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STATEMENT OF

MARTIN J. GRUENBERG
ACTING CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

on

IMPLEMENTATION OF THE DODD-FRANK ACT

before the

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Chairman Johnson, Ranking Member Shelby and members of the Committee, thank you for the opportunity to testify on the Federal Deposit Insurance Corporation's continued implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).

It has now been nearly 17 months since enactment of the Dodd-Frank Act. The Act gives financial regulators important authorities to enhance financial stability and to manage the regulatory challenges posed by large, complex systemically important financial institutions (SIFIs). The Act also provides for a new SIFI resolution framework that includes an orderly liquidation authority and a requirement for SIFIs to submit resolution plans that demonstrate how they can be resolved through the bankruptcy process. These changes give regulators better tools to manage the potential risks and failure of complex financial institutions. A credible capacity to place a SIFI into an orderly resolution process is essential to subjecting these companies to meaningful market discipline.

The Act specifically provides the FDIC new enhanced authority to manage the deposit insurance fund (DIF) as well as to oversee the orderly resolution of systemically important financial institutions. My testimony today will focus on the progress the FDIC has made in implementing these important provisions of the Dodd-Frank Act, including international efforts on systemic resolution planning. The testimony will also provide an update on implementation of bank capital provisions of the Dodd-Frank Act, as well as an overview of progress on important interagency rulemaking efforts.

Core FDIC Rulemakings

The Dodd-Frank Act granted the FDIC sole rulemaking authority in two primary areas: orderly liquidation authority and deposit insurance reforms. Within a year after passage of the Dodd-Frank Act, the FDIC had completed five major final rules for which the Act granted it sole rulemaking authority.[1] I will discuss these completed rules in more detail below.

Deposit Insurance Reforms and Strengthening the Deposit Insurance Fund

The FDIC moved expeditiously to implement changes to the FDIC's deposit insurance program required by the Dodd-Frank Act. In August 2010, the FDIC issued a final rule to make permanent the increase in the standard coverage limit to $250,000. In December 2010, the FDIC adopted a final rule amending its deposit insurance regulations to provide for unlimited deposit insurance for "noninterest-bearing transaction accounts" through December 31, 2012.

Changing the Assessment Base. In February 2011, the FDIC adopted a final rule redefining the deposit insurance assessment base as average consolidated total assets minus average tangible equity. The deposit insurance assessment base was previously defined as domestic deposits.

As Congress intended, the change in the assessment base reduced the share of assessments paid by community banks compared to the largest institutions, which rely less on domestic deposits for their funding than do smaller institutions. Second quarter 2011 assessments for banks with less than $10 billion in assets were about a third (about $340 million) lower in aggregate than first quarter assessments. This shift in the share of assessments better reflects each group's share of industry assets. The change in the

[1]Two remaining rules have been postponed for practical reasons. First, the rule defining the criteria for consolidated revenues for financial companies predominantly engaged in financial activities has been postponed to ensure consistency with a similar rule being issued by the Board of Governors of the Federal Reserve. Second, the FDIC has postponed the rule offsetting the effect on institutions with less than $10 billion in assets of requiring that the DIF reserve ratio reach 1.35 percent by September 30, 2020 (rather than 1.15 percent by 2016, as previously required) to better enable the FDIC to take into account prevailing industry conditions at the time of the offset.

assessment base did not materially affect the overall amount of assessment revenue collected. In fact, assessments for the second quarter of 2011 (the quarter when the new rule took effect) were nearly the same as assessments for the prior quarter.

Deposit Insurance Fund Management. Since year-end 2007, 412 FDIC-insured institutions failed resulting in total estimated losses of $86 billion to the DIF. The DIF balance hit a low of negative $20.9 billion in the fourth quarter of 2009. The FDIC took a number of actions to stabilize the DIF and deal with the losses associated with the high volume of failures, including increasing assessment rates, imposing a special assessment and requiring that the industry prepay assessments.

The DIF balance increased throughout 2010 and turned positive again as of June 30 of this year. As of September 30, 2011, the fund balance was $7.8 billion (0.12 percent of estimated insured deposits). The Dodd-Frank Act requires that the DIF reserve ratio reach 1.35 percent by September 30, 2020.

The actions undertaken to stabilize the DIF were taken before passage of the Dodd-Frank Act. The Dodd-Frank Act, however, gave the FDIC enhanced authority to manage the DIF. In particular, the Act gave the FDIC substantial flexibility to set reserve ratio targets and pay dividends. Using this flexibility, the FDIC has adopted a long-term fund management plan designed to maintain a positive fund balance even during a banking crisis while preserving steady and predictable assessment rates through economic and credit cycles. In December 2010, the FDIC set a long-term reserve ratio target of 2 percent. In February 2011, also pursuant to the plan, the FDIC adopted lower assessment rates that will take effect when the DIF reserve ratio reaches 1.15 percent, with progressively lower assessment rates if the reserve ratio exceeds 2 percent or 2.5 percent.

Orderly Resolution of Failed Systemically-Important Financial Institutions

In addition to issuing rules to implement deposit insurance and DIF management reforms, the FDIC has made significant progress in adopting regulations and in conducting ongoing planning to facilitate implementation of its new orderly liquidation authority for systemically important financial institutions (SIFIs). These responsibilities include a requirement for firms to maintain resolution plans that will give regulators additional tools to manage the failure of large, complex enterprises, and an orderly liquidation authority to resolve bank holding companies and, if necessary, nonbank financial institutions.

Orderly Liquidation Authority. Title II of the Dodd-Frank Act vests the FDIC with orderly liquidation authority (OLA) that is similar in many respects to the authorities it already has for insured depository institutions. On July 6, 2011, the FDIC issued a final rule on OLA that provides the regulatory framework defining how creditors will be treated and how claims will be resolved in an FDIC receivership under the Dodd-Frank Act. Many aspects of the process are similar to that in bankruptcy -- and creditors will be exposed to losses under the statutory priority of claims. However, unlike bankruptcy, an orderly resolution under the Dodd-Frank Act allows continuity of critical operations both to prevent a freezing-up of the financial system and to maximize the value recoverable from the assets of the failed company. These rules provide the key elements of the framework for implementing OLA, if it is ever necessary.

While the adoption of the final rule completes a large portion of the rulemaking required with respect to the exercise of OLA under the Dodd-Frank Act, there is still work to be done. The FDIC is currently working on other rules and guidance:

- The FDIC is completing a proposed rule to be issued in consultation with the Department of the Treasury regarding certain key definitions for determining which organizations are financial companies within the meaning of the Dodd-Frank Act.
- The FDIC is working with the Securities and Exchange Commission (SEC) on a joint regulation implementing the Title II authority to resolve covered broker-dealers.
- The FDIC is working toward a joint rule ensuring that appropriate records are available with respect to all of a financial institution's derivative transactions. The FDIC's similar existing regulation requiring troubled insured institutions to maintain records on derivative contracts is being used as a template for this new joint rule.
- The FDIC is working on other rulemakings required by Title II of the Act, including a rule governing eligibility of prospective purchasers of assets of failed financial institutions.
- The FDIC is working on additional guidance to the industry in response to questions and comments received on areas such as the creation, operation, and termination of bridge financial companies, and the implementation of certain minimum recovery requirements established under the Act.

Financial Stability for Systemically-Important Financial Institutions

In addition to the FDIC's OLA, the Dodd-Frank Act provided regulators with tools to assist in ensuring financial stability, including the requirement for companies to provide resolution plans, and the authority for certain firms to be designated for oversight by the Board of Governors of the Federal Reserve (FRB).

The Act's provisions are designed so that the OLA would be used only as a last resort. SIFIs and large bank holding companies are required to prepare a resolution plan that would detail how the firm could be resolved under the Bankruptcy Code. If the firms are successful in their resolution planning, then the OLA would only be used in the rare instance where resolution under the Bankruptcy Code would have serious adverse effects on U.S. financial stability.

Resolution Plans. The FDIC has adopted two rules regarding resolution plans. The first resolution plan rule, jointly issued with the FRB, with an effective date of November 30, 2011, implements the requirements of Section 165(d) of the Dodd-Frank Act. This section requires bank holding companies with total consolidated assets of $50 billion or more and certain nonbank financial companies that the Financial Stability Oversight Council (FSOC) designates as systemic, to develop, maintain and periodically submit resolution plans to regulators. The plans will detail how each covered company would be resolved under the U.S. Bankruptcy Code, including information on their credit exposure, cross-guarantees, organizational structures, and a strategic analysis describing the company's plan for rapid and orderly resolution.

The resolution planning undertaken in connection with the two rules will complement the internal planning process that the FDIC began upon enactment of the Dodd-Frank Act to prepare for the orderly resolution of a systemically significant institution under the OLA. While the OLA planning process is well underway, and those plans are in an advanced stage of development, they continue to be refined. The information obtained as a result of the resolution plan submissions under the two rules will serve as a significant source of information for the further development of the FDIC's OLA plans.

Submission of resolution plans will be staggered based on the asset size of a covered company's U.S. operations. Companies with $250 billion or more in nonbank assets must submit plans on or before July 1, 2012; companies with $100 to $250 billion or more in total nonbank assets must submit plans on or before July 1, 2013; and all other covered companies that predominantly operate through one or more insured depository institutions must submit plans on or before December 31, 2013. A company's plan is required to be updated annually as well as after a company experiences a material event.

Following submission of a plan, the FDIC and the FRB will review the plan to determine if it is not credible or would not facilitate an orderly resolution of the covered company under the Bankruptcy Code. If a resolution plan does not meet the statutory standards, after an opportunity to remedy its deficiencies, the agencies may jointly decide to impose more stringent regulatory requirements on the covered company. Further, if, after two years following the imposition of the more stringent standards, the resolution plan still does not meet the statutory standards, the FDIC and the FRB may, in consultation with the appropriate FSOC member, direct a company to divest certain assets or operations.

The FDIC also issued an Interim Final Rule in September 2011 requiring any FDIC-insured depository institution with assets of $50 billion or more to develop, maintain and periodically submit contingency plans outlining how the FDIC would resolve the depository institution through the FDIC's traditional resolution powers under the Federal Deposit Insurance Act. While not required by the Dodd-Frank Act, this complements the joint final rule on resolution plans for SIFIs.

These two resolution plan rulemakings are designed to ensure comprehensive and coordinated resolution planning for both the insured depository and its holding company and affiliates in the event that an orderly liquidation is required. Both of these resolution plan requirements will improve efficiencies, risk management and contingency planning at the institutions themselves. We expect that the process of developing these plans will be a dialogue between the regulators and the firm. It is not a simple "check-the-box" exercise, and it must take into account each firm's unique characteristics. The planning process must be an interactive dialogue, especially for the largest and most complicated firms. Ultimately, the goal is to have an integrated process of supervision and resolution that will reduce the risk of failure, but that will enable the FDIC to prepare to carry out an orderly resolution if necessary.

The FDIC has initiated with the FRB a series of joint communications that will provide institutions with additional guidance on how initial resolution plans should be drafted. Covered companies have been informed that the planning process will be iterative and that frequent communications are expected as resolution plans are developed.

Implementation of Joint Rules on SIFI Designation. Some of the key purposes of the FSOC, chaired by the Secretary of the Treasury, is to facilitate regulatory coordination and information sharing among its member agencies, to identify and respond to emerging risks to financial stability, and to promote market discipline. The FSOC is also responsible for designating SIFIs for heightened supervision by the FRB.

In October of 2010, the FSOC issued an advanced notice of proposed rulemaking and, in January of 2011, followed up with a notice of proposed rulemaking describing the processes and procedures that will inform the FSOC's designation of nonbank financial companies under the Dodd-Frank Act. In response to concerns raised by commenters, the FSOC issued a second notice of proposed rulemaking and proposed interpretive guidance on October 18, 2011 to clarify the process for SIFI designations, to specify additional details, and to enhance the transparency of the designation process.

The second notice of proposed rulemaking and interpretive guidance supersedes the prior notice of proposed rulemaking, and describes the manner in which the FSOC intends to apply the statutory standards and considerations and the process and procedures that the FSOC intends to follow in making SIFI designations. Under the second notice of proposed rulemaking, nonbank financial companies will generally be assessed using a three-stage process where each stage will involve an increasingly in-depth evaluation and analysis. The evaluation will be based on both quantitative thresholds and qualitative factors. The designation process will also analyze the extent to which the company can be resolved in bankruptcy, which is key to whether a company should be designated as a SIFI.

Once designated, SIFIs will be subject to heightened supervision by the FRB and required to maintain detailed resolution plans as discussed above.

International Efforts

In the event of a cross-border resolution of a covered financial company, Section 210 of the Dodd-Frank Act requires the FDIC to "coordinate, to the maximum extent possible" with appropriate foreign regulatory authorities. An important element of the FDIC's implementation of the Dodd-Frank Act has been the creation of a new Office of Complex Financial Institutions. The international outreach and coordination group in this office will coordinate the FDIC's efforts with those in other jurisdictions charged with similar responsibilities.

While no international framework currently exists for the insolvency and resolution of financial institutions, the FDIC and other U.S. regulators have taken the lead in promoting consistent best practices in international insolvencies and resolutions. The structures of international financial companies are often highly complex, and the issues associated with their resolution can be challenging. With planning and cross-border coordination, however, disruptions to global financial markets can be minimized.

The crises in 2008, and the current international instability, demonstrate the necessity for closer cooperation in supervision and in the resolution of cross-border institutions. Given our responsibility for the resolution of a global SIFI, this is a major focus of the FDIC. To achieve this goal, the FDIC and other U.S. regulators are pursuing a number of efforts.

First, the FDIC and its colleagues are working through the Financial Stability Board (FSB) and the Basel Committee on Banking Supervision to promote greater harmonization of national laws governing resolutions and improved coordination. The FDIC co-chairs the Cross-Border Bank Resolution Group (CBRG) of the Basel Committee, which made specific recommendations for reforms to enhance resolution capabilities. These reforms focused on greater legal harmonization, improved information sharing, and market structure enhancements that would make the global financial system more resilient. Last year, the FSB and the G-20 leaders endorsed these recommendations and tasked the CBRG to assess progress. That progress report, released in July, identified a number of areas where significant improvements have been made, but also detailed areas requiring renewed national and international effort.

In October, the FSB released a set of "Key Attributes of Effective Resolution Regimes for Financial Institutions." These Key Attributes build on the CBRG recommendations and expand their scope to include non-bank financial institutions. In fact, the Key Attributes substantively build upon the framework included in the Dodd-

Frank Act. Now that the Key Attributes were endorsed by the G-20 last month, all of the major financial centers are required to move toward a resolution framework to resolve systemic financial institutions in an orderly manner that places losses on shareholders and unsecured creditors. A number of key jurisdictions, including the United Kingdom and the European Union, have made significant progress.

Second, the FDIC and its U.S. colleagues are working through Crisis Management Groups (CMGs) for all of the global SIFIs to enhance institution-specific planning for any future resolution. The CMGs allow the regulators to identify impediments to more effective resolution based on the unique characteristics of a particular financial institution. This work, initiated under the auspices of the FSB, has been underway for almost two years for the major U.S. and U.K. institutions; other countries are moving rapidly forward as well.

Finally, the FDIC is actively engaged in working with individual foreign regulators to explore more effective means of cooperation. This work entails, initially, gaining a clear understanding of how U.S. and foreign laws governing cross-border institutions will interact in any crisis. The FDIC is working with these regulators to identify the most effective ways to implement the OLA for a U.S. cross-border institution under the host country’s applicable laws.

In addition to efforts to achieve harmonization of legal frameworks, the FDIC has been engaged in cooperative resolution planning with supervisory and resolution authorities in foreign countries. In the wake of the financial crisis, there has been an increased international awareness of the need for greater inter-jurisdictional cooperation in the planning for resolution of specific cross-border institutions. Our initial interactions with foreign authorities have proven very promising, and the FDIC will continue to pursue these efforts vigorously.

Similar to the U.S., other countries have recognized the need to have a resolution regime separate from the bankruptcy process to resolve large, international financial companies in a manner that can take into account the impact on financial stability.

Promoting Financial Stability by Strengthening Bank Capital. The FDIC strongly supports recent international efforts to strengthen banks' capital adequacy through the Basel III standards and recent agreements regarding capital held by so-called "Global Systemically Important Banks."

The FDIC is working closely with the other federal banking agencies to complete a notice of proposed rulemaking seeking comment on domestic implementation of the Basel III agreement published by the Basel Committee on Banking Supervision (BCBS) in December 2010. The agencies are also working to finalize changes to the Market Risk Capital Rule agreed to by the BCBS in 2009. The agencies have reached agreement on the notice of proposed rulemaking to implement the internationally agreed changes to the Market Risk Rule in a manner consistent with certain requirements of the Dodd-Frank Act, as described in more detail below. The FDIC Board of Directors is scheduled to consider this proposal tomorrow.

Section 939 of the Dodd-Frank Act requires the agencies to remove references to credit ratings from their regulations. There are many references to credit ratings in the agencies' current capital regulations, as well as in Basel III and the 2009 BCBS reforms to the Market Risk Rules. The agencies' permissible investment regulations also reference credit ratings. Replacing these various references requires the development of credit risk metrics that identify gradations of risk in a consistent and supportable manner, and in a manner that can be reasonably implemented by a wide range of banks. Tomorrow, the FDIC Board will consider a specific proposed alternative to credit ratings that the agencies have developed for use by banks subject to the Market Risk Rule. Developing this proposal has been a challenging task, and marks an important step in fulfilling international regulatory capital agreements in a manner consistent with the Act. The FDIC Board will also be considering a notice of proposed rulemaking regarding permissible investments for savings associations, a rulemaking that will mirror the Office of the Comptroller of the Currency's (OCC) recently published proposal regarding permissible investments for national banks.

Other Rules in Progress

The FDIC is also working with other regulators on implementing several additional important parts of the Dodd-Frank Act.

Volcker Rule. In October, the FDIC, jointly with the FRB, the OCC, and the SEC, issued a notice of proposed rulemaking requesting public comment on a proposed regulation implementing the Volcker Rule requirements of section 619 of the Dodd-Frank Act. The comment period closes on January 13, 2012.

Risk Retention Rule. In March 2011, six agencies, including the FDIC, issued a notice of proposed rulemaking seeking comment on a proposal to implement Section 941 of the Act.[2] The proposed rule would require sponsors of asset-backed securities to retain at least 5 percent of the credit risk of the assets underlying the securities and not permit sponsors to transfer or hedge that credit risk. The proposed rule would provide sponsors with various options for meeting the risk-retention requirements. It also provides, as

[2] The rule was proposed by the Federal Reserve Board, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the U.S. Securities and Exchange Commission, the Federal Housing Finance Agency, and the Department of Housing and Urban Development.

required by Section 941, proposed standards for a Qualified Residential Mortgage (QRM) which, if met, would result in exemption from the risk retention requirement. During the comment period, which was extended to August 1, 2011, the agencies received numerous comment letters. The agencies are in the process of evaluating those comments.

Margin and Capital Requirements for Covered Swap Entities. In May, the FDIC, jointly with the FRB, the OCC, the Farm Credit Administration, and the Federal Housing Finance Agency (FHFA), published a notice of proposed rulemaking that would impose margin requirements on certain swaps entered into by regulated entities as required under sections 731 and 734 of the Dodd-Frank Act. Since the issuance of the notice of proposed rulemaking, the FSB has initiated an effort to develop an international convergence in margin requirements and has asked the BCBS, in conjunction with the International Organization of Securities Commissions, to develop a consultation document by June 2012. The FDIC, along with the other banking agencies, is actively participating in the FSB initiative. In order to reduce competitive concerns, the agencies have decided to take into consideration, to the extent possible, the margin recommendations developed by this international initiative as they work toward the development of a final rule by mid-2012.

Incentive Compensation. The FDIC continues to work with other agencies, including the federal banking agencies, FHFA, and the SEC, to implement the incentive compensation requirements in section 956 of the Dodd-Frank Act. Section 956 addresses a key safety and soundness issue that contributed to the recent financial crisis -- that poorly designed compensation structures can misalign incentives and promote excessive risk-taking within financial organizations.

In April 2011, the agencies jointly issued a notice of proposed rulemaking that would, among other things, prohibit compensation arrangements that are "excessive" or that "could lead to material financial loss" at a covered financial institution and enhance regulatory reporting of incentive-based compensation arrangements. Section 956 exempts approximately 7,000 institutions with less than $1 billion in total assets from its requirements. For larger institutions, those with $50 billion or more in total consolidated assets, the proposed rule would prescribe payment deferral and other compensation structure requirements for senior policymakers and other key employees.

The agencies are in the process of considering public comments received on the proposed rule.

Consumer Financial Protection Bureau Transition. The FDIC has been working cooperatively with the Consumer Financial Protection Bureau (CFPB) on several transition issues, including supervision and enforcement cases, procedures for consultations on future rulemakings and consumer complaint processing. Several FDIC employees worked temporarily at the CFPB to assist in its start-up. The FDIC continues to meet with CFPB officials weekly to establish processes required by the Act, such as the sharing of draft examination reports for institutions where the CFPB has jurisdiction.

Stress Tests. The FDIC has been coordinating with the FRB to develop a proposed rule governing stress tests for financial companies. These tests, required under section 165 of the Dodd-Frank Act, are an essential component of the collective effort to ensure that financial companies have the resilience required to weather a future crisis.

Diversity. The Director of the FDIC's Office of Minority and Women Inclusion is continuing work to develop diversity standards for the FDIC workforce and management, and for increased participation of minority- and women-owned businesses in FDIC programs and contracts, as provided in the Dodd-Frank Act. This work continues efforts begun by the Office's predecessor, the FDIC's Office of Diversity and Economic Opportunity.

FDIC Community Banking Initiatives

Given the impact of the recent financial crisis on community banks and concerns raised about the potential effect of the Dodd-Frank Act on these institutions, the FDIC believes that there is value in taking a broad-based look at community banks and the issues that will affect their future. As the primary federal regulator for the majority of community banks, the FDIC has developed a set of community banking initiatives to further its dialogue with the industry and better its understanding of the challenges and opportunities for community banks.

As part of these initiatives, the FDIC will hold a national conference early next year that will focus on the future of community banks, their unique role in supporting our nation's economy, and the challenges and opportunities that they face in this difficult economic environment. Following the conference, the FDIC will organize a series of roundtable discussions with community bankers in each of the FDIC's six regional offices around the country in which senior FDIC executives, including myself, will participate.

The FDIC is also undertaking a major research initiative to examine a variety of issues related to community banks, including their evolution, characteristics, performance, challenges, and role in supporting local communities. The FDIC's research agenda will cover topics such as changes in community bank size and geographic concentration over time, measuring the performance of community banks, and changes in community bank business models and cost structures. The research will also look at how trends in technology and the small business economy have affected community banks and the lessons for community banks from the current crisis.

Also as part of these initiatives, the FDIC is continuing to look for ways to improve the effectiveness of its examination and rulemaking processes. The FDIC will seek to identify supervisory improvements and efficiencies that can be made while maintaining our supervisory standards. In particular, the FDIC is exploring enhancements to its offsite reviews, pre-examination planning processes, information requests and examination coordination. In addition, the FDIC is exploring communications strategies to update the industry on upcoming guidance and rulemakings that affect FDIC-supervised community banks in an organized and understandable way so that institutions can more effectively plan to meet their compliance obligations. The FDIC continues to ensure that examination guidance takes into account the size, complexity, and risk profile of each institution. To that end, the FDIC now includes a section in each Financial Institution Letter sent to insured depository institutions that describes its applicability to institutions with total assets of less than $1 billion.

Conclusion

Today's testimony highlights the FDIC's progress in implementing financial reforms authorized by the Dodd-Frank Act. While the FDIC has completed the fundamental rulemakings necessary to fulfill its responsibilities under the Act, there is considerable work to do. Throughout this process, the FDIC has sought input from the industry and the public, has worked cooperatively with fellow regulators, and has been transparent in its deliberations and rulemakings. The FDIC believes that successful implementation of the Act will represent a significant step forward in providing a foundation for a financial system that is more stable and less susceptible to crises in the future, and better prepared to respond to future crises.

Thank you. I would be glad to respond to your questions..