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Statement by
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Chairman
Board of Governors of the Federal Reserve System
before the
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C.
February 17, 2011

Chairman Johnson, Ranking Member Shelby, and other members of the Committee, thank you for the opportunity to testify about the Federal Reserve's implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act). The Dodd-Frank Act addresses critical gaps and weaknesses in the U.S. regulatory framework, many of which were revealed by the recent financial crisis. The Federal Reserve is committed to working with the other U.S. financial regulatory agencies to implement the act effectively and expeditiously. We are also cooperating with our international counterparts to further strengthen financial regulation, to ensure a level playing field across countries, and to enhance international supervisory cooperation. And we have revamped the supervisory function at the Federal Reserve to allow us to better meet the objectives of the act.

The act gives the Federal Reserve important responsibilities both to make rules to implement the law and to apply the new rules. In particular, the act requires the Federal Reserve to complete more than 50 rulemakings and sets of formal guidelines, as well as a number of studies and reports. We have also been assigned formal responsibilities to consult and collaborate with other agencies on a substantial number of additional rules, provisions, and studies. So that we meet our obligations on time, we are drawing on expertise and resources from across the Federal Reserve System in banking supervision, economic research, financial markets, consumer protection, payments, and legal analysis. In all, more than 300 members of the Federal Reserve staff are working on Dodd-Frank implementation projects. We have created a senior staff position to coordinate our efforts and have developed project-reporting and tracking tools to facilitate management and oversight of all of our implementation responsibilities.

We have made considerable progress in carrying out our assigned responsibilities. We have been providing significant support to the Financial Stability Oversight Council, of which the Federal Reserve is a member. We are assisting the council in designing its systemic risk monitoring and evaluation process and in developing its analytical framework and procedures for identifying systemically important nonbank firms and financial market utilities. We also are helping the new Office of Financial Research at the Treasury Department develop potential data reporting standards to support the council's systemic risk monitoring and evaluation duties. We contributed significantly to the council's recent studies--one on the Volcker rule's restrictions on banking entities' proprietary trading and private fund activities and a second one on the act's financial-sector concentration limit. And we are now developing for public comment the necessary rules to implement these important restrictions and limits. Last week, the Board adopted a final rule to ensure that activities prohibited by the Volcker rule are divested or terminated in the time period required by the act.

We also have been moving forward rapidly in other areas. Last fall, we issued a study on the potential effect of the act's credit risk retention requirements on securitization markets, as well as an advance notice of proposed rulemaking on the use of credit ratings in the regulations of the federal banking agencies. In addition, in December, the Board and the other federal banking agencies requested comment on a proposed rule that would implement the capital floors required by the Collins Amendment. In December, we also requested comment on proposed rules that would establish standards for debit card interchange fees and implement the act's prohibition on network exclusivity arrangements and routing restrictions. In January, the Board, together with the Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, and Office of Thrift Supervision (OTS), provided the Congress a comprehensive

report on the agencies' progress and plans relating to the transfer of the supervisory authority of the OTS for thrifts and thrift holding companies. In addition, as provided by the act, we and the Federal Reserve Banks each established offices to consolidate and build on our existing equal opportunity programs to promote diversity in management, employment, and business activities.

We continue to work closely and cooperatively with other agencies to develop joint rules to implement the credit risk retention requirements for securitizations, resolution plans (or "living wills") for large bank holding companies and council-designated nonbank firms, and capital and margin requirements for swap dealers and major swap participants. We are consulting with the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC) on a variety of rules to enhance the safety and efficiency of the derivatives markets, including rules that would require most standardized derivatives to be centrally traded and cleared, require the registration and prudential regulation of swap dealers and major swap participants, and improve the transparency and reporting of derivatives transactions. We also are coordinating with the SEC and the CFTC on the agencies' respective rulemakings on risk-management standards for financial market utilities, and we are working with market regulators and central banks in other countries to update the international standards for these types of utilities.

The transfer of the Federal Reserve's consumer protection responsibilities specified in the act to the new Bureau of Consumer Financial Protection (CFPB) is well under way. A team at the Board, headed by Governor Duke, is working closely with the staff at the CFPB and at the Treasury to facilitate the transition. We have provided technical assistance as well as staff members to the CFPB to assist it in setting up its functions. We have finalized funding agreements and provided initial funding to the CFPB. Moreover, we have made substantial

progress toward a framework for transferring Federal Reserve staff members to the CFPB and integrating CFPB employees into the relevant Federal Reserve benefit programs.

One of the Federal Reserve's most important Dodd-Frank implementation projects is to develop more-stringent prudential standards for all large banking organizations and nonbank firms designated by the council. Besides capital, liquidity, and resolution plans, these standards will include Federal Reserve- and firm-conducted stress tests, new counterparty credit limits, and risk-management requirements. We are working to produce a well-integrated set of rules that will significantly strengthen the prudential framework for large, complex financial firms and the financial system.

Complementing these efforts under Dodd-Frank, the Federal Reserve has been working for some time with other regulatory agencies and central banks around the world to design and implement a stronger set of prudential requirements for internationally active banking firms. These efforts resulted in the adoption in the summer of 2009 of more-stringent regulatory capital standards for trading activities and securitization exposures. And, of course, it also includes the agreements reached in the past couple of months on the major elements of the new Basel III prudential framework for globally active banks. Basel III should make the financial system more stable and reduce the likelihood of future financial crises by requiring these banks to hold more and better-quality capital and more-robust liquidity buffers. We are committed to adopting the Basel III framework in a timely manner. In December 2010, we requested comment with the other U.S. banking agencies on proposed rules that would implement the 2009 trading book reforms, and we are already working to incorporate other aspects of the Basel III framework into U.S. regulations.

To be effective, regulation must be supported by strong supervision. The act expands the supervisory responsibilities of the Federal Reserve to include thrift holding companies and nonbank financial firms that the council designates as systemically important, along with certain payment, clearing, and settlement utilities that are similarly designated. Reflecting the expansion of our supervisory responsibilities, we are working to ensure that we have the necessary resources and expertise to oversee a broader range of financial firms and business models.

The act also requires supervisors to take a macroprudential approach; that is, the Federal Reserve and other financial regulatory agencies are expected to supervise financial institutions and critical infrastructures with an eye toward not only the safety and soundness of each individual firm, but also taking into account risks to overall financial stability.

We believe that a successful macroprudential approach to supervision requires both a multidisciplinary and wide-ranging perspective. Our experience in 2009 with the Supervisory Capital Assessment Program (popularly known as the bank stress tests) demonstrated the feasibility and benefits of employing such a perspective. Building on that experience and other lessons learned from the recent financial crisis, we have reoriented our supervision of the largest, most complex banking firms to include greater use of horizontal, or cross-firm, evaluations of the practices and portfolios of firms, improved quantitative surveillance mechanisms, and better use of the broad range of skills of the Federal Reserve staff. And we have created a new Office of Financial Stability within the Federal Reserve, which will monitor financial developments across a range of markets and firms and coordinate with the council and with other agencies to strengthen systemic oversight.

The Federal Reserve is committed to its long-standing practice of ensuring that all of its rulemakings are conducted in a fair, open, and transparent manner. Accordingly, we are

disclosing on our public website summaries of all communications with members of the public--including banks, trade associations, consumer groups, and academics--regarding matters subject to a proposed or potential future rulemaking under the act. We also have implemented measures within the act to enhance the Federal Reserve's transparency. In December, we publicly released detailed information regarding individual transactions conducted between December 1, 2007, and July 20, 2010, across a wide range of Federal Reserve credit and liquidity programs, and we are developing the necessary processes to disclose information concerning transactions conducted after July 20, 2010, on a delayed basis as provided in the act.

To conclude, the Dodd-Frank Act is a major step forward for financial regulation in the United States. The Federal Reserve will work closely with our fellow regulators, the Congress, and the Administration to ensure that the law is implemented expeditiously and in a manner that best protects the stability of our financial system and our economy.