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The Honorable Jacob J. Lew
U.S. Department of the Treasury
Hearing on the Financial Stability Oversight Council's Nonbank Financial Company Designations Process
Senate Committee on Banking, Housing, and Urban Affairs
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Chairman Shelby, Ranking Member Brown, and members of the Committee, thank you for inviting me here today to discuss the Financial Stability Oversight Council's nonbank financial company designations process.

As no one here needs reminding, the financial crisis caused great hardship for millions of individuals and families in communities throughout the country, and revealed some central shortcomings of our financial regulatory framework. We witnessed the effects of lax regulation and supervision for financial firms like Lehman Brothers and AIG. These names have already been written into history as companies whose failure, or near failure, helped contribute to the near-collapse of the financial system. At the time, the regulatory structure was ill-equipped to oversee these large, complex, interconnected financial companies. This outdated structure also meant that regulators had limited tools to protect the financial system from the failure of these companies. As a result, the American taxpayer had to step in with unprecedented actions to stop the financial system from collapsing.

Congress responded with a historic and comprehensive set of financial reforms — the Dodd-Frank Wall Street Reform and Consumer Protection Act — to put in place critical reforms for taxpayers, investors, and consumers. The aim of this reform is to guard against future crises while making sure taxpayers are never again put at risk for the failure of a financial institution.

To lead the effort to better protect taxpayers, Wall Street Reform created FSOC. FSOC is the first forum for the entire financial regulatory community to come together, identify risks in the financial system, and work collaboratively to respond to potential threats to financial stability. Over the past five years, FSOC has demonstrated a sustained commitment to working collaboratively to fulfill its statutory mission in a transparent and accountable manner. This work has not been easy; we built a new organization and developed strong working relationships among FSOC members and their staffs to allow the types of candid conversations, exchange of confidential, market sensitive information, and tough questions that will make our financial system safer.

Today, FSOC convenes regularly to monitor market developments, to consider a wide range of potential risks to financial stability, and, when necessary, to take action to protect the American people against potential threats to the financial system. Our approach from day one has been data-driven and deliberative, while providing the public with as much transparency as possible regarding our actions and views. We have published four annual reports that describe our past work and future priorities; regularly opened FSOC meetings to the public; published minutes of all of our meetings that include a record of every vote the FSOC has ever taken; and solicited public input on both our processes and areas of potential risk.

I and the other members nonetheless recognize that FSOC is a young organization that should be open to changes to its procedures when good ideas are raised by stakeholders. Just over the last year alone, FSOC has enhanced its transparency policy, strengthened its internal governance, solicited public comment on potential risks from asset management products and activities, and adopted refinements to its nonbank financial company designations process.

I believe that our adoption of these changes to the nonbank financial company designations process represents a prime example of the way FSOC should go about refining its processes without compromising its fundamental ability to conduct its work. Last year, prior to making any changes, FSOC conducted extensive outreach with a wide range of stakeholders. The FSOC Deputies Committee — senior staff who coordinate FSOC activities — hosted a series of meetings in November with more than 20 trade groups, companies, consumer advocates, and public interest organizations. We also solicited input from each of the three companies then subject to a designation. FSOC discussed the findings from this outreach and proposed changes during a public meeting in January.

FSOC adopted a set of supplemental procedures last month. These changes address the areas that stakeholders were most interested in and formalized a number of existing FSOC practices regarding engagement with companies. Under the new procedures, companies will know early in the process where they stand, and they will have earlier opportunities to provide input. Additionally, the changes will provide the public with additional information about the process, while still allowing FSOC to meet its obligation to protect sensitive, nonpublic materials. And finally, FSOC will provide companies with a clearer and more robust annual review process. This will open the door to more engagement with FSOC following a designation to make sure there is ample opportunity to discuss and address any specific issues that a company wants to put before the FSOC. These changes strengthen the FSOC's process while also addressing many of the suggestions made from stakeholders.

Despite our responsiveness and willingness to engage with stakeholders in this case and others — but perhaps due in part to our successful pursuit of our mission — some opponents of reform have been trying to undermine the FSOC, its members and its ability to respond to potential threats to financial stability. Many of the arguments levied at FSOC are not based on the actual record, and opponents object to our efforts to bring regulators together to work collaboratively to monitor risks and protect the U.S. financial system. But Congress gave FSOC a clear mission to address the kinds of risks and regulatory gaps that resulted in the financial crisis, and we are doing what Congress asked us to do, using the tools Congress gave us.

I am pleased to report to this Committee that the vast majority of key reforms contained in Wall Street Reform are now in place, due to the hard work and diligence of the independent regulatory agencies. We have made substantial progress since the law's enactment almost five years ago toward shaping a financial system that is safer, more resilient, and supportive of long-term economic growth. I would like to take a moment to briefly highlight some key milestones that illustrate the scope and significance of Wall Street Reform.

- Regulators now have tools to address the riskiness of the largest, most complex firms — whether banks or nonbanks — in a manner that is commensurate with their systemic footprint.

- In addition, resolution planning and the orderly liquidation authority – a tool that Members on both sides of the aisle in this Committee helped craft – give us the ability to allow any financial firm to fail without putting the rest of the financial system at risk, and — just as importantly — without imposing costs on U.S. taxpayers.

- The previously-unregulated swaps market, notionally valued at around $600 trillion dollars, has been fundamentally transformed through the introduction of a comprehensive regulatory regime that is making these markets safer and more transparent.

- The Volcker Rule, which was adopted in late 2013 and is scheduled to take effect this summer, prohibits banks from speculative short-term trading and fund investing for their own accounts. This important rule will reduce both the incentive and ability of banks to take excessive risks, and limit conflicts of interest.

- And with creation of the CFPB, we now have a financial regulator dedicated to looking out for consumers and protecting them from deceptive, unfair, and abusive practices by mortgage originators, payday lenders, and debt collectors, to name a few. To date, CFPB enforcement actions have resulted more than $5 billion in relief to 15 million consumers who have been harmed by illegal practices.

- Other recently-completed reforms include: implementing enhanced prudential standards for the largest U.S. bank holding companies and for foreign banking organizations operating in the United States; new rules requiring banking organizations to hold sufficient liquidity buffers; establishing financial sector concentration limits, which set a cap on growth by acquisition for the largest financial companies; risk retention requirements for asset-backed securitizations; and enhanced leverage requirements to strengthen and backstop firms' risk-based capital standards.

- Finally, enhanced prudential standards continue to be applied in a manner that focuses the most stringent requirements on those few firms that pose the greatest risks to financial stability, including a proposed capital surcharge that is proportional to the risks posed by the largest and most complex banks. Also, there is a proposal for a new minimum standard for total loss-absorbing capacity (TLAC). This proposed standard would strengthen the capital framework to help ensure that the largest and most complex banks have sufficient capital to absorb losses, and would help facilitate an orderly resolution in a manner that minimizes any impact on financial stability if the bank fails.

Today, because of Wall Street Reform, the financial system is in a more robust and resilient position than it was prior to the crisis. We have reduced overall leverage in the banking system. Banks have added over $500 billion of capital since the crisis to serve as a buffer for absorbing unexpected losses. The recently completed annual stress tests cover a wider swath of institutions, and illustrate that our largest banks have sufficient capital to withstand adverse shock scenarios and continue to lend to businesses.

In fact, despite suggestions by some that Wall Street Reform would impair our economic growth, the exact opposite has been true. While banks have adjusted to more prudent rules, they continue to increase lending to small businesses and families, helping to fuel the creation of 12 million jobs over 60 straight months of job growth – a record that our economy, with a safer financial system, continues to build on. This progress is both real and consequential.

The true test of reform should not be whether it prevents firms from taking risk or making mistakes, but whether it shapes a financial system strong and resilient enough to support long-term economic growth while remaining innovative and dynamic. In working toward this end, Treasury and the independent regulators continue to monitor carefully the effects of new reforms and to ensure that they are properly calibrated to the size, complexity and risk profiles of individual institutions. Just as the business environment is constantly evolving, the regulatory community must be flexible enough to keep up with new challenges — including making adjustments where necessary and remaining vigilant to new emerging threats.

No law is perfect. But let me be clear: we will vigilantly defend Wall Street Reform against any change that increases risk within the financial system, weakens consumer, investor or taxpayer protections, or impedes the ability of regulators to carry out their mission. Amid these discussions of technical fixes and tweaks to Wall Street Reform, we must not forget what we learned from the financial crisis: our financial firms are constantly evolving, and we must remain alert and responsive to new challenges in a dynamic system, toward the ultimate goal of maintaining the safety, soundness and resiliency of our financial system.

We must also not forget who will pay a steep price if Congress rolls back critical safeguards, weakens oversight, and waters down appropriate rules of the road. It will be companies that play by the rules and serve their customers well. It will be small businesses who need access to credit to grow their businesses and create jobs. It will be working men and women trying to save for their children's education, a down payment on a home, and their own retirement.

Promoting financial stability and protecting the American public from the next financial crisis should be an objective shared by the Administration, regulators, the financial sector, and members of Congress, regardless of party. I look forward to working with this Committee, and with Congress as a whole, to continue to make progress in creating a more resilient and stable financial system.