cards, debt collection, and payday lending. And we are conducting intensive research on overdraft services and various other topics to determine what kind of rulemaking activity may be warranted in those areas.

Another key task for the Bureau has been to build effective supervision and enforcement programs to ensure compliance with Federal consumer financial laws. This work is critical to protect consumers, yet at the same time it is designed to create fair markets through evenhanded oversight. For the first time ever, this new

Federal agency has authority to supervise not only the larger banks but also a broad range of nonbank financial companies, including mortgage lenders and servicers, payday lenders, student loan originators and servicers, debt collectors, and credit reporting companies. As we have built and refined our supervision program, we have devised a system of risk-based prioritization to make the best use of our examination resources. This prioritization includes an assessment of potential consumer risk along with factors such as product market size, the entity's market share, the potential for consumer harm, and field and market intelligence that includes other factors such as management quality, prior regulatory history, and consumer complaints.

We strive to conduct effective examinations while minimizing unnecessary burden on supervised entities. Examinations typically involve work done both off site and on site, scoped to focus on areas posing the highest potential risks to consumers. We have made it a priority to coordinate the timing and substance of examination activities with our Federal and State regulatory partners. By these methods, our supervision program is helping to drive a cultural change within financial institutions that places more emphasis on compliance with the law and treating customers fairly. When examinations reveal legal violations, we require appropriate corrective action, including financial restitution to consumers. We are also insistent that institutions must have compliance management systems to prevent violations and ensure appropriate self-monitoring, correction, and remediation where violations have occurred. This work has strengthened compliance management at the large banks and caused many large nonbank firms to implement compliance management systems for the first time. Reinforcement of these expectations is helping to level the playing field for competitors across entire markets, regardless of charter or corporate form.

Our enforcement team is responsible for investigating possible violations of Federal consumer financial laws and enforcing the law through administrative and judicial proceedings. Consistent enforcement of the laws under our jurisdiction benefits consumers, honest businesses, and the economy as a whole. To date, our enforcement actions amount to $4.7 billion in relief for roughly 15 million consumers who were harmed by illegal practices.

Let me give just a few recent examples. Along with officials in 49 States, we took action against the Nation's largest nonbank mortgage loan servicer for misconduct at every stage of the mortgage servicing process. A Federal court consent order requires the company to provide $2 billion in principal reduction to underwater borrowers and to refund $125 million to nearly 185,000 borrowers who had already been foreclosed upon. We also partnered with 13 State attorneys general to obtain $92 million in debt relief for about 17,000 servicemembers and others harmed by a company's predatory lending scheme involving inflated prices for electronics where the actual annual percentage rate charged exceeded 100 percent more than six times the rate that was disclosed to servicemembers and other consumers.

We worked with the Department of Justice on two significant matters. First, we secured an order from a Federal district court in Pennsylvania requiring a bank to pay $35 million to African American and Hispanic borrowers who were charged higher prices on mortgage loans than nonminority borrowers. Second, we ordered one of the largest indirect auto lenders to pay $80 million in damages to 235,000 Hispanic, African American, and Asian and Pacific Islander borrowers because of discriminatory practices in "marking up" interest rates on auto loans to rates higher than those charged to similarly situated white borrowers. The $80 million refund to consumers and $18 million civil penalty stand as the largest amount of relief that the Federal Government has ever secured in a case of auto loan discrimination.

We also took action against two of the Nation's largest payday lenders for violations of the law. In one of the actions, we secured complete consumer refunds of up to $14 million and a $5 million civil penalty from a company for robo-signing court documents related to debt collection lawsuits, illegally overcharging servicemembers in violation of the Military Lending Act, and destroying records in advance of our examination. In the other matter, we determined after an investigation that the company used illegal debt collection tactics—including harassment and false threats of lawsuits or criminal prosecution—to bully overdue borrowers into taking out new payday loans with expensive fees despite their demonstrated inability to repay their existing loans. The company will pay $10 million in restitution and penalties. In both matters, injunctive relief has been imposed to prevent such misconduct from recurring in the future.

At the heart of our mission is the premise that consumers deserve to have someone stand on their side and make sure they are treated fairly in the financial marketplace. Since the day we opened our doors and received our first few hundred consumer complaints, we have now handled nearly 440,000 complaints and secured both monetary and nonmonetary relief on behalf of tens of thousands of individual consumers, including many people in each of your States.

Consumers should also have the tools and information they need to navigate financial choices. We have developed consumer resources such as the "Ask CFPB" feature on our Web site, which allows consumers to find answers to more than a thousand common financial questions and has been visited by more than 3.3 million unique visitors. We developed "Know Before You Owe" tools to make the costs and risk of financial products more clear. We also worked with the Department of Education to develop the "Financial Aid Shopping Sheet", which has now been adopted by more than 2,000 colleges and universities to help students make apples-to-apples comparisons of college costs. We constantly engage in extensive outreach efforts, and our Office of Servicemember Affairs, led by Holly Petraeus, has visited 91 military installations and units to hear concerns and share information with servicemembers.

All of our work has benefited by the engagement of millions of Americans, and our constructive dialogue with financial institutions, including community banks and credit unions in regular meetings all around the country. My outstanding colleagues at the Consumer Bureau, as well as the leaders of our fellow agencies represented on this panel, are strongly dedicated to a shared vision of a healthy consumer financial marketplace and we continue to work very well together in pursuit of that goal.

Thank you and I look forward to your questions.

PREPARED STATEMENT OF MARY JO WHITE

CHAIR, SECURITIES AND EXCHANGE COMMISSION

SEPTEMBER 9, 2014

Chairman Johnson, Ranking Member Crapo, and Members of the Committee, thank you for inviting me to testify about the Securities and Exchange Commission's ("SEC" or "Commission") ongoing implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act" or "Act") to reduce systemic risks, enhance transparency and better protect investors, as well as other steps taken to improve financial stability, close regulatory gaps, and better coordinate with domestic and international regulators. [1]

The Dodd-Frank Act gave the SEC significant new responsibilities, requiring the agency to undertake the largest and most complex rulemaking agenda in its history. The Act includes some 90 provisions that require SEC rulemaking and more than 20 other provisions that require studies or reports. In addition, the Act and the financial crisis focused the SEC's efforts more directly on enhancing financial stability and the reduction of systemic risk.

The SEC has made substantial progress implementing this agenda, even as we have continued our core responsibilities of pursuing securities violations, reviewing public company disclosures and financial statements, inspecting the activities of regulated entities, and maintaining fair and efficient markets, including enhancements to our equity market structure.

Since I became SEC Chair in April of 2013, the Commission has focused on eight key areas addressed by the Dodd-Frank Act: credit rating agencies; asset-backed securities; municipal advisors; asset management, including regulation of private fund advisers; over-the-counter derivatives; clearance and settlement; proprietary activities by financial institutions; and executive compensation. In furtherance of those regulatory objectives, the Commission has, to date, implemented new restrictions on the proprietary activities of financial institutions through the Volcker Rule, created a wholly new regulatory framework for municipal advisors, and advanced significant new standards for the clearing agencies that stand at the center of our financial system. We also have finalized critical Dodd-Frank Act rules intended to strengthen the integrity of credit ratings, reducing conflicts of interest in ratings and improving their transparency. We have adopted significantly enhanced disclosures for asset-backed securitizations and completed structural and operational reforms to address risks of investor runs in money market funds. We have pushed forward new rules for previously unregulated derivatives and begun implementing additional executive compensation disclosures. And we have put in place strong new controls on broker-dealers that hold customer assets, reduced reliance on credit ratings, and barred bad actors from private securities offerings. Since April 2013, the SEC has proposed or adopted nearly 20 significant Dodd-Frank Act rules, in addition to adopting structural reforms for money market funds, which were highlighted as a systemic vulner-

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[1] The views expressed in this testimony are those of the Chair of the Securities and Exchange Commission and do not necessarily represent the views of the full Commission.

ability in the financial crisis. Attached as Appendix A is a detailed summary of the agency's required Dodd-Frank Act rulemaking, which reflects that the Commission has proposed or adopted rules with respect to approximately 90 percent of all of the provisions of the Dodd-Frank Act that mandate Commission rulemaking.

We have worked closely with our fellow financial regulators to ensure that our financial regulatory system works together to protect against risks, both by promoting financial stability and supporting a sensible and integrated financial regulatory framework that works effectively for market participants. The Financial Stability Oversight Council (FSOC) established by the Dodd-Frank Act, in which I participate as a member, also serves an important role in this effort.

While the SEC has made significant progress, more remains to be done on both our Dodd-Frank Act and Jumpstart Our Business Startups (JOBS) Act rulemakings, and we must continue our work with intensity. As we do so, we must be deliberate as we consider and prioritize our remaining mandates and deploy our broadened regulatory authority, supported by robust economic analysis. Progress will ultimately be measured based on whether we have implemented rules that create a strong and effective regulatory framework and stand the test of time under intense scrutiny in rapidly changing financial markets. Our responsibility is much greater than simply "checking the box" and declaring the job done. We must be focused on fundamental and lasting reform.

As requested by the Committee, my testimony today will provide an overview of the Commission's Dodd-Frank Act implementation and discuss those rules that are yet to be completed.

Credit Ratings

The Dodd-Frank Act requires the Commission to undertake a number of rulemakings related to nationally recognized statistical rating organizations (NRSROs). The Commission began the process of implementing these mandates with the adoption of a rule in January 2011[2] requiring NRSROs to provide a description of the representations, warranties, and enforcement mechanisms available to investors in an offering of asset-backed securities, including how they differ from those of similar offerings. Last month, the Commission completed its required rulemaking for NRSROs by adopting rules requiring NRSROs to, among other things: (1) report on internal controls; (2) protect against potential conflicts of interest; (3) establish professional standards for credit analysts; (4) publicly provide—along with the publication of a credit rating—disclosure about the credit rating and the methodology used to determine it; and (5) enhance their public disclosures about the performance of their credit ratings.[3] These rules create an extensive framework of robust reforms and will significantly strengthen the governance of NRSROs. The reforms will also significantly enhance the transparency of NRSRO activities and thereby promote greater scrutiny and accountability of NRSROs. Together, this package of reforms should improve the overall quality of NRSRO credit ratings and protect against the reemergence of practices that contributed to the recent financial crisis.

The Dodd-Frank Act also mandated three studies relating to credit rating agencies: (1) a study on the feasibility and desirability of standardizing credit rating terminology, which was published in September 2012;[4] (2) a study on alternative compensation models for rating structured finance products, which was published in December 2012;[5] and (3) a study on NRSRO independence, which was published in November 2013.[6] In response to the study on alternative compensation models for rating structured finance products, the Commission held a public roundtable in May 2013 to invite discussion regarding, among other things, the courses of action discussed in the report. The staff has considered the various viewpoints presented dur-

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[2] See Release No. 33-9175, "Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act" (January 20, 2011), *http://www.sec.gov/rules/final/2011/33-9175.pdf.* In addition, pursuant to Section 939B of the Act, the Commission issued an amendment to 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. See Release No. 33-9146, "Removal from Regulation FD of the Exemption for Credit Rating Agencies" (September 29, 2010), *http://www.sec.gov/rules/final/2010/33-9146.pdf.*

[3] See Release No. 34-72936, "Nationally Recognized Statistical Rating Organizations" (August 27, 2014), *http://www.sec.gov/rules/final/2014/34-72936.pdf.*

[4] Credit Rating Standardization Study (September 2012), *http://www.sec.gov/news/studies/2012/939h_credit_rating_standardization.pdf.*

[5] Report to Congress on Assigned Credit Ratings (December 2012), *http://www.sec.gov/news/studies/2012/assigned-credit-ratings-study.pdf.*

[6] Report to Congress on Credit Rating Agency Independence Study (November 2013), *http://www.sec.gov/news/studies/2013/credit-rating-agency-independence-study-2013.pdf.*

ing discussion at the roundtable, as well as in the related public comment letters, and is discussing potential approaches with the Commission.

As required by the Dodd-Frank Act, the Commission established an Office of Credit Ratings (OCR) charged with administering the rules of the Commission with respect to NRSROs, promoting accuracy in credit ratings issued by NRSROs, and helping to ensure that credit ratings are not unduly influenced by conflicts of interest and that NRSROs provide greater disclosure to investors. As required by the Dodd-Frank Act, OCR conducts examinations of each NRSRO at least annually and the Commission makes available to the public an annual report summarizing the essential exam findings. The third annual report of the staff's examinations was published in December 2013.[7]

The Dodd-Frank Act also requires the SEC, to the extent applicable, to review its regulations that require use of credit ratings as an assessment of the creditworthiness of a security, remove these references, and replace them with appropriate standards of creditworthiness. The Commission has adopted final amendments that remove references to credit ratings from most of its rules and forms that contained such references, including rules adopted in December 2013 removing references to credit ratings in certain provisions applicable to investment companies and broker-dealers,[8] and in August 2014 new requirements to replace the credit rating references in shelf eligibility criteria for asset-backed security offerings with new shelf eligibility criteria.[9]

Asset-Backed Securities

The Commission has completed implementing several significant provisions of the Dodd-Frank Act related to asset-backed securities (ABS), and I have focused the staff and Commission on finalizing the remaining mandates. Within a year of the enactment of the Act, the Commission adopted rules to implement Sections 943 and 945 of the Act. The rules implementing Section 943 require ABS issuers to disclose the history of repurchase requests received and repurchases made relating to their outstanding ABS.[10] The rules implementing Section 945 require an asset-backed issuer in offerings registered under the Securities Act of 1933 (Securities Act) to perform a review of the assets underlying the ABS that must be designed and effected to provide reasonable assurance that the prospectus disclosure about the assets is accurate in all material respects and disclose the nature of such review.[11] Shortly after the 1-year anniversary of the Act, the Commission adopted rules in connection with Section 942(a) of the Act, which eliminated the automatic suspension of the duty to file reports under Section 15(d) of the Exchange Act for ABS issuers and granted the Commission authority to issue rules providing for the suspension or termination of this duty to file reports.[12]

Just last month, the Commission adopted expansive new requirements for enhanced disclosures for ABS, including requiring standardized asset-level data for certain asset classes.[13] For those asset classes, the new requirements implement Section 942(b) of the Act, which directed the Commission to adopt regulations to re-

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[7] 2013 Summary Report of Commission Staff's Examinations of Each Nationally Recognized Statistical Rating Organization (December 2013), *http://www.sec.gov/news/studies/2013/nrsro-summary-report-2013.pdf.*

[8] See Release No. 34-60789, "References to Ratings of Nationally Recognized Statistical Rating Organizations", (October 5, 2009) (pre- Dodd-Frank Act adopting amendments to remove references to credit ratings in certain Commission rules) *http://www.sec.gov/rules/final/2009/34-60789.pdf;* Release No. 33-9245, "Security Ratings", (July 27, 2011) (post- Dodd-Frank Act adopting amendments to remove references to credit ratings in certain Commission rules) *http://www.sec.gov/rules/final/2011/33-9245.pdf;* Release No. 33-9506, "Removal of Certain References to Credit Ratings Under the Investment Company Act", (December 27, 2013) (post-Dodd-Frank Act adopting amendments to remove references to credit ratings in certain Commission rules), *http://www.sec.gov/rules/final/2013/33-9506.pdf;* Release No. 34-71194, "Removal of Certain References to Credit Ratings Under the Securities Exchange Act of 1934", (December 27, 2013) (post- Dodd-Frank Act adopting amendments to remove references to credit ratings in certain Commission rules), *http://www.sec.gov/rules/final/2013/34-71194.pdf.*

[9] See Release No. 34-72936, "Nationally Recognized Statistical Rating Organizations" (August 27, 2014), *http://www.sec.gov/rules/final/2014/34-72936.pdf.*

[10] See Release No. 33-9175, "Disclosure for Asset-Backed Securities Required by Section 943 of the Dodd-Frank Wall Street Reform and Consumer Protection Act" (January 20, 2011), *http://www.sec.gov/rules/final/2011/33-9175.pdf.*

[11] See Release No. 33-9176, "Issuer Review of Assets in Offerings of Asset-Backed Securities" (January 20, 2011), *http://www.sec.gov/rules/final/2011/33-9176.pdf.*

[12] See Release No. 34-65148, "Suspension of the Duty To File Reports for Classes of Asset-Backed Securities Under Section 15(d) of the Securities Exchange Act of 1934" (August 17, 2011), *http://www.sec.gov/rules/final/2011/34-65148.pdf.*

[13] See Release No. 33-9638, "Asset-Backed Securities Disclosure and Registration" (August 27, 2014), *http://www.sec.gov/rules/final/2014/33-9638.pdf.*

quire asset-level information to the extent necessary for investors to independently perform due diligence. The final rules require that prospectuses and ongoing reports of securities backed by assets related to real estate or automobiles, or backed by debt securities, contain detailed asset-level information about each of the assets in the pool. The Commission continues to consider whether asset-level disclosure would be useful to investors across other asset classes. The rules also provide investors with more time to consider transaction-specific information, including information about the pool assets. These measures should better protect investors in these markets by providing important data and other information that will allow investors to conduct diligence on asset-backed securities that is independent of a credit rating agency. Although not mandated by the Dodd-Frank Act, the staff continues to monitor the private placement securitization markets to determine whether they should recommend advancing similar measures for those markets.

In addition, the Commission is working with other Federal regulators to jointly develop risk retention rules, as required by Section 941 of the Act. These rules will address the appropriate amount, form, and duration of required risk retention for securitizers of ABS. In March 2011, the Commission joined its fellow regulators in proposing rules to implement Section 941[14] and, after careful consideration of the many comments received, in August 2013 reproposed these rules with several significant modifications.[15] Together with the other agencies, we have made significant progress toward developing a final rule and we are nearing the final stages of that rulemaking.

In September 2011, the Commission proposed a rule to implement Section 621 of the Act, which prohibits entities that create and distribute ABS from engaging in transactions that involve or result in material conflicts of interest with respect to the investors in such ABS.[16] The proposed rule would prohibit underwriters and other "securitization participants" from engaging in such transactions with respect to both nonsynthetic and synthetic asset-backed securities, whether in a registered or unregistered offering. The proposal is not intended to prohibit legitimate securitization activities, and the Commission asked questions in the release to help strike an appropriate balance. The proposal generated substantial comment that included requests for significant alterations to the proposed rule, which the staff is carefully considering in preparing its recommendation for consideration by the Commission.

Municipal Securities

The Dodd-Frank Act imposed a new requirement that "municipal advisors" register with the SEC. This registration requirement applies to persons who provide advice to municipal entities or obligated persons on municipal financial products or the issuance of municipal securities, or who solicit municipal entities or obligated persons.[17] In September 2013, the Commission adopted final rules for municipal advisor registration.[18] The new registration requirements and regulatory standards aim to address problems observed with the conduct of some municipal advisors, including failure to place the duty of loyalty to their municipal entity client ahead of

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[14] See Release No. 34-64148, "Credit Risk Retention" (March 30, 2011), *http://www.sec.gov/rules/proposed/2011/34-64148.pdf.* Section 941 of the Act generally requires the Commission, the Federal Reserve Board, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency and, in the case of the securitization of any "residential mortgage asset," the Federal Housing Finance Agency and Department of Housing and Urban Development, to jointly prescribe regulations that require a securitizer to retain not less than 5 percent of the credit risk of any asset that the securitizer, through the issuance of an ABS, transfers, sells, or conveys to a third party. It also provides that the jointly prescribed regulations must prohibit a securitizer from directly or indirectly hedging or otherwise transferring the credit risk that the securitizer is required to retain. See 15 U.S.C. §78o-11(c)(1)(A).

[15] See Release No. 33-34-70277, "Credit Risk Retention" (August 28, 2013), *http://www.sec.gov/rules/proposed/2013/34-70277.pdf.*

[16] See Release No. 34-65355, "Prohibition Against Conflicts of Interest in Certain Securitizations" (September 19, 2011), *http://www.sec.gov/rules/proposed/2011/34-65355.pdf.*

[17] In September 2010, the Commission adopted, and subsequently extended, an interim final rule establishing a temporary means for municipal advisors to satisfy the registration requirement. See Release No. 34-62824, "Temporary Registration of Municipal Advisors", (September 1, 2010), *http://www.sec.gov/rules/interim/2010/34-62824.pdf.* The Commission received over 1,200 confirmed registrations of municipal advisors pursuant to this temporary rule.

[18] See "Registration of Municipal Advisors", Release No. 34-70462 (September 20, 2013), *http://www.sec.gov/rules/final/2013/34-70462.pdf.* See also "Registration of Municipal Advisors Frequently Asked Questions" (issued on January 10, 2014, and last updated on May 19, 2014), *http://www.sec.gov/info/municipal/mun-advisors-faqs.pdf.* The staff in the Office of Municipal Securities provided this interpretive guidance to address certain questions that arose from municipal market participants relating to the implementation of the final rules.

their own interests, undisclosed conflicts of interest, advice rendered by financial advisors without adequate training or qualifications, and "pay to play" practices.

Municipal advisors were required to comply with the final rules as of July 1, 2014,[19] and to register with the SEC using the final registration forms during a 4-month phased-in compliance period, which began on July 1, 2014.[20] Except for certain personally identifiable information, the SEC municipal advisor registration information is available to the public through the SEC's Electronic Data Gathering, Analysis, and Retrieval (EDGAR) system Web site.[21]

In addition, Commission staff in August of this year launched an examination initiative to conduct focused, risk-based examinations of municipal advisors.[22] These examinations will be specifically focused and shorter in duration than typical examinations. The initiative is designed both to provide targeted outreach to inform new municipal advisor registrants of their obligations as registered entities and to permit the Commission to examine a significant percentage of new municipal advisor registrants. Additionally, Commission staff will oversee the Financial Industry Regulatory Authority (FINRA) staff in its examinations of municipal advisors that are also FINRA members.

The Dodd-Frank Act also required the Commission to establish an Office of Municipal Securities (OMS), reporting directly to the Chair, to administer the rules pertaining to broker-dealers, municipal advisors, investors and issuers of municipal securities, and to coordinate with the Municipal Securities Rulemaking Board (MSRB) on rulemaking and enforcement actions.[23] During its first 2 years of operations, OMS devoted its attention primarily to finalizing and implementing the municipal advisor registration rules, including providing interpretive guidance to market participants and participating in the review of municipal advisor registrations. Over the next year, OMS expects to continue to devote significant attention to implementing these final rules, to review a considerable number of rule filings by the MSRB related to municipal advisor regulation, and to coordinate with SEC examination staff in their examinations of municipal advisors. In addition, OMS also continues to monitor current issues in the municipal securities market (such as pension disclosure, accounting, and municipal bankruptcy issues) and to assist in considering further recommendations to the Commision with respect to disclosure, market structure, and price transparency in the municipal securities markets.[24]

Private Fund Adviser Registration and Reporting

Title IV of the Dodd-Frank Act directed the Commission to implement a number of provisions designed to enhance the oversight of private fund advisers, including registration of advisers to hedge funds and other private funds that were previously exempt from SEC registration. These provisions enable regulators to have a more comprehensive view of private funds and the investment advisers managing those assets.

The SEC's implementation of required rulemaking under Title IV is complete. In June 2011, the Commission adopted rules requiring advisers to hedge funds and other private funds to register by March 2012, addressing what had once been a sizable gap in regulators' ability to monitor for systemic risk and potential misconduct.[25] As a result of the Dodd-Frank Act and the SEC's new rules, the number of SEC-registered private fund advisers has increased by more than 50 percent to 4,322 advisers. Even after accounting for the shift of mid-sized advisers to State registration pursuant to the Dodd-Frank Act,[26] the total amount of assets managed by SEC-registered advisers has increased significantly from $43.8 trillion in April 2011 to $62.3 trillion in August 2014, while the total number of SEC-registered advisers has remained relatively unchanged from 11,505 to 11,405.

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[19] See Release No. 34-71288, "Registration of Municipal Advisors"; Temporary Stay of Final Rule, (January 13, 2014), *http://www.sec.gov/rules/final/2014/34-71288.pdf.*

[20] The final rules require municipal advisors to register with the SEC by completing a Form MA and to provide information regarding natural persons associated with the municipal advisor and engaged in municipal advisory activities on such municipal advisor's behalf by completing a Form MA-I for each such natural person.

[21] To search by a municipal advisor company's name, see *http://www.sec.gov/edgar/searchedgar/companysearch.html.*

[22] See "Industry Letter for the Municipal Advisor Examination Initiative" (August 19, 2014), available at: *http://www.sec.gov/about/offices/ocie/muni-advisor-letter-081914.pdf.*

[23] See Section 979 of the Dodd-Frank Act.

[24] See recommendations in the "Commission's Report on the Municipal Securities Market" (July 31, 2012), *http://www.sec.gov/news/studies/2012/munireport073112.pdf.*

[25] See Release No. IA-3221, "Rules Implementing Amendments to the Investment Advisers Act of 1940" (June 22, 2011), *http://www.sec.gov/rules/final/2011/ia-3221.pdf.*

[26] Id.

For private fund advisers required to be registered with the Commission, pursuant to the Dodd-Frank Act the Commission adopted confidential systemic risk reporting requirements on Form PF in October 2011 to assist the FSOC in systemic risk oversight.[27] As required by the Act, Form PF was designed in consultation with FSOC, and the data filed on Form PF has been made available to the Office of Financial Research within the Department of the Treasury.

To date, approximately 2,700 investment advisers have filed Form PF reporting information on approximately 8,000 hedge funds, 70 liquidity funds, and 7,000 private equity funds. During the past year, the Commission's staff has focused its efforts on utilizing Form PF data in examinations and investigations of private fund advisers, using Form PF data in the Commission's risk monitoring activities, providing additional guidance to filers, and working with other Federal regulators and international organizations regarding issues relating to private fund advisers. As required by the Dodd-Frank Act, Commission staff transmitted an annual report to Congress this past August on these uses.[28]

During the past 2 years, Commission staff reviewed the Advisers Act and its rules and provided guidance regarding their application to private fund advisers, including guidance to clarify: the application of the custody rule when advisers to audited private funds utilize special purpose vehicles;[29] how the custody rule applies to escrows utilized by private fund advisers upon the sale of a portfolio company;[30] when an adviser to an audited private fund may itself maintain custody of private stock certificates instead of holding them at a third-party custodian;[31] the definition of "knowledgeable employees" for purposes of the Investment Company Act;[32] when certain private fund investors are "qualified clients" under the Advisers Act;[33] and the application of the venture capital exemption in certain common scenarios.[34]

In addition, I anticipate that in October 2014, Commission staff will conclude a 2-year initiative to conduct focused, risk-based exams of newly registered private fund advisers. These "presence" examinations have been shorter in duration and more streamlined than typical examinations, and have been designed both to engage with the new registrants to inform them of their obligations as registered entities and to permit the Commission to examine a higher percentage of new registrants. The initiative has included outreach, as well as examinations that have focused on five critical areas: (1) marketing; (2) portfolio management; (3) conflicts of interest; (4) safety of client assets; and (5) valuation. As of early September 2014, staff had completed approximately 340 examinations of newly registered private fund advisers, and over 40 additional examinations are underway.

Over-the-Counter Derivatives

The Dodd-Frank Act established a new oversight regime for the over-the-counter derivatives marketplace. Title VII of the Act requires the Commission to regulate "security-based swaps" and to write rules that address, among other things: mandatory clearing and the end-user exemption; trade reporting and trade execution; the operation of clearing agencies, trade data repositories, and trade execution facilities; capital, margin, and segregation requirements and business conduct standards for dealers and major market participants; and public transparency for transactional information. Such rules are intended to achieve a number of goals, including:

- Facilitating the centralized clearing of security-based swaps, whenever possible and appropriate, with the intent of reducing counterparty and systemic risk;

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[27] See Release No. IA-3308, "Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF"; Joint Final Rule (October 21, 2011), *http://www.sec.gov/rules/final/2011/ia-3308.pdf.*

[28] See "Annual Staff Report Regarding the Use of Data Collected from Private Fund Systemic Risk Reports" (August 15, 2014), *http://www.sec.gov/reportspubs/special-studies/im-private-fund-annual-report-081514.pdf.*

[29] See "IM Guidance Update 2014-08, Private Funds and the Application of the Custody Rule to Special Purpose Vehicles and Escrows" (June 2014), *http://www.sec.gov/investment/im-guidance-2014-07.pdf.*

[30] Id.

[31] See "IM Guidance Update 2013-04, Privately Offered Securities under the Investment Advisers Act Custody Rule" (August 2013), *http://www.sec.gov/divisions/investment/guidance/im-guidance-2013-04.pdf.*

[32] See "SEC No-Action Letter, Managed Funds Association" (February 6, 2014), *http://www.sec.gov/divisions/investment/noaction/2014/managed-funds-association-020614.htm.*

[33] See "IM Guidance Update 2013-10, Status of Certain Private Fund Investors as Qualified Clients" (November 2013), *http://www.sec.gov/divisions/investment/guidance/im-guidance-2013-10.pdf.*

[34] See "IM Guidance Update, Guidance on the Exemption for Advisers to Venture Capital Funds" (December 2013), *http://www.sec.gov/divisions/investment/guidance/im-guidance-2013-13.pdf.*

- Increasing transparency for market participants and regulators in their efforts to monitor the market and, as appropriate, address risks to financial stability;
- Increasing security-based swap transaction disclosure;
- Reducing counterparty and systemic risk through capital, margin and segregation requirements for nonbank dealers and major market participants; and
- Addressing potential conflict of interest issues relating to security-based swaps.

Since I testified before this Committee last February, the Commission has proposed rules relating to books and records [35] and proposed rules to enhance the oversight of clearing agencies deemed to be systemically important or that are involved in complex transactions, such as security-based swaps. [36] With these steps, the Commission has now proposed all the core rules required by Title VII of the Dodd-Frank Act.

Most recently, in June of this year, the Commission adopted the critical, initial set of cross-border rules and guidance, focusing on the swap dealer and major swap participant definitions. [37] The rules and guidance explain when a cross-border transaction must be counted toward the requirement to register as a security-based swap dealer or major security-based swap participant. The rules also address the scope of the SEC's cross-border antifraud authority. In addition, the Commission adopted a procedural rule regarding the submission of "substituted compliance" requests. This rule represents a major step in the Commission's efforts to establish a framework to address circumstances in which market participants may be subject to more than one set of comparable regulations across different jurisdictions.

These rules and guidance focus on a central aspect of the Commission's May 2013 comprehensive proposal regarding the application of Title VII to cross-border security-based swap transactions. [38] The cross-border application of other substantive requirements of Title VII will be addressed in subsequent releases, resulting in final rules in a particular substantive area that apply to the full range of security-based swap transactions, not just purely domestic ones. I believe that this integrated approach will reduce undue costs and provide a more orderly implementation process for both regulators and market participants. In addition, the Commission previously adopted a number of key definitional and procedural rules, provided a "roadmap" for the further implementation of its Title VII rulemaking, and took other actions to provide legal certainty to market participants during the implementation process.

Commission staff also continues to work intensively on recommendations for final rules required by Title VII that have been proposed but not yet adopted. These final rules will address regulatory reporting and post-trade public transparency; [39] security-based swap dealer and major security-based swap participant requirements, including business conduct and financial responsibility requirements; [40] mandatory

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[35] See "Recordkeeping and Reporting Requirements for Security-Based Swap Dealers, Major Security-Based Swap Participants, and Broker-Dealers; Capital Rule for Certain Security-Based Swap Dealers", Release No. 34-71958 (April 17, 2014), *http://www.sec.gov/rules/proposed/2014/34-71958.pdf.*

[36] See "Standards for Covered Clearing Agencies", Release No. 34-71699 (March 12, 2014), *http://www.sec.gov/rules/proposed/2014/34-71699.pdf.*

[37] See Release No. 34-72474, "Application of 'Security-Based Swap Dealer' and 'Major Security-Based Swap Participant' Definitions to Cross-Border Security-Based Swap Activities" (June 25, 2014), *http://www.sec.gov/rules/final/2014/34-72472.pdf.*

[38] See Release No. 34-69490, "Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants" (May 1, 2013), *http://sec.gov/rules/proposed/2012/34-68071.pdf.*

[39] See Release No. 34-63346, "Regulation SBSR—Reporting and Dissemination of Security-Based Swap Information" (November 19, 2010), *http://www.sec.gov/rules/proposed/2010/34-63346.pdf;* and Release No. 34-63347, "Security-Based Swap Data Repository Registration, Duties, and Core Principles" (November 19, 2010), *http://www.sec.gov/rules/proposed/2010/34-63347.pdf.* In 2013, the Commission reproposed Regulation SBSR. See Release No. 34-69490, "Cross-Border Security-Based Swap Activities; Re-Proposal of Regulation SBSR and Certain Rules and Forms Relating to the Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants" (May 1, 2013), *http://www.sec.gov/rules/proposed/2013/34-69490.pdf;* and Release No. 34-69491.

[40] See Release No. 34-65543, "Registration of Security-Based Swap Dealers and Major Security-Based Swap Participants" (October 12, 2011), *http://www.sec.gov/rules/proposed/2011/34-65543.pdf;* Release No. 34-68071, "Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers" (October 18, 2012), *http://www.sec.gov/rules/proposed/2012/34-68071.pdf;* Release No. 34-64766, "Business Conduct Standards for Security-Based Swaps Dealers and Major Security-Based Swap Participants" (June 29, 2011), *http://www.sec.gov/rules/proposed/2011/34-64766.pdf;* and Release No. 34-63727, "Trade Acknowledgment and Verification on Security-

clearing, the end-user exemption and trade execution, and the regulation of clearing agencies and security-based swap execution facilities;[41] and enforcement and market integrity, including swap-specific antifraud measures.[42] In addition, I expect that the Commission will soon consider the application of mandatory clearing requirements to single-name credit default swaps, starting with those that were first cleared prior to the enactment of the Dodd-Frank Act.

In March 2012, the Commission adopted rules providing exemptions under the Securities Act of 1933, the Securities Exchange Act of 1934, and the Trust Indenture Act of 1939 for security-based swaps transactions involving certain clearing agencies satisfying certain conditions. See Release No. 33-9308, "Exemptions for Security-Based Swaps Issued by Certain Clearing Agencies" (March 30, 2012), *http://www.sec.gov/rules/final/2012/33-9308.pdf.*

Clearing Agencies

Title VIII of the Dodd-Frank Act provides for increased regulation of financial market utilities[43] (FMUs) and financial institutions that engage in payment, clearing, and settlement activities designated as systemically important. The purpose of Title VIII is to mitigate systemic risk in the financial system and promote financial stability. In addition, Title VII of the Dodd-Frank Act requires, among other things, that an entity acting as a clearing agency with respect to security-based swaps register with the Commission and that the Commission adopt rules with respect to clearing agencies that clear security-based swaps.

Registration of Security-Based Swap Clearing Agencies

There are now three clearing agencies registered with the Commission to clear security-based swaps, and Commission staff maintains regular channels of communication with those clearing agencies regarding their operations. In 2013, the Commission also amended its established rule filing procedures to accommodate the special circumstances of clearing agencies registered with both the Commission and the Commodity Futures Trading Commission (CFTC) to help ensure that the new regulatory regime for security-based swaps operates as intended and without undue burdens on dually registered security-based swap clearing agencies.[44]

Clearing Agency Standards

To further the objectives of Title VIII and promote the integrity of clearing agency operations and governance, the Commission adopted rules in October 2012 requiring all registered clearing agencies to maintain certain standards with respect to risk management and certain operational matters.[45] The rules also contain specific requirements for clearing agencies that perform central counterparty services, such as provisions governing credit exposures and the financial resources of the clearing agency, and establish record keeping and financial disclosure requirements for all registered clearing agencies.

In March of this year, the Commission proposed a series of additional clearing agency standards.[46] The proposed rules would establish a new category of "covered clearing agency" subject to enhanced standards. The comment period on the pro-

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Based Swap Transactions" (January 14, 2011), *http://www.sec.gov/rules/proposed/2011/34-63727.pdf.*

[41] See Release No. 34-63556, "End-User Exception of Mandatory Clearing of Security-Based Swaps" (December 15, 2010), *http://www.sec.gov/rules/proposed/2010/34-63556.pdf;* Release No. 34-63107, "Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges With Respect to Security-Based Swaps under Regulation MC" (October 14, 2010), *http://www.sec.gov/rules/proposed/2010/34-63107.pdf;* and "Registration and Regulation of Security-Based Swap Execution Facilities" (February 2, 2011), *http://www.sec.gov/rules/proposed/2011/34-63825.pdf.*

[42] See Release No. 34-63236, "Prohibition Against Fraud, Manipulation, and Deception in Connection With Security-Based Swaps" (November 3, 2010), *http://www.sec.gov/rules/proposed/2010/34-63236.pdf.*

[43] Section 803(6) of the Dodd-Frank Act defines a financial market utility as "any person that manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and the person."

[44] See Release No. 34-69284, "Amendment to Rule Filing Requirements for Dually-Registered Clearing Agencies" (April 3, 2013), *http://www.sec.gov/rules/final/2014/34-69284.pdf.*

[45] See Release No. 34-68080, "Clearing Agency Standards" (October 22, 2012), *http://www.sec.gov/rules/final/2012/34-68080.pdf.*

[46] See Release No. 34-71699, "Standards for Covered Clearing Agencies" (March 12, 2014), *http://www.sec.gov/rules/proposed/2014/34-71699.pdf.*

posal closed in May 2014, and Commission staff is preparing a recommendation to the Commission for final rules.

The proposed rules benefited from consultations between the Commission staff and staffs of the CFTC and the Board of Governors of the Federal Reserve System (the "Board"), and are designed to further strengthen the Commission's oversight of securities clearing agencies and promote consistency in the regulation of clearing organizations generally, thereby helping to ensure that clearing agency regulation reduces systemic risk in the financial markets.

Systemically Important Clearing Agencies

Under Title VIII, FSOC is authorized to designate an FMU as systemically important if the failure or a disruption to the functioning of the FMU could create or increase the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the U.S. financial system. SEC staff participates in the interagency committee established by FSOC to develop a framework for the designation of systemically important FMUs. In July 2012, FSOC designated six clearing agencies registered with the Commission as systemically important FMUs under Title VIII.[47]

Title VIII also provides a framework for an enhanced supervisory regime for designated FMUs, including oversight in consultation with the Board and FSOC. The Commission is expected to consider regulations containing risk management standards for the designated FMUs it supervises, taking into consideration relevant international standards and existing prudential requirements for such FMUs.[48] The Commission also is required to examine such FMUs annually, and to consider certain advance notices identifying changes to its rules, procedures, or operations that could materially affect the nature or level of risks presented by the FMU in consultation with the Board.[49]

In June 2012, the Commission adopted rules that establish procedures for how it will address advance notices of significant rule filings from the FMUs,[50] and it has since considered a significant number of such notices.[51] Commission staff also has completed the second series of annual examinations of the designated FMUs for which it acts as supervisory agency and recently initiated the third series of annual examinations.

Volcker Rule

On December 10, 2013, the Commission joined the Board, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC) (collectively, the "Federal banking agencies"), and the CFTC in adopting the same rule under the Bank Holding Company Act to implement Section 619 of the Dodd-Frank Act, known as the "Volcker Rule".[52]

Consistent with Section 619, the final rule generally restricts "banking entities"—including bank-affiliated, SEC-registered broker-dealers, security-based swap deal-

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[47] Clearing agencies that have been designated systemically important are Chicago Mercantile Exchange, Inc., The Depository Trust Company, Fixed Income Clearing Corporation, ICE Clear Credit LLC, National Securities Clearing Corporation, and The Options Clearing Corporation.

[48] See Section 805(a)(2) of the Dodd-Frank Act. Commission staff also worked jointly with the staffs of the CFTC and the Board to submit a report required under the Dodd-Frank Act to Congress in July 2011 discussing recommendations regarding risk management supervision of clearing entities that are DFMUs. See also "Risk Management Supervision of Designated Clearing Entities", Report by the Commission, Board and CFTC to the Senate Committees on Banking, Housing, and Urban Affairs and Agriculture pursuant to Section 813 of Title VIII of the Dodd-Frank Act (July 2011), *http://www.sec.gov/news/studies/2011/813study.pdf.*

[49] See Section 806(e)(4) of the Dodd-Frank Act.

[50] See Release No. 34-67286, "Process for Submissions for Review of Security-Based Swaps for Mandatory Clearing and Notice Filing Requirements for Clearing Agencies"; Technical Amendments to Rule 19b-4 and Form 19b-4 Applicable to All Self-Regulatory Organizations (June 28, 2012), *http://www.sec.gov/rules/final/2012/34-67286.pdf.*

[51] Advance notices are published on the Commission Web site at *http://www.sec.gov/rules/sro.shtml.*

[52] See Release No. BHCA-1, "Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds" (December 10, 2013), *http://www.sec.gov/rules/final/2013/bhca-1.pdf.* The CFTC (CFTC) adopted the same rule on the same date. See *http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/federalregister121013.pdf.* On January 14, 2014, the Commission, together with the Federal banking agencies and the CFTC, approved a companion interim final rule that permits banking entities to retain interests in certain collateralized debt obligations backed primarily by trust preferred securities. See Release No. BHCA-2, "Treatment of Certain Collateralized Debt Obligations Backed Primarily by Trust Preferred Securities With Regard to Prohibitions and Restrictions on Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds" (January 17, 2014), *http://www.sec.gov/rules/interim/2014/bhca-2.pdf.*

ers, and investment advisers—from engaging in proprietary trading, sponsoring hedge funds and private equity funds, or investing in such funds.

As with any regulatory initiative of this scope and complexity, the final rule demands close attention to the nature and pace of implementation, particularly with respect to smaller banking entities. The Dodd-Frank Act provides a period for banking entities to bring their activities and investments into conformance with Section 619 that is scheduled to end on July 21, 2015. During the conformance period, the largest trading firms must begin to record and report certain quantitative measurements. The first of these data submissions were received on September 2. Staged implementation of metrics reporting and enhanced compliance standards will continue after the end of the conformance period based on size and activity thresholds. Among other benefits, this incremental approach will allow the agencies to review the data collection and revise or tailor its application, as appropriate.

Currently, the regulatory agencies and banking entities are closely focused on implementation of the final rule. The collaborative relationships among the agencies that developed during the rulemaking process are carrying forward and are supporting closely coordinated staff guidance and action. The interagency working group meets regularly to discuss implementation issues including, among other things, coordinated responses to interpretive questions, technical issues related to the collection of metrics data, and approaches to supervising and examining banking entities. In response to banking entities' interpretive questions on the final rule, the staffs of the agencies have published coordinated responses to frequently asked questions on various aspects of the rule. As banking entities seek to comply with the final rule and request additional guidance, I expect the interagency group to continue working together in this manner, as well as in the coordination of examinations for compliance with the final rule.

Corporate Governance and Executive Compensation

The Dodd-Frank Act includes a number of corporate governance and executive compensation provisions that require Commission rulemaking. Among others, such rulemakings include:

- *Say on Pay.* In accordance with Section 951 of the Act, in January 2011, the Commission adopted rules that require public companies subject to the Federal proxy rules to provide shareholder advisory say-on-pay, say-on-frequency and "golden parachute" votes on executive compensation.[53] The Commission also proposed rules to implement the Section 951 requirement that institutional investment managers report their votes on these matters at least annually.[54] Staff is working on draft final rules for this remaining part of Section 951 for the Commission's consideration in the near term.
- *Compensation Committee and Adviser Requirements.* In June 2012, the Commission adopted rules to implement Section 952 of the Act, which requires the Commission, by rule, to direct the national securities exchanges and national securities associations to prohibit the listing of any equity security of an issuer that does not comply with new compensation committee and compensation adviser requirements.[55] To conform their rules to the new requirements, national securities exchanges that have rules providing for the listing of equity securities

[53] See Release No. 33-9178, "Shareholder Approval of Executive Compensation and Golden Parachute Compensation" (January 25, 2011), *http://www.sec.gov/rules/final/2011/33-9178.pdf.*

[54] See Release No. 34-63123, "Reporting of Proxy Votes on Executive Compensation and Other Matters" (October 18, 2010), *http://www.sec.gov/rules/proposed/2010/34-63123.pdf.*

[55] See Release No. 33-9330, "Listing Standards for Compensation Committees" (June 20, 2012), *http://www.sec.gov/rules/final/2012/33-9330.pdf.*

filed proposed rule changes with the Commission.[56] The Commission issued final orders approving the proposed rule changes in January 2013.[57]

- *Pay Ratio Disclosure.* As required by Section 953(b) of the Act, in September 2013, the Commission proposed rules that would amend existing executive compensation rules to require public companies to disclose the ratio of the compensation of a company's chief executive officer to the median compensation of its employees.[58] The Commission has received over 128,000 comment letters on the proposal, including more than 1,000 unique comment letters. The staff is carefully considering those comments and is preparing recommendations for the Commission for a final rule.
- *Incentive-Based Compensation Arrangements.* Section 956 of the Dodd-Frank Act requires the Commission, along with multiple other financial regulators, to jointly adopt regulations or guidelines governing the incentive-based compensation arrangements of certain financial institutions, including broker-dealers and investment advisers with $1 billion or more of assets. Working with the other regulators, in March 2011, the Commission published for public comment a proposed rule that would address such arrangements.[59] The Commission has received a significant number of comment letters on the proposed rule, and I have asked the Commission staff to work with their fellow regulators to develop a recommendation to finalize rules to implement this provision.
- *Prohibition on Broker Voting of Uninstructed Shares.* Section 957 of the Act requires the rules of each national securities exchange to be amended to prohibit brokers from voting uninstructed shares in director elections (other than uncontested elections of directors of registered investment companies), executive compensation matters, or any other significant matter, as determined by the Commission by rule. The Commission has approved changes to the rules with regard to director elections and executive compensation matters for all of the national securities exchanges, and these rules are all now effective.[60]

The Commission also is required by the Act to adopt several additional rules related to corporate governance and executive compensation, including rules mandating new listing standards relating to specified "clawback" policies,[61] and new disclosure requirements about executive compensation and company performance,[62] and employee and director hedging.[63] The staff currently is developing recommendations for the Commission concerning the implementation of these provi-

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[56] See Release No. 34-68022 (October 9, 2012), *http://www.sec.gov/rules/sro/bats/2012/34-68022.pdf* (BATS Exchange, Inc.); Release No. 34-68020 (October 9, 2012), *http://www.sec.gov/rules/sro/cboe/2012/34-68020.pdf* (Chicago Board of Options Exchange, Inc.); Release No. 34-68033 (October 10, 2012), *http://www.sec.gov/rules/sro/chx/2012/34-68033.pdf* (Chicago Stock Exchange, Inc.); Release No. 34-68013 (October 9, 2012), *http://www.sec.gov/rules/sro/nasdaq/2012/34-68013.pdf* (Nasdaq Stock Market LLC); Release No. 34-68018 (October 9, 2012), *http://www.sec.gov/rules/sro/bx/2012/34-68018.pdf* (Nasdaq OMX BX, Inc.); Release No. 34-68039 (October 11, 2012), *http://www.sec.gov/rules/sro/nsx/2012/34-68039.pdf* (National Stock Exchange, Inc.); Release No. 34-68011 (October 9, 2012), *http://www.sec.gov/rules/sro/nyse/2012/34-68011.pdf* (New York Stock Exchange LLC); Release No. 34-68006 (October 9, 2012), *http://www.sec.gov/rules/sro/nysearca/2012/34-68006.pdf* (NYSEArca LLC); Release No. 34-68007 (October 9, 2012), *http://www.sec.gov/rules/sro/nysemkt/2012/34-68007.pdf* (NYSE MKT LLC).

[57] See Release No. 34-68643 (January 11, 2013), *http://www.sec.gov/rules/sro/bats/2013/34-68643.pdf* (BATS Exchange, Inc.); Release No. 34-68642 (January 11, 2013), *http://www.sec.gov/rules/sro/cboe/2013/34-68642.pdf* (Chicago Board of Options Exchange, Inc.); Release No. 34-68653 (January 14, 2013), *http://www.sec.gov/rules/sro/chx/2013/34-68653.pdf* (Chicago Stock Exchange, Inc.); Release No. 34-68640 (January 11, 2013), *http://www.sec.gov/rules/sro/nasdaq/2013/34-68640.pdf* (Nasdaq Stock Market LLC); Release No. 34-68641 (January 11, 2012), *http://www.sec.gov/rules/sro/bx/2013/34-68641.pdf* (Nasdaq OMX BX, Inc.); Release No. 34-68662 (January 15, 2012), *http://www.sec.gov/rules/sro/nsx/2013/34-68662.pdf* (National Stock Exchange, Inc.); Release No. 34-68635 (January 11, 2013), *http://www.sec.gov/rules/sro/nyse/2013/34-68635.pdf* (New York Stock Exchange LLC); Release No. 34-68638 (January 11, 2013), *http://www.sec.gov/rules/sro/nysearca/2013/34-68638.pdf* (NYSEArca LLC); Release No. 34-68637 (January 11, 2013), *http://www.sec.gov/rules/sro/nysemkt/2013/34-68637.pdf* (NYSE MKT LLC).

[58] See Release No. 33-9452, "Pay Ratio Disclosure" (September 18, 2013), *http://www.sec.gov/rules/proposed/2013/33-9452.pdf.*

[59] See Release No. 34-64140, "Incentive-Based Compensation Arrangements", (March 29, 2011), *http://www.sec.gov/rules/proposed/2011/34-64140.pdf.*

[60] See Release No. 34-64140, "Incentive-Based Compensation Arrangements", (March 29, 2011), *http://www.sec.gov/rules/proposed/2011/34-64140.pdf.*

[61] See Section 954 of the Dodd-Frank Act.

[62] See Section 953(a) of the Dodd-Frank Act.

[63] See Section 955 of the Dodd-Frank Act.

sions of the Act, which I expect to be taken up by the Commission in the near future.

Broker-Dealer Audit Requirements

The Dodd-Frank Act provided the Public Company Accounting Oversight Board (PCAOB) with explicit authority, among other things, to establish, subject to Commission approval, auditing standards for broker-dealer audits filed with the Commission. In August 2013, the Commission amended the broker-dealer financial reporting rule to require that broker-dealer audits be conducted in accordance with PCAOB standards and to more broadly provide additional safeguards with respect to broker-dealer custody of customer securities and funds.[64]

Whistleblower Program

Pursuant to Section 922 of the Dodd-Frank Act, the SEC established a whistleblower program to pay awards to eligible whistleblowers who voluntarily provide the agency with original information about a violation of the Federal securities laws that leads to a successful SEC enforcement action in which over $1 million in sanctions is ordered. As detailed in the SEC's Office of the Whistleblower third annual report to Congress,[65] during FY2013 the Commission received 3,238 tips from whistleblowers in the United States and 55 other countries. The high quality information we have received from whistleblowers has allowed our investigative staff to work more efficiently and better utilize agency resources. Last fall, the Commission made its largest whistleblower award to date, awarding over $14 million to a whistleblower whose information led to an SEC enforcement action that recovered substantial investor funds,[66] and this July we awarded more than $400,000 to a whistleblower who reported a fraud to the SEC after the company failed to address the issue internally.[67] We expect future awards to further increase the visibility and effectiveness of this important enforcement initiative.

In addition, the Dodd-Frank Act expanded whistleblower protections by empowering the Commission to bring enforcement actions against employers that retaliate against whistleblowers. Earlier this year, we exercised this authority for the first time when we penalized a firm and its principal for retaliating against a whistleblower who reported potential securities violations to the SEC.[68]

Investment Advisers and Broker-Dealers' Standards of Conduct

Section 913 of the Dodd-Frank Act granted the Commission broad authority to impose a uniform standard of conduct for broker-dealers and investment advisers when providing personalized investment advice about securities to retail customers. The question of whether and, if so, how to use this authority is very important to investors and the Commission.

In January 2011, the Commission submitted to Congress a staff study required by Section 913 (the "IA/BD Study"), which addressed the obligations of investment advisers and broker-dealers when providing personalized investment advice about securities to retail customers, and recommended, among other things, that the Commission exercise the discretionary rulemaking authority provided by Section 913.[69] In March 2013, the Commission issued a public Request for Data and Other Information (Request) relating to the provision of retail investment advice and regulatory alternatives, which sought data to assist the Commission in determining whether

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[64] See Release No. 43-0073, "Broker-Dealer Reports" (August 21, 2013), *http://www.gpo.gov/fdsys/pkg/FR-2013-08-21/pdf/2013-18738.pdf.*

[65] Annual Report on the Dodd-Frank Whistleblower Program Fiscal Year 2013 (November 2013), *http://www.sec.gov/about/offices/owb/annual-report-2013.pdf.*

[66] See "In the Matter of Claim for Award", SEC Release No. 34-70554 (September 30, 2013), *http://www.sec.gov/rules/other/2013/34-70554.pdf,* and "SEC Awards More Than $14 Million to Whistleblower", SEC Release No. 2013-209 (October 1, 2013), *http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539854258.*

[67] See "In the Matter of Claim for Award", SEC Release No. 34-72727 (July 31, 2014), *http://www.sec.gov/rules/other/2014/34-72727.pdf,* and "SEC Announces Award for Whistleblower Who Reported Fraud to SEC After Company Failed To Address Issue Internally", SEC Release No. 2014-154 (July 31, 2014), *http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542578457.*

[68] See "SEC Charges Hedge Fund With Conducting Conflicted Transactions and Retaliating Against Whistleblower", SEC Release No. 2014-118 (June 16, 2014), *http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542096307.*

[69] See "Study on Investment Advisers and Broker-Dealers" (January 2011), *http://www.sec.gov/news/studies/2011/913studyfinal.pdf;* see also "Statement by SEC Commissioners Kathleen L. Casey and Troy A. Paredes Regarding Study on Investment Advisers and Broker-Dealers" (January 21, 2011), *http://www.sec.gov/news/speech/2011/spch012211klctap.htm.*

to engage in rulemaking, and if so, what the nature of that rulemaking ought to be.[70]

In order to more fully inform the Commission's decision on this matter, I directed the staff to evaluate all of the potential options available to the Commission, including a uniform fiduciary standard for broker-dealers and investment advisers when providing personalized investment advice to retail customers. As part of its evaluation, the staff has been giving serious consideration to, among other things, the IA/BD Study's recommendations, the views of investors and other interested market participants, potential economic and market impacts, and the information we received in response to the Request. I have asked the staff to make its evaluation of options a high priority.

In addition to considering the potential options available to the Commission, Commission staff continues to provide regulatory expertise to Department of Labor staff as they consider potential changes to the definition of "fiduciary" under the Employee Retirement Income Security Act (ERISA). The staff and I are committed to continuing these conversations with the Department of Labor, both to provide technical assistance and information with respect to the Commission's regulatory approach and to discuss the practical effect on retail investors, and investor choice, of their potential amendments to the definition of "fiduciary" for purposes of ERISA.

Specialized Disclosure Provisions

Title XV of the Act contains specialized disclosure provisions related to conflict minerals, coal or other mine safety, and payments by resource extraction issuers to foreign or U.S. Government entities. In December 2011, the Commission adopted final rules for the mine safety provision.[71] In August 2012, the Commission adopted final rules for the disclosures relating to conflict minerals and payments by resource extraction issuers.[72]

A lawsuit was filed challenging the resource extraction issuer rules, and in July 2013, the U.S. District Court for the District of Columbia vacated the rules.[73] Since the court's decision, members of the Commission and the staff have met with interested parties and are considering comments submitted by stakeholders in order to formulate a recommendation for revised rules for the Commission's consideration.

A lawsuit (NAM vs. SEC) also was filed challenging the conflict minerals rule, and in April 2014, the U.S. Court of Appeals for the D.C. Circuit upheld the rule against all challenges made under the Administrative Procedure Act and the Exchange Act, but held that a portion of the rule violated the First Amendment.[74] Following the Court of Appeals decision in NAM, Commission staff issued a statement on April 29, 2014, that provides detailed guidance regarding compliance with those portions of the rule that were upheld, pending any further action by the Commission or the courts. On May 2, 2014, the Commission ordered a stay of the effective date for compliance with those portions of Rule 13p-1 and Form SD subject to the constitutional holding of the Court of Appeals. On May 29, 2014, the Commission filed a petition asking the Court of Appeals to hold the case for potential panel rehearing or rehearing en banc once the Court of Appeals issued a decision in another First Amendment case then pending before the en banc Court (American Meat Institute v. USDA). The intervenor in the NAM case, Amnesty International, also filed a petition for rehearing or rehearing en banc of the First Amendment portion of the panel opinion. The Court issued its en banc decision in American Meat Institute on July 29, 2014. On August 28, 2014, the Court ordered the appellants to file a response to both the SEC's and Amnesty International's petitions for rehearing en banc in NAM by September 12, 2014.

Exempt Offerings

In December 2011, the Commission adopted rule amendments to implement Section 413(a) of the Act, which requires the Commission to exclude the value of an individual's primary residence when determining if that individual's net worth ex-

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[70] See "Request for Data and Other Information: Duties of Brokers, Dealers, and Investment Advisers" (March 1, 2013), *http://www.sec.gov/rules/other/2013/34-69013.pdf.*

[71] See Release No. 33-9286, "Mine Safety Disclosure" (December 21, 2011), *http://www.sec.gov/rules/final/2011/33-9286.pdf.*

[72] See Release No. 34-67716, "Conflict Minerals" (August 22, 2012), *http://www.sec.gov/rules/final/2012/34-67716.pdf* and "Disclosure of Payments by Resource Extraction Issuers" (August 22, 2012), *http://www.sec.gov/rules/final/2012/34-67717.pdf.*

[73] See "American Petroleum Institute, et al. v. Securities and Exchange Commission and Oxfam America Inc.", No. 12-1668 (D.D.C. July 2, 2013).

[74] See "National Association of Manufacturers, et al. v. Securities and Exchange Commission, et al.", No. 13-5252 (D.C. Cir. April 14, 2014).

ceeds the $1 million threshold required for "accredited investor" status.[75] The staff also currently is conducting a review of the accredited investor definition, as mandated by Section 413(b)(2)(A) of the Act.

In July 2013, the Commission implemented Section 926 of the Act by adopting final rules that disqualify securities offerings involving certain "felons and other 'bad actors' " from relying on the safe harbor from Securities Act registration provided by Rule 506 of Regulation D.[76]

Office of Minority and Women Inclusion

In July 2011, pursuant to Section 342 of the Dodd Frank Act, the SEC formally established its Office of Minority and Women Inclusion (OMWI). OMWI is responsible for matters related to diversity in management, employment, and business activities at the SEC. This includes developing standards for equal employment opportunity and diversity of the workforce and senior management of the SEC, the increased participation of minority-owned and women-owned businesses in the SEC's programs and contracts, and assessing the diversity policies and practices of entities regulated by the SEC.

To improve diversity in our workforce and in SEC contracts, OMWI has deployed an outreach strategy where the SEC participates in minority- and women-focused career fairs, conferences, and business matchmaking events to attract diverse suppliers and job seekers to the SEC. As a result of its outreach efforts, as of FY2014 Q3, 31.9 percent of the total contract dollars awarded by the SEC were awarded to minority and women contractors, up from 28.7 percent awarded in FY2013. As of FY2014 Q3, 35.8 percent of new hires were minorities and 40.7 percent were women, up from 33.5 percent minorities and 40.3 percent women hired in FY2013. OMWI and the Commission are committed to continuing to work proactively to increase the participation of minority-owned and women-owned businesses in our programs and contracting opportunities and to encourage diversity and inclusion in our workforce.

OMWI also continues to make progress on the development of standards and policies relating to regulated entities and contracting. On October 23, 2013, pursuant to Section 342(b)(2)(C) of the Act, the SEC, along with the OCC, the Board, the FDIC, the National Credit Union Administration, and the Consumer Financial Protection Bureau, issued an interagency policy statement proposing joint standards for assessing the diversity policies and practices of the entities they regulate.[77] The standards are intended to promote transparency and awareness of diversity policies and practices within federally regulated financial institutions. The public comment period for the policy statement ended on February 7, 2014,[78] and after careful review and consideration of the more than 200 comment letters received, the OMWI Directors are currently drafting the final interagency policy statement. I anticipate that the final interagency policy statement will be circulated within the agencies for review and formal approval over the next few months.

Customer Data Protection—Identity Theft Red Flags and Financial Privacy Rules

In April 2013, to implement Section 1088 of the Dodd-Frank Act, the SEC and the CFTC jointly adopted Regulation S–ID.[79] Regulation S–ID requires certain regulated financial institutions such as broker-dealers and registered investment advisers to adopt and implement identity theft programs. Specifically, the regulation requires covered firms to implement policies and procedures designed to:

- identify relevant types of identity theft red flags;
- detect the occurrence of those red flags;
- respond appropriately to the detected red flags; and

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[75] See Release No. 33-9287, "Net Worth Standard for Accredited Investors" (December 21, 2011) and (March 23, 2012), *http://www.sec.gov/rules/final/2011/33-9287.pdf* and *http://www.sec.gov/rules/final/2012/33-9287a.pdf* (technical amendment).

[76] See Release No. 33-9214, "Disqualification of Felons and Other 'Bad Actors' from Rule 506 Offerings" (July 10, 2013), *http://www.sec.gov/rules/final/2013/33-9414.pdf.*

[77] See Release No. 34-70731, "Proposed Interagency Policy Statement Proposing Joint Standards for Assessing the Diversity Policies and Practices of the Entities Regulated by the Agencies and Request for Comment" (October 23, 2013) *https://www.sec.gov/rules/policy/2013/34-70731.pdf.*

[78] See "Public Comment on the Proposed Interagency Policy Statement Establishing Joint Standards for Assessing the Diversity Policies of Practices of Entities Regulated by the Agencies", (December 19, 2013) *https://www.sec.gov/rules/policy/2013/comments-joint-standards-diversity.shtml.*

[79] See Release No. 34-69359, "Identity Theft Red Flags Rules" (April 10, 2013), *https://www.sec.gov/rules/final/2013/34-69359.pdf.* See also 17 CFR Part 248, Subpart C.

- periodically update the identity theft program.

Regulation S–ID's requirements complement the SEC's other rules for protecting customer data.[80]

SEC Resources

The SEC collects transaction fees that offset the annual appropriation to the SEC. Accordingly, regardless of the amount appropriated to the SEC, our funding level will not take resources from other agencies, nor will it have an impact on the Nation's budget deficit. Yet, since FY2012, the SEC has not received a significant increase in resources to permit the agency to bring on the additional staff needed to adequately carry out our mission.

Our budgetary needs have, of course, been increased by the responsibilities added by the Dodd-Frank and JOBS Acts, but our significant budgetary gap and needs would remain had those extensive additional responsibilities not been added. There is an immediate and pressing need for significant additional resources to permit the SEC to increase its examination coverage of registered investment advisers so as to better protect investors and our markets. While the SEC makes increasingly effective and efficient use of its limited resources, we nevertheless were in a position to only examine 9 percent of registered investment advisers in fiscal year 2013. In 2004, the SEC had 19 examiners per trillion dollars in investment adviser assets under management. Today, we have only eight. Additional resources are vital to increase exam coverage over investment advisers and other key areas, and also to bolster our core investigative, litigation, and analytical enforcement functions. It is also a high priority for us to continue the agency's investments in the technologies needed to keep pace with today's high-tech, high-speed markets.

With respect to our new responsibilities, we need additional staff experts to focus on enforcement, examinations, and regulatory oversight. We must strengthen our ability to take in, organize, and analyze data on the new markets and entities under the agency's jurisdiction. The new responsibilities cannot be handled appropriately with the agency's existing resource levels without undermining the agency's other core duties, particularly as we turn from rule writing to implementation and enforcement of those rules.

Also critical will be the SEC's continued use of the Reserve Fund, established under the Dodd-Frank Act. The SEC dedicated the Reserve Fund to critical IT upgrades, and, if funding permits, plans to continue investing in areas such as data analysis, EDGAR and sec.gov modernization, enforcement and examinations support, and business process improvements.

If the SEC does not receive sufficient additional resources, the agency will be unable to fully build out its technology and hire the industry experts and other staff needed to oversee and police our areas of responsibility, especially in light of the expanding size and complexity of our overall regulatory space. Our Nation's markets are the safest and most dynamic in the world, but without sufficient resources, it will become increasingly difficult for our talented professionals to detect, pursue, and prosecute violations of our securities laws as the size, speed, and complexity of the markets grow around us.

Conclusion

The Commission has made tremendous progress implementing the extensive rulemakings and other initiatives mandated by the Dodd-Frank Act to strengthen regulation and our financial system. As the Commission strives to complete the remaining work, I look forward to working with this Committee and others in the financial marketplace to adopt rules that protect investors, maintain fair, orderly and efficient markets, and facilitate capital formation—as we also undertake the necessary measures to enhance financial stability and limit potential systemic risks. Thank you for your support of the SEC's mission and for inviting me to share our progress with you. I look forward to answering your questions.

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[80] Regulation S–P requires broker-dealers, investment companies, and registered investment advisers to adopt and implement written policies and procedures to safeguard customer records and information. See Release 34-42974, "Privacy of Consumer Financial Information" (Regulation S–P) (June 22, 2000), *https://www.sec.gov/rules/final/34-42974.htm.* See also 17 CFR Part 248, Subpart A.

Appendix A

Status of Dodd-Frank Requirements
Applicable to the SEC

I. Rulemaking Provisions

The following list groups Dodd-Frank Act rulemaking provisions applicable to the SEC into 10 categories and indicates whether rules have been adopted, proposed, or yet to be proposed with respect to each provision.

A. Private Funds - 8 total rulemaking provisions

1. Rules adopted with respect to 8 provisions:

- Sec. 404—Records to be maintained and reports to be provided by private funds
- Sec. 406—Disclosure rules on private funds
- Sec. 407—Exemption of venture capital fund advisers, definition of "venture capital fund"
- Sec. 408—Exemption from registration by certain private fund advisers/requirement of records for such advisers
- Sec. 409—Family office
- Sec. 410—State and federal responsibilities/ asset threshold for registration of federal advisers
- Sec. 413—Adjustment of the accredited investor standard
- Sec. 418—Qualified client standard, inflation adjustment

2. Rules proposed with respect to 0 provisions.

3. Rules yet to be proposed with respect to 0 provisions.

B. Volcker Rule - 1 total rulemaking provision

1. Rules adopted with respect to 1 provision:

- Sec. 619—Prohibition on proprietary trading and certain relationships with hedge funds and private equity funds

2. Rules proposed with respect to 0 provisions.

3. Rules yet to be proposed with respect to 0 provisions.

C. Security-Based Swaps - 29 total rulemaking provisions

1. Rules adopted with respect to 11 provisions:

- Sec. 712—Joint CFTC and SEC rulemaking regarding mixed swaps
- Sec. 712(d)(1)—Joint CFTC and SEC rulemaking concerning swaps-related definitions
- Sec. 712(d)(2)(B)—Joint CFTC and SEC rulemaking regarding recordkeeping by trade repositories with respect to security-based swap agreement transactions
- Sec. 712(d)(2)(C)— Joint CFTC and SEC rulemaking regarding recordkeeping by security-based swap dealers, swap dealers, major security-based swap participants and major swap participants for security-based swap agreement transactions
- Sec. 761(a)(6)—Rules to facilitate identification of major security-based swap participants
- Sec. 761(a)(6)—Exemption from the definition of security-based swap dealer for *de minimis* activity
- Sec. 763(a)—Rules providing process for clearing agencies to request to clear security-based swaps
- Sec. 763(a)—Rules for providing a process for staying a clearing requirement and reviewing clearing arrangements for swaps approved by the SEC for clearing
- Sec. 763(a)—Rules to prevent evasion of clearing requirements
- Sec. 763(b)—Rules governing clearing agencies for security-based swaps
- Sec. 766(a)—Transition rules regarding the reporting of pre-enactment security-based swap transactions

2. Rules proposed with respect to 18 provisions:

- Sec. 763(a)—SEC transition reporting rules for security-based swaps
- Sec. 763(c)—Data collection and reporting rules for security-based swap execution facilities
- Sec. 763(c)—Rules governing security-based swap execution facilities
- Sec. 763(g)—Rules regarding fraud in the security-based swap market
- Sec. 763(i)—Rules providing for public availability of security-based swap transaction and pricing data to enhance price discovery
- Sec. 763(i)—Rules regarding the type of data to be collected with respect to security-based swap transactions
- Sec. 763(i)—Duties of security-based swap data repositories
- Sec. 763(i)—Rules governing registered security-based swap data repositories
- Sec. 764—Rules regarding the registration of security-based swap dealers or major security-based swap participants
- Sec. 764(a)—Reporting and recordkeeping rules applicable to security-based swap dealers and major security-based swap participants
- Sec. 764(a)—Rules regarding daily trading recordkeeping

- Sec. 764(a)—Rules, including capital and margin, governing security-based swap dealers and major security-based swap participants that are not banks
- Sec. 764(a)—Business conduct standards applicable to security-based swap dealers and security-based swap major participants
- Sec. 764(a)—Rules relating to documentation of security-based swap transactions
- Sec. 764(j)—Duties of security-based swap dealers and major security-based swap participants related to monitoring of trading, risk management procedures, disclosure of general information, ability to obtain information, conflicts, and antitrust considerations
- Sec. 765(a)—Conflicts of interest
- Sec. 766(a)—Reporting of uncleared security-based swap transactions
- Sec. 766(a)—Recordkeeping for certain security-based swaps

3. Rules yet to be proposed with respect to 0 provisions.

D. Clearing Agencies - 2 total rulemaking provisions

1. Rules adopted with respect to 2 provisions:

- Sec. 805(a)(2)(A)—Authority to prescribe risk management standards for designated clearing entities
- Sec. 806(e)(1)—Changes to rules, procedures or operation of designated financial market utilities

2. Rules proposed with respect to 0 provisions.

3. Rules yet to be proposed with respect to 0 provisions.

E. Municipal Securities Advisors – 1 total rulemaking provision

1. Rules adopted with respect to 1 provision:

- Sec. 975—Municipal advisor regulation

2. Rules proposed with respect to 0 provisions.

3. Rules yet to be proposed with respect to 0 provisions.

F. Executive Compensation - 12 total rulemaking provisions

1. Rules adopted with respect to 6 provisions:

- Sec. 951—Shareholder approval of executive compensation[1]
- Sec. 952 (Exchange Act Sec. 10C(a))—Compensation committee independence—Commission to direct SROs to prohibit listing of certain securities unless issuers are in compliance with compensation committee independence requirements
- Sec. 952 (Exchange Act Sec. 10C(b))—Compensation committee independence—Commission to identify factors that may affect independence
- Sec. 952 (Exchange Act Sec. 10C(c)(2))—Compensation committee independence—Commission to issues rules relating to proxy disclosure regarding compensation consultants
- Sec. 952 (Exchange Act Sec. 10C(f))—Compensation committee independence—Commission to direct SROs to prohibit listing of securities of an issuer that is not in compliance with the requirements of the section
- Sec. 972—Chairman/CEO structure disclosure in annual proxy

2. Rules proposed with respect to 3 provisions:

- Sec. 953(b)—Additional executive compensation disclosure (pay ratio)
- Sec. 956(a)—Compensation structure reporting (joint rulemaking)
- Sec. 956(b)—Prohibition on certain compensation arrangements (joint rulemaking)

3. Rules yet to be proposed with respect to 3 provisions:

- Sec. 953(a)—Pay v. performance disclosure
- Sec. 954—Recovery of executive compensation
- Sec. 955—Disclosure regarding employee and director hedging

G. Asset-backed Securities - 7 total rulemaking provisions

1. Rules adopted with respect to 3 provisions:

- Sec. 942(b)—ABS disclosure[2]
- Sec. 943—ABS reps and warranties
- Sec. 945—ABS due diligence disclosure

[1] The significant part of the rulemaking contemplated by this section is complete, but part of it remains to be completed.

[2] The Commission has adopted asset-level disclosure rules with respect to securitizations of residential and commercial mortgages, auto loans and leases, debt securities, and resecuritizations of those asset classes; proposed rules for other assets classes remain outstanding.

2. Rules proposed with respect to 4 provisions:

- Sec. 621—Conflicts of interest regarding certain securitizations
- Sec. 941(b)—Credit risk retention (general) (joint rulemaking)
- Sec. 941(b)—Credit risk retention (residential mortgages) (joint rulemaking)
- Sec. 941(b)—Credit risk retention exemptions (joint rulemaking)

3. Rules yet to be proposed with respect to 0 provisions.

H. Credit Rating Agencies - 12 total rulemaking provisions

1. Rules adopted with respect to 12 provisions:

- Sec. 932(a)(2)(B)—Internal controls governing the implementation of and adherence to policies, procedures and methodologies for determining credit ratings
- Sec. 932(a)(4)—Separation of ratings from sales and marketing
- Sec. 932(a)(4)—Policies and procedures relating to look back reviews
- Sec. 932(a)(8)—Fines and penalties
- Sec. 932(a)(8)—Transparency of ratings performance
- Sec. 932(a)(8)—Credit rating methodologies
- Sec. 932(a)(8)— Form and certification to accompany credit ratings
- Sec. 932(a)(8)—Third-party due diligence services for asset-backed securities
- Sec. 936— Standards of training, experience, and competence for credit rating analysts
- Sec. 938—Universal ratings symbols
- Sec. 939—Removal of statutory references to credit ratings[3]
- Sec. 939A—Review of reliance on credit ratings[4]

2. Rules proposed with respect to 0 provisions.

3. Rules yet to be proposed with respect to 0 provisions.

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[3] Section 939 removes references to NRSRO ratings in the Investment Company Act (section 939(c)) and the Exchange Act (section 939(e)) and substitutes standards of credit-worthiness to be established by the Commission. The SEC has adopted rules under section 939(c), but has not yet adopted rules under section 939(e) to establish substitute standards of credit-worthiness in the Exchange Act definitions of "mortgage related security" and "small business related security".

[4] The significant part of the rulemaking contemplated by this section is complete, but part of it remains to be completed. Since enactment of the Dodd-Frank Act, the Commission has removed references to credit ratings used for purposes of assessing credit-worthiness from 22 separate rules and forms. The Commission has proposed removal of such references from four additional rules and forms relating to money market mutual funds (Investment Company Act Rule 2a-7 and Form N-MFP) and distributions of securities (Rules 101 and 102 of Regulation M).

Appendix A

I. Specialized Disclosures - 2 total rulemaking provisions

1. Rules adopted with respect to 2 provisions:

- Sec. 1502—Conflict minerals[5]
- Sec. 1504—Disclosure of payment by resource extraction issuers[6]

2. Rules proposed with respect to 0 provisions.

3. Rules yet to be proposed with respect to 0 provisions.

J. Other - 12 total rulemaking provisions

1. Rules adopted with respect to 7 provisions:

- Sec. 916—Streamlining of filing procedures for self-regulatory organizations
- Sec. 924—Whistleblower provisions
- Sec. 929W—Notice to missing security holders
- Sec. 939B—Elimination of exemption from fair disclosure rule
- Sec. 989G—Exemption for nonaccelerated filers
- Sec. 1088(a)(8)—Red flag guidelines and regulations (joint rules)
- Sec. 926—Disqualifying felons and other "bad actors" from Reg. D offerings

2. Rules proposed with respect to 0 provisions.

3. Rules yet to be proposed with respect to 5 provisions:

- Sec. 165—Stress tests
- Sec. 205(h)—Orderly liquidation of covered brokers and dealers (joint rulemaking)
- Sec. 915—Regulations for Office of Investor Advocate
- Sec. 929X(a)—Short sale reforms
- Sec. 984(b)—Increased transparency of information available to brokers, dealers, investors, with respect to loan or borrowing of securities

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[5] The Commission adopted rules with respect to section 1502 on 8/22/12. The U.S. Court of Appeals for the District of Columbia upheld the majority of the provisions of the rule but held that one provision violated the First Amendment on 4/14/14. Petitions for rehearing and rehearing *en banc* are currently pending before the Court of Appeals.

[6] The Commission adopted rules with respect to section 1504 on 8/22/12, but the U.S. District Court for the District of Columbia vacated the rule and remanded it to the SEC on 7/2/13. The Commission did not appeal the district court's decision and will need to engage in further rulemaking consistent with the decision.

Appendix A

II. New SEC Offices

The Dodd-Frank Act requires the SEC to create 5 new offices:

- Office of the Whistleblower
- Office of Credit Ratings
- Office of the Investor Advocate
- Office of Minority and Women Inclusion
- Office of Municipal Securities

All of these offices have been established.

III. Studies and Reports

The Dodd-Frank Act requires the SEC to issue 28 studies or reports, including 18 one-time studies or reports and 10 that must be issued on a recurring basis.

A. One-Time Studies or Reports

The SEC has completed 15 of the 18 one-time studies or reports:

- Sec. 417—Report to Congress on short sales reporting (1-year report) (6/5/2014)
- Sec. 719(b)—Report to Congress, jointly with the CFTC, regarding a study regarding the feasibility of requiring the derivatives industry to adopt standardized computer-readable algorithmic descriptions (4/8/2011)
- Sec. 719(c)—Report to Congress, jointly with the CFTC, regarding a study regarding how swaps are regulated in the United States, Asia, and Europe, to identify areas of regulation that are similar and could be harmonized (2/1/2012)
- Sec. 750(e) – Report to Congress by an interagency working group, including the SEC Chairman, on the oversight of existing and prospective carbon markets (1/18/2011)
- Sec. 813—Report to Congress, jointly with the CFTC and the Federal Reserve, on risk management supervision of designated clearing entities (7/21/2011)
- Sec. 913—Report to Congress on the study of the obligations of brokers, dealers, and investment advisers (1/22/2011)
- Sec. 914—Report to Congress on the need for enhanced resources for investment adviser examinations and enforcement (1/19/11)
- Sec. 917—Study regarding financial literacy among retail investors (8/30/2012)
- Sec. 919B—Study of ways to improve investor access to information about investment advisers and broker-dealers (1/27/2011)
- Sec. 929Y—Study on the cross-border scope of the private right of action under Section 10(b) of the Securities Exchange Act (4/11/2012)
- Sec. 939(h)— Report to Congress on standardization of credit ratings (9/7/2012)
- Sec. 939A—Report to Congress on review of reliance on credit ratings (7/21/2011)
- Sec. 939C—Report to Congress on credit rating agency independence (11/21/2013)

- Sec. 939F—Study on the rating process for structured finance products and the feasibility of a credit rating assignment system (12/18/2012)
- Sec. 989G—Report to Congress on study regarding reducing the costs to smaller issuers (with market capitalization between $75 million and $ 250 million) for complying with §404(b) of the Sarbanes-Oxley Act of 2002 (4/22/2011)

Three of the one-time studies or reports have not yet been completed:

- Sec. 417—Report to Congress on "the state of short selling on national securities exchanges and in the over-the-counter markets" (2-year report)
- Sec. 952—Study and Report to Congress to review of the use of compensation consultants and the effects of such use
- Sec. 719(d)—Joint SEC/CFTC study concerning stable value contracts

B. Recurring Reports

The Dodd-Frank Act also requires the Commission, a specific office of the Commission, or an individual within the Commission to issue 10 recurring reports. Eight of these recurring reports are being issued:

- Sec. 342—Annual report to Congress on the activities of the Office of Minority and Women Inclusion (4/18/2014; 4/24/2013; 4/10/2012)
- Sec. 404—Annual report to Congress on the use of data collected from advisers to hedge funds and other private funds to aid in monitoring system financial risk (8/15/2014; 7/25/2013)
- Sec. 915—Annual report to Congress on the objectives of the Investor Advocate for the following fiscal year (6/30/2014)
- Secs. 922 and 924—Annual report to Congress on the securities whistleblower incentive and protection program (11/15/2013; 11/15/2012; 11/15/2011; 10/29/2010)
- Sec. 932—Annual summary report of Commission staff's examinations of NRSROs (12/24/2013; 11/15/2012; 9/30/2011)
- Sec. 961—Annual report and certification sent to Congress regarding the SEC's internal supervisory controls (12/20/13; 12/20/12; 12/22/2011; 12/21/2010)
- Sec. 963—Annual financial controls audit report (included in the SEC's annual financial reports)
- Sec. 967—Report to Congress on the implementation of SEC organizational reform recommendations, with follow-up reports over a two-year period (4/30/2013; 10/17/2012; 3/30/2012; 9/12/2011; 3/10/2011)

Two of these recurring reports have not yet begun to be issued:

- Sec. 763(i)—Reports on aggregate security-based swap data
- Sec. 915—Annual report to Congress on the activities of the Investor Advocate during the immediately preceding fiscal year (*Note*: The Investor Advocate was appointed in February 2014.)

PREPARED STATEMENT OF TIMOTHY G. MASSAD

CHAIR, COMMODITY FUTURES TRADING COMMISSION

SEPTEMBER 9, 2014

Thank you Chairman Johnson, Ranking Member Crapo, and Members of the Committee. I am pleased to testify before you today on behalf of the Commission. This is my first official hearing as Chairman of the CFTC. It is truly an honor to serve as Chairman at this important time.

I met and spoke with several Members of this Committee during the confirmation process, and I appreciated hearing your thoughts and suggestions during that time. I look forward to this Committee's input going forward.

During the last 5 years, we have made substantial progress in recovering from the worst financial crisis since the Great Depression. The Dodd-Frank Act was a comprehensive response, and much has been accomplished in implementing it. The CFTC has largely completed the rulemaking stage of Dodd-Frank implementation. However, much work remains to finish the job Congress has given us.

I look forward to working together with you, as well as my colleagues at the CFTC and others around the globe to ensure that our futures, swaps and options markets remain the most efficient and competitive in the world, and to protect the integrity of the markets.

The Significance of Derivatives Market Oversight

Very few Americans participate directly in the derivatives markets. Yet these markets profoundly affect the prices we all pay for food, energy, and most other goods and services we buy each day. They enable farmers to lock in a price for their crops, utility companies or airlines to hedge the costs of fuel, and auto companies or soda bottlers to know what aluminum will cost. They enable exporters to manage fluctuations in foreign currencies, and businesses of all types to lock in their borrowing costs. In the simplest terms, derivatives enable market participants to manage risk.

In normal times, these markets create substantial, but largely unseen, benefits for American families. During the financial crisis, however, they created just the opposite. It was during the financial crisis that many Americans first heard the word derivatives. That was because over-the-counter swaps—a large, unregulated part of these otherwise strong markets—accelerated and intensified the crisis like gasoline poured on a fire. The Government was then required to take actions that today still stagger the imagination: for example, largely because of excessive swap risk, the Government committed $182 billion to prevent the collapse of a single company—AIG—because its failure at that time, in those circumstances, could have caused our economy to fall into another Great Depression.

It is hard for most Americans to fathom how this could have happened. While derivatives were just one of many things that caused or contributed to the crisis, the structure of some of these products created significant risk in an economic downturn. In addition, the extensive, bilateral transactions between our largest banks and other institutions meant that trouble at one institution could cascade quickly through the financial system like a waterfall. And, the opaque nature of this market meant that regulators did not know what was going on or who was at risk.

Responding to the Crisis—Enactment and Implementation of the Dodd-Frank Act

The lessons of this tragedy were not lost on the leaders of the United States and the G20 Nations. They committed to bring the over-the-counter swaps market out of the shadows. They agreed to do four basic things: require regulatory oversight of the major market players; require clearing of standardized transactions through regulated clearinghouses known as central counterparties or CCPs; require more transparent trading of standardized transactions; and require regular reporting so that we have an accurate picture of what is going on in this market.

In the United States, these commitments were set forth in Title VII of the Dodd-Frank Act. Responsibility for implementing these commitments was given primarily to the CFTC. I would like to review where we stand in implementing the regulatory framework passed by Congress to bring the over-the-counter swaps market out of the shadows.

Oversight

The first of the major directives Congress gave to the CFTC was to create a framework for the registration and regulation of swap dealers and major swap participants. The agency has done so. As of August 2014, there are 104 swap dealers and two major swap participants provisionally registered with the CFTC.

We have adopted rules requiring strong risk management. We will also be making periodic examinations to assess risk and compliance. The new framework requires registered swap dealers and major swap participants to comply with various business conduct requirements.

These include strong standards for documentation and confirmation of transactions, as well as dispute resolution processes. They include requirements to reduce risk of multiple transactions through what is known as portfolio reconciliation and portfolio compression. In addition, swap dealers are required to make sure their counterparties are eligible to enter into swaps, and to make appropriate disclosures to those counterparties of risks and conflicts of interest.

As directed by Congress, we have worked with the SEC, other U.S. regulators, and our international counterparts to establish this framework. We will continue to work with them to achieve as much consistency as possible. We will also look to make sure these rules work to achieve their objectives, and fine-tune them as needed where they do not.

Clearing

A second commitment of Dodd-Frank was to require clearing of standardized transactions at central counterparties. The use of CCPs in financial markets is commonplace and has been around for over 100 years. The idea is simple: if many participants are trading standardized products on a regular basis, the tangled, hidden Web created by thousands of private two-way trades can be replaced with a more transparent and orderly structure, like the spokes of a wheel, with the CCP at the center interacting with other market participants. The CCP monitors the overall risk and positions of each participant.

Clearing does not eliminate the risk that a counterparty to a trade will default, but it provides us various means to mitigate that risk. As the value of positions change, margin can be collected efficiently to ensure counterparties are able to fulfill their obligations to each other. And if a counterparty does default, there are tools available to transfer or unwind positions and protect other market participants. To work well, active, ongoing oversight is critical. We must be vigilant to ensure that CCPs are operated safely and deliver the benefits they are designed to provide.

The CFTC was the first of the G20 Nations' regulators to implement clearing mandates. We have required clearing for interest rate swaps (IRS) denominated in U.S. dollars, Euros, Pounds and Yen, as well as credit default swaps (CDS) on certain North American and European indices. Based on CFTC analysis of data reported to swap data repositories, as of August 2014, measured by notional value, 60 percent of all outstanding transactions were cleared. This is compared to estimates by the International Swaps and Derivatives Association (ISDA) of only 16 percent in December 2007. With regard to index CDS, most new transactions are being cleared—85 percent of notional value during the month of August.

Our rules for clearing swaps were patterned after the successful regulatory framework we have had in place for many years in the futures market. We do not require that clearing take place in the United States, even if the swap is in U.S. dollars and between U.S. persons. But we do require that clearing occurs through registered CCPs that meet certain standards—a comprehensive set of core principles that ensures each clearinghouse is appropriately managing the risk of its members, and monitoring its members for compliance with important rules.

Fourteen CCPs are registered with the CFTC as derivatives clearing organizations (DCOs) either for swaps, futures, or both. Five of those are organized outside of the United States, including three in Europe which have been registered since 2001 (LCH.Clearnet Ltd.); 2010 (ICE Clear Europe Ltd); and 2013 (LCH.Clearnet SA). In some cases, a majority of the trades cleared on these European-based DCOs are for U.S. persons.

At the same time, the CFTC has specifically exempted most commercial end users from the clearing mandate. We have been sensitive to Congress's directive that these entities, which were not responsible for the crisis and rely on derivatives primarily to hedge commercial risks, should not bear undue burdens in accessing these markets to hedge their risk.

Of course, central clearing by itself is not a panacea. CCPs do not eliminate the risks inherent in the swaps market. We must therefore be vigilant. We must do all we can to ensure that CCPs have financial resources, risk management systems, settlement procedures, and all the necessary standards and safeguards consistent with the core principles to operate in a fair, transparent and efficient manner. We must also make sure that CCP contingency planning is sufficient.

Trading

The third area for reform under Dodd-Frank was to require more transparent trading of standardized products. In the Dodd-Frank Act, Congress provided that certain swaps must be traded on a swap execution facility (SEF) or another regulated exchange. The Dodd Frank Act defined a SEF as "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." The trading requirement was designed to facilitate a more open, transparent and competitive marketplace, benefiting commercial end users seeking to lock in a price or hedge risk.

The CFTC finalized its rules for SEFs in June 2013. Twenty-two SEFs have temporarily registered with the CFTC, and two applications are pending. These SEFs are diverse, but each will be required to operate in accordance with the same core principles. These core principles provide a framework that includes obligations to establish and enforce rules, as well as policies and procedures that enable transparent and efficient trading. SEFs must make trading information publicly available, put into place system safeguards, and maintain financial, operational, and managerial resources to discharge their responsibilities.

Trading on SEFs began in October of last year. Beginning February 2014, specified interest rate swaps and credit default swaps must be traded on a SEF or another regulated exchange. Notional value executed on SEFs has generally been in excess of $1.5 trillion weekly.

It is important to remember that trading of swaps on SEFs is still in its infancy. SEFs are still developing best practices under the new regulatory regime. The new technologies that SEF trading requires are likewise being refined. Additionally, other jurisdictions have not yet implemented trading mandates, which has slowed the development of cross-border platforms. There will be issues as SEF trading continues to mature. We will need to work through these to achieve fully the goals of efficiency and transparency SEFs are meant to provide.

Data Reporting

The fourth Dodd-Frank reform commitment was to require ongoing reporting of swap activity. Having rules that require oversight, clearing, and transparent trading is not enough. We must have an accurate, ongoing picture of what is going on in the marketplace to achieve greater transparency and to address potential systemic risk.

Title VII of the Dodd-Frank Act assigns the responsibility for collecting and maintaining swap data to swap data repositories (SDRs), a new type of entity necessitated by these reforms. All swaps, whether cleared or uncleared, must be reported to SDRs. There are currently four SDRs that are provisionally registered with the CFTC.

The collection and public dissemination of swap data by SDRs helps regulators and the public. It provides regulators with information that can facilitate informed oversight and surveillance of the market and implementation of our statutory responsibilities. Dissemination, especially in real-time, also provides the public with information that can contribute to price discovery and market efficiency.

While we have accomplished a lot, much work remains. The task of collecting and analyzing data concerning this marketplace requires intensely collaborative and technical work by industry and the agency's staff. Going forward, it must continue to be one of our chief priorities.

There are three general areas of activity. We must have data reporting rules and standards that are specific and clear, and that are harmonized as much as possible across jurisdictions. The CFTC is leading the international effort in this area. It is an enormous task that will take time. We must also make sure the SDRs collect, maintain, and publicly disseminate data in the manner that supports effective market oversight and transparency. Finally, market participants must live up to their reporting obligations. Ultimately, they bear the responsibility to make sure that the data is accurate and reported promptly.

Our Agenda Going Forward

The progress I have outlined reflects the fact that the CFTC has finished almost all of the rules required by Congress in the Dodd-Frank Act to regulate the over-the-counter swaps market. This was a difficult task, and required tremendous effort and commitment. My predecessor, Gary Gensler, deserves substantial credit for leading the agency in implementing these reforms so quickly. All of the Commissioners contributed valuable insight and deserve our thanks. But no group deserves more credit than the hardworking professional staff of the agency. It was an extraordinary effort. I want to publicly acknowledge and thank them for their contributions.

The next phase requires no less effort. I want to highlight several areas going forward that are critical to realizing the benefits Congress had in mind when it adopted this new framework and to minimizing any unintended consequences.

Finishing and Fine-Tuning Dodd-Frank Regulations

First, as markets develop and we gain experience with the new Dodd-Frank regulations, I anticipate we will, from time to time, make some adjustments and changes. This is to be expected in the case of a reform effort as significant as this one. These are markets that grew to be global in nature without any regulation, and the effort to bring them out of the shadows is a substantial change. It is particularly difficult to anticipate with certainty how market participants will respond and how markets will evolve. At this juncture, I do not believe wholesale changes are needed, but some clarifications and improvements are likely to be considered.

In fine-tuning existing rules, and in finishing the remaining rules that Congress has required us to implement, we must make sure that commercial businesses like farmers, ranchers, manufacturers, and other companies can continue to use these markets effectively. Congress rightly recognized that these entities stand in a different position compared to financial firms. We must make sure the new rules do not cause inappropriate burdens or unintended consequences for them. We hope to act on a new proposed rule for margin for uncleared swaps in the near future. On position limits, we have asked for and received substantial public comment, including through roundtables and face-to-face meetings. This input has been very helpful enabling us to calibrate the rules to achieve the goals of reducing risk and improving the market without imposing unnecessary burdens or causing unintended consequences.

Cross-Border Regulation of the Swaps Market

A second key area is working with our international counterparts to build a strong global regulatory framework. To succeed in accomplishing the goals set out in the G20 commitments and embodied in the Dodd-Frank Act, global regulators must work together to harmonize their rules and supervision to the greatest extent possible. Fundamentally, this is because the markets that the CFTC is charged to regulate are truly global. What happens in New York, Chicago, or Kansas City is inextricably interconnected with events in London, Hong Kong and Tokyo. The lessons of the financial crisis remind us how easy it is for risks embedded in overseas derivatives transactions to flow back into the United States. And Congress directed us to address the fact that activities abroad can result in importation of risk into the United States.

This is a challenging task. Although the G20 Nations have agreed on basic principles for regulating over-the-counter derivatives, there can be many differences in the details. While many sectors of the financial industry are global in nature, applicable laws and rules typically are not. For example, no one would expect that the laws which govern the selling of securities, or the securing of bank loans, should be exactly the same in all the G20 Nations. While our goal should be harmonization, we must remember that regulation occurs through individual jurisdictions, each informed by its own legal traditions and regulatory philosophies.

Our challenge is to achieve as consistent a framework as possible while not lowering our standards simply to reach agreement, thus triggering a "race to the bottom." We must also minimize opportunities for regulatory arbitrage, where business moves to locales where the rules are weaker or not yet in place.

The CFTC's adoption of regulations for systemically important CCPs is a useful model for success. Our rules were designed to meet the international standards for the risk management of systemically important CCPs, as evidenced by the Principles for Financial Market Infrastructures (PFMIs) published by the Bank of International Settlement's Committee on Payment and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions, to which the Commission was a key contributor.

Since the day I joined the CFTC, I have been focused on cross-border issues. In my first month in office I went to Europe twice to meet with my fellow regulators, and I have been engaged in ongoing dialogue with them.

Robust Compliance and Enforcement

A third major area is having robust compliance and enforcement activities. It is not enough to have rules on the books. We must be sure that market participants comply with the rules and fulfill their obligations. That is why, for example, several weeks ago we fined a large swap dealer for failing to abide by our data reporting rules.

A strong compliance and enforcement function is vital to maintaining public confidence in our markets. This is critical to the participation of the many Americans

who depend on the futures and swaps markets—whether they are farmers, oil producers or exporters. And even though most Americans do not participate directly in the futures and swaps markets, our enforcement efforts can help rebuild and maintain public confidence and trust in our financial markets.

We must aggressively pursue wrongdoers, big or small, and vigorously fulfill our responsibility to enforce the regulations governing these markets. Our pursuit of those who have manipulated benchmarks like LIBOR, a key global benchmark underlying a wide variety of financial products and transactions, is a prime example of this principle in practice. So is our successful litigation against Parnon Energy and Arcadia, two energy companies that systematically manipulated crude oil markets to realize illicit profits.

Dodd-Frank provided the Commission with a number of new statutory tools to ensure the integrity of our markets, and we have moved aggressively to incorporate these tools into our enforcement efforts. Our new antimanipulation authority gives us enhanced ability to go after fraud-based manipulation of our markets. We have put that authority to good use in a host of cases and investigations, including actions against Hunter Wise and a number of smaller firms for perpetrating precious metals scams. Congress also gave us new authority to attack specific practices that unscrupulous market participants use to distort the markets, such as "spoofing," where a party enters a bid or offer with the intent to move the market price, but not to consummate a transaction. We used this new antispoofing provision to successfully prosecute Panther Energy for its spoofing practices in our energy markets.

Going forward, protecting market integrity will continue to be one of our key priorities. Market participants should understand that we will use all the tools at our disposal to do so.

Information Technology and Data Management

It is also vital that the CFTC have up to date information technology systems. Handling massive amounts of swaps data and effective market oversight both depend on the agency having up-to-date technology resources, and the staff—including analysts and economists, as well as IT and data management professionals—to make use of them. The financial markets today are driven by sophisticated use of technology, and the CFTC cannot effectively oversee these markets unless it can keep up.

Cybersecurity is a related area where we must remain vigilant. As required by Congress, we have implemented new requirements related to exchanges' cybersecurity and system safeguard programs. The CFTC conducts periodic examinations that include review of cybersecurity programs put in place by key market participants, and there is much more we would like to do in this area. Going forward, the Commission's examination expertise will need to be expanded to keep up with emerging risks in information security, especially in the area of cybersecurity.

Resources and Budget

All of these tasks represent the significant increases in responsibility that came with Dodd Frank. They require resources. But the CFTC does not have the resources to fulfill these tasks as well as all the responsibilities it had—and still has—prior to the passage of Dodd Frank. The CFTC is lucky to have a dedicated and resourceful professional staff. Although I have been at the agency a relatively short time, I am already impressed by how much this small group is able to accomplish. Still, as good as they are, the reality of our current budget is evident.

I recognize that there are many important priorities that Congress must consider in the budgeting process. I appreciate the importance of being as efficient as possible. I have also encouraged our staff to be creative in thinking about how we can best use our limited resources to accomplish our responsibilities. We will keep the Teddy Roosevelt adage in mind, that we will do what we can, with what we have, where we are.

But I hope to work with members of Congress to address our budget constraints. Our current financial resources limit our ability to fulfill our responsibilities in a way that most Americans would expect. The simple fact is that Congress's mandate to oversee the swaps market in addition to the futures and options markets requires significant resources beyond those the agency has previously been allocated. Without additional resources, our markets cannot be as well supervised; participants cannot be as well protected; market transparency and efficiency cannot be as fully achieved.

Specifically, in the absence of additional resources, the CFTC will be limited in its ability to:

- Perform adequate examinations of market intermediaries, including systemically important DCOs and the approximately 100 swap dealers that have reg-

istered with the Commission under the new regulatory framework required by Dodd-Frank.

- Use swaps data to address risk in a marketplace that has become largely automated, and to develop a meaningful regulatory program that is required to promote price transparency and market integrity.
- Conduct effective daily surveillance to identify the buildup of risks in the financial system, including for example, review of CFTC registrant activity reports submitted by Commodity Pool Operators and banking entities, as well as to monitor compliance with rules regarding prohibitions and restrictions on proprietary trading.
- Investigate and prosecute major cases involving threats to market integrity and customer harm and strengthen enforcement activities targeted at disruptive trading practices and other misconduct of registered entities such as precious metals schemes and other forms of market manipulation.

Conclusion

A few core principles must motivate our work in implementing Dodd-Frank. The first is that we must never forget the cost to American families of the financial crisis, and we must do all we can to address the causes of that crisis in a responsible way. The second is that the United States has the best financial markets in the world. They are the strongest, most dynamic, most innovative, most competitive and transparent. They have been a significant engine of our economic growth and prosperity. Our work should strengthen our markets and enhance those qualities. We must be careful not to create unnecessary burdens on the dynamic and innovative capacity of our markets. I believe the CFTC's work can accomplish these objectives. We have made important progress but there is still much to do. I look forward to working with the Members of this Committee and my fellow regulators on these challenges.

Thank you again for inviting me today. I look forward to your questions.

RESPONSES TO WRITTEN QUESTIONS OF CHAIRMAN JOHNSON FROM DANIEL K. TARULLO

Q.1. Since the Volcker Rule was finalized last December, what has the Fed done with other regulators to coordinate its interpretation and enforcement, and how has the Interagency Working Group facilitated these efforts?

A.1. In pursuit of our goals for a consistent application of the Volcker Rule across banking entities, the Federal Reserve continues to work with the Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Securities and Exchange Commission, and Commodity Futures Trade Commission (the Agencies). Staffs of the Agencies meet regularly to address key implementation and supervisory issues as they arise. An interagency group that includes staff from the Agencies reviews and discusses all substantive questions received. Two subcommittees of the interagency group have been established. One is developing a framework for coordinating examinations among the Agencies. The other addresses issues related to the required submission of metrics which certain of the largest firms began reporting in September.

External guidance will be handled through agency-issued frequently asked questions (FAQs) and other forms of guidance as needed. Nine FAQs have been published to date that clarify particular provisions of the final rule, including the submission of metrics, expectations during the conformance period, the application of certain covered funds restrictions, and clarification regarding the annual CEO attestation.

Staffs of the Agencies also continue to meet with and collect questions from banking entities under their respective jurisdictions, and banking entities may submit questions regarding matters of interest raised by the Volcker Rule to the Agencies. Staffs of the Agencies expect to continue to coordinate responding to matters that are of common interest in public statements, including through public responses to FAQs and in public guidance.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CRAPO FROM DANIEL K. TARULLO

Q.1. On September 3, the FRB, FDIC, and OCC issued final liquidity rules for large banks that will require more than 30 U.S. banks to add a combined $100 billion more in liquid assets than they currently hold. A Fed economist said that the rule "will to some extent make credit a bit more costly." Has the FRB conducted a detailed analysis to determine exactly how much more costly credit will become as a consequence of this rule for both small businesses and individual consumers? If yes, please provide that analysis and the ensuing result. If not, please explain why the FRB did not undertake such analysis.

A.1. The economist who provided the referenced quote explained that the liquidity coverage ratio (LCR) could make lending incrementally more costly in the sense that the LCR standard would cause banks to hold more liquid balance sheets than without the LCR requirement. He also noted, however, that the increased liquidity will also make financial crises less likely to occur and less severe if they do. As we saw in 2007 to 2009, financial crises result

in a sharp decline in credit availability and an increase in its cost, and viewed over time and on average, credit availability may increase and credit may be less costly as a result of the LCR. Indeed, that was a conclusion of the study on the likely impact of the LCR and new capital requirements, which was conducted by the Bank for International Settlements (with participation from Board economists) and released in August, 2010.[1]

Over the past several years, Federal Reserve Board (Board) staff has observed a material improvement in the liquidity position of banks, with limited impact to the overall market because banks tended to take low-cost measures to improve their liquidity positions. For example, banks have improved collateral management and decreased the size of commitments to better reflect customer needs, two measures which incur minimal cost. Banks have also taken other actions such as improving the mix of liabilities to include more stable funding like retail deposits, which also has had limited impact on their cost of funding. We anticipate that banks will continue to take these and similar low-cost measures to improve their liquidity positions and eliminate the estimated shortfall.

Q.2. In your testimony you mention that global regulators are working on an ISDA protocol resolving the insolvency of a SIFI. Under such protocol, would U.S. market participants be potentially asked to waive their rights to protections afforded under U.S. law, such as netting and termination rights?

A.2. On November 12, 2014, the International Swaps and Derivatives Association (ISDA) issued for adoption by companies the ISDA 2014 Resolution Stay Protocol.[2] The protocol amends the ISDA Master Agreement between parties adhering to the protocol to provide for a suspension of early termination rights and other remedies upon the commencement of certain resolution proceedings. These contractual amendments align with the provisions of the Federal Deposit Insurance Act and Title II of the Dodd-Frank Wall Street Reform and Consumer Protection Act concerning stays of early termination rights in qualified financial contracts, but would apply those provisions to derivatives transaction counterparties that are not otherwise subject to U.S. law. Thus, the ISDA protocol will better effectuate U.S. law in the event of the resolution of a U.S. company operating cross-borders. Furthermore, the protocol amendments would create similar stays applicable to derivatives transactions if the parent or other affiliate of the adhering counterparty has entered into an orderly resolution proceeding under the U.S. Bankruptcy Code. The protocol would not affect the application of U.S. law to contracts in the United States or those involving U.S. parties, nor would it impact the jurisdiction of U.S. courts and Federal regulators.

Q.3. The issue of FSOC accountability and transparency is one that I have raised numerous times. Given the magnitude of the regulatory burden and other costs imposed by a SIFI designation, it is

[1] The protocol and additional information regarding the protocol is available on ISDA's Web site at *http://www2.isda.org/functional-areas/protocol-management/protocol/20.*

[2] Ibid.

imperative that the designation process be as transparent and objective as possible.

Do you object to the public disclosure of your individual votes, including an explanation of why you support or oppose such designation?

A.3. I am not a member of the Financial Stability Oversight Council (FSOC), so I do not have a vote in the body.

Q.4. Will you commit to pushing for greater accountability and transparency reforms for FSOC? Specifically, will you commit to push the FSOC to allow more interaction with companies involved in the designation process, greater public disclosure of what occurs in FSOC principal and deputy meetings, publish for notice and comment any OFR report used for evaluating industries and companies, and publish for notice and comment data analysis used to determine SIFI designations? If you do not agree with these proposed reforms, what transparency and accountability reforms would you be willing to support?

A.4. On February 4, the FSOC approved a set of procedures for the designation process that are intended to supplement its rule and guidance. The changes are intended to bring more transparency to the process and provide companies that have passed the initial thresholds for consideration with the opportunity to engage with FSOC staff and the staff of member agencies at an early point in the process. As FSOC considers other potential changes to the process, the FSOC will need to balance the need for greater transparency with the need to protect information that is supervisory, proprietary, or otherwise confidential in nature. Public disclosure of such information could harm firms. Accordingly, the FSOC is careful to protect such information in providing a public basis statement that makes clear the basis for designation. The FSOC will also need to ensure that any changes to the process do not impinge on a free and frank deliberation within the FSOC as this is an important part of an effective designation process. The publicly available basis for the FSOC's determination contains an extensive explanation of the analysis the Council took into account when considering whether to designate a nonbank financial company for supervision by the Board.

Finally, while the Office of Financial Research did not request comment on its asset manager study, the Securities and Exchange Commission received and published comments on the study that have been reviewed by staff at member agencies.

Q.5. In the July FSOC meeting, the Council directed staff to undertake a more focused analysis of industrywide products and activities to assess potential risks associated with the asset management industry.

Does the decision to focus on "products and activities" mean that the FSOC is no longer pursuing designations of asset management firms?

Did the FSOC vote on whether to advance the two asset management companies to Stage 3? If so, why was this not reported? If not, why was such a vote not taken in order to provide clarity to the two entities as well as the industry?

A.5. At its July 2014 meeting, the FSOC discussed its ongoing evaluation of the potential systemic threats posed by asset management firms and their activities. At the conclusion of that discussion, the FSOC directed staff to undertake a more focused analysis of these issues and, at its December public meeting, the FSOC issued a notice published in the *Federal Register* seeking public comment on potential risks to U.S. financial stability from asset management products and activities. The FSOC's work in this area is ongoing but still preliminary. The Board is committed to helping ensure that the Council updates the public about its work in this important area as it becomes possible to do so.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MERKLEY FROM DANIEL K. TARULLO

Q.1. With the Volcker Rule, we finally learned the lessons from the bailout of Long-Term Capital Management and then the 2008 financial crisis that we simply cannot afford to have big, systemically significant firms making big bets on the ups and downs of the market. Casino banking is over—if you stick to your guns and enforce the Rule.

I deeply appreciate the hard work you did to getting to a final rule last December, and I recognize the hard work you are doing now to implement it. However, we are still at the beginning legs of the journey, and I believe in "trust but verify"—which requires full, continued cooperation by our regulators and engagement with the public.

During the financial crisis, we all saw the horrific results when different regulators saw only parts of the risks to some firms. There were too many regulatory silos, which do not work because firms do not function that way. You also need a complete picture of what is going on in any one institution and across different firms. Indeed, one of the least recognized benefits of the Volcker Rule is to force the regulators to pay attention, together, to trading activities, which have become so important at so many banks. But critically, this means all the regulators need full access to all collected data and information.

In addition, accountability to the public through disclosure provides another layer of outside oversight and analysis, as well as equally importantly, public confidence that Wall Street reform is real.

Based on the track record of various public disclosure mechanisms out there already—including for example, the CFTC's positions of traders—there is significant space for reasonably delayed disclosures of metrics data to enhance Volcker Rule accountability and public confidence. Now Treasury Deputy Secretary and then-Federal Reserve Governor Sarah Bloom Raskin highlighted disclosure in her statement on adoption of the final rule, and financial markets expert Nick Dunbar has similarly called for disclosure as a key tool. (See Nick Dunbar, "Volcker Sunlights Should Be the Best Disinfectant", July 25, 2014, *http://www.nickdunbar.net/articles/volcker-sunlight-should-be-the-best-disinfectant/*.) The OCC's Quarterly Trading Activity Report may be a perfect venue to en-

gage in this type of disclosure, provided it is expanded to cover the entire banking group.

First, will each of you commit to working to ensure that each of your agencies has a complete picture of an entire firm's trading and compliance with the Volcker Rule, which can best be accomplished by having all data in one place so that all regulators have access to it?

A.1. Section 13 of the Bank Holding Company Act (BHC Act) allocates authority among the Office of the Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC), Federal Reserve, Securities and Exchange Commission (SEC) and Commodity Futures Trading Commission (CFTC) (the Agencies) with respect to banking entities for which each Agency is the primary Federal regulator. In light of how the statute allocates authority among the Agencies, the final rule implementing section 13 requires that each banking entity provide periodic reports of certain quantitative measurements to its primary Federal regulator. A frequently asked question issued by the Agencies in June 2014, explained that a trading desk that spans multiple legal entities must report the quantitative measurements to each of the Agencies with jurisdiction under section 13 of the BHC Act over any of the entities.[1] The Agencies have been and continue to cooperate in reviewing the data submitted by firms.

While the Agencies do not currently have plans to have all the data in one place, the Federal Reserve intends to work with the other Agencies to coordinate supervision and enforcement of section 13 and implementing regulations. This coordination includes sharing the metrics data provided by banking entities under the final rule as appropriate.

Q.2. Second, are you committed to using disclosure to help advance compliance with and public trust from the Volcker Rule?

A.2. In the preamble of the final rule, the Agencies emphasized that the purpose of the quantitative measurements is not as a dispositive tool for determining compliance with the rule but rather would be used to monitor patterns and identify activity that may warrant further review. Banking entities that are subject to metrics reporting as of September 2014, generally have requested confidential treatment of the metrics data under the Freedom of Information Act as trade secrets and commercial or financial information obtained from a person that is privileged or confidential.

The Agencies also indicated in the final rule that they intended to revisit the quantitative measurements in September 2015, after having gained experience with the data. At that time, the Federal Reserve will consult with the other Agencies regarding the potential for release of aggregated data on a delayed basis that would not identify the trading positions of any individual firm.

Q.3. The success of the Volcker Rule over the long term will depend upon the commitment of regulators to the vision of a firewall between high risk, proprietary trading and private fund activities, on the one hand, and traditional banking and client-oriented investment services on the other hand. One of the most important

[1] See *http://www.federalreserve.gov/bankinforeg/volcker-rule/faq.htm#2.*

parts of ensuring that vision is meaningfully implemented is the December 2013 final rule's application of its provisions at the "trading desk" level, defined as the "smallest discrete unit of organization" that engages in trading.

Unfortunately, reports have emerged suggesting that banks are already attempting to combine and reorganize what had been separate trading desks into one "trading desk" for Volcker Rule purposes, as a way to game the metrics-based reporting essential to effective monitoring by regulators of each institution's compliance with the Volcker Rule. The OCC has already identified this risk in its Interim Examination Procedures, and attempted to limit such actions to instances where the desks were engaged in "similar strategies," the combination has a "legitimate business purpose," and the combination assists the firm to "more accurately reflect the positions and fluctuations" of its trading. I feel that the OCC's interim protections may not, however, be enough ensure compliance with the final rule.

I am deeply concerned that combining or reorganizing trading desks would undermine the strength of the metrics-based oversight, particularly related to whether market-making is truly to serve near-term customer demand and whether hedging is truly that. To avoid obscuring evasion by changing the mixture and volume of the "flow" of trading that is reported by the "trading desk" unit, I would suggest that examiners ought to strictly apply the final rule's approach to "trading desk" and apply the guidance set out by the OCC extremely narrowly, along with additional protections. For instance, "similar strategies" would need to include both the type of the trading (e.g., market-making) but also the same or nearly identical products, as well as be serving the same customer base, among other standards. As an example, if two desks traded in U.S. technology stocks and technology stock index futures, combining those into one desk might make sense, depending on other factors, such as where the desks were located and what customers they were serving. But combining, for example, various industry-specific U.S. equities desks that today are separate would not pass muster for complex dealer banks.

It is also important to remember that an important supervisory benefit from implementing the Volcker Rule at a genuine trading desk level is that regulators will gain a much deeper, more granular understanding of the risks emanating the large banks' many different trading desks—the kind of risks that led one particular trading desk to become famous as the London Whale.

When confronted with attempts to reorganize trading desks, regulators should look carefully at whether submanagement structures, bonus structures, or other indicia exist that would suggest that the reorganized "trading desk" is not actually the smallest discrete unit of organization contemplated by the final rule and essential to the metrics-based oversight system being developed.

Will you commit to scrutinizing, for the purposes of the Volcker Rule, any reorganizations of trading desks as posing risks of evasion and will you commit to working jointly to clarify any guidance on the definition of trading desk for market participants?

A.3. The final rule implementing section 13 of the BHC Act applies various requirements to a trading desk of a banking entity and re-

quires banking entities subject to quantitative measurements reporting under Appendix A of the final rule to report the required metrics for each trading desk. As you note, the final rule defines a "trading desk" to mean the smallest discrete unit of organization of a banking entity that purchases or sells financial instruments for the trading account of the banking entity or an affiliate thereof.[2] In issuing the final rules, the Agencies explained that adopting an approach focused on the trading desk level would allow banking entities and the Agencies to better distinguish between permitted market making-related activities and trading that is prohibited by section 13 of the BHC Act and will thus prevent evasion of the statutory requirements.[3]

As part of the supervisory process, the Federal Reserve intends to monitor how banking entities define a trading desk and to monitor any reorganizations of trading desks in order to avoid evasion of the requirements of section 13 and the final rule. The Federal Reserve will work with the other Agencies to clarify any guidance on the definition of trading desk if needed to address concerns about such reorganizations and evasion.

Q.4. Ensuring speedy compliance with the provisions of the Merkley-Levin Volcker Rule is a top priority for strong implementation. It has already been 4 years since adoption, and banks should be well on their way to conforming their trading and fund operations.

However, as you know, we also provided for an additional 5 years of extended transition for investments in "illiquid funds," which were expected to include some types of private equity funds. We did this because some private equity funds, such as venture capital funds, do not usually permit investors to enter or exit during the fund's lifetime (usually 10 years or so) because of the illiquidity of those investments.

As you know, the Federal Reserve Board's rule on the "illiquid funds" extended transition interprets the statutory provision of a "contractual commitment" to invest as requiring a banking entity, where a contract permits divestment from a fund, to seek a fund manager's and the limited partners' consent to exit a fund. The rule, however, provides for the Board to consider whether the banking entity used reasonable best efforts to seek such consent but that an unaffiliated third party general partner or investors made unreasonable demands.

I strongly support the Board's desire to implement the Volcker Rule in a speedy manner. In addition, the Board's approach in the final conformance rule goes a long way to ensuring that the illiquid funds extended transition only be available for investments in truly illiquid funds, and not a way to avoid divestment of hedge funds and private equity funds.

At the same time, we designed the provision to provide for a smooth wind-down for illiquid funds. Indeed, I am sensitive to the legitimate business needs of firms seeking to comply with the Volcker Rule while maintaining relationships with important cus-

[2] See 12 CFR 248.3(e)(13).
[3] See 76 FR 5536 at 5591.

tomers to whom they may seek to provide traditional banking services.

Accordingly, I would urge the Board to clarify that a banking entity's requirement to make "reasonable efforts" to exercise its contractual rights to terminate its investment in an illiquid fund could be satisfied, for example, by a certification by the banking entity (a) that the banking entity's exit from the fund would be extraordinary from the perspective of how most investors enter or exit the fund (i.e., the investment contract does not routinely or ordinarily contemplate entry or exit, and/or such other indicia as are necessary to help distinguish between illiquid private equity funds and other funds, like hedge funds, that ordinarily and routinely permit investor redemptions), (b) that inquiring with third-party fund managers and limited partners regarding termination would result in a significant detriment to the business of the banking entity and (c) that the banking entity believes that the divestment would result in losses, extraordinary costs, or otherwise raise unreasonable demands from the third-party manager relating to divestment (or the de facto equivalent thereto).

Such a certification from the banking entity, along with the language of the relevant fund agreements and such other requirements as the Board determines appropriate, would obviate the need to seek consent from third-party fund managers. Have you considered clarifying this in a FAQ?

A.4. A number of commenters have requested that the Federal Reserve modify the meaning of what is "necessary to fulfill a contractual obligation" of the banking entity under the Board's 2011 conformance rule. The Federal Reserve is considering these comments in light of the requirements of section 13. The Federal Reserve will consider your comments regarding a potential certification for illiquid funds in determining what next steps to take on these matters.

Q.5. We've recently seen reports that the largest Wall Street banks are nominally "deguaranteeing" their foreign affiliates in order to avoid coverage under U.S. regulatory rules, especially those related to derivatives. This "deguaranteeing" appears to be based on a fiction that U.S. banks do not actually guarantee the trading conducted by foreign subsidiaries, and hence would not be exposed to any failure by the foreign subsidiary.

Can you comment on that, and specifically, whether you believe that U.S. bank or bank holding company could be exposed to losses from—or otherwise incur liability related to—a foreign affiliate's trading even when no explicit guarantee to third parties exists. Please specifically address whether an arrangement, commonly known as a "keepwell," provided by the U.S. parent or affiliate to the foreign affiliate potentially could create such exposure—and specifically, liability—for the U.S. entity.

A.5. As a general matter, the Federal Reserve engages in consolidated supervision and regulation of bank holding companies (BHCs) and banks. Most of the Federal Reserve's BHC regulations apply on a consolidated basis; accordingly, removal of any BHC parent guarantees of, or keepwell arrangements with, foreign subsidiaries have little or no effect on the BHC's consolidated risk-

based capital, leverage, and liquidity requirements. In other words, for most of our key BHC regulations, we generally treat the assets, liabilities, and exposures of a BHC's foreign subsidiaries as owned by the BHC, whether or not there is an explicit guarantee by the BHC parent of the assets, liabilities, or exposures of the foreign subsidiary. Our basic supervisory stance is to require a BHC to manage its own risks as well as the risks of all of its domestic and foreign consolidated subsidiaries.

With respect to rules related to derivatives transactions, in September 2014, the prudential regulators (including the OCC, the Federal Reserve, the FDIC, the Farm Credit Administration, and the Federal Housing Finance Agency) released a proposed rule for margin requirements for covered swap entities. Covered swap entities are defined to mean entities registered as swap dealers or major swap participants with the CFTC, or registered as security-based swap dealers or major security-based swap participants with the SEC and that are regulated by one of the prudential regulators.

The proposed rule addressed the cross-border application of the margin requirements, including the treatment of guarantees. In particular, the proposal stated that the requirements would not apply to any foreign noncleared swap of a foreign covered swap entity. To qualify as a foreign noncleared swap eligible for this exclusion, no guarantor of either party's obligations under the swap could be a U.S. entity. Moreover, the proposed rule also provided that certain covered swap entities may be eligible for substituted compliance, whereby they could comply with the swap margin rules of another jurisdiction instead of the U.S. rule if the prudential regulators made a comparability determination. The proposal explicitly provided that a covered swap entity was eligible for substituted compliance only if the covered swap entity's obligations under the swap were not guaranteed by a U.S. entity.

Q.6. Moreover, please comment on whether the size and importance to the U.S. parent or affiliate of the foreign affiliate's activities could itself create an implied guarantee such that the U.S. firm would have major reputational or systemic risk reasons to prevent the foreign affiliate from incurring significant losses or even failing—similar to rescues that occurred during the financial crisis of entities that were supposed to be bankruptcy remote.

A.6. Please see response to Question 5 above. As noted above, the Federal Reserve generally takes a consolidated approach to supervision regardless of the size or importance of the U.S. entity.

Q.7. Finally, many of these foreign bank subsidiaries are so-called "Edge Act" corporations, which I understand are consolidated with the insured depository subsidiary for many purposes. Please comment on whether there is any chance that losses in these Edge Act corporations, particularly losses in their derivatives operations, could impact the deposit insurance fund.

A.7. The potential for losses at subsidiaries to affect the operations of a parent BHC or bank, and in turn affect the deposit insurance fund, is one of the important reasons why the Federal Reserve takes a consolidated approach to supervision and regulation of BHCs and banks. Elimination of guarantees and keepwell arrangements between a bank and its Edge Act subsidiary would not affect

our supervision of the BHC, the bank, or the Edge Act corporation, nor would it change the bank's capital or liquidity requirements.

Q.8. There have been several recent stories in Reuters that highlight how some large bank holding companies continue to be engaged deeply in the investment and trading in physical commodities—ownership of oil trains and natural gas plants businesses.

Are you concerned about the continued expansion by some of our largest bank holding companies into activities? Can you provide an update on the status of your physical commodities review, and whether you intend to at least ensure that short term trading in physical commodities are covered by appropriate limits, protections, and prohibitions against conflicts of interest?

A.8. In January 2014, the Federal Reserve Board (Board) invited public comment through an advance notice of proposed rulemaking (ANPR) on a range of issues related to the commodities activities of financial holding companies. The scope of our ongoing review covers commodities activities and investments under section 4(k) complementary authority, merchant banking authority, and section 4(o) grandfather authority. Recently, some of the financial holding companies engaged in physical commodities activities have publicly indicated that they are reducing or terminating some of these activities.

As the ANPR explains, we are exploring what further prudential restrictions or limitations on the ability of financial holding companies to engage in commodities-related activities are warranted to mitigate the risks associated with these activities. Such additional restrictions could include reductions in the maximum amount of assets or revenue attributable to such activities, increased capital or insurance requirements on such activities, and prohibitions on holding specific types of physical commodities that pose undue risk to the company. We also are exploring what restrictions or limitations on investments made through the merchant banking authority would appropriately address those or similar risks.

In response to the notice, the Board received 184 unique comments and more than 16,900 form letters. Commenters included Members of Congress, individuals, public interest groups, academics, end users, banks, and trade associations. The comments present a range of views and suggested Board actions—from no action to prohibiting trading or ownership of commodities associated with catastrophic risk, strengthening prudential safeguards (such as reducing caps on the amount of permitted activities), strengthening risk-management practices, enhancing public disclosure, requiring additional capital, increasing regulatory coordination, and developing risk-management best practices. The Board has been reviewing the comments and considering what steps would be appropriate to address the risks posed by physical commodities activities.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR TOOMEY FROM DANIEL K. TARULLO

Q.1. In June 2013, the FSOC voted to designate AIG, GE Capital, and Prudential as nonbank SIFIs. Shortly thereafter, in July 2013, the Financial Stability Board, of which the Federal Reserve is an influential member, voted to designate AIG, Prudential, and

MetLife as systemically important. What warranted the immediate designation of AIG and Prudential and the substantial delay in designating MetLife?

A.1. Under the Dodd-Frank Wall Street and Consumer Protection Act (Dodd-Frank Act), the Financial Stability Oversight Council (FSOC) may only designate financial companies that are not bank holding companies. MetLife was a U.S. bank holding company until February 14, 2013. On that date, it received the required approvals from both the Federal Deposit Insurance Corporation and the Federal Reserve Board (Board) to deregister as a bank holding company. These approvals followed the completed sale of MetLife Bank's depository business to General Electric Capital Corporation (GECC) on January 11, 2013.

Because MetLife—unlike AIG, GECC, and Prudential—was a bank holding company until February 2013, FSOC's designation process for MetLife trailed that of AIG, GECC, and Prudential.

Q.2. It makes logical sense for national Governments to conduct their own reviews of potentially systemically important firms within their countries before voting to designate them as such at an international body. However, this was not the case with MetLife. Why did the Fed vote first to designate MetLife as a SIFI at the FSB before voting to designate MetLife as a domestic nonbank SIFI?

A.2. As noted in the prior response, because MetLife was a bank holding company until February 2013, the FSOC designation process for MetLife was delayed. Moreover, it is important to note that the Financial Stability Board's (FSB) process for identifying global systemically important insurers (G–SIIs) is independent from the FSOC's designation process. Among other differences, the FSB and FSOC have different designation frameworks and standards. In addition, any standards adopted by the FSB, including designation of an entity as a global systemically important financial institution (G–SIFI), are not binding on the Board or any other agency of the U.S. Government, or any U.S. companies. Thus, FSB designation of an entity as a nonbank SIFI does not automatically result in the Board becoming the entity's prudential regulator. Under the Dodd-Frank Act, the FSOC is responsible for deciding whether a nonbank financial company should be regulated and supervised by the Board, based on its assessment of the extent to which the failure, material distress, or ongoing activities of that entity could pose a risk to the U.S. financial system.

Q.3. What analysis and review did the Federal Reserve conduct prior to supporting the FSB's July 2013 designation of MetLife, AIG, and Prudential?

A.3. The methodology for identifying G–SIIs was developed by the International Association of Insurance Supervisors (IAIS). The IAIS' assessment methodology identifies five categories to measure relative systemic importance: (1) nontraditional insurance and noninsurance activities, (2) interconnectedness, (3) substitutability, (4) size, and (5) global activity. Within these five categories, there are 20 indicators, including: intrafinancial assets and liabilities, gross notional amount of derivatives, Level 3 assets, nonpolicyholder liabilities and noninsurance revenues, derivatives trading, short

term funding and variable insurance products with minimum guarantees. The initial assessment methodology involved three steps: (1) the collection of data, (2) a methodical assessment of that data, and (3) a supervisory judgment and validation process. Documents associated with the development of the methodology were reviewed by Board staff.

Q.4. What analysis and review did the Federal Reserve conduct on MetLife after July 2013 but before the recent FSOC vote on designation?

A.4. The FSOC's analysis is based on a broad range of quantitative and qualitative information available to the FSOC through existing public and regulatory sources, and information submitted by MetLife. The analysis is tailored, as appropriate, to address company-specific risk factors, including but not limited to, the nature, scope, size, scale, concentration, interconnectedness, and mix of the activities of MetLife. Board staff, along with the staffs other FSOC member agencies and offices, contributed to this analysis.

Q.5. What kind of contact have you or your colleagues at the Federal Reserve had with the FSB as it relates to reviewing asset managers?

A.5. The FSB, in consultation with the International Organization of Securities Commissions (IOSCO), is currently developing methodologies to identify systemically important nonbank noninsurer (NBNI) firms. The purpose of this exercise is to fulfill a request by the G20 Leaders to identify threats to global financial stability that could arise from the material financial distress or failure of NBNI firms, mirroring a process for identifying global systemically important banks and insurers.[1] The Board is participating in this process, along with other U.S. agencies.

Earlier this year, the FSB issued a consultative document on "Assessment Methodologies for Identifying Non-Bank Non-Insurer (NBNI) Global Systemically Important Financial Institutions."[2] It proposed assessing the systemic importance of NBNI firms with reference to a set of five factors: size; interconnectedness; substitutability; complexity and global activities. These factors are broadly consistent with those that have been used in the identification of globally significant banks and insurers. For practical reasons, the FSB also proposed using a "materiality threshold" of $100 billion in net assets under management (AUM) to limit the set of firms for which detailed data on these five factors would be collected. (Hedge funds would be subject to an additional threshold of $400 to $600 billion in gross notional exposure.) NBNI firms that are considered potentially systemically important by their national supervisors could be added to the assessment pool, even when they fall below this threshold.

In its consultation paper, the FSB sought comments on the merits of the proposed threshold, and solicited proposals for alternative practicable screening mechanisms. The comments received, includ-

[1] See paragraph 70 of the G20 Leaders' Declaration from the St. Petersburg Summit, September 2013: *https://www.g20.org/sites/default/files/g20_resources/library/Saint_Petersburg_Declaration_ENG_0.pdf.*

[2] The consultation paper is available for download at: *http://www.financialstabilityboard.org/wp-content/uploads/r_140108.pdf.*

ing those from many U.S. firms and industry associations, will be an important input that will help refine the assessment methodologies.[3] Moreover, there will continue to be significant input from U.S. agencies before an assessment methodology is approved by the FSB. U.S. agencies are also active participants in IOSCO. This work is ongoing and has yet to reach any conclusions.

It is important to note that any standards adopted by the FSB, including designation of an entity as a G–SIFI, are not binding on the Board or any other agency of the U.S. Government, or any U.S. companies. Under the Dodd-Frank Act, the FSOC is responsible for deciding whether a nonbank financial company should be regulated and supervised by the Board, based on its assessment of the extent to which the failure, material distress, or ongoing activities of that entity could pose a risk to the U.S. financial system. Moreover, the Board would only adopt FSB regulatory standards after following the well-established rulemaking protocols under U.S. law, which include a transparent process for proposal issuance, solicitation of public comments, and rule finalization.

As stated above, the purpose of the FSB exercise is to identify threats to global financial stability that could arise from the material financial distress or failure of NBNI firms. It is possible that the FSB may decide that, at present, none of these firms poses such a threat. However, in the event that financial stability risks are identified by the FSB, and U.S. authorities agree with this identification, the FSOC has a range of policies options at its disposal. These include communicating such risks in its annual report to Congress; recommending that existing primary regulators apply heightened standards and safeguards; and designating individual firms as "systemically important financial institutions," thereby subjecting them to supervision and regulation by the Board. The appropriate response will depend upon the nature of the risks identified, and will seek to maximize net benefits to the economy.

This past July, the FSOC directed staff to "undertake a more focused analysis of industrywide products and activities to assess potential risks associated with the asset management industry." The FSOC's work program is complementary to that of the FSB—in both cases, the purpose is to identify metrics that can be used across the industry to feed into an assessment of financial stability risks generated by asset management funds and activities. There is ample opportunity for mutually beneficial information sharing in these processes.

Q.6. How does the FSOC's new approach with respect to asset managers affect the United States' input into the same process with respect to the FSB?

A.6. Please see the response to Question 5.

Q.7. The FSB has proposed a "materiality threshold" of $100 billion in assets under management (AUM), which would capture only U.S. mutual funds, and no funds from other countries. Did you and do you continue to support a $100 billion AUM test for materiality?

A.7. Please see the response to Question 5.

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[3] Responses to the consultation paper are available for download at: *http://www.iosco.org/library/index.cfm?section=pubdocs&publicDocID=435.*

Q.8. Because this test disproportionately affects U.S. funds, doesn't it put them at a disadvantage vis-a-vis their international competitors?

A.8. Please see the response to Question 5.

Q.9. Does it seem at all inconsistent to you that the FSOC went ahead with designating nonbank firms as SIFIs before knowing what regulatory framework would be applied once designated?

A.9. The Dodd-Frank Act authorizes the FSOC to make a determination as to whether the material financial distress of a nonbank financial company could pose a threat to U.S. financial stability; the nature of the enhanced prudential standards to be applied to a company if the FSOC determines that the company could pose such a threat is a separate process conducted by the Board. Under section 113 of the Dodd-Frank Act, the FSOC is required to consider a specific set of factors when determining whether a nonbank financial company should be designated by the FSOC for supervision by the Board. There is no requirement in section 113 or elsewhere for the FSOC to consider the standards to be applied to nonbank financial companies designated for supervision by the Board (designated firms). The FSOC has not found that its conclusion of whether a company's material financial risk could pose a threat to U.S. financial stability required a determination beforehand as to how enhanced prudential standards would apply to the company.

Section 165 of the Dodd-Frank Act establishes mandated enhanced prudential standards that must be applied to any nonbank financial company designated by the FSOC. Section 165(a)(2) requires the Board to tailor prudential standards for a designated firm as appropriate in light of any predominant line of business and activities of the firm, among other factors. Consistent with section 165, the Board has chosen not to adopt a universal, one-size-fits-all regulation governing all designated firms. Instead, the Board has chosen to apply enhanced prudential standards to designated firms individually through an order or rule following an evaluation of the business model, capital structure, and risk profile of each designated firm. This individualized approach allows the Board to tailor its supervision and adapt standards as appropriate to each designated firm.

Q.10. How do we know if the systemic risks perceived by the FSOC can be effectively addressed through designation, if the Federal Reserve and the FSOC don't currently know how they plan to regulate these entities?

A.10. The application of enhanced prudential standards by the Board to designated firms will mean that these firms must meet new capital and liquidity standards which aim to decrease the risk they may pose to U.S. financial stability. As described in response to Question 9 above, the Board is committed to tailoring the application of such standards to designated firms to best address the unique business model, capital structure, risk profile, and systemic footprint of each designated firm before crafting the applicable enhanced prudential standards. We believe this individualized approach will allow us to best address and ameliorate any risks they pose to the financial system.

Q.11. Has the Federal Reserve already thought about how to regulate nonbank SIFIs? If so, when will the Fed articulate this framework to the public and the entities subject to regulation?

A.11. As described in response to Questions 9 and 10 above, the precise details of the frameworks for nonbank SIFIs will be informed by analysis of the capital structures, financial activities, riskiness, and complexity of these firms, along with other relevant risk-related factors. For example, with regard to the development of enhanced prudential standards for designated firms that are insurance companies, the Board began a quantitative impact study (QIS) to evaluate the potential effects of its capital framework on designated firms that are substantially engaged in insurance underwriting activities. We will use the results of the QIS to inform the design of an appropriate framework for these firms that respects the realities of insurance activities.

With regard to GECC, the remaining designated firm, the Board proposed for public comment in November 2014, a comprehensive set of enhanced prudential standards for the firm. The comment period closed in February, and staff is analyzing comments received. We expect to have these frameworks in place as soon as practicable.

Q.12. Given the recent decision by FSOC to take a new approach with respect to asset managers, should Congress expect the FSOC to take a similar approach with respect to insurance companies?

If so, what impact will this have on insurance companies already designated by FSOC?

If not, doesn't this exemplify quite a bit of methodological inconsistency, subjecting some nonbank firms to certain kinds of reviews, while subjecting other firms to different reviews?

A.12. Under the Dodd-Frank Act, the FSOC has a variety of authorities to address risks to financial stability from the nonbanking firms. These authorities include designating nonbank financial companies for supervision by the Federal Reserve Board as well as making recommendations to existing primary regulators to apply new or heightened standards and safeguards to the financial activities or practices of such firms.

In exercising this authority, the FSOC, to date, has designated four nonbank financial companies based on a consideration of the statutory factors as applied to each individual company's unique business model as well as its leverage, liabilities, activities, and interconnectedness to the financial system, among other factors. In the event that the material financial distress of a nonbank financial company would pose a threat to U.S. financial stability, it is appropriate for the FSOC to designate that firm as systemically important, as FSOC has determined in the case of three insurance companies—AIG, Prudential, and MetLife.

With regard to asset managers, the FSOC is currently studying the relationship of the asset management industry generally to U.S. financial stability, including analysis of potential risks such as the transmission of the material financial distress of an asset manager to the broader financial system. At its December 2014 public meeting, the FSOC issued a notice published in the Federal Register seeking public comment on potential risks to U.S. financial

stability from asset management products and activities. The FSOC's work in this area is ongoing and no determinations have been made at this time.

Q.13. A number of ABS classes, including securitized auto and credit card loans, were denied any HQLA status in the recently finalized LCR rule. What was your reasoning for this?

A.13. The banking agencies that issued the liquidity coverage ratio (LCR) rule analyzed and considered many asset classes for treatment as high-quality liquid assets (HQLA) in the LCR. Evidence from the 2007 to 2009 financial crisis and the period following indicates that the market demand for securitization issuances can decline rapidly during a period of stress and may not rapidly recover. The ability to monetize these securitization issuances through or in the repurchase market may be limited in a period of stress. Ultimately, a number of types of asset-backed securities (ABS), including securitized auto and credit card loans, were not treated as HQLA under the final rule because the banking agencies concluded that as an asset class, they are not sufficiently liquid, particularly during times of stress.

Q.14. Because many of the banks that need to comply with the LCR comprise a significant number of the investors in these ABS, will denying HQLA status to ABS increase borrowing costs for consumers and small businesses? Was a cost-benefit analysis conducted on this particular provision of the rule? Would you be open to sharing that analysis, on this provision or on the rule as a whole, with Congress?

A.14. We do not believe that demand for private label ABS will be materially affected by the LCR; nor do we believe that the borrowing costs to consumers and small businesses will be materially affected by the non-HQ LA status of private label ABS in the LCR. In this regard, it is important to note that the LCR contains provisions that provide favorable treatment to borrowings from retail and small business customers as compared to borrowings from large businesses. In addition, the banking agencies reviewed investments in ABS by banking organizations subject to the LCR final rule and found that ABS holdings by these firms comprise a limited amount of the total ABS market.

In developing and finalizing the LCR rule, the banking agencies considered the various benefits and costs associated with the LCR, including the potential economic impact of asset classes being treated or not treated as HQLA and the potential impact of the rule as a whole on mitigating systemic risk. We also took into account a 2010 study by the Bank for International Settlements, which was contributed to by the U.S. banking agencies, on the long-term economic impact of stronger liquidity and capital requirements for banks. The study suggested that over time and on average, credit availability would increase and credit would be less costly due to the likelihood that such regulations will make future financial crisis less likely and less severe.

Q.15. Additionally, the finalized LCR rule confers no HQLA status to private-label mortgage-backed securities while conferring GSE-guaranteed mortgage-backed securities Level 2A HQLA status. Re-

publicans and Democrats are committed to attracting more private capital to housing finance. To what extent did you consider the ramifications of this decision as it relates to broader housing finance reform?

A.15. Data indicates that Government-sponsored enterprise (GSE) guaranteed mortgage-backed securities (MBS) have been and continue to be very liquid instruments, which is the basis for their treatment as Level 2A HQLA (subject to operational and other requirements) in the LCR issued by the banking agencies. In contrast, evidence from the 2007 to 2009 financial crisis and the period following indicates that the market demand for a variety of private label securitization issuances can decline rapidly during a period of stress, and that such demand may not rapidly recover. The banking agencies determined that private-label MBS do not exhibit the through-the-cycle liquidity characteristics necessary to be included as HQLA under the final rule, and as noted in response to Question 14 above, we considered the costs and benefits of treating privatelabel MBS as HQLA in developing and finalizing the LCR. Like other assets not treated as HQLA that are nevertheless permissible investments, we believe banking organizations will continue to invest in these types of assets in order to meet the demands of their customers and benefit from the yields these investments offer.

Q.16. Doesn't the disparate treatment of PLMBS and GSE MBS direct more funding into GSE-guaranteed mortgages and make it harder for private capital (without Government guarantees from the GSEs, FHA, VA, or USDA) to re-enter the market?

A.16. We recognize the importance of private capital as a source of funding to the U.S. residential mortgage markets and note that the LCR rule does not prohibit banking organizations from continuing to invest in private label MBS. In recognition of the fact that many types of permissible investments for banking organizations may not be readily liquid during times of financial stress, the LCR requires banking organizations to meet the proposed liquidity requirements with assets that have historically been a reliable source of liquidity in the United States during times of stress. As discussed above, the banking agencies determined that private label MBS did not meet this standard. The agencies do not anticipate, however, that the exclusion of this asset class from HQLA will significantly deter investment by banking organizations in these assets.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR KIRK FROM DANIEL K. TARULLO

Q.1. The Federal Reserve's earliest regulatory proposals setting requirements for Savings and Loan Holding Companies recognized a difference between top-tier holding companies that are insurance companies themselves and shell-holding companies carrying out a broad range of financial activities outside of the regulated insurance umbrella, such as AIG. This distinction seems appropriate.

Do you see any compelling reason to change capital rules for top-tier insurance SLHCs in the U.S. from those currently utilized under State law?

A.1. Section 171 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) requires, in part, that the Federal Reserve Board (Board) establish consolidated minimum risk-based and leverage requirements for depository institution holding companies, which includes Savings and Loan Holding Companies (SLHCs), and nonbank financial companies supervised by the Board. Thus, section 171 of the Dodd-Frank Act requires the Board to establish consolidated requirements for these firms at the holding company level, in contrast to the capital requirements that are imposed under individual State insurance laws on insurance companies on a stand-alone, legal entity basis.

In June 2012, the Board proposed changes to its regulatory capital framework that would, in part, establish consolidated capital requirements for savings and loan holding companies, including those with substantial insurance underwriting activity (insurance SLHCs). In finalizing the framework in July 2013, the Board excluded insurance SLHCs from application of the revised capital rule pending further consideration of whether and how the proposed requirements should be modified for these companies. The Board has been working to develop a revised regulatory capital framework for insurance SLHCs that appropriately addresses the risks to capital adequacy on a consolidated level, not just at the level covered by the State insurance laws. In October 2014, the Federal Reserve began a quantitative impact study (QIS) to evaluate the potential effects of its revised regulatory capital framework on insurance SLHCs and nonbank financial companies supervised by the Board that engage substantially in insurance underwriting activity. The Board is conducting the QIS to inform the design of an appropriate capital framework for these firms.

Q.2. The Fed is tasked with developing capital rules for both insurance-based SLHCs and SIFIs. What differences do you see between SLHCs and SIFIs, and how will the capital rules reflect these differences? Do your international efforts for globally systemic firms have any influence on your development of capital rules for insurance-based SLHCs?

A.2. While the capital standards applied to insurance-based SLHCs and nonbank financial companies supervised by the Board will respect the realities of insurance activities, the precise details of the standards will be informed by analysis of the capital structures, financial activities, riskiness, and complexity of these two sets of firms, along with other relevant risk-related factors. To the extent that there are similarities in these areas between insurance-based SLHCs and nonbank financial companies, elements of the capital standards applied to them would likely be similar. Where differences exist, the standards would be tailored to take into account the unique characteristics of these firms' insurance operations.

The Board's understanding of these two sets of firms has been informed by work in a number of different areas, including what has been learned through the Board's supervision of insurance-based SLHCs over the past 3 years, the Board's membership in the International Association of Insurance Supervisors, the Board's discussions with State insurance commissioners, and the QIS described in response to Question 1. We are committed to developing

capital requirements that are appropriate for the business mixes, risk profiles, and systemic footprints of these two sets of firms.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CRAPO FROM THOMAS J. CURRY

Q.1. The issue of FSOC accountability and transparency is one that I have raised numerous times. Given the magnitude of the regulatory burden and other costs imposed by a SIFI designation, it is imperative that the designation process be as transparent and objective as possible.

Do you object to the public disclosure of your individual votes, including an explanation of why you support or oppose such designation?

Will you commit to pushing for greater accountability and transparency reforms for FSOC? Specifically, will you commit to push the FSOC to allow more interaction with companies involved in the designation process, greater public disclosure of what occurs in FSOC principal and deputy meetings, publish for notice and comment any OFR report used for evaluating industries and companies, and publish for notice and comment data analysis used to determine SIFI designations? If you do not agree with these proposed reforms, what transparency and accountability reforms would you be willing to support?

A.1. I am committed to a designation process that is fair, that provides appropriate levels of transparency, and that is based on an objective analysis and consideration of the statutory factors set forth by Congress in the Dodd-Frank Act. The current designations process, which the Council published for notice and comment, includes various mechanisms to promote accountability and to provide companies the ability to interact and respond to a proposed designation prior to any final action by the Council. In particular, the Stage 3 phase of the designation process is iterative providing extensive opportunities for the company to interact with staff conducting the analysis and to present information and data that the company believes is relevant for FSOC's analysis. For example, for one of the companies that has been designated, the FSOC spent almost a year conducting its analysis after beginning its engagement with the company, and the Council considered more than 200 data submissions from the company that totaled over 6,000 pages. Staff of FSOC members and member agencies had contact with the company at least 20 times, including seven meetings with senior management and numerous other telephone meetings. The FSOC's evaluation, which considered the company's views and information, culminated in a detailed and lengthy analysis (over 200 pages) that the FSOC shared with the company following the proposed designation and before a vote by the Council on a final designation.

The Council's public basis document, which is part of the record whenever the Council decides to designate a company, provides a public record of the views of Council members. Specifically, the public basis document, which is posted to the Council's Web site, reflects the views by the assenting Council members for the designation, with any dissenting views recorded as part of the public record.

The FSOC recently issued responses to frequently asked questions about the designation process to provide greater clarity and transparency on the current process. The Council has also discussed various changes proposed by stakeholders, Members of Congress, and other interested parties that could enhance the current process. Such changes could include, for example, earlier notification of companies that they are under review. At the Council's direction, the FSOC's Deputies Committee has recently held meetings with various stakeholders to solicit their views and feedback on steps that the Council could take to provide additional transparency and engagement during the various phases of the designation process. The Council intends to have further discussions on this issue at its upcoming meetings.

More broadly, the Council has taken steps to increase the overall transparency of Council actions, including providing more detail in Council minutes and publishing Council meeting agendas a week in advance, except in exigent circumstances.

Q.2. In the July FSOC meeting, the Council directed staff to undertake a more focused analysis of industrywide products and activities to assess potential risks associated with the asset management industry.

Does the decision to focus on "products and activities" mean that the FSOC is no longer pursuing designations of asset management firms?

Did the FSOC vote on whether to advance the two asset management companies to Stage 3? If so, why was this not reported? If not, why was such a vote not taken in order to provide clarity to the two entities as well as the industry?

A.2. At its recent meetings, the FSOC discussed the Council's various work streams related to asset managers, including its work related to analyzing industrywide and firm-specific risks. Based on those discussions, the Council has agreed to undertake a more focused analysis of industrywide products and activities. The objective of this work is to inform the Council, about what, if any, additional policy actions by FSOC or its members may be appropriate. The Dodd-Frank Act provides FSOC with a range of policy tools, including making recommendations to regulators and the industry in the FSOC's annual report, issuing formal recommendations to primary financial regulatory agencies to apply new or heightened standards or safeguards, designating a nonbank financial company to be supervised by the Federal Reserve, or designating payment, clearing, or settlement activities as systemically important. It would be premature to determine which, if any, of these policy tools may be most appropriate until the Council's more in-depth analysis of the industry and its activities are completed. In light of these decisions, and pending the completion of these work streams, the Council has not voted on any action with respect to specific asset management firms.

Q.3. There has been much attention surrounding Operation Choke Point, a DOJ-led effort with your agencies participating. Unfortunately, this Operation has resulted in numerous legitimate small businesses losing access to basic banking services. I appreciate that your agencies have issued new guidance last month to address

market uncertainty. It is my understanding that your agencies, as part of this Operation, refer cases to DOJ if you suspect a violation of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA).

Please provide the number of FIRREA referrals each of your agencies has made to DOJ as a part of Operation Choke Point.

A.3. The OCC is not a part of Operation Choke Point and has not made any referrals to DOJ as a part of Operation Choke Point.

Q.4. If your agency did not provide any FIRREA referrals to DOJ directly in connection with Operation Choke Point, how many FIRREA referrals has your agency provided to DOJ since DOJ commenced its Operation Choke Point?

A.4. The OCC expects that potential criminal violations and suspicious transactions that are indicative of money laundering or terrorist financing would be referred to the DOJ through the Suspicious Activity Reporting (SAR) system maintained by FinCEN. Most SARs are filed by the institutions themselves, although the OCC may also file SARs, e.g., where a bank fails to file, or files an incomplete or inaccurate SAR. Since December 2012, the OCC has filed nine SARs.

The OCC may also reach out directly to DOJ to bring priority SARs to their attention. In addition, under the Equal Credit Opportunity Act (ECOA), the OCC is also required to make a referral to DOJ when it has a "reason to believe" that a bank has engaged in a pattern or practice of discrimination on a prohibited basis.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MERKLEY FROM THOMAS J. CURRY

Q.1. With the Volcker Rule, we finally learned the lessons from the bailout of Long-Term Capital Management and then the 2008 financial crisis that we simply cannot afford to have big, systemically significant firms making big bets on the ups and downs of the market. Casino banking is over—if you stick to your guns and enforce the Rule.

I deeply appreciate the hard work you did to getting to a final rule last December, and I recognize the hard work you are doing now to implement it. However, we are still at the beginning legs of the journey, and I believe in "trust but verify"—which requires full, continued cooperation by our regulators and engagement with the public.

During the financial crisis, we all saw the horrific results when different regulators saw only parts of the risks to some firms. There were too many regulatory silos, which do not work because firms do not function that way. You also need a complete picture of what is going on in any one institution and across different firms. Indeed, one of the least recognized benefits of the Volcker Rule is to force the regulators to pay attention, together, to trading activities, which have become so important at so many banks. But critically, this means all the regulators need full access to all collected data and information.

In addition, accountability to the public through disclosure provides another layer of outside oversight and analysis, as well as

equally importantly, public confidence that Wall Street reform is real.

Based on the track record of various public disclosure mechanisms out there already—including for example, the CFTC's positions of traders—there is significant space for reasonably delayed disclosures of metrics data to enhance Volcker Rule accountability and public confidence. Now Treasury Deputy Secretary and then-Federal Reserve Governor Sarah Bloom Raskin highlighted disclosure in her statement on adoption of the final rule, and financial markets expert Nick Dunbar has similarly called for disclosure as a key tool. (See Nick Dunbar, "Volcker Sunlights Should Be the Best Disinfectant", July 25, 2014, *http://www.nickdunbar.net/articles/volcker-sunlight-should-be-the-best-disinfectant/*.) The OCC's Quarterly Trading Activity Report may be a perfect venue to engage in this type of disclosure, provided it is expanded to cover the entire banking group.

First, will you commit to working to ensure that each of your agencies has a complete picture of an entire firm's trading and compliance with the Volcker Rule, which can best be accomplished by having all data in one place so that all regulators have access to it?

A.1. We agree that it is important for regulators to have a complete picture of a firm's trading activities and Volcker compliance efforts. Toward this end, we are working closely with the other Volcker rulewriting agencies to coordinate our oversight across multiple legal entities. Coordinated oversight requires information sharing which in turn may require the agencies to enter into memoranda of understanding that will govern the sharing. We are currently working to put such memoranda in place where needed.

Q.2. Second, are you committed to using disclosure to help advance compliance with and public trust from the Volcker Rule?

A.2. We support appropriate public disclosures. For example, the revised market risk capital rule requires banks to publish data on their trading activities. We note that public disclosure must be consistent with the Trade Secrets Act and the Freedom of Information Act. Moreover, as we noted in the final rule, the purpose of the metrics is to flag activity that warrants further supervisory scrutiny. The metrics alone are not necessarily indicative of proprietary trading. As a result, the metrics data may not provide sufficient information to help the public identify proprietary trading.

Q.3. The success of the Volcker Rule over the long term will depend upon the commitment of regulators to the vision of a firewall between high risk, proprietary trading and private fund activities, on the one hand, and traditional banking and client-oriented investment services on the other hand. One of the most important parts of ensuring that vision is meaningfully implemented is the December 2013 final rule's application of its provisions at the "trading desk" level, defined as the "smallest discrete unit of organization" that engages in trading. Unfortunately, reports have emerged suggesting that banks are already attempting to combine and reorganize what had been separate trading desks into one "trading desk" for Volcker Rule purposes, as a way to game the metrics-based reporting essential to effective monitoring by regu-

lators of each institution's compliance with the Volcker Rule. The OCC has already identified this risk in its Interim Examination Procedures, and attempted to limit such actions to instances where the desks were engaged in "similar strategies," the combination has a "legitimate business purpose," and the combination assists the firm to "more accurately reflect the positions and fluctuations" of its trading. I feel the OCC's interim protections may not, however, be enough to ensure compliance with the final rule. I am deeply concerned that combining or reorganizing trading desks would undermine the strength of the metrics-based oversight, particularly related to whether market-making is truly to serve near-term customer demand and whether hedging is truly that. To avoid obscuring evasion by changing the mixture and volume of the "flow" of trading that is reported by the "trading desk" unit, I would suggest that examiners ought to strictly apply the final rule's approach to "trading desk" and apply the guidance set out by the OCC extremely narrowly, along with additional protections. For instance, "similar strategies" would need to include both the type of the trading (e.g., market-making) but also the same or nearly identical products, as well as by serving the same customer base, among other standards. As an example, if two desks traded in U.S. technology stocks and technology stock index futures, combining those into one desk might make sense, depending on other factors, such as where the desks were located and what customers they were serving. But combining, for example, various industry-specific U.S. equities desks that today are separate would not pass muster for complex dealer banks.

It is also important to remember that an important supervisory benefit from implementing the Volcker Rule at a genuine trading desk level is that regulators will gain a much deeper, more granular understanding of the risks emanating the large banks' many different trading desks the kind of risks that led one particular trading desk to become famous as the London Whale. When confronted with attempts to reorganize trading desks, regulators should look carefully at whether submanagement structures, bonus structures, or other indicia exist that would suggest that the reorganized "trading desk" is not actually the smallest discrete unit of organization contemplated by the final rule and essential to the metrics-based oversight system being developed.

Will you commit to scrutinizing, for the purposes of the Volcker Rule, any reorganizations of trading desks as posing risks of evasion and will you commit to working jointly to clarify any guidance on the definition of trading desk for market participants?

A.3. Yes. As you noted, the OCC has been proactive on this issue, and we will continue to closely scrutinize any conduct that could indicate an attempt to evade the requirements of the Volcker Rule.

Q.4. Ensuring speedy compliance with the provisions of the Merkley-Levin Volcker Rule is a top priority for strong implementation. It has already been 4 years since adoption, and banks should be well on their way to conforming their trading and fund operations. However, as you know, we also provided for an additional 5 years of extended transition for investments in "illiquid funds," which were expected to include some types of private equity

funds. We did this because some private equity funds, such as venture capital funds, do not usually permit investors to enter or exit during the fund's lifetime (usually 10 years or so) because of the illiquidity of those investments.

As you know, the Federal Reserve Board's rule on the "illiquid funds" extended transition interprets the statutory provision of a "contractual commitment" to invest as requiring a banking entity, where a contract permits divestment from a fund, to seek a fund manager's and the limited partners' consent to exit a fund. The rule, however, provides for the Board to consider whether the banking entity used reasonable best efforts to seek such consent but that an unaffiliated third party general partner or investors made unreasonable demands. I strongly support the Board's desire to implement the Volcker Rule in a speedy manner. In addition, the Board's approach in the final conformance rule goes a long way to ensuring that the illiquid funds extended transition only be available for investments in truly illiquid funds, and not a way to avoid divestment of hedge funds and private equity funds.

At the same time, we designed the provision to provide for a smooth wind-down for illiquid funds. Indeed, I am sensitive to the legitimate business needs of firms seeking to comply with the Volcker Rule while maintaining relationships with important customers to whom they may seek to provide traditional banking services.

Accordingly, I would urge the Board to clarify that a banking entity's requirement to make "reasonable efforts" to exercise its contractual rights to terminate its investment in an illiquid fund could be satisfied, for example, by a certification by the banking entity (a) that the banking entity's exit from the fund would be extraordinary from the perspective of how most investors enter or exit the fund (i.e., the investment contract does not routinely or ordinarily contemplate entry or exit, and/or such other indicia as are necessary to help distinguish between illiquid private equity funds and other funds, like hedge funds, that ordinarily and routinely permit investor redemptions), (b) that inquiring with third-party fund managers and limited partners regarding termination would result in a significant detriment to the business of the banking entity and (c) that the banking entity believes that the divestment would result in losses, extraordinary costs, or otherwise raise unreasonable demands from the third-party manager relating to divestment (or the de facto equivalent thereto).

Such a certification from the banking entity, along with the language of the relevant fund agreements and such other requirements as the Board determines appropriate, would obviate the need to seek consent from third-party fund managers.

Have you considered clarifying this in a FAQ?

A.4. By statute, the Board of Governors of the Federal Reserve System has sole authority to grant the special conformance period for illiquid funds, and, accordingly, we defer to the Board on this issue.

Q.5. We've recently seen reports that the largest Wall Street banks are nominally "deguaranteeing" their foreign affiliates in order to avoid coverage under U.S. regulatory rules, especially those related to derivatives. This "deguaranteeing" appears to be based on a fic-

tion that U.S. banks do not actually guarantee the trading conducted by foreign subsidiaries, and hence would not be exposed to any failure by the foreign subsidiary.

Can you comment on that, and specifically, whether you believe that U.S. bank or bank holding company could be exposed to losses from—or otherwise incur liability related to—a foreign affiliate's trading even when no explicit guarantee to third parties exists. Please specifically address whether an arrangement, commonly known as a "keepwell," provided by the U.S. parent or affiliate to the foreign affiliate potentially could create such exposure—and specifically, liability—for the U.S. entity.

A.5. There are a number of transactions and arrangements that could expose a U.S. bank or a bank holding company to losses from a foreign affiliate's trading activities. For example, as the OCC, the Federal Reserve Board, FDIC and Federal Housing Finance Agency noted in the joint proposed swaps margin rule, many swaps agreements contain cross-default provisions that give swaps counterparties legal rights against certain "specified entities," even when no explicit guarantee to a third party exists. See "Margin and Capital Requirements for Covered Swaps Entities", 79 FR 57348 (Sept. 24, 2014). In these arrangements, a swaps counterparty of a foreign subsidiary of a U.S. covered swap entity may have a contractual right to close out and settle its swaps positions with the U.S. entity if the foreign subsidiary of the U.S. entity defaults on its own swaps positions with the counterparty. While not technically a guarantee of the foreign subsidiary's swaps, these provisions may be viewed as reassuring counterparties to foreign subsidiaries that the U.S. bank stands behind its foreign subsidiaries' swaps. Other similar arrangements may include liquidity puts or keepwell agreements.

In a keepwell agreement between a bank and an affiliate, a bank or holding company typically commits to maintain the capital levels or solvency of the affiliate. To the extent a foreign affiliate's trading activity reduces its capital or threatens its solvency, a keepwell agreement issued by a U.S. member bank could potentially expose the bank to losses.

In addition, the Federal Reserve generally views a keepwell agreement between a member bank and its affiliate as similar in terms of credit risk to issuing a guarantee on behalf of an affiliate. See 67 *Federal Register* 76560, 76569 (Dec. 12, 2002). 23A does not hinge on credit risk. Such an agreement would generally be subject to the quantitative and collateral restrictions in section 23A of the Federal Reserve Act. Under section 23A's quantitative limits, the maximum amount of covered transactions that a member bank may enter into with an affiliate, including guarantees issued on behalf of the affiliate, is 10 percent of the bank's capital. Accordingly, the quantitative limits would prohibit a keepwell agreement that is unlimited in amount. Even if the bank's obligations under the keepwell agreement is limited to less than 10 percent of the bank's capital, the collateral requirements in section 23A, as amended by section 608 of Dodd-Frank, require that a bank's guarantee be secured by eligible collateral at all times the guarantee is in place.

Q.6. Moreover, please comment on whether the size and importance to the U.S. parent or affiliate of the foreign affiliate's activities could itself create an implied guarantee such that the U.S. firm would have major reputational or systemic risk reasons to prevent the foreign affiliate from incurring significant losses or even failing—similar to rescues that occurred during the financial crisis of entities that were supposed to be bankruptcy remote.

A.6. In the absence of an explicit guarantee, a U.S. bank or bank holding company ordinarily would not have a legal obligation to step in. Moreover, a bank's ability to provide assistance to a foreign affiliate would be limited under various laws including sections 23A and 23B of the Federal Reserve Act. For example, under section 23B, a member bank could not provide assistance to a foreign affiliate unless that assistance was provided to the affiliate on terms and under circumstances, including credit standards, that are substantially the same as a comparable transaction between a bank and a nonaffiliate. In addition, the requirement under section 23B also applies to certain transactions in which a member bank engages with an unaffiliated party where the transaction benefits an affiliate. It also applies to transactions with an unaffiliated party if an affiliate has a financial interest in the unaffiliated party or is a participant in the transaction.

Q.7. Finally, many of these foreign bank subsidiaries are so-called "Edge Act" corporations, which I understand are consolidated with the insured depository subsidiary for many purposes. Please comment on whether there is any chance that losses in these Edge Act corporations, particularly losses in their derivatives operations, could impact the deposit insurance fund.

A.7. A bank's Edge Act subsidiaries are consolidated with the bank for financial reporting purposes under GAAP. However, accounting consolidation does not affect the bank's legal liability for its subsidiaries. Absent a guarantee or similar arrangement, the bank is not ordinarily liable for an Edge Act subsidiary's losses. See 12 U.S.C. 621 (shareholders in an Edge Act corporation are liable for the amount of their unpaid stock subscriptions). If an Edge Act subsidiary incurred losses in excess of the bank's equity investment, then the bank could place the subsidiary in bankruptcy (or a similar proceeding). Under GAAP, this would deconsolidate the subsidiary from the bank's balance sheet. In addition, Edge Act corporations generally may not take deposits in the United States, and the FDIC only insures U.S. deposits.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR HAGAN FROM THOMAS J. CURRY

Q.1. During the July 15th Semiannual Monetary Policy Report hearing with Chair Yellen, I outlined the importance for State and local governments of including municipal securities as "High Quality Liquid Assets" in the Liquidity Coverage Ratio (LCR) rule proposed by the Federal Reserve, FDIC, and OCC. I was therefore disappointed to learn that municipal securities were excluded from eligibility when the rule was recently finalized, in spite of comments by the Federal Reserve suggesting municipal securities are suffi-

ciently liquid and their inclusion as HQLA should be given additional consideration. I was also pleased to hear your responses during the hearing indicating you would be open to revising the inclusion of municipal securities as HQLA if additional analysis showed they had similar liquidity levels. As banks are now beginning the process of optimizing their balance sheets around the final LCR rule, it is important that the issue of municipal securities is addressed expeditiously to avoid an impact on this market.

What is the timeline for issuing a proposal specific to municipal securities and the LCR, given that Federal Reserve Board staff analysis has demonstrated that some municipal securities are at least as liquid as corporate bonds that are included as HQLA?

A.1. The OCC looks forward to discussing with the Federal Reserve Board any additional research or specific proposals on the possibility of calibrating an LCR standard that differentiates certain municipal securities from others with broader illiquid characteristics. If such a standard is identified that is consistent with the liquidity risk management goals of the LCR rule, the OCC will work with the Federal Reserve Board and the Federal Deposit Insurance Corporation (FDIC) to adjust the rule accordingly. The OCC generally regards banks' investments in municipal securities as a prudent activity, in which banks have historically engaged for purposes of yield and community support, not for liquidity risk management. In fact, banks covered by the LCR rule have substantially increased their investments in municipal securities since the agencies issued the LCR proposal and final rule that did not include municipal securities as HQLA. Over the past year, LCR banks' percent increase in holdings of municipal securities is nearly double the percent increase in such holdings for the overall banking industry.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR TOOMEY FROM THOMAS J. CURRY

Q.1. *On the Liquidity Coverage Ratio (LCR) Rule:* A number of ABS classes, including securitized auto and credit card loans, were denied any HQLA status in the recently finalized LCR rule. What was your reasoning for this?

A.1. Evidence from the 2007–2009 financial crisis and the period following indicates that the market demand for a variety of securitization issuances can decline rapidly during a period of stress and may not rapidly recover. ABS may be dependent on a diverse range of underlying asset classes, each of which may suffer from adverse effects during a period of significant stress. Furthermore, the characteristics of ABS securitization structures may be tailored to a limited range of investors. The ability to monetize these securitization issuances and whole loans through or in the repurchase market may be limited in a period of stress.

Moreover, although certain ABS issuances, such as ABS backed by loans under the Federal Family Education Loan Program and residential mortgage-backed securities (RMBS) backed solely by securitized "qualified mortgages" or mortgages guaranteed by the Federal Housing Authority or the Department of Veterans Affairs, may have lower credit risk, the liquidity risk profile of such securi-

ties, including the inability to monetize the issuance during a period of stress, does not warrant treatment as HQLA. The ace notes that ABS and RMBS issuances have substantially lower trading volumes than MBS that are guaranteed by U.S. GSEs and demand for such securities has decreased, as shown by the substantial decline in the number of issuances since the recent financial crisis.

Q.2. Because many of the banks that need to comply with the LCR comprise a significant number of the investors in these ABS, will denying HQLA status to ABS increase borrowing costs for consumers and small businesses? Was a cost-benefit analysis conducted on this particular provision of the rule? Would you be open to sharing that analysis, on this provision or on the rule as a whole, with Congress?

A.2. The OCC reviewed investments in ABS by banks that need to comply with the LCR final rule and notes that holdings by these banks comprise less than 10 percent of the total ABS market as of the second quarter of 2014. Furthermore, the final rule does not prohibit covered companies from continuing to invest in ABS. Banks covered by the LCR rule generally have already adjusted their funding profile and assets in anticipation of the LCR requirement with little impact on the overall market. Moreover, because the LCR rule applies to a limited number of U.S. financial institutions, we do not expect a significant general increase in costs or prices for consumers. Therefore, we do not believe the final rule will have a significant impact on overall demand for ABS and increase the cost of funding.

The OCC has analyzed the final rule, as a whole, under the factors set forth in the Unfunded Mandates Reform Act of 1995 (UMRA) (2 U.S.C. 1532). For purposes of this analysis, the ace considered whether the final rule includes a Federal mandate that may result in the expenditure by State, local, and tribal governments, in the aggregate, or by the private sector, of $100 million or more (adjusted annually for inflation) in any 1 year. The OCC's UMRA written statement is available at: *http://www.regulations.gov,* Docket ID OCC-20130016.

Q.3. Additionally, the finalized LCR rule confers no HQLA status to private-label mortgage-backed securities while conferring GSE-guaranteed mortgage-backed securities Level 2A HQLA status. Republicans and Democrats are committed to attracting more private capital to housing finance. To what extent did you consider the ramifications of this decision as it relates to broader housing finance reform?

A.3. In identifying the types of assets that would qualify as HQLA in the final rule, the agencies considered the following categories of liquidity characteristics, which are generally consistent with those of the Basel III Revised Liquidity Framework: (a) risk profile; (b) market-based characteristics; and (c) central bank eligibility. The agencies continue to believe that private-label mortgage-backed securities do not meet the liquid and readily marketable standard in U.S. markets, and thus do not exhibit the liquidity characteristics necessary to be included as HQLA under the final rule. Evidence from the 2007–2009 financial crisis and the period following indicates that the market demand for a variety of

securitization issuances can decline rapidly during a period of stress, and that such demand may not rapidly recover. In contrast, the OCC recognizes that some securities issued and guaranteed by U.S. GSEs consistently trade in very large volumes and generally have been highly liquid, including during times of stress.

Q.4. Doesn't the disparate treatment of PLMBS and GSE MBS direct more funding into GSE-guaranteed mortgages and make it harder for private capital (without Government guarantees from the GSEs, FHA, VA, or USDA) to reenter the market?

A.4. The agencies recognize the importance of capital funding to the U.S. residential mortgage markets and highlight that the final rule does not prohibit covered companies from continuing to invest in private label MBS. The agencies do not expect, and have not observed, that banking organizations base their investment decisions solely on regulatory considerations and do not anticipate that exclusion of this asset class from HQLA will significantly deter investment in these assets.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR KIRK FROM THOMAS J. CURRY

Q.1. As we examine Wall Street regulation and soundness, it is critical that we be alert to outside threats as well. Over the past year, there have been a number of extensive cyberattacks on American companies, including large financial institutions. Combatting these transnational crimes requires cooperation across Government and industry.

As I have previously asked both Secretary Lew and Chair Yellen—Do you pledge to make cybersecurity a priority?

Do you believe FSOC can fulfill its statutory mandate to identify risks and respond to emerging threats to financial stability without making cybersecurity a priority?

As a member of FSOC, can you identify any deficiencies in the U.S.'s ability to prevent cyberattacks that require Congressional action?

What steps has FSOC taken to address the prevention of future cyberattacks on financial institutions, such as the recent breach at JPMorgan Chase?

A.1. As noted in my written testimony, the operational risks posed by cyberattacks is one of the most pressing concerns facing the financial services industry today. It is a priority that FSOC members share and is one of the emerging threats that the FSOC identified and discussed in its annual reports. FSOC provides a mechanism to achieve collaborative efforts to address emerging cyberthreats and has set forth specific recommendations to advance efforts on cybersecurity. For example, in its 2014 annual report, FSOC recommended that Treasury continue to work with regulators, other appropriate Government agencies and private sector financial entities to develop the ability to leverage insights from across the Government and other sources to inform oversight of the financial sector and to assist institutions, market utilities, and service providers that may be targeted by cyberincidents. The Council also recommended that financial regulators continue their efforts to assess

cyber-related vulnerabilities facing their regulated entities, identify gaps in oversight that may need to be addressed, and to inform and raise awareness of cyber threats and incidents.

Shoring up the industry's defenses against cyberthreats also is one of my key priorities as Comptroller and as chairman of the Federal Financial Institutions Examination Council (FFIEC). Combating the threats posed by such attacks requires ongoing vigilance and close cooperation and collaboration by regulators, law enforcement, and industry participants. To help foster such coordination, one of my first actions as chairman of the FFIEC was to call for the creation of the Cybersecurity and Critical Infrastructure Working Group (CCIWG). This group coordinates with intelligence, law enforcement, the Department of Homeland Security, and industry officials to provide member agencies with accurate and timely threat information.

The FFIEC's CCIWG work is consistent with the FSOC's recommendations. A key activity of the working group is to monitor and issue alerts to the industry about emerging threats. Within its first year, this working group released joint statements on the risks associated with "distributed denial of service" attacks, automated teller machine "cashouts," and the wide-scale "Heartbleed" vulnerability. Last month, the group prepared and issued an alert to institutions about a material security vulnerability in Bourne-again shell (Bash) system software widely used in servers and other computing devices that could allow attackers to access and gain control of operating systems. The joint statements and alerts outline the risks associated with the threats and vulnerabilities, the risk mitigation steps that financial institutions are expected to take, and additional resources to help institutions mitigate the risks. In addition to these actions, OCC staff and other CCIWG members work closely with law enforcement, Treasury, and other Government officials to share information about emerging threats on both a classified and unclassified basis. The threat of cyberattacks is not limited to large institutions. Earlier this year, the CCIWG hosted an industry webinar for over 5,000 community bankers to help raise the awareness of cybersecurity issues and steps that smaller banks can take to guard against such threats. The group recently conducted a cybersecurity assessment of over 500 community institutions. The information from this assessment will help FFIEC members identify and prioritize actions that can enhance the effectiveness of cybersecurity-related guidance to community financial institutions.

The CCIWG is also working to identify any gaps in the regulators' legal authorities, examination procedures and examiner training in connection with our supervision of the banking industry's cybersecurity readiness and its ability to address the evolving and increasing cyberthreats. If our work identifies gaps in our legal authorities that require Congressional action, we will be happy to share those with the Committee.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR HELLER FROM THOMAS J. CURRY

Q.1. Last year, I wrote to the Office of the Comptroller of the Currency (OCC) regarding the implementation of rules and guidance regarding private flood insurance policies, as required under the Biggert-Waters Flood Insurance Reform Act. In passing that legislation, it was the intent of Congress to reaffirm existing law that lenders accept private flood insurance policies to provide more choices for consumers. The OCC, Federal Reserve, FDIC and several other agencies issued a guidance memo claiming private insurance provisions in Biggert-Waters are not effective until final rulemaking. This has caused confusion among lenders who now routinely reject all private flood insurance policies.

In response to my letter, the OCC wrote back explaining, "We expect to issue a proposed rule within the next several months." That was over a year ago I received that response and there is still no progress on this issue.

I would like to receive a status update on the details about this proposed rule on private flood insurance and receive a timeline of when it will be issued.

If there is not going to be regulations anytime soon, is there any way the OCC, FDIC, Federal Reserve can allow lenders to accept private flood insurance at their discretion without penalty until there is a final rule?

Senator Tester and I have introduced legislation that would solve this problem by allowing private flood insurance to be sold if approved by State regulators. Would the OCC, FDIC, or Federal Reserve consider supporting a legislative solution to this problem instead of rulemaking?

A.1. Agency staffs are meeting regularly to draft rules that take into account the public comments received from our notice of proposed rulemaking implementing the Biggert-Waters Act and the many issues they raised. With respect to private flood insurance, commenters generally supported adding a provision to the final rule specifically permitting the discretionary acceptance of private flood insurance, and requested more guidance as to the statute's definition of private flood insurance. The agencies are working to determine the best way to provide this guidance in our rule.

Until the agencies issue final rules, current law applicable to private insurance will continue to apply. Under current law, banks and thrifts may continue to accept private flood insurance in satisfaction of the National Flood Insurance Program (NFIP) requirements, without penalty, if certain conditions are met.[1] The Biggert-Waters Act did not change the discretionary acceptance of private flood insurance, but merely mandated the acceptance of certain pri-

[1] In general, a lender may accept a private flood insurance policy that meets the criteria for a standard flood insurance policy (SFIP) set forth by FEMA in its former Mandatory Purchase of Flood Insurance Guidelines. To the extent a policy differs from a SFIP, a lender should carefully examine the differences before accepting the policy. See "Loans in Areas Having Special Flood Hazards; Interagency Questions and Answers Regarding Flood Insurance", 74 FR 35914 (July 21, 2009). See also OCC regulations at 12 CFR 22.3, which require that a designated loan be covered by "flood insurance" without specifying that it be flood insurance provided under the NFIP or a private policy. Furthermore, the sample flood insurance notice included in Appendix A of part 22 includes language informing the borrower that flood insurance coverage may be available from private insurers that do not participate in the NFIP.

vate policies that meet the statutory definition of "private flood insurance." The agencies have consistently advised institutions that they may continue to accept such private flood insurance at this time, and that the requirement to accept private flood insurance that meets the Biggert-Waters definition is not effective until our final rule is issued. We specifically made these points in the preamble to our notice of proposed rulemaking. [2]

We believe that a regulatory solution regarding private flood insurance is possible and that it is premature to pursue legislation such as the Heller-Tester bill.

Q.2. Recently, the Treasury Department indicated that the Financial Stability Oversight Council was switching the focus of its asset management examination toward activities and products rather than individual entities.

Will you confirm that individual asset management companies are no longer being considered for possible systemically important designation?

A.2. At its recent meetings, the FSOC discussed the Council's various work streams related to asset managers, including its work related to analyzing industrywide and firm-specific risks. Based on those discussions, the Council agreed to undertake a more focused and fuller analysis of industrywide products and activities. The objective of this work is to inform the Council about what, if any, additional policy actions by FSOC or its members may be appropriate. The Dodd-Frank Act provides FSOC with a range of policy tools, including making recommendations to regulators and the industry in the FSOC's annual report, issuing formal recommendations to primary financial regulatory agencies to apply new or heightened standards or safeguards to an activity, designating a nonbank financial company to be supervised by the Federal Reserve, or designating payment, clearing, or settlement activities as systemically important. It would be premature to determine which, if any, of these policy tools may be most appropriate until the Council's more in-depth analysis of the industry and its activities is completed.

RESPONSES TO WRITTEN QUESTIONS OF CHAIRMAN JOHNSON FROM RICHARD CORDRAY

Q.1. In your testimony before this Committee in June, you discussed the progress being made on coming up with a rural definition for the Bureau's mortgage rules. Can you provide an update on that process?

A.1. The Consumer Financial Protection Bureau (Bureau) has received extensive feedback on its definitions of "underserved" and "rural" since it first interpreted the statutory term "rural or underserved areas" for purposes of its mortgage rules under Title XIV of the Dodd-Frank Wall Street Reform and Consumer Financial Protection Act. As you know, the Bureau amended the Ability-to-Repay Rule last year to provide a 2-year transition period, during which balloon loans made by small creditors and held in portfolio will be treated as Qualified Mortgages regardless of where a particular

[2] See 78 FR 65108, at 65110 and 65114. (Oct. 30, 2013).

creditor originates mortgage loans. During this transition period, the Bureau committed to reviewing whether its definitions of "rural" and "underserved" should be adjusted. We committed to such a review to ensure that the Bureau's definitions reflect significant differences among geographic areas, to calibrate access to credit concerns, and to facilitate implementation and consumer protection as mandated by Congress. The Bureau expects to release in early 2015 a notice of proposed rulemaking in connection with certain provisions that modify general requirements for small creditors that operate predominantly in "rural or underserved" areas, while it continues to assess possible additional guidance that would facilitate the development of automated underwriting systems for purposes of calculating debt-to-income ratios in connection with qualified mortgage determinations and other topics.

Q.2. Although the CFPB does not have examination authority over financial institutions with total assets of less than $10 billion, its rules can have an impact on smaller institutions. Can you describe what you have done to ensure that the needs and concerns of community banks and credit unions are considered at the Bureau?

A.2. Community banks and credit unions play critical roles in ensuring a fair, transparent, and competitive marketplace for consumer financial products and services. They generally base their businesses on building personal, long-term customer relationships, and can be a lifeline to hard-working families.

As you note, the Consumer Financial Protection Bureau (Bureau) has supervisory authority over depository institutions and credit unions with total assets of more than $10 billion and their respective affiliates, but other than the limited authority under the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), the Bureau does not have supervisory authority regarding credit unions and depository institutions with total assets of $10 billion or less. Although the Bureau does not have regular contact with these institutions in its supervisory capacity, the Bureau takes steps to ensure that the agency considers the needs and concerns of community banks and credit unions.

Before proposing certain rules that may have a significant impact on a substantial number of small entities, the Bureau convenes a Small Business Review Panel pursuant to the Small Business Regulatory Enforcement Fairness Act and meets with and gathers input from community banks and credit unions under $550 million in assets. The Bureau also engages in other outreach efforts to gather feedback from community banks and credit unions, including holding roundtables and other outreach meetings and consulting with the financial regulatory agencies that have primary examination authority over such entities. In fact, the Bureau has met with representatives from community banks and credit unions in all 50 States.

After issuing significant substantive regulations, the Bureau continues to support community banks and credit unions with their regulatory implementation and compliance efforts. For example, in connection with the new mortgage rules recently issued pursuant to Title XIV of the Dodd-Frank Act, the Bureau published small entity compliance guides and other support materials on its Web site,

held educational webinars, and participated in numerous presentations and speaking events attended by community banks and credit unions.

As you know, the Bureau also created the Community Bank Advisory Council and the Credit Union Advisory Council, at your and others' urging. Those councils, which consist of community bankers and credit union leaders from across the country, advise the Bureau on regulating consumer financial products or services and specifically share their unique perspectives and provide feedback on the Bureau's activities. The Bureau also established the Office of Financial Institutions and Business Liaison to ensure that the Bureau understands the needs and concerns of financial institutions, including community banks and credit unions.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CRAPO FROM RICHARD CORDRAY

Q.1. The issue of FSOC accountability and transparency is one that I have raised numerous times. Given the magnitude of the regulatory burden and other costs imposed by a SIFI designation, it is imperative that the designation process be as transparent and objective as possible.

Do you object to the public disclosure of your individual votes, including an explanation of why you support or oppose such designation?

Will you commit to pushing for greater accountability and transparency reforms for FSOC? Specifically, will you commit to push the FSOC to allow more interaction with companies involved in the designation process, greater public disclosure of what occurs in FSOC principal and deputy meetings, publish for notice and comment any OFR report used for evaluating industries and companies, and publish for notice and comment data analysis used to determine SIFI designations? If you do not agree with these proposed reforms, what transparency and accountability reforms would you be willing to support?

A.1. The Financial Stability Oversight Council (Council) is firmly committed to conducting its business openly and transparently. For example, consistent with this commitment, the Council voluntarily solicited public comment three separate times on its process for designating nonbank financial companies. The Council published a final rule and interpretive guidance in 2012. As described in the rule and interpretive guidance, firms under review have extensive opportunities to engage with staff representing the Council members before any vote on a proposed designation. Before the Council votes on whether to make a proposed designation, the company is invited to submit information and meet with staff, and the Council carefully considers the submitted information and the views of the company. For example, for one of the companies that has been designated, the Council spent over a year conducting its analysis and considered more than 200 data submissions from the company that totaled over 6,000 pages. Council staff engaged with this company at least 20 times, including seven meetings with senior management and numerous other telephone meetings.

After the Council votes to make a proposed designation, it provides the company with a detailed written explanation of the Council's basis. Before any decision to designate becomes final, the company has a right to a hearing to contest the proposed designation, for which the company can submit written materials. The company may also request an oral hearing. These procedures provide the company with an opportunity to respond directly to the specific information that the Council has considered. Of the three companies that the Council has designated, only one firm requested a hearing, and the Council heard directly from the company's representatives. The Council considered the information presented during this hearing in its evaluation of the company before a final designation was made.

Although the Council is not subject to the Sunshine Act, it has voluntarily adopted nearly all of the statute's transparency-related provisions in its own transparency policy. For example, the Council opens meetings to the public whenever possible, publicly announces meetings and information about meeting agendas 1 week in advance, and publishes minutes that include a record of all votes. The minutes of the meetings describing the vote also detail the votes of individual members of the Council.

Regarding the information used by the Council in its analysis, it is critical to recognize that much of this information contains supervisory and other market-sensitive data, including information about individual firms, transactions, and markets that may only be obtained if maintained on a confidential basis. Protection of this information is necessary in order to, among other things, prevent the disclosure of trade secrets and commercial or financial information obtained from the firm and to prevent potential destabilizing market speculation that could occur if that information were to be disclosed.

Q.2. In the July FSOC meeting, the Council directed staff to undertake a more focused analysis of industrywide products and activities to assess potential risks associated with the asset management industry.

Does the decision to focus on "products and activities" mean that the FSOC is no longer pursuing designations of asset management firms?

Did the FSOC vote on whether to advance the two asset management companies to Stage 3? If so, why was this not reported? If not, why was such a vote not taken in order to provide clarity to the two entities as well as the industry?

A.2. At its meeting on July 31, 2014, the Council discussed its ongoing assessment of potential industrywide and firm-specific risks to the United States' financial stability arising from the asset management industry and its activities. At that meeting, the Council directed staff to undertake a more focused analysis of industrywide products and activities to assess potential risks associated with the asset management industry. At its meeting on September 4, 2014, after discussing Council members' views of priorities for the analysis of potential risks associated with the asset management industry, the Council directed staff to further develop their detailed work plan for carrying out the analysis of industrywide products and ac-

tivities. As the Council continues to review this industry, it is important to note that there are no predetermined outcomes. There are a number of options available if the Council identifies meaningful risks to United States' financial stability.

Q.3. I understand that the Department of Education (DOE) has been collaborating with the CFPB on a rulemaking for student bank accounts so I want to raise the same concerns with you that I raise in a letter to Secretary Duncan last month. Specifically, I am concerned that a final DOE rule that fails to take into account existing prudential and consumer finance regulations for the underlying banking products will create regulatory confusion and cause some financial institution to exit this market to the detriment of students.

Please explain the scope and extent of CFPB's collaboration with the DOE on this rulemaking. Specifically, please explain how the CFPB has advised the DOE on ensuring that DOE's regulations are not in conflict with existing laws and guidance.

Has the CFPB conducted any analysis on the cost and availability of credit and banking products to students as a result of the DOE's proposed rules? If not, why not and will the CFPB undertake such analysis at a future date?

A.3. The Consumer Financial Protection Bureau (Bureau) shares many of the concerns raised by the Government Accountability Office and the Department of Education's Inspector General, among others, about challenges in the market for student banking products, particularly financial products used to access Federal grants and scholarships.

In 2012, the Federal Deposit Insurance Corporation (FDIC) reached a settlement with one of the largest participants in this market. Among other things, the FDIC found that Higher One was: charging student account holders multiple nonsufficient fund (NSF) fees from a single merchant transaction; allowing these accounts to remain in overdrawn status over long periods of time, thus allowing NSF fees to continue accruing; and collecting the fees from subsequent deposits to the students' accounts, typically funds for tuition and other college expenses. The settlement provides for $11 million in refunds to approximately 60,000 student victims, in addition to civil money penalties. [1]

In July of this year, the Federal Reserve Board of Governors (Board) also issued a consent order to Cole Taylor Bank to address illegal conduct related to its partnership with Higher One. The order requires Cole Taylor Bank to cease its illegal conduct and pay a civil money penalty of approximately $3.5 million. The Board is also pursuing remedial actions against Higher One, including the payment of restitution for its past practices. Actions are also being pursued against another State member bank that has a similar arrangement with Higher One. [2]

On March 26, 2014, at the invitation of the Department of Education, the Bureau provided a technical presentation to the negotiated rulemaking committee established to consider regulations related to third-party disbursement of Federal student aid. The pres-

[1] *https://www.fdic.gov/news/news/press/2012/pr12092.html*
[2] *http://www.federalreserve.gov/newsevents/press/enforcement/20140701b.htm*

entation was conducted at a public meeting hosted by the Department of Education. Written materials are available on both the Department of Education's and the Bureau's Web sites.[3]

One of the primary purposes of the Department of Education's consultation with the Bureau is to ensure that any potential regulations do not overlap or conflict with Federal consumer financial laws. As the Secretary considers any potential regulations, Department of Education staff solicited feedback from the Bureau on the applicability of certain Federal consumer financial laws on products heavily used in this marketplace, such as debit and prepaid cards. To date, the Department of Education has not proposed any regulations related to third-party disbursement of Federal student aid.

However, in the Bureau's presentation to the Department of Education's negotiated rulemaking committee on March 26, 2014, Bureau staff shared relevant analysis at the request of the Department of Education to assess whether marketing partnerships between institutions of higher education and financial institutions increase availability of banking products to enrolled students.

The Bureau, in coordination with the FDIC, analyzed the 2011 National Survey of Unbanked and Underbanked Households, a supplement to the Census Bureau's Current Population Survey. The analysis suggests that almost all students without bank accounts have the ability to access one outside of any school marketing partnership, but have not yet done so or have chosen not to open one. Very few students (< 0.5 percent) are unable to open a bank account. Reasons include:

- Negative reporting to specialty credit bureaus due to past issues (e.g., Chex Systems)
- Undocumented students who are unable or have not obtained Individual Taxpayer Identification Numbers
- Suspicion of being a threat to national security or engaging in money laundering

The Bureau also looked at the student banking product offerings for many financial institutions with a national reach. Many of these financial institutions offer products to students at schools which do not have a marketing arrangement with a financial institution.

This preliminary analysis suggests that students currently have choice in a competitive marketplace, even when their institution of higher education is not being paid to market a product for a particular financial institution.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR TOOMEY FROM RICHARD CORDRAY

Q.1. *On Data Gathering:* In questions for the record following the Senate Committee on Banking, Housing, and Urban Affairs hearing on "The Consumer Financial Protection Bureau's Semi-Annual Report to Congress", I noted that both the CFPB and the OCC had each gathered similar data from nine credit card issuers. I also

[3] *http://www.consumerfinance.gov/f/201403__cfpb__presentation-to-department-education-rulemaking-committee.pdf*

noted that gathering data from ten issuers would have triggered an OMB review and a period for public comment. It would appear that the decision to gather data from nine issuers each and then share that data, as agreed to in a memorandum of understanding, was made to circumvent the important safeguards of OMB review and public comment.

My question to you was "With a data mining exercise of this size and scope, shouldn't it be reviewed and shouldn't the public have the opportunity to express their opinions on what is happening with their data?" Unfortunately, your response that the "Bureau made the determination that the PRA does not apply . . . " did not directly address my question. Can you please provide a more thorough answer to my question? Does the CFPB believe that there is no value in being transparent and gathering public comment before a large-scale data collection effort begins?

A.1. The Consumer Financial Protection Bureau (Bureau) values transparency in its work. We have been open about the fact that we collect information on the credit card industry, and have been responsive to inquiries from Members of Congress and other oversight bodies about the nature of our credit card data collection. Please note that the Bureau's credit card database does not contain any directly identifying personal information such as name, address, social security number, or credit card account numbers.

The Bureau has a robust Paperwork Reduction Act (PRA) program designed to ensure the transparency, quality, and economy of information gathered by the Bureau. This program includes reviewing potential data collections with the Office of Management and Budget (OMB), and providing public notice and seeking comment on the Bureau's proposed information collections as defined by the PRA.

The Bureau, through its PRA Officer, recently consulted again with the OMB regarding the applicability of the PRA to the Bureau's ongoing collection of credit card information, and the Bureau's credit card data information-sharing agreement with the Office of the Comptroller of the Currency (OCC). Following its consultation with the Bureau, OMB has confirmed that the Bureau's data collection, including its information-sharing agreement with the OCC, is in compliance with the PRA. In its written response to the Bureau, OMB states that the Bureau's credit card data collection effort "is not covered by the Paperwork Reduction Act (PRA)" (emphasis in original) and therefore does not require any additional action by the Bureau.

Q.2. In questions for the record following the Senate Committee on Banking, Housing, and Urban Affairs hearing on "The Consumer Financial Protection Bureau's Semi-Annual Report to Congress, I asked the question, "When the Bureau decides to publish a Bulletin, does it follow an established process?" The answer I received stated that the Administrative Procedure Act does not apply to bulletins and that the CFPB values public input. Setting aside the APA, could you please elaborate on what process (either established or ad-hoc) the CFPB goes through when putting out a bulletin?

A.2. The Administrative Procedure Act (APA) sets out certain procedures that Federal agencies must follow when they take agency actions. When an agency promulgates a rule in certain cases, the APA requires the agency to issue a notice and solicit comments from the public about the proposed rule. The APA, however, does not impose a notice and comment requirement for a general statement of policy, an interpretive rule, or actions that do not constitute rules.

Whether or not required by statute, the Bureau values public input in our formulation of policy, and engages stakeholders using a variety of mechanisms. For example, our staff engages in informal consultations with industry and other interested parties. The Bureau has also voluntarily provided notice and sought comment for various rules for which notice-and-comment rulemaking were not required under the APA. We sometimes find, however, that a notice-and-comment process may not be the optimal process for a particular type of action we are considering. For example, in October 2013 the Bureau issued a bulletin explaining the meaning of certain provisions in its mortgage servicing rules. The Bureau issued that bulletin in response to requests from various stakeholders that we provide additional information about certain topics before the mortgage rules came into effect. Seeking notice and comment in that circumstance could have impaired our ability to provide needed information to the industry in sufficient time for them to use the information to comply with the mortgage rules that were about to take effect. In that situation, we determined that issuing a bulletin was the best option to address the industry's concerns.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR KIRK FROM RICHARD CORDRAY

Q.1. As we examine Wall Street regulation and soundness, it is critical that we be alert to outside threats as well. Over the past year, there have been a number of extensive cyberattacks on American companies, including large financial institutions. Combatting these transnational crimes requires cooperation across Government and industry.

As I have previously asked both Secretary Lew and Chair Yellen—Do you pledge to make cybersecurity a priority?

A.1. Yes, the Consumer Financial Protection Bureau (Bureau) continues to be committed to cybersecurity in its operations and as cybersecurity relates to the Bureau's mission and purview. We also carry that commitment to our work with the Financial Stability Oversight Council and the Federal Financial Institutions Examinations Council.

Q.2. Do you believe FSOC can fulfill its statutory mandate to identify risks and respond to emerging threats to financial stability without making cybersecurity a priority?

A.2. The Financial Stability Oversight Council (Council) recognizes the importance of cybersecurity as a priority in the means and methods by which the Council meets its statutory mandates to identify and monitor risks to the United States' financial system. In the Council's 2014 Annual Report, the Council reported that the

vulnerabilities posed by cross-sector dependencies and interconnected systems across firms, markets, and service providers can lead to significant cybersecurity risks. The Council recommended in the report that Treasury continue to work with the public and private sector, as appropriate, to work toward developing methods to manage risk. The Council also recommended that regulatory agencies continue to promote awareness and assess the use by regulated entities of both regulatory as well as nonregulatory methods to support risk management, including the National Institute of Standards and Technology (NIST) Cybersecurity Framework.[1] While the report recommends that financial regulators continue to assess cyber-related vulnerabilities facing regulated entities and identify gaps in oversight that need to be addressed, the Council also noted the role that the private sector plays in supporting the cybersecurity posture of the national infrastructure.

Q.3. As a member of FSOC, can you identify any deficiencies in the U.S.'s ability to prevent cyberattacks that require Congressional action?

A.3. The Council has recognized the importance of removing legal barriers to information sharing between public and private sector partners to enhance overall awareness of cyberthreats, vulnerabilities, and attacks, including through Congress' passage of comprehensive cybersecurity legislation.

Q.4. What steps has FSOC taken to address the prevention of future cyberattacks on financial institutions, such as the recent breach at JPMorgan Chase?

A.4. The vulnerabilities posed by cross-sector dependencies and interconnected systems across firms, markets, and service providers can lead to significant cybersecurity risks. These risks could impact economic security, demanding a coordinated and collaborative Governmentwide commitment and partnership with the private sector to promote infrastructure security and resilience.

The Council has recommended that the Treasury continue to work with regulators, other appropriate Government agencies, and private sector financial entities to develop the ability to leverage insights from across the Government and other sources to inform oversight of the financial sector and to assist institutions, market utilities, and service providers that may be targeted by cyber incidents. The Council has recommended that regulators continue to undertake awareness initiatives to inform institutions, market utilities, service providers, and other key stakeholders of the risks associated with cyber incidents, and assess the extent to which regulated entities are using applicable existing regulatory requirements and nonregulatory principles, including the National Institute of Standards and Technology (NIST) Cybersecurity Framework.

The Council has recommended that financial regulators continue their efforts to assess cyber-related vulnerabilities facing their regulated entities and identify gaps in oversight that need to be addressed. The Council has also recognized the overarching contribution the private sector makes to infrastructure cybersecurity and

[1] *http://www.nist.gov/cyberframework/*

urges continued expansion of this work to engage institutions of all sizes and their service providers.

The Council has recommended that the Finance and Banking Information Infrastructure Committee, financial institutions, and financial sector coordinating bodies establish, update, and test their crisis communication protocols to account for cyber incidents and enable coordination, and with international regulators where warranted, to assess and share information.

As previously noted, the Council has recognized the importance of removing legal barriers to information sharing between public and private sector partners to enhance overall awareness of cyberthreats, vulnerabilities, and attacks, including through Congress' passage of comprehensive cybersecurity legislation.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR HELLER FROM RICHARD CORDRAY

Q.1. Recently, the Treasury Department indicated that the Financial Stability Oversight Council was switching the focus of its asset management examination toward activities and products rather than individual entities.

Will you confirm that individual asset management companies are no longer being considered for possible systemically important designation?

A.1. At its meeting on July 31, 2014, the Financial Stability Oversight Council (Council) discussed its ongoing assessment of potential industrywide and firm-specific risks to the United States' financial stability arising from the asset management industry and its activities. At that meeting, the Council directed staff to undertake a more focused analysis of industrywide products and activities to assess potential risks associated with the asset management industry. At its meeting on September 4, 2014, after discussing Council members' views of priorities for the analysis of potential risks associated with the asset management industry, the Council directed staff to further develop their detailed work plan for carrying out the analysis of industrywide products and activities. As the Council continues to review this industry, it is important to note that there are no predetermined outcomes. There are a number of options available if the Council identifies meaningful risks to the United States' financial stability.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CRAPO FROM MARY JO WHITE

Q.1. The issue of FSOC accountability and transparency is one that I have raised numerous times. Given the magnitude of the regulatory burden and other costs imposed by a SIFI designation, it is imperative that the designation process be as transparent and objective as possible.

Do you object to the public disclosure of your individual votes, including an explanation of why you support or oppose such designation?

A.1. As I have previously stated publicly, I support FSOC's efforts to enhance transparency surrounding the nonbanking designation

process. These efforts are ongoing. In addition, as discussed in the meeting minutes from the October 6, 2014, FSOC meeting, the Council has asked staff to review and evaluate certain potential process changes to the nonbanks designation process. See *http://www.treasury.gov/initiatives/fsoc/council-meetings/Documents/October%206,%202014%20(Meeting%20Minutes).pdf.* We are actively engaged in these discussions and look forward to considering the staff's recommendations.

Q.2. Will you commit to pushing for greater accountability and transparency reforms for FSOC? Specifically, will you commit to push the FSOC to allow more interaction with companies involved in the designation process, greater public disclosure of what occurs in FSOC principal and deputy meetings, publish for notice and comment any OFR report used for evaluating industries and companies, and publish for notice and comment data analysis used to determine SIFI designations? If you do not agree with these proposed reforms, what transparency and accountability reforms would you be willing to support?

A.2. As discussed above, FSOC staff is in the midst of a process to review and evaluate changes to the nonbanks designation process. The process includes continuing to reach out to the financial industry, the advocacy community, and others for input. See *http://www.treasury.gov/initiatives/fsoc/council-meetings/Documents/November%2012,%202014,%20Outreach%20Engagement.pdf.* As I have previously said publicly, I support the effort on enhancing the Council's transparency, public disclosures, and engagement with nonbank companies under consideration for designation. At the same time, the nonbank designation process requires consideration of sensitive company information. Any approach must balance these competing interests.

Q.3. In the July FSOC meeting, the Council directed staff to undertake a more focused analysis of industrywide products and activities to assess potential risks associated with the asset management industry.

Does the decision to focus on "products and activities" mean that the FSOC is no longer pursuing designations of asset management firms?

A.3. Although the FSOC has not designated any investment adviser as systemically important, it has not stated that it will no longer consider asset management companies for designation. However, as your question notes, the FSOC did state in the readout of the July 31, 2014, FSOC meeting available at *http://www.treasury.gov/initiatives/fsoc/council-meetings/Documents/July%2031%202014.pdf* that the FSOC has directed staff to undertake a more focused analysis of industrywide products and activities to assess potential risks associated with the asset management industry. On December 18, 2014, FSOC released a notice seeking public comment regarding potential risks to U.S. financial stability from asset management products and activities.

Q.4. Did the FSOC vote on whether to advance the two asset management companies to Stage 3? If so, why was this not reported?

If not, why was such a vote not taken in order to provide clarity to the two entities as well as the industry?

A.4. All Council votes are announced publicly. See, e.g., *http://www.treasury.gov/initiatives/fsoc/council-meetings/Documents/August%2019,%202014,%20Notational%20Vote.pdf.* Under its current guidance, the Council does not disclose the identities of firms under consideration for designation unless and until a final designation is made.

Q.5. At a Senate Banking Committee hearing in July about the role of regulation in shaping equity market structure, market participants expressed concerns regarding the stability, resiliency and undue complexity of the equity markets resulting from the SEC's "one size fits all" set of regulations.

Given your June speech as well as the comments made by other Commissioners, what does the SEC plan to do to address such concerns and when can we expect such SEC action?

A.5. I agree that one market structure does not fit all. I have emphasized the importance of accounting for the varying nature of companies and products, with a particular sensitivity to the needs of smaller companies. To this end, the SEC published an order in June 2014 directing the exchanges and FINRA to submit a tick size pilot plan that is designed to gather and evaluate data related to whether wider tick sizes would benefit small capitalization companies and their investors. At the conclusion of the pilot, the exchanges and FINRA would complete and submit a data driven impact assessment to the Commission. The exchanges and FINRA have filed a plan in response to the June 2014 order that was published for public comment in November 2014. The comment period has now closed and we have received several thoughtful and substantive letters from commenters. We are actively considering these comments in evaluating how to proceed with this initiative.

I also have directed the staff to develop recommendations for the Commission to address a range of market structure issues, including potential initiatives to address disruptive trading practices and to enhance transparency of institutional order routing practices and ATS operations. In addition, I have directed the staff to explore whether changes to the current market structure are warranted for smaller companies, such as affording more flexibility to exchanges that are targeted specifically toward the needs of smaller companies. In developing rulemaking initiatives, I anticipate that the staff and Commission will carefully consider the varying nature of companies and markets and whether any potential regulatory requirements should be tailored to reflect these differences.

Q.6. Additionally, what does the SEC expect to accomplish in this space by the end of the year and what review is the SEC undertaking in terms of the fixed income market, specifically municipal and corporate debt market?

A.6. The staff is advancing all of the equity market structure rulemakings I directed in my June speech, with a focus in the near-term on enhancements to our core regulatory tools of registration and firm oversight. In particular, we are making significant progress on rules to clarify the status of unregistered active proprietary traders to subject them to our rules as dealers and to elimi-

nate an exception from FINRA membership requirements for dealers that trade in off-exchange venues. In addition, we recently have established the Market Structure Advisory Committee to aid us in evaluating more fundamental questions in equity market structure.

As you know, the U.S. regulatory regime also assigns important responsibilities to the SROs, which work in close coordination with the Commission to determine the optimal market structure for the equity markets. Since my speech in June, the SROs have made significant progress in addressing equity market structure concerns. These steps include: (i) enhancing the technological resilience of the consolidated market data systems and other critical market infrastructure; (ii) publicly disclosing how and for what purpose the SROs are using consolidated and direct market data feeds; (iii) improving the consolidated market data feeds by adding new time stamps for when a trading venue processed the display of an order or execution of a trade; (iv) providing greater public disclosure of trading volume by alternative trading systems; and (v) comprehensively reviewing exchange order types and how they operate in practice. SEC staff is now reviewing the results of SRO order type audits.

With respect to fixed income, the Commission recently approved a new MSRB rule to require municipal securities dealers to seek best execution of retail customer orders for municipal securities. We also are committed to working closely with FINRA and the MSRB to encourage their development of further guidance on best execution of trades in both the municipal and corporate debt markets. In addition, FINRA and the MSRB recently published regulatory notices requiring better disclosures of pricing information for certain same-day principal trades.

These steps are related to a broader initiative that I have asked the staff to undertake to enhance the public availability of pre-trade pricing information in the fixed income markets. This initiative would potentially require the public dissemination of the best prices generated by electronic systems, such as alternative trading systems and other electronic dealer networks, in the corporate and municipal bond markets. This potentially transformative change would broaden access to pricing information that today is available only to select parties.

Q.7. It was reported in the press the week of September 8th that the SEC is preparing additional disclosure rules as well as stress test rules for asset managers. What is the expected timeline for such new rules and how would they work together with the recent money market fund rules that the SEC adopted this summer?

A.7. Staff from the Division of Investment Management has been developing a set of rulemaking recommendations for Commission consideration to strengthen our efforts to address the increasingly complex portfolio composition and operations of today's asset management industry. The recommendations will include reporting and disclosure enhancements and new stress testing requirements, as well as several additional initiatives. I outlined these initiatives in a recent speech. See *http://www.sec.gov/News/Speech/Detail/Speech/1370543677722.*

The Commission regularly evaluates and enhances its regulations to address risks, such as the money market fund reforms that required enhanced reporting and provided new tools to address certain risks of those funds. The new staff recommendations the staff is considering would complement the Commission's money market fund reforms, but it is not expected that they would include changes specific to money market funds.

Q.8. Chair White, I have repeatedly stated that the SEC and CFTC need to move in a more coordinated fashion with respect to Dodd-Frank implementation and cross-border initiatives for derivatives. In a hearing in February, I asked you and then-Acting Chairman Mark Wetjen about their efforts to ensure coordination on the remaining Title VII rulemakings, and they responded that the two agencies are continually in discussions and that coordination is a priority for both agencies. What specific progress has your agency made in this venue since February, and what key obstacles still exist?

A.8. Since I became Chair in April 2013, I have prioritized the coordination between the SEC and CFTC at both the senior staff level and principal level. In addition to numerous staff consultations, Chairman Massad and I frequently consult on a range of issues, including implementation under the Dodd-Frank Act of the rules governing derivatives. Our close coordination with the CFTC is not new. In particular, the SEC has been consulting over the past several years with the CFTC on our respective approaches to the application of Title VII. For our part, since February, the SEC has proposed rules relating to books and records and proposed rules to enhance the oversight of clearing agencies deemed to be systemically important or that are involved in complex transactions, such as security-based swaps. In June of this year, we adopted a critical, initial set of cross-border rules and guidance, focusing on the swap dealer and major swap participant definitions. Most recently, on January 14, we adopted 21 new rules that would increase transparency and provide enhanced reporting requirements in the security-based swap market. In connection with all of these actions, we have benefited greatly from our consultations and coordination with the CFTC.

For example, in connection with our final cross-border rules adopted in June, we and the CFTC discussed and compared our respective approaches to the registration and regulation of foreign entities engaged in cross-border swap and security-based swap transactions involving U.S. persons to determine where those approaches converge and diverge. The results are reflected in the final rules we adopted in June, which brought the Commission's cross-border framework to the same place as the CFTC in key respects. As those final rules illustrate, we recognize the importance of consistency. At the same time, the Dodd-Frank Act gave the CFTC and the SEC different statutory authority for addressing activity that occurs outside the United States. In particular, Dodd-Frank included in the Commodity Exchange Act a focus on activities outside the United States that "have a direct and significant connection with activities in, or effect on, commerce of the United

States." The Dodd-Frank Act did not include a similar focus in the Securities Exchange Act.

As the Commission proceeds with finalizing the Title VII rules, including the cross-border application of those rules, I and my staff intend to continue working closely with the CFTC to reduce divergence where possible, where reasonable in light of our different markets, and where consistent with our statutory authority.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR TESTER FROM MARY JO WHITE

Q.1. Chair White, investor protection was one of the most significant issues contemplated in Dodd-Frank, including the direction given to the SEC to examine the standards of care for broker-dealers and investment advisors in providing investors advice. I know we've had many conversations about the importance of the SEC and the DOL harmonizing a Fiduciary standard for broker-dealers.

Can you provide us with an update on where the SEC is in regards to a fiduciary duty rule?

A.1. As you know, the question of whether and, if so, how to use the authority provided under Section 913 of the Dodd-Frank Act is very important to investors and the Commission. Whenever you have substantially similar services regulated differently, I believe you should carefully consider whether the distinctions make sense from both the perspective of investors and strong or optimal regulation, and if not, what to do about it. I have directed the staff to evaluate all of the potential options available to the Commission on this matter, including whether to impose a uniform fiduciary standard on broker-dealers and investment advisers when providing personalized investment advice to retail customers.

At the same time, the staff continues to provide regulatory expertise to Department of Labor (DOL) staff as they consider potential changes to the definition of "fiduciary" under the Employee Retirement Income Security Act (ERISA). While we are separate and distinct agencies, I understand the importance of consistency and the impact the DOL's rulemaking may have on SEC registrants, particularly broker-dealers. Accordingly, the staff and I are committed to continuing these conversations with the DOL, both to provide technical assistance and information with respect to the Commission's regulatory approach and to discuss the practical effect on retail investors, and investor choice, of DOL's potential amendments to the definition of "fiduciary" for purposes of ERISA.

Q.2. One other quick question and I apologize that it's JOBS Act related, not Dodd-Frank related: Do you have a timeframe for finalizing Reg A+ rules?

A.2. While we are unable to provide a specific date for the adoption of final rules, the Commission has included the adoption of the Regulation A+ rules on its most recent Regulatory Flexibility Act agenda, which covers the period from November 2014 to October 2015. Finalizing the rules mandated by the Dodd-Frank and JOBS Acts, including Regulation A+, remains a top priority for the Commission.

To date, the Commission has received more than 100 comment letters on the Regulation A+ rule proposal. These commenters have expressed a variety of different views on how the Commission should implement Regulation A+, including the proposed approach to state securities law registration and qualification requirements and other important aspects of the rulemaking. The staff is carefully reviewing the comments as it works to develop recommendations for final rules for the Commission's consideration. In addition, the staff is closely monitoring the development and implementation of the North American Securities Administrators Association's multistate coordinated review program for Regulation A offerings.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MERKLEY FROM MARY JO WHITE

Q.1. With the Volcker Rule, we finally learned the lessons from the bailout of Long-Term Capital Management and then the 2008 financial crisis that we simply cannot afford to have big, systemically significant firms making big bets on the ups and downs of the market. Casino banking is over—if you stick to your guns and enforce the Rule.

I deeply appreciate the hard work you did to getting to a final rule last December, and I recognize the hard work you are doing now to implement it. However, we are still at the beginning legs of the journey, and I believe in "trust but verify"—which requires full, continued cooperation by our regulators and engagement with the public.

During the financial crisis, we all saw the horrific results when different regulators saw only parts of the risks to some firms. There were too many regulatory silos, which do not work because firms do not function that way. You also need a complete picture of what is going on in any one institution and across different firms. Indeed, one of the least recognized benefits of the Volcker Rule is to force the regulators to pay attention, together, to trading activities, which have become so important at so many banks. But critically, this means all the regulators need full access to all collected data and information.

In addition, accountability to the public through disclosure provides another layer of outside oversight and analysis, as well as equally importantly, public confidence that Wall Street reform is real.

Based on the track record of various public disclosure mechanisms out there already—including for example, the CFTC's positions of traders—there is significant space for reasonably delayed disclosures of metrics data to enhance Volcker Rule accountability and public confidence. Now Treasury Deputy Secretary and then-Federal Reserve Governor Sarah Bloom Raskin highlighted disclosure in her statement on adoption of the final rule, and financial markets expert Nick Dunbar has similarly called for disclosure as a key tool. (See Nick Dunbar, "Volcker Sunlights Should Be the Best Disinfectant", July 25, 2014, *http://www.nickdunbar.net/articles/volcker-sunlight-should-be-the-best-disinfectant/*.) The OCC's Quarterly Trading Activity Report may be a perfect venue to en-

gage in this type of disclosure, provided it is expanded to cover the entire banking group.

First, will each of you commit to working to ensure that each of your agencies has a complete picture of an entire firm's trading and compliance with the Volcker Rule, which can best be accomplished by having all data in one place so that all regulators have access to it?

A.1. The final rule is largely constructed around the trading desk, with many of the rule's requirements applying at that level. Importantly, the definition of trading desk is based on the operational functionality of banking entities' trading activities, and the final rule recognizes that a trading desk may book positions in different affiliated legal entities. Under the final rule, if a trading desk spans more than one affiliated legal entity, each agency with regulatory authority over a relevant legal entity under section 13(b)(2)(B) of the Bank Holding Company Act will have access to records and data regarding the trading desk. For example, if a market-making desk manages positions booked in two affiliated entities, a banking entity must be able to provide supervisors or examiners of any agency that has regulatory authority over the banking entity pursuant to section 13(b)(2)(B) of the Bank Holding Company Act with records, promptly upon request, that identify any related positions held at an affiliated entity that are being included in the trading desk's financial exposure for purposes of the market-making exemption. Similarly, metrics data for a trading desk is generally provided to each agency with regulatory authority over any legal entity in which the trading desk books trades, although a few firms have determined to provide all metrics data to all relevant agencies. As a result, in most cases, metrics data for a particular trading desk is provided to multiple agencies.

Given the rule's focus on activity at the trading desk level, the metrics are designed to help identify activity that may warrant further review to determine whether an individual trading desk is complying with the rule. As discussed in the preamble to the final rule, the agencies will be revisiting the metrics requirement based on data collected by September 30, 2015. This review process will enable us to assess the utility of the metrics, including how they can better foster compliance with the final rule and support agency monitoring and enforcement efforts.

Q.2. Are you committed to using disclosure to help advance compliance with and public trust from the Volcker Rule?

A.2. Metrics data required under the rule is not intended alone to show compliance with the prohibition on proprietary trading or related exemptions. Instead, this data is intended to be used to identify activities that may warrant further review by examiners. The agencies have committed to review the metrics reporting requirement, based on data received through September 30, 2015. As part of that process, we should consider whether there is any aggregate information derived from the metrics that might be meaningfully disclosed to the public.

Q.3. The success of the Volcker Rule over the long term will depend upon the commitment of regulators to the vision of a firewall between high risk, proprietary trading and private fund activities,

on the one hand, and traditional banking and client-oriented investment services on the other hand. One of the most important parts of ensuring that vision is meaningfully implemented is the December 2013 final rule's application of its provisions at the "trading desk" level, defined as the "smallest discrete unit of organization" that engages in trading.

Unfortunately, reports have emerged suggesting that banks are already attempting to combine and reorganize what had been separate trading desks into one "trading desk" for Volcker Rule purposes, as a way to game the metrics-based reporting essential to effective monitoring by regulators of each institution's compliance with the Volcker Rule. The OCC has already identified this risk in its Interim Examination Procedures, and attempted to limit such actions to instances where the desks were engaged in "similar strategies," the combination has a "legitimate business purpose," and the combination assists the firm to "more accurately reflect the positions and fluctuations" of its trading. I feel that the OCC's interim protections may not, however, be enough ensure compliance with the final rule.

I am deeply concerned that combining or reorganizing trading desks would undermine the strength of the metrics-based oversight, particularly related to whether market-making is truly to serve near-term customer demand and whether hedging is truly that. To avoid obscuring evasion by changing the mixture and volume of the "flow" of trading that is reported by the "trading desk" unit, I would suggest that examiners ought to strictly apply the final rule's approach to "trading desk" and apply the guidance set out by the OCC extremely narrowly, along with additional protections. For instance, "similar strategies" would need to include both the type of the trading (e.g., market-making) but also the same or nearly identical products, as well as be serving the same customer base, among other standards. As an example, if two desks traded in U.S. technology stocks and technology stock index futures, combining those into one desk might make sense, depending on other factors, such as where the desks were located and what customers they were serving. But combining, for example, various industry-specific U.S. equities desks that today are separate would not pass muster for complex dealer banks.

It also is important to remember that an important supervisory benefit from implementing the Volcker Rule at a genuine trading desk level is that regulators will gain a much deeper, more granular understanding of the risks emanating the large banks' many different trading desks—the kind of risks that led one particular trading desk to become famous as the London Whale.

When confronted with attempts to reorganize trading desks, regulators should look carefully at whether submanagement structures, bonus structures, or other indicia exist that would suggest that the reorganized "trading desk" is not actually the smallest discrete unit of organization contemplated by the final rule and essential to the metrics-based oversight system being developed.

Will you commit to scrutinizing, for the purposes of the Volcker Rule, any reorganizations of trading desks as posing risks of evasion and will you commit to working jointly to clarify any guidance on the definition of trading desk for market participants?

A.3. Yes, I agree that the trading desk structure is a core component of the final rule, and preventing evasion in this area is critical. Since many of the rule's proprietary trading and compliance provisions are built around the trading desk, improperly constructed trading desks could lead to outcomes that are counter to the goals of section 13 of the Bank Holding Company Act and the final rule. As a result, we will closely focus on potentially unsuitable interpretations of the definition of trading desk. To the extent additional guidance on the definition of trading desk is needed, we will work together with our fellow regulators to develop and implement that guidance.

Q.4. Ensuring speedy compliance with the provisions of the Merkley-Levin Volcker Rule is a top priority for strong implementation. It has already been four years since adoption, and banks should be well on their way to conforming their trading and fund operations.

However, as you know, we also provided for an additional five years of extended transition for investments in "illiquid funds," which were expected to include some types of private equity funds. We did this because some private equity funds, such as venture capital funds, do not usually permit investors to enter or exit during the fund's lifetime (usually 10 years or so) because of the illiquidity of those investments.

As you know, the Federal Reserve Board's rule on the "illiquid funds" extended transition interprets the statutory provision of a "contractual commitment" to invest as requiring a banking entity, where a contract permits divestment from a fund, to seek a fund manager's and the limited partners' consent to exit a fund. The rule, however, provides for the Board to consider whether the banking entity used reasonable best efforts to seek such consent but that an unaffiliated third party general partner or investors made unreasonable demands.

I strongly support the Board's desire to implement the Volcker Rule in a speedy manner. In addition, the Board's approach in the final conformance rule goes a long way to ensuring that the illiquid funds extended transition only be available for investments in truly illiquid funds, and not a way to avoid divestment of hedge funds and private equity funds.

At the same time, we designed the provision to provide for a smooth wind-down for illiquid funds. Indeed, I am sensitive to the legitimate business needs of firms seeking to comply with the Volcker Rule while maintaining relationships with important customers to whom they may seek to provide traditional banking services.

Accordingly, I would urge the Board to clarify that a banking entity's requirement to make "reasonable efforts" to exercise its contractual rights to terminate its investment in an illiquid fund could be satisfied, for example, by a certification by the banking entity (a) that the banking entity's exit from the fund would be extraordinary from the perspective of how most investors enter or exit the fund (i.e., the investment contract does not routinely or ordinarily contemplate entry or exit, and/or such other indicia as are necessary to help distinguish between illiquid private equity funds and other funds, like hedge funds, that ordinarily and routinely permit

investor redemptions), (b) that inquiring with third-party fund managers and limited partners regarding termination would result in a significant detriment to the business of the banking entity and (c) that the banking entity believes that the divestment would result in losses, extraordinary costs, or otherwise raise unreasonable demands from the third-party manager relating to divestment (or the de facto equivalent thereto).

Such a certification from the banking entity, along with the language of the relevant fund agreements and such other requirements as the Board determines appropriate, would obviate the need to seek consent from third-party fund managers. Have you considered clarifying this in a FAQ?

A.4. While the Agencies acted together in adopting the final rule and are continuing to work closely together with regard to the implementation of the Volcker Rule, the Federal Reserve Board alone is authorized under section 13 of the Bank Holding Company Act to grant extensions to the conformance period provided by section 13.

Q.5. We've recently seen reports that the largest Wall Street banks are nominally "deguaranteeing" their foreign affiliates in order to avoid coverage under U.S. regulatory rules, especially those related to derivatives. This "deguaranteeing" appears to be based on a fiction that U.S. banks do not actually guarantee the trading conducted by foreign subsidiaries, and hence would not be exposed to any failure by the foreign subsidiary.

Can you comment on that, and specifically, whether you believe that U.S. bank or bank holding company could be exposed to losses from—or otherwise incur liability related to—a foreign affiliate's trading even when no explicit guarantee to third parties exists. Please specifically address whether an arrangement, commonly known as a "keepwell," provided by the U.S. parent or affiliate to the foreign affiliate potentially could create such exposure—and specifically, liability—for the U.S. entity.

Moreover, please comment on whether the size and importance to the U.S. parent or affiliate of the foreign affiliate's activities could itself create an implied guarantee such that the U.S. firm would have major reputational or systemic risk reasons to prevent the foreign affiliate from incurring significant losses or even failing—similar to rescues that occurred during the financial crisis of entities that were supposed to be bankruptcy remote.

Finally, many of these foreign bank subsidiaries are so-called "Edge Act" corporations, which I understand are consolidated with the insured depository subsidiary for many purposes. Please comment on whether there is any chance that losses in these Edge Act corporations, particularly losses in their derivatives operations, could impact the deposit insurance fund.

A.5. We and our fellow regulators have been following closely the reports that at least some U.S. financial institutions have begun removing guarantees from some swap transactions of their foreign affiliates. The reports I have seen attribute the change, at least in part, to the cross-border guidance issued in July 2013 by the CFTC.

The CFTC has apprised us of its efforts to monitor this shift in the marketplace, and we plan to continue discussions with the CFTC as they continue their efforts. We also are coordinating with the CFTC and other authorities in the U.S. and overseas to monitor changes to industry practices as regulations are implemented. More generally, as we move forward with the further adoption and implementation of the SEC's Title VII-related rules, we will pay close attention to the changing state of the OTC derivatives markets.

With respect to your question regarding keepwells, the Commission's focus is on the substance of the agreement. The Commission's final rules require the foreign affiliate of a U.S. person to include in its de minimis calculation any security-based swap transaction arising out of its dealing activity to the extent that the transaction is subject to a recourse guarantee. This final rule clarifies that for these purposes a counterparty would have rights of recourse against the U.S. person "if the counterparty has a conditional or unconditional legally enforceable right, in whole or in part, to receive payments from, or otherwise collect from, the U.S. person in connection with the security-based swap." To the extent that an agreement, such as a keepwell, gives rise to this type of conditional or unconditional legally enforceable right under a security-based swap against the U.S. person, the Commission would treat that agreement as a recourse guarantee.

At the same time, the Commission recognizes that more general financial support arrangements, including certain keepwells (depending on their terms), also may pose risks to U.S. persons and potentially to the U.S. financial system, even if all recourse guarantees are removed from the foreign affiliate's transactions. U.S. entities that are affiliated with non-U.S. persons for reputational reasons may determine to support their non-U.S. affiliates at times of crisis. As reflected in your question, this reputational concern may be particularly strong in the case of a non-U.S. affiliate that holds significant assets or is otherwise important to the financial institution as a whole. To the extent that these new financial arrangements do not include a legally enforceable right of recourse against a U.S. person, our rules may not bring these affiliates within the SEC's regulatory oversight due to the limits of our statutory authority.

Notwithstanding these limits, I believe that the risks to U.S. financial firms associated with the activities of these deguaranteed foreign affiliates should be addressed. While the SEC will continue to look into these developments and act where necessary and authorized to do so, these risks can also be addressed through other tools established by Congress, such as holding company oversight. By accounting for risks at the consolidated level, these tools address risks posed by guaranteed and nonguaranteed subsidiaries within U.S.-based financial groups, regardless of whether the subsidiaries are based in the United States or outside the United States. I and my staff recognize the need for continued close coordination across regulators, both in the U.S. and overseas, to address regulatory issues in this market.

With respect to your question on "Edge Act" corporations, I would note that the Edge Act is administered by our colleagues at

the Federal Reserve, and thus they would be in a better position to provide a definitive response, including how the Edge Act addresses any potential risks to domestic operations of insured depository institutions from the international operations of "Edge Act" corporations. However, to the extent that arrangements between "Edge Act" corporations and their affiliates give rise to legally enforceable rights of the type described above, the Commission would treat the arrangement as a recourse guarantee.

Q.6. The banking regulators made important progress in the past year in completing Dodd-Frank Wall Street reforms, especially in the realm of prudential banking oversight, but the pace of SEC rulemaking has not kept up.

Can you please provide a rough timeframe for when you plan on completing the following rulemakings, all of which were due years ago:

- Section 621's prohibitions on designing asset-backed securities and betting on their failure,
- All compensation provisions,
- All security-based swaps reforms,
- Crowdfunding, Regulation A+, and investor protection provisions of the JOBS Act, and
- Risk retention rules.

A.6. Since April 2013, the Commission has proposed or adopted over 25 substantive rules called for by the Dodd-Frank Act and other rules directly responding to the financial crisis. These actions include the Volcker rule and major reforms addressing money market funds, credit rating agencies, asset-backed securities, and security-based swaps, among others. Most recently, we adopted rules that would increase transparency and provide enhanced reporting requirements in the security-based swap market, and also adopted final rules for risk retention jointly with our fellow regulators.

With these efforts, we have completed our rulemaking mandates in many of the central areas targeted by the Dodd-Frank Act. And we have finalized nearly all of the more than two dozen studies and reports that it was directed to complete under these Acts.

Some areas remain to complete—in security-based swaps and executive compensation in particular—and I expect that we will soon be making significant progress in both areas. It is important to finish these rules, as well as those required under Section 621, but we must take the time necessary to carefully consider all of the issues raised by commenters and perform rigorous economic analysis, which is critically important and helps inform and guide our rulemaking decisions.

With respect to the JOBS Act, we have, since April 2013, either adopted or proposed all of the required rules, and we will soon be moving to adopt the most critical that remain to be finalized.

Q.7. In addition, the SEC's capital framework for broker-dealers has remained unchanged after the financial crisis, despite its catastrophic failure and despite significant progress by other regulators on capital, leverage, and liquidity.

When will your agency begin work on this important task?

A.7. Since the financial crisis, the Commission has taken a number of actions to strengthen broker-dealer financial responsibility requirements, including capital requirements. For example, in response to the crisis, the Commission staff began targeting the short-term funding activities of the larger broker-dealers, and in general these firms have extended the terms of their repurchase transactions under that enhanced focus. They also are required to apply greater capital charges for certain structured finance products.

In addition, in 2012, the Commission proposed additional liquidity requirements for certain of the largest broker-dealers as well as raising their minimum net capital requirements as part of its rulemaking to establish financial responsibility requirements for security-based swap dealers.[1] Under the proposal, these broker-dealers would be required, among other things, to conduct a liquidity stress test at least monthly that takes into account certain assumed conditions lasting for thirty consecutive days and to establish a written contingency funding plan.[2] Based on the results of the monthly liquidity stress test, the broker-dealers also would need to maintain at all times liquidity reserves comprised of unencumbered cash or U.S. Government securities.[3] In addition to these proposals, the Commission staff is actively working on recommendations that would apply the proposed liquidity requirements to a broader range of broker-dealers and would impose a leverage ratio requirement for broker-dealers to complement existing leverage constraints in the rule.[4]

In addition, in July 2013, the Commission adopted a set of amendments to the broker-dealer financial responsibility rules (including the broker-dealer net capital rule).[5] Among other things, these amendments require broker-dealers to document their risk management procedures, report on secured financing transactions, and take 100 percent capital charges relating to nonpermanent capital infusions. Also, in July 2013, the Commission adopted amendments to the broker-dealer reporting rule that, among other things, promote capital compliance.[6] In particular, broker-dealers that carry customer securities and/or cash (which includes the largest broker-dealers) are required to annually file a "compliance report" in which they must state whether their internal controls over compliance with the financial responsibility rules (including the broker-dealer net capital rule) were effective during the most recently ended fiscal year.[7] They cannot state that their internal con-

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[1] See "Capital, Margin, and Segregation Requirements for Security-Based Swap Dealers and Major Security-Based Swap Participants and Capital Requirements for Broker-Dealers", Exchange Act Release No. 68071 (Oct. 18, 2012), 77 FR 70213 (Nov. 23, 2012).

[2] Id. at 70252-70253.

[3] Id.

[4] See, e.g., Chair Mary Jo White, Chairman's Address at SEC Speaks (Feb. 2014), available at *http://www.sec.gov/News/Speech/Detail/Speech/1370540822127* ("We will also increase our oversight of broker-dealers with initiatives that will strengthen and enhance their capital and liquidity, as well as providing more robust protections and safeguards for customer assets"); Office of Management and Budget, Office of Information and Regulatory Affairs, Broker-Dealer Leverage Ratio, available at *http://www.reginfo.gov/public/do/eAgendaViewRule?pubId=201404&RIN=3235-AL50.*

[5] See "Financial Responsibility Rules for Broker-Dealers, Exchange Act Release No. 70072" (July 30, 2013), 78 FR 51824 (Aug. 21, 2013).

[6] See "Broker-Dealer Reports, Exchange Act Release No. 70073" (July 30, 2013), 78 FR 70073 (Aug. 21, 2013).

[7] Id. at 51916-51920.

trols were effective if there was a material weakness in the internal controls. In addition, the statements in the compliance report must be examined by an independent public accountant registered with the Public Company Accounting Oversight Board.[8]

These activities reflect the Commission's ongoing efforts to ensure that the broker-dealer financial responsibility rules continue to achieve their objectives.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR WARREN FROM MARY JO WHITE

Q.1. As you know, during your nomination process, we discussed how you would handle potential conflicts of interest—or the appearance of conflicts of interest—between your responsibilities as Chair of the SEC and your husband's ongoing work as a partner representing financial institutions at the law firm of Cravath, Swaine & Moore LLP. I believe that conflicts of interest, or the appearance thereof, should not undermine the SEC's critical work enforcing our securities laws and regulating and supervising the securities industry.

Now that you have been Chair for over a year, I'd like to revisit that discussion.

Is there a written policy in place that governs when you must recuse yourself in any matter—enforcement, regulatory, supervisory, or otherwise—in which Cravath, Swaine & Moore is involved? If so, can you provide a copy of it? If not, do you have an informal policy in place, and can you describe it?

Since you were confirmed as Chair of the SEC, have you recused yourself from any matter in which Cravath, Swaine & Moore was involved? If so, how many times have you recused yourself? Please categorize those recusals by the type of matter—enforcement, regulatory, supervisory, or other.

A.1. As part of my confirmation as Chair, I entered into an Ethics Agreement that governs my recusal from matters in which the law firm that employs my spouse, Cravath, Swaine & Moore LLP, represents a party. Such ethics agreements are entered into by all Commissioners to address a variety of potential conflicts of interest or other issues. My Ethics Agreement is public and was provided to the Senate Banking Committee as part of my confirmation, and is publicly available on the Office of Government Ethics Web site. My staff and I also follow procedures (which contain nonpublic and/or confidential client information) to determine whether recusals are appropriate. Out of the over a thousand Enforcement matters in which I have participated since becoming Chair, I have been recused from approximately 10 matters, as well as one nonenforcement matter, as a result of the participation of Cravath on behalf of a party. I have not been recused from any rulemakings.

Q.2. Last June, you announced that the SEC would seek more admissions of fault in its settlement agreements, rather than allowing settling parties to "neither admit nor deny" liability. Since that announcement, how many settlement agreements has the SEC entered into? In how many of those agreements did the SEC require

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[8] Id. at 51928-51937.

an admission of fault? If those agreements including admissions of fault are not confidential, can you provide copies to my office?

A.2. As you indicate, in 2013 we made an important modification to our settlement practices, and we now demand an additional measure of public accountability through an acknowledgement of wrongdoing in certain of our cases, including from major financial institutions and senior executives. Under this policy, the Division of Enforcement now considers requiring admissions in cases where the violation of the securities laws includes particularly egregious conduct; where large numbers of investors were harmed; where the markets or investors were placed at significant risk; where the conduct obstructs the Commission's investigation; where an admission can send a particularly important message to the markets; or where the wrongdoer poses a particular future threat to investors or the markets.

Additionally, we do not accept "no admit, no deny" settlements where a defendant has admitted relevant facts in a settlement with other criminal or civil authorities. This regularly occurs in connection with guilty pleas that arise from a parallel criminal investigation, which frequently are matters that we referred to a criminal prosecutor in which our own investigation assisted in securing a favorable resolution on the criminal side as well. Often in such cases a person allocutes to certain facts as part of a guilty plea, or is found guilty after trial, and the involvement of the criminal authorities in such cases may indicate that these cases involve particularly egregious misconduct. In such cases, our practice is to remove the "no admit, no deny" language from our settlement documents and incorporate a reference to the guilty plea or other resolution.

In other cases, we have determined that it is appropriate to continue to settle on a "no admit, no deny" basis, as do other Federal agencies and regulators with civil enforcement powers. We made this decision because the practice allows us to get significant relief, eliminate litigation risk, return money to victims more expeditiously, and conserve our enforcement resources for other matters. That protocol too is a very important tool in a strong enforcement regime.

From the time we instituted the admissions policy change through the end of September, the Commission settled approximately 520 enforcement actions.[1] During that period, the Commission entered into settlements requiring admissions on a dozen occasions, including cases involving JPMorgan Chase and Bank of America, among others, as defendants.[2] More recently, the Commission has entered into settlements requiring admissions in four additional cases, bringing the total to 16. Those settlement documents are public, and I have instructed my staff to contact your staff to provide copies of them to you. In addition, there have been dozens of SEC settlements in that period that settled without per-

[1] This figure is an approximation. It excludes follow-on administrative proceedings (e.g., where someone is barred from the industry following the imposition of an injunction by a district court in an action brought by the Commission, which action would be counted separately). It also excludes cases against issuers who are delinquent in their filing obligations.

[2] Two of these occasions arose from the same matter, but occurred approximately 1 year apart.

mitting defendants to include "no admit no deny" language and that incorporated a reference to guilty pleas or other admissions made in non-SEC criminal or civil cases.

Q.3. In Section 922 of Dodd-Frank, Congress directed the SEC to provide awards to whistleblowers whose assistance helped the SEC obtain monetary sanctions against a private party. The SEC, through its new Office of the Whistleblower, has already furnished several awards to whistleblowers. However, according to a recent *Washington Post* story,[3] companies are using nondisclosure agreements and other tools to limit the ability of employees to go to the SEC after they have reported purported misconduct internally.

Under SEC Rule 21F-6 (17 CFR §240.21F-6), a whistleblower's "participation in internal compliance systems" is a "factor that may increase the amount of a whistleblower's award." Given concerns about companies using internal compliance systems to deter whistleblowing activity, why does the SEC give potential whistleblowers a financial incentive to report internally before coming to the SEC? More broadly, if the SEC believes that whistleblowers play an important enforcement role, why does it encourage employees not to blow the whistle and to instead report concerns internally?

A.3. Our whistleblower program is making significant contributions to the enforcement work of the Commission. In this past fiscal year, among other accomplishments, our program awarded nine whistleblowers approximately $35 million in the aggregate. In addition, the Commission made the first use of its authority to bring antiretaliation enforcement actions. As a result of the Commission's issuance of significant whistleblower awards, enforcement of the antiretaliation provisions, and protection of whistleblower confidentiality, the agency has continued to receive an increasing number of whistleblower tips. In Fiscal Year 2014, our whistleblower office received over 3,600 whistleblower tips, a more than 20 percent increase in the number of whistleblower tips in just 2 years. The program has thus been an early success, and as awareness of the program increases, it should continue to be an important part of our enforcement efforts.

With respect to your question regarding corporate compliance programs, as you note, Rule 21F-6 provides that, in determining the size of a whistleblower award, the Commission will assess whether, and the extent to which, the whistleblower participated in internal compliance systems. Among other considerations, internal reporting may increase the size of an award, while interfering with established compliance procedures may decrease the size of an award. However, Rule 21F-5 states that discretion remains with the Commission, and Rule 21F-6 states in part that the Commission "*may* consider [the enumerated factors] *in relation to the unique facts and circumstances of each case*" (emphases added).

The Commission's rules give discretion to each whistleblower to decide how best to report suspected wrongdoing: he or she may report internally before going to the Commission, may go directly to

[3] Scott Higham, and Kaley Belval, "Workplace Secrecy Agreements Appear To Violate Federal Whistleblower Laws" (June 29, 2014), available at *http://www.washingtonpost.com/investigations/workplace-secrecy-agreements-appear-to-violate-federal-whistleblower-laws/2014/06/29/d22c8f02-f7ba-11e3-8aa9-dad2ec039789_story.html.*

the Commission right away, or may report to both simultaneously. In other words, he or she does not lose eligibility for an award by reporting internally. And it is not the case that anyone who first comes directly to the Commission necessarily will receive a lower award as a result of not having participated in his or her employer's internal compliance systems.[4]

This rule was passed in 2011 following a robust debate over the question of whether an SEC whistleblower should be required to first report internally to be eligible for an award. The Commission declined to require an internal report, but did provide that making an internal report could be weighed as a factor to potentially increase the size of an award. This decision was driven by several considerations. It is a simple fact that, as an agency with limited resources, the SEC needs to leverage its resources by promoting stronger internal compliance. That has long been an emphasis and priority of the SEC, as it has with other Federal agencies. The Commission concluded that a strong whistleblower program can and should coexist with credible, robust internal reporting mechanisms. The objective was to support effective internal controls while not requiring a whistleblower to choose between internal and external reporting. This rule should create an incentive for companies to take a fresh look at their compliance systems to make them as strong and transparent as possible. Had the Commission not provided some incentive for internal compliance reporting, companies might not have thought it worth the time and expense to bolster their internal functions under the assumption that their employees would never report internally.

With respect to your reference to nondisclosure agreements, I share your concerns about any misuse of employee confidentiality, severance, and other kinds of agreements to hinder an employee's ability to report potential wrongdoing to the Commission. To address issues such as this, the Commission adopted Rule 21F-17(a), which makes it an independent violation of the Commission's rules for any person to "take any action to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement . . . with respect to such communications." This rule provides the Commission with express authority to take action whenever we find that otherwise legitimate employment agreements are being used in a manner that discourages or curtails employee whistleblowing.

Commission staff is focused on cases in which the use of confidentiality or other agreements may violate this Commission rule, and will continue to concentrate on practices that may result in silencing employees from reporting securities violations to the Com-

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[4] In its Adopting Release, the Commission stated:

> [A] whistleblower would not be penalized for not satisfying any one of the positive factors. For example, a whistleblower who provides the Commission with significant information about a possible securities violation and provides substantial assistance in the Commission action or related action could receive the maximum award regardless of whether the whistleblower satisfied other factors such as participating in internal compliance programs. In the end, we anticipate that the determination of the appropriate percentage of a whistleblower award will involve a highly individualized review of the facts and circumstances surrounding each award using the analytical framework set forth in the final rule.

Implementation of the Whistleblower Provisions of Section 21F of the Securities Exchange Act of 1934, at 124, available at *http://www.sec.gov/rules/final/2011/34-64545.pdf.*

mission by threatening liability or employee discipline. In appropriate cases, I expect the Commission will bring enforcement actions under Rule 21F-17(a).

Q.4. Additionally, do you believe the SEC has sufficient authority to issue a rule banning efforts to curtail evidentiary disclosures to the Commission, as undertaken through job perquisites, personnel actions such as termination, lawsuits seeking damages, or any other form of retaliation? If so, please cite and describe those sources of authority. If not, please describe what additional statutory authority is needed.

A.4. Yes, at this time we believe we have sufficient authority, and we have implemented that authority by passing Rule 21F-17(a). It provides in part as follows (emphasis added):

> No person may take *any action* to impede an individual from communicating directly with the Commission staff about a possible securities law violation, including enforcing, or threatening to enforce, a confidentiality agreement . . . with respect to such communications.

By prohibiting "any action" that could curtail evidentiary disclosures to the Commission, this rule provides the Commission with the broadest authority and most effective tool possible to deter the kinds of conduct described in your question. Although I cannot comment on any specific ongoing investigation, enforcing this provision is a high priority for our whistleblower program.

Q.5. Large brokers and other financial intermediaries are taking advantage of individual mutual fund investors by charging them excessive fees for administrative and distribution activities. Rule 12b-1 fees, account management charges, and revenue-sharing payments are extracting billions of dollars each year out of the pockets of the 96 million individual investors who rely on mutual funds for their savings goals. I understand that the SEC is gathering information about some or all of these mutual fund administrative and distribution fees. What is the status of this investigation and does the SEC plan on taking action to reduce these fees?

A.5. The staff of the Commission currently is engaged in a series of risk-targeted examinations of investment companies, advisers, and intermediaries designed to gather information on current fee practices related to distribution and administrative services provided to funds. These examinations are ongoing, with more than a dozen major market participants already examined. The staff has reviewed the size and purpose of administrative, distribution, and revenue sharing payments at these firms, how they were negotiated, and how they are disclosed to investors as well as the funds' directors, among many other issues. These exams already have resulted in certain of the targeted firms changing some of their practices to the benefit of investors. This particular series of examinations is expected to be completed in the near future, and the results of the exams will inform any policy changes that the Commission may undertake to address issues with distribution and administrative fee payments made by funds and advisers to intermediaries.

Q.6. The mutual fund industry has evolved into a "pay to play" business model in which brokers and other intermediaries are com-

pensated handsomely to sell certain funds to their customers, despite the merits of investing in these funds. As an example, revenue-sharing payments from fund management companies are being paid to intermediaries based on the amount of fund shares sold to investors. These payments are not disclosed properly to mutual fund investors because the payments are not being made directly from fund assets. Do you believe this is a problem? If so, what steps can the SEC take to ensure that both funds and their intermediaries are specifically disclosing the amount of these payments and their potential impact on fund performance?

A.6. While not disclosed in the same way as fees deducted directly from fund assets, the Commission requires that the existence of revenue sharing payments and the nature and extent of the conflicts they present be disclosed to investors. Intermediaries can make these disclosures through several channels, such as fund prospectuses and other disclosure documents. Nonetheless, I share the concern about the effectiveness of such disclosure and the impact of revenue sharing on fund recommendations by intermediaries. As previously noted, the staff of the Commission currently is engaged in an ongoing series of examinations with a focus on revenue sharing practices, including how they are negotiated and disclosed. I expect that the results of these examinations will be used to inform policy changes that the Commission might take to address any problems identified, including potential disclosure reforms.

Q.7. A mutual fund investor receives a prospectus that describes the terms and conditions of investing in each fund regulated by the SEC. These terms and conditions—which include a number of protections and benefits for investors—are not being applied uniformly to mutual fund investors because more than 50 percent of fund shares are traded using omnibus accounts. An intermediary holding customer shares in an omnibus account does not provide underlying investor information to a fund for prospectus compliance purposes. Mutual funds are, therefore, not able to ensure that frequent trading rules, sales load discounts and other investor-friendly policies in the prospectus are available to investors who invest through these third-party accounts. Do you believe this is a problem? If so, what can the SEC do to ensure that investors who purchase mutual fund shares through brokers and other intermediaries are treated the same as investors who invest directly, with regard to prospectus terms and conditions?

A.7. Funds have a number of ways to assure themselves of compliance with prospectus terms and conditions for shareholders investing through omnibus accounts. These include third party audits of intermediaries, certifications, questionnaires, on-site reviews, and independently developed compliance tools such as the Statement on Standards for Attestation Engagements (SSAE) No. 16 and the Financial Intermediary Controls and Compliance Assessments (FICCA).

Even with these tools, compliance in an omnibus account environment can pose difficulties for funds and their directors. As noted above, the staff is engaged in a series of exams on distribution and administration fees which have included an exploration of issues

related to compliance through omnibus accounts. The results of these exams should help better inform the Commission of any issues in omnibus account compliance, and I expect will be used to inform any policy changes that the Commission might take to address any problems identified.

Q.8. Public companies are not currently required to report their political spending to shareholders. Academics who have studied this issue have shown that public companies spend significant amounts of shareholder money on politics, but that it is impossible to know how much money companies are spending, or who is benefiting from that spending.[5] I believe that public companies should not be able to spend huge sums of shareholder money on political communication without informing investors, and that it is appropriate for the SEC, whose core mission is to protect investors, to issue a rule on this matter.

To date, a petition for SEC rulemaking on corporate political spending disclosure has generated more than one million comments—most of which support a disclosure rule. Despite that overwhelming public support, last December, the SEC removed from its regulatory agenda a proposed rule to require public companies to disclose political spending.

In January, I joined Senator Menendez and other Senators in a letter asking you when the SEC planned to move forward with a disclosure rule for corporate political spending. Although I appreciated the response I received from you in February, you did not indicate when the SEC planned to address this issue.

Please detail what the Commission has done this year to look into implementing a corporate political spending disclosure rule. Please also state when the Commission plans to initiate a rulemaking proceeding, and when it intends to complete that rulemaking proceeding.

A.8. As I indicated in my February 28, 2014, letter to you, I recognize the public interest in the topic of mandated corporate political spending disclosure. And as I noted in my testimony last September, a number of companies—including a significant percentage of the companies in the S&P 100—are voluntarily providing public disclosures for political contributions. Shareholders also can, and do, submit shareholder proposals on the topic for inclusion in companies' proxy materials, and a number of these proposals have been voted on by shareholders. With respect to a consideration of a mandatory disclosure rule, in light of the numerous rulemakings and other initiatives mandated for the SEC by the Dodd-Frank Wall Street Reform and Consumer Protection Act and the Jumpstart Our Business Startups Act, as well as the need to act on pressing issues such as money market fund reform and strengthening the technology infrastructure of the U.S. securities markets, the Commission and its staff have focused on implementing these rules during the last year and have not devoted resources to a consideration of a corporate political spending disclosure rule. As indicated by the Regulatory Flexibility Act agenda published in the fall of this year, I expect that completion of the remaining statutorily-mandated

[5] Lucian A. Bebchuk and Robert J. Jackson, Jr., "Shining a Light on Corporate Political Spending", 101 *GEO. L.J.* 923, 925 (2013).

rulemakings and projects will continue to be a primary focus of the Commission's agenda for the upcoming year, along with rulemakings that seek to enhance our equity market structure and risk monitoring and regulatory safeguards for the asset management industry.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR KIRK FROM MARY JO WHITE

Q.1. As we examine Wall Street regulation and soundness, it is critical that we be alert to outside threats as well. Over the past year, there have been a number of extensive cyberattacks on American companies, including large financial institutions. Combatting these transnational crimes requires cooperation across Government and industry.

As I have previously asked both Secretary Lew and Chair Yellen—Do you pledge to make cybersecurity a priority?

A.1. I fully agree with your concerns about cyber risks. Cybersecurity has been, and will continue to be, a priority for the SEC and for me personally. Our efforts and initiatives related to cybersecurity span multiple divisions and offices, including the Divisions of Trading and Markets, Investment Management, Enforcement, the Office of Compliance Inspections and Examination (OCIE), the Office of Credit Ratings, and the Division of Corporation Finance. They include the following:

- In 2014, OCIE's examination priorities included a focus on technology, including cybersecurity preparedness. As part of this effort, OCIE issued a Risk Alert on April 15, 2014, to provide additional information concerning its cybersecurity initiative. The initiative was designed to assess cybersecurity preparedness in the securities industry and to obtain information about the industry's recent experiences with certain types of cyberthreats. On January 13, 2015, OCIE announced that its 2015 Examination Priorities again include examination of broker-dealers' and investment advisers' cybersecurity compliance and controls, and also announced that it would expand this initiative to cover transfer agents.
- In the spring of 2014, the SEC hosted a cybersecurity roundtable to encourage a discussion of sharing of information and best practices in this area. Participants included representatives from industry, law enforcement, the legal community and the SEC.
- At my direction, in the summer of 2014, the staff formed a Cybersecurity Working Group to facilitate communication within the SEC on issues relating to cybersecurity and keep abreast of cybersecurity issues and trends relevant to the securities industry. This group assists the SEC's divisions and offices by providing a forum for sharing information and coordinating activities relating to cybersecurity.
- The Division of Corporation Finance issued staff cybersecurity guidance in 2011 setting forth the staff's views on how existing disclosure requirements under the Federal securities laws apply to cybersecurity risks and cyber incidents. Since issuing

the guidance, the staff has routinely evaluated public company disclosures, including cybersecurity disclosure, and issued comments to elicit better compliance with applicable disclosure requirements when it believes material information may not have been provided.

- Staff participate in interagency groups focused on cybersecurity issues, including the Financial and Banking Information Infrastructure Committee (FBIIC) and the Interagency Cybersecurity Forum.

Q.2. Do you believe FSOC can fulfill its statutory mandate to identify risks and respond to emerging threats to financial stability without making cybersecurity a priority?

A.2. I agree that part of FSOC's role in identifying threats to the financial stability of the United States includes highlighting, identifying and analyzing the risks to cybersecurity. Each of FSOC's Annual Reports has identified cybersecurity as a focus for regulators and financial institutions. In its most recent Annual Report, published in June 2014, the Council provided a more detailed set of recommendations on cybersecurity issues. Among the recommendations in the 2014 Annual Report are:

- The Council recommends that regulators and other agencies work with private sector financial institutions to share insights from across the Government and inform institutions, market utilities, and service providers of the risks associated with cyber incidents.
- The Council recommends that regulators assess the extent to which regulated entities are employing principles such as the National Institute of Standards and Technology's Cybersecurity Framework.
- The Council recognizes the overarching contribution of the private sector to cybersecurity infrastructure.
- The Council recommends the continued use of FBIIC to establish, update, and test crisis communication protocols, as well as the equivalents in the private sector.

Q.3. As a member of FSOC, can you identify any deficiencies in the U.S.'s ability to prevent cyberattacks that require Congressional action?

A.3. Cybersecurity and the need to specifically address the threats from cyberattacks must be high priorities for both Government agencies and the private sector. As described above, the SEC has prioritized cybersecurity issues within the bounds of our jurisdictional mandate. We also are involved in interagency efforts to coordinate and share information across the Government. Similarly, the FSOC has made recommendations in its annual reports regarding steps that regulators and financial market participants should consider to improve coordination and communication about the threats of cyber incidents. Although there may be areas where cybersecurity legislation would be helpful—for example, in areas such as information sharing and data breach notification—I am not aware of deficiencies specific to the SEC and its jurisdiction that might require Congressional action at this time.

Q.4. What steps has FSOC taken to address the prevention of future cyberattacks on financial institutions, such as the recent breach at JPMorgan Chase?

A.4. Certain members of FSOC, including the SEC, participate in FBIIC, which has been coordinating information sharing related to cyber incidents, including the recent breach at JPMorgan Chase. As a member of FBIIC, the SEC has participated in those discussions.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR HELLER FROM MARY JO WHITE

Q.1. Recently, the Treasury Department indicated that the Financial Stability Oversight Council was switching the focus of its asset management examination toward activities and products rather than individual entities.

Will you confirm that individual asset management companies are no longer being considered for possible systemically important designation?

A.1. Although the FSOC has not designated any investment advisor as systemically important, it has not stated that it will no longer consider asset management companies for designation. However, as your question notes, FSOC did state in the readout of the July 31, 2014, FSOC meeting available at *http://www.treasury.gov/initiatives/fsoc/council-meetings/Documents/July%2031%202014.pdf* that the FSOC has directed staff to undertake a more focused analysis of industrywide products and activities to assess potential systemic risks associated with the asset management industry. And on December 18, 2014, FSOC released a notice seeking public comment regarding potential risks to U.S. financial stability from asset management products and activities.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR CRAPO FROM TIMOTHY G. MASSAD

Q.1. The issue of FSOC accountability and transparency is one that I have raised numerous times. Given the magnitude of the regulatory burden and other costs imposed by a SIFI designation, it is imperative that the designation process be as transparent and objective as possible.

Do you object to the public disclosure of your individual votes, including an explanation of why you support or oppose such designation?

Will you commit to pushing for greater accountability and transparency reforms for FSOC? Specifically, will you commit to push the FSOC to allow more interaction with companies involved in the designation process, greater public disclosure of what occurs in FSOC principal and deputy meetings, publish for notice and comment any OFR report used for evaluating industries and companies, and publish for notice and comment data analysis used to determine SIFI designations? If you do not agree with these proposed reforms, what transparency and accountability reforms would you be willing to support?

A.1. The Council releases the minutes of its meetings, and I think that process is working well. In practice, the votes of the individual Council members are disclosed, and I have no objection to the disclosure. These are collective decisions of the Council, however, just as the decisions of the Federal Reserve Board, FDIC, SEC, and CFTC are decisions of those collective bodies.

Regarding your second question, in the Dodd-Frank Act, the Council was required to assess potential risks to financial stability. The Council also was given authority to designate nonbank financial companies for supervision by the Federal Reserve if the material financial distress or activities of the company could pose risks to U.S. financial stability. These responsibilities involve information and deliberations that can be very market sensitive. Due to the sensitive nature of its mission, the Council must carefully balance confidentiality with transparency. While I understand that some may see it differently, I believe that the Council generally has done a good job of reaching the right balance. In practice, there have been no limits on the amount of materials companies have been able to submit, and it is carefully reviewed and considered.

It's also fair to say that we're open to suggestions on how the Council can do better in any of its activities, and I pledge to be vigilant in this regard. Staff and principals of the agencies have an ongoing dialogue about possible improvements to the process, including whether to make official any the practices the Council has been following that provide greater access to the process.

Q.2. In the July FSOC meeting, the Council directed staff to undertake a more focused analysis of industrywide products and activities to assess potential risks associated with the asset management industry.

Does the decision to focus on "products and activities" mean that the FSOC is no longer pursuing designations of asset management firms?

Did the FSOC vote on whether to advance the two asset management companies to Stage 3? If so, why was this not reported? If not, why was such a vote not taken in order to provide clarity to the two entities as well as the industry?

A.2. The Council continues to study the asset management industry, and I look forward to being involved in that process. In addition, the SEC has announced actions concerning asset managers that may have an impact on the issues. At this point, I don't think any of us can say where a fuller examination of the issues will take us.

I cannot comment—one way or the other—on any nonpublic matters that may or may not be pending before the Council. As stated above, I look forward to being actively involved as the Council moves forward on asset management issues. Determining the extent to which an individual company potentially may contribute to systemic risk is a difficult issue, and clear answers are seldom available. A more fulsome examination of issues in the asset management industry will help our analysis, but at this point, I cannot say where that analysis will lead us.

Q.3. *CFTC–SEC Coordination:* Chairman Massad, I have repeatedly stated that the SEC and CFTC need to move in a more coordi-

nated fashion with respect to Dodd-Frank implementation and cross-border initiatives for derivatives. In a hearing in February, I asked Chair White and then-Acting Chairman Mark Wetjen about their efforts to ensure coordination on the remaining Title VII rulemakings, and they responded that the two agencies are continually in discussions and that coordination is a priority for both agencies. What specific progress has your agency made in this venue since February, and what key obstacles still exist?

A.3. *CFTC–SEC Coordination on Margin for Uncleared Swaps:* The SEC and CFTC have a long history of interagency coordination in a wide variety of ways in terms of surveillance, enforcement, development of complementary rules, trading in security-related products, and dual-registrant issues. With the passage of the Dodd-Frank Act, interagency cooperation has only grown. The chairs and staff of the CFTC and SEC talk regularly in order to coordinate efforts. We are also working with our international counterparts to harmonize the rules across borders as much as possible, consistent with our statutory responsibilities.

Regarding the remaining Title VII rulemakings, CFTC staff has been in regular contact with the SEC, sharing information and providing detailed input. The SEC also provides input to the CFTC. For example, in developing margin requirements for uncleared swap transactions for SDs and MSPs, Commission staff has continued to consult with staff of both the SEC and banking regulators.

Section 4s(e) of the Dodd-Frank Act requires the CFTC to adopt rules imposing initial and variation margin on uncleared swap transactions entered into by SDs and MSPs that are not subject to regulation by a Prudential Regulator (i.e., the Federal Reserve Board (FRB), the Office of the Comptroller of the Currency (OCC), the Federal Deposit Insurance Corporation (FDIC), the Farm Credit Administration, and the Federal Housing Finance Agency). Section 4s(e) further provides that the CFTC, Securities and Exchange Commission (SEC), and Prudential Regulators shall, to the maximum extent practicable, adopt comparable margin regulations.

The CFTC initially proposed margin requirements for uncleared swap transactions in April 2011 (76 FR 23732 (Apr. 28, 2011)). Subsequent to the initial proposal, the Basel Committee on Banking Supervision and the International Organization of Securities Commissions, in consultation with the Committee on Payment and Settlement Systems and the Committee on Global Financial Systems, formed a working group to develop international standards for margin requirements for uncleared swaps. Representatives of more than 20 regulatory authorities participated, including from the United States, the CFTC, the FDIC, the FRB, the OCC, the Federal Reserve Bank of New York, and the SEC.

In July 2012, the working group published a proposal for public comment. In addition, the group conducted a study to assess the potential liquidity and other quantitative impacts associated with margin requirements. A final report was issued in September 2013 outlining principles for margin rules for uncleared derivative transactions.

The CFTC considered the comments received on its initial proposal and the report issued by the international working group and decided to repropose margin rules for uncleared swap transactions.

The reproposal was approved by the CFTC on September 23, 2014 ("Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants", 79 FR 59898 (Oct. 3, 2014)). In developing the reproposal, CFTC staff worked closely with the staff of the Prudential Regulators, and consulted with staff of the SEC.

The comment period for the reproposal closed on December 2, 2014, and staff is currently considering the comments in developing the final margin rules. Staff also will consult with staff of the Prudential Regulators and SEC in developing its final regulations.

Q.4. *Cross-Border:* In November 2013, CFTC staff issued an advisory indicating that in certain instances U.S. rules would apply to a transaction between a non-U.S. swap dealer and a non-U.S. person, without the possibility of substituted compliance. As I indicated in my November 15th letter, this surprised the market, creating uncertainty and the potential for market disruptions. The CFTC has since solicited comments on the advisory and extended its effective date to December 31st of this year. Given that the effective date is rapidly approaching, is the CFTC considering extending the effective date given the continued issues implementation would cause, the concerns raised by commenters, and the need to provide market participants sufficient time to come into compliance with however the CFTC resolves those issues?

A.4. As you noted, the Commission invited public comment on the staff advisory on cross-border, issued on November 14, 2013, and the staff subsequently extended time-limited no-action relief from the relevant provisions of the CEA and Commission rules. The relief was intended to be responsive to industry's concerns regarding implementation and thereby ensure that market practices would not be unnecessarily disrupted. The staff has extended this relief through September 30, 2015. The staff has reviewed the public comments on the advisory and is developing recommendations. I can assure you that the Commission will carefully consider these public comments and staff recommendations. In doing so, the Commission will also consider extending appropriate relief in order to ensure that market participants have sufficient time to come into compliance with applicable provisions of the CEA and Commission rules.

Q.5. *Swap Dealer De Minimis:* The swap dealer de minimis level is set to automatically drop to $3 billion unless the CFTC takes action. Will you commit to publish for public notice and comment any proposal to drop the de minimis level? As you know, many parties will be affected by any drop in the de minimis level, and the public should be afforded an opportunity to comment on any such changes.

A.5. Commodity Exchange Act section 1a(49)(D) directs the Commission to exempt from designation as a swap dealer an entity that engages in a de minimis quantity of swap dealing. CFTC regulation 1.3(ggg)(4) sets the de minimis level at $3 billion subject to a phase-in period during which the level is $8 billion until: (1) five years after a swap data repository first receives data pursuant to the Commission's regulations at which time the level would automatically go to $3 billion, or (2) another date set by the Commission based on a study to be performed by CFTC staff. I think it will

be important to study this rule, incorporating public input and current market data into the analysis. Any changes to current rules would need to be data-driven and carefully considered. As of December 5, 2014, there were 105 swap dealers provisionally registered with the Commission of which approximately 60 belong to one of 15 corporate families that have registered from 2 to 10 affiliates as swap dealers.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MERKLEY FROM TIMOTHY G. MASSAD

Q.1. *Volcker Rule:* Will you commit to working to ensure that each of your agencies has a complete picture of an entire firm's trading and compliance with the Volcker Rule, which can best be accomplished by having all data in one place so that all regulators have access to it?

A.1. Pursuant to the jurisdictional provisions of sections 2 and 619 of the Dodd-Frank Act, banking entities covered by the Volcker Rule are required to report metrics data for certain of their trading desks to specific regulatory agencies depending on the activities of those desks and the legal entities in which those desks book trades. The CFTC is working with the other four agencies to coordinate oversight of the banking entities' trading activities and to analyze and improve the metrics data. We believe that the agencies can work together to obtain a coherent, informative picture of the trading activities of each reporting firm.

Q.2. Are you committed to using disclosure to help advance compliance with and public trust from the Volcker Rule?

A.2. The CFTC remains committed to utilizing our oversight of certain of the banking entities' trading operations to advance compliance with, and public trust from, the Volcker Rule. The metrics reporting required by the Volcker Rule is a critical piece of that oversight.

Q.3. *Volcker Rule:* Will you commit to scrutinizing, for the purposes of the Volcker Rule, any reorganizations of trading desks as posing risks of evasion and will you commit to working jointly to clarify any guidance on the definition of trading desk for market participants?

A.3. The CFTC is aware that the flexibility afforded in the Volcker Rule's definition of "trading desk" could be misused by some banking entities in an attempt to evade detection of impermissible trading activities. We are actively monitoring the trading desk reorganizations in light of the reported metrics data and will coordinate with the other four agencies on any possible related guidance.

Q.4. *Volcker Rule:* I would urge the Board to clarify that a banking entity's requirement to make "reasonable efforts" to exercise its contractual rights to terminate its investment in an illiquid fund could be satisfied, for example, by a certification by the banking entity (a) that the banking entity's exit from the fund would be extraordinary from the perspective of how most investors enter or exit the fund (i.e., the investment contract does not routinely or ordinarily contemplate entry or exit, and/or such other indicia as are

necessary to help distinguish between illiquid private equity funds and other funds, like hedge funds, that ordinarily and routinely permit investor redemptions), (b) that inquiring with third-party fund managers and limited partners regarding termination would result in a significant detriment to the business of the banking entity and (c) that the banking entity believes that the divestment would result in losses, extraordinary costs, or otherwise raise unreasonable demands from the third-party manager relating to divestment (or the de facto equivalent thereto).

Such a certification from the banking entity, along with the language of the relevant fund agreements and such other requirements as the Board determines appropriate, would obviate the need to seek consent from third-party fund managers. Have you considered clarifying this in a FAQ?

A.4. The CFTC supports the Board's efforts to determine the veracity of claims of illiquidity for various covered funds and will coordinate with the other agencies on the appropriate method through which to clarify the issue, should the agencies choose to clarify.

Q.5. *Deguaranteeing of Wall Street Banks:* We've recently seen reports that the largest Wall Street banks are nominally "deguaranteeing" their foreign affiliates in order to avoid coverage under U.S. regulatory rules, especially those related to derivatives. This "deguaranteeing" appears to be based on a fiction that U.S. banks do not actually guarantee the trading conducted by foreign subsidiaries, and hence would not be exposed to any failure by the foreign subsidiary. Can you comment on that, and specifically, whether you believe that U.S. bank or bank holding company could be exposed to losses from—or otherwise incur liability related to—a foreign affiliate's trading even when no explicit guarantee to third parties exists. Please specifically address whether an arrangement, commonly known as a "keepwell," provided by the U.S. parent or affiliate to the foreign affiliate potentially could create such exposure—and specifically, liability—for the U.S. entity.

A.5. The CFTC is aware of "deguaranteeing" activities by five registered swap dealers that have U.S. based parents. We are concerned about these activities both from the perspective of whether they are compliant with the CEA and CFTC regulations and the effect they may have on risk transfer back to the U.S. We have gathered detailed information from all five registrants on the how, what, why and when of such activities and are now assessing this information and consulting with prudential regulators. As stated in the Commission's cross border guidance, the Commission believes that "it is the substance, rather than the form, of the [financial support] arrangement that determines whether the arrangement should be considered a guarantee for purposes of the application of section 2(i) [of the CEA]." 78 FR 45320 (2013). In a footnote to the quoted text, the Commission noted that "keepwells" would, in essence, be guarantees for purposes of section 2(i).

Q.6. Please comment on whether the size and importance to the U.S. parent or affiliate of the foreign affiliate's activities could itself create an implied guarantee such that the U.S. firm would have major reputational or systemic risk reasons to prevent the foreign affiliate from incurring significant losses or even failing—similar to

rescues that occurred during the financial crisis of entities that were supposed to be bankruptcy remote.

A.6. The size and importance of an affiliate's activities could influence a U.S. parent's assessment of how much financial support to provide to that affiliate to prevent its failure. Reputational concerns could lead a parent to provide financial support to an affiliate. This is a concern that the Commission acknowledged in its cross border guidance when declining to identify only certain types of guarantees as relevant for registration purposes. 78 FR 45320. We note that if there is no agreement under which the parent is obligated to another party to provide financial support, then providing such support is not a legal requirement. Another possible way of addressing this issue may be through effective resolution plans that provide for the winding up of such an affiliate instead of "rescuing" the affiliate.

Q.7. Many of these foreign bank subsidiaries are so-called "Edge Act" corporations, which I understand are consolidated with the insured depository subsidiary for many purposes.

Please comment on whether there is any chance that losses in these Edge Act corporations, particularly losses in their derivatives operations, could impact the deposit insurance fund.

A.7. The CFTC does not oversee the deposit insurance fund and therefore does not have the information necessary to answer this question.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR KIRK FROM TIMOTHY G. MASSAD

Q.1. *Cybersecurity:* As I have previously asked both Secretary Lew and Chair Yellen—Do you pledge to make cybersecurity a priority?

A.1. Yes, working to improve the cyber and information security and the cyber-related resilience, preparedness, and mitigation capabilities of the financial sector, and of U.S. futures and swap markets and clearing organizations in particular, is and will continue to be a priority.

Q.2. Do you believe FSOC can fulfill its statutory mandate to identify risks and respond to emerging threats to financial stability without making cybersecurity a priority?

A.2. Cyber and information security must be a high priority for the financial sector. Recognizing that automated systems play a central and critical role in the modern, predominantly electronic financial marketplace, cybersecurity is a statutory and regulatory priority for the CFTC: the Commodity Exchange Act and CFTC regulations require the infrastructures that we supervise, namely designated contract markets, swaps execution facilities, clearing organizations, and swap data repositories, to have programs of risk analysis and oversight that address cyber and information security. In addition, I agree it should be a priority generally for U.S. financial regulators: the Financial and Banking Information Infrastructure Committee or FBIIC—which is chaired by the Department of the Treasury and includes the CFTC—aids U.S. financial regulators in their efforts to strengthen financial sector resilience, preparedness, and mitigation capabilities with respect to cybersecurity, business con-

tinuity, and disaster recovery. The FBIIC also has an effective partnership concerning cybersecurity and automated system resiliency with its private sector counterpart, the Financial Services Sector Coordinating Council, which includes major markets, clearing organizations, and firms across the U.S. financial sector.

Q.3. As a member of FSOC, can you identify any deficiencies in the U.S.'s ability to prevent cyberattacks that require Congressional action?

A.3. One key way to increase financial sector resiliency with respect to cybersecurity is ensuring timely information sharing concerning cyberthreats, to the greatest extent practicable. Before undertaking a legislative initiative, we should endeavor to work within existing authorities to examine ways that financial regulators, the Intelligence Community, and law enforcement agencies might facilitate timely cyberthreat information-sharing. In that connection, the Commission already has authority under the CEA to share information with Federal and State agencies, as well as foreign regulators, subject to assurances of confidentiality.

Q.4. What steps has FSOC taken to address the prevention of future cyberattacks on financial institutions, such as the recent breach at JPMorgan Chase?

A.4. U.S. financial regulators work closely together through the FBIIC to improve financial sector resiliency and preparedness with respect to cyberattacks. Both the FBIIC and its private sector counterpart, the FSSCC, have response protocols in place for use when cyberattacks occur. FBIIC and FSSCC are currently engaged in updating these protocols in light of recent experience in this area, and they are working to match up the protocols of the public and private sectors even more closely, to help facilitate timely coordination concerning cyber incidents. FBIIC and FSSCC are conducting exercises, with participation of financial regulators, the private sector, and law enforcement and other parts of the Government with specialized cyber expertise, to enhance our joint understanding and planning processes. In addition, FBIIC, FSSCC, and the Financial Sector Information Sharing and Analysis Center are working together, and consulting with the Intelligence Community and law enforcement, to identify measures and best practices for strengthening the resiliency, preparedness, and mitigation capabilities of the financial sector with respect to cyberthreats.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR MORAN FROM TIMOTHY G. MASSAD

Q.1. *Position Limits:* Mr. Chairman, in a recent media appearance, you said that the CFTC intends to address end-user concerns with position limits. I have heard concerns about the aggregation of positions even where a person does not control day-to-day trading. Does the CFTC intend to address these types of concerns in its work on end-user issues?

A.1. CFTC is now considering public comments received on a notice of proposed rulemaking (NPRM) that would modify the aggregation provisions of the position limit regime under part 150 of CFTC's regulations. We are soliciting extensive input on the position limits

rule—78 FR 68946 (Nov. 15, 2013), comment period extended 79 FR 2394 (Jan. 14, 2014), comment period reopened 79 FR 30762 (May 29, 2014), June 19, 2014, staff roundtable,[1] comment period extended 79 FR 37973 (July 3, 2014), comment period reopened 79 FR 71973 (Dec. 4, 2014). In light of the language in section 4a of the Commodity Exchange Act (CEA), its legislative history, subsequent regulatory developments, and CFTC's historical practices in this regard, CFTC noted in the NPRM that it believes CEA section 4a requires aggregation on the basis of either ownership or control of an entity. The NPRM would add a new exemption, by way of notice filing, for a person seeking disaggregation relief, under specified circumstances, for positions held or controlled by a separately organized entity (owned entity), for ownership or equity interests of not more than 50 percent in the owned entity. The proposal also would add a new exemption, by way of application, for a person seeking disaggregation relief, under specified circumstances, for positions held or controlled by an owned entity, for ownership or equity interests of greater than 50 percent in the owned entity.

Q.2. *Swap Dealer De Minimis:* Mr. Chairman, as you know the swap dealer de minimis level is set to automatically drop to $3 billion unless the CFTC takes action. Will any action taken by the CFTC to address the swap dealer de minimis issue be open to public notice and comment?

A.2. Commodity Exchange Act section 1a(49)(D) directs the Commission to exempt from designation as a swap dealer an entity that engages in a de minimis quantity of swap dealing. CFTC regulation 1.3(ggg)(4) sets the de minimis level at $3 billion subject to a phase-in period during which the level is $8 billion until: (1) five years after a swap data repository first receives data pursuant to the Commission's regulations at which time the level would automatically go to $3 billion, or (2) another date set by the Commission based on a study to be performed by CFTC staff. I think it will be important to study this rule, incorporating public input and current market data into the analysis. Any changes to current rules would need to be data-driven and carefully considered. As of December 5, 2014, there were 105 swap dealers provisionally registered with the Commission of which approximately 60 belong to 1 of 15 corporate families that have registered from two to ten affiliates as swap dealers.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR HELLER FROM TIMOTHY G. MASSAD

Q.1. *FSOC:* Recently, the Treasury Department indicated that the Financial Stability Oversight Council was switching the focus of its asset management examination toward activities and products rather than individual entities. Will you confirm that individual asset management companies are no longer being considered for possible systemically important designation?

A.1. As you know, the OFR released a report on asset management issues a year ago, and the Council held an asset management conference last spring. This topic is an important one. The Council

[1] Transcript available at *http://www.cftc.gov/PressRoom/Events/opaevent_cftcstaff061914.*

continues to study issues that affect the asset management industry and the financial markets. I expect the Council will provide industry and the public ample opportunity to comment further later this year as it further explores these issues, and I look forward to being involved in that process. At this point, I do not know where further discussion of the issues will take us, but I hope to gain a better understanding of the risks surrounding this industry.