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S. HRG. 112–594

INTERNATIONAL HARMONIZATION OF WALL STREET REFORM: ORDERLY LIQUIDATION, DERIVATIVES, AND THE VOLCKER RULE

HEARING

BEFORE THE

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

ONE HUNDRED TWELFTH CONGRESS

SECOND SESSION

ON

EXAMINING ORDERLY LIQUIDATION, DERIVATIVES, AND THE VOLCKER RULE

MARCH 22, 2012

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

Available at: http://www.fdsys.gov/

U.S. GOVERNMENT PRINTING OFFICE

76–591 PDF WASHINGTON : 2013

For sale by the Superintendent of Documents, U.S. Government Printing Office
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INTERNATIONAL HARMONIZATION OF WALL STREET REFORM: ORDERLY LIQUIDATION, DERIVATIVES, AND THE VOLCKER RULE

THURSDAY, MARCH 22, 2012

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

The Committee met at 9:48 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.

I thank our witnesses for joining us.

Today, this Committee continues its oversight of the implementation of the Wall Street Reform Act. Since our last Wall Street Reform hearing in December, there have been significant developments on implementation, including new proposed and final rules in areas critical to strengthening market oversight and stability.

Among the many lessons apparent from the recent financial crisis is that the financial system is truly global and that risks and regulations in one country can have significant effects on institutions and markets worldwide. Last month, we held a hearing to examine the European debt crisis and any potential spillover effects in the U.S. Today's hearing will focus on the possible effects of our new financial rules on international markets and on international competitiveness for U.S. institutions.

Some of the most complex and critical rulemakings of the Wall Street Reform Act are the ones with international implications that we will focus on today. The FDIC's new orderly liquidation authority, as well as the creation of living wills and the SIFI designation, will together help ensure that large, multinational, interconnected financial institutions may be quickly wound down in times of stress without exposing taxpayers to losses or threatening the financial system.

In order to fully implement these important rules, our agencies must work closely with their international partners to make cross-border resolutions orderly and coordinated so that global firms will no longer be too big to fail. I look forward to the agencies providing an update on efforts to harmonize regulations.

The Volcker Rule also raises a number of complicated issues with potential international effects. It is important to carefully implement the rule's prohibitions on prop trading and fund investments

in a manner that does not impair market making, underwriting, client services, hedging, and other permitted activities so important to our economy. Market participants need greater clarity about the conformance period and what will be required of them starting this July. I look forward to hearing the witnesses' comments on these issues as well as their views on the rule's potential impact on capital markets, Governments, and institutions around the world.

Additionally, international coordination is key to bringing greater stability and transparency to the $700 trillion global derivatives market. Ideally, the rules the CFTC, SEC, and prudential regulators are working to finalize should have no substantive degree of variance and only differ for kinds of firms and transactions the rules are being applied to. In addition, global harmonization and rules relating to margin, capital, and clearing will be essential to promoting financial stability, effective oversight, and competitiveness of U.S. companies doing business abroad.

I welcome the regulators' updates on these developments and on the next steps for strengthening the global financial system.

While our economy is starting to show signs of recovery from the financial crisis, we must remain vigilant in ensuring that Wall Street Reform is implemented thoughtfully and with full consideration of international implications. The Wall Street Reform law gave our regulators the tools to address global threats to financial stability as well as oversight over new, uncharted areas of the international financial markets. We have already seen good progress in the recently announced stress tests, showing U.S. banks in a much stronger position than they were before the crisis. But until the new rules are fully implemented, our financial system remains vulnerable to threats both from within the U.S. and from abroad.

I believe our Committee's robust oversight of Wall Street Reform has reaffirmed the need for, and improved the implementation of, this important legislation. As I have said before, I am open to the idea of improving Wall Street Reform by making technical corrections and fixing unintended consequences, but in today's political environment, there will need to be broad bipartisan support to get anything approved.

Senator Shelby, your opening statement.

STATEMENT OF SENATOR RICHARD C. SHELBY

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

Today, our financial regulators will update us on their efforts to harmonize the requirements of the Dodd-Frank Act with the financial regulations of other countries. I think this is an important issue due to the global nature of modern financial markets.

Today, nearly all major U.S. financial institutions have operations overseas, and most major foreign financial institutions have operations, of course, in the U.S. The globalization of finance has generally been a positive development. It helps firms raise capital at lower rates and more effectively manage their risk. This, in turn, helps financial institutions lend more cheaply to businesses and to consumers.

Yet the globalization of finance means that regulators need to be mindful of how their regulations interact with the regulations of other countries. Poorly conceived loans or ineffective coordination by regulators can easily undermine the efficiency of the international economic system. And although such regulatory failures often go largely unnoticed, the consequences can be significant.

The impacts show up in the form of higher interest rates and fees for consumers and higher operating costs for businesses. Ultimately, higher prices reduce economic growth and job creation.

We only need to recall how poor international economic coordination in the 1930s stemming from the Smoot-Hawley Act and other laws worsened the Great Depression. Accordingly, I believe it is critical that Congress and our financial regulators make sure that Dodd-Frank does not worsen an already troubled economy by unnecessarily impeding the international financial system.

I think it is worth noting that 2 years ago, when Dodd-Frank was passed, the thought that Dodd-Frank would create any international coordination problems was not on the minds of the Act's supporters. Rather, we were told here that the rest of the world would follow our lead and adopt legislation similar to Dodd-Frank. Of course, this has not happened.

To the contrary, foreign regulators and Governments have publicly expressed serious concerns about Dodd-Frank. Canada, Germany, Japan, the United Kingdom, as well as European Union have all identified profound problems with the implementation of Dodd-Frank. These problems include reducing the liquidity of their Government bond markets and the discriminatory treatment of foreign firms.

In addition, many market participants have expressed concerns about the extraterritorial reach of Dodd-Frank. They justifiably fear that they will find themselves caught in a regulatory trap, as many Dodd-Frank rules may conflict with theirs. These concerns have been worsened by the fact that our financial regulators have already missed 70 percent of the Dodd-Frank rulemaking deadlines. And as a consequence, 2 years after the passage of Dodd-Frank, market participants are still unclear if and how Dodd-Frank rules will apply to their international banking operations.

The risk of having to comply with Dodd-Frank's costly regulations is causing many firms to reconsider doing business in the U.S. The U.S. should be the market of choice because it is the most sophisticated and modern. It should not be the market firms desperately seek to avoid due to its costly and heavy-handed regulatory approach.

But looking forward, it is my hope that our regulators will take the time to ensure that the Dodd-Frank rulemakings have as few unintended consequences as possible. I hope to hear today how our financial regulators are working with their foreign counterparts to address legitimate concerns about Dodd-Frank. In particular, I hope to hear how our regulators are working to address the major discrepancies that exist between the U.S. and international derivatives rules, especially with respect to margin and capital requirements.

I also hope to learn today what specific steps regulators have taken to ensure that the FDIC's new orderly liquidation authority

can effectively wind down a large international firm. As we saw with the failure of Lehman and, more recently, MF Global, the collapse of an international financial firm can leave customer assets frozen in several countries, making resolution of a firm substantially more difficult. Hopefully, the next time a major international financial institution fails, regulators will have a far more efficient and effective response than the CFTC's response to MF Global.

Unfortunately, in the nearly 2 years since the passage of Dodd-Frank, regulators have done little to instill confidence that Dodd-Frank will do anything other than increase the cost of doing business in America.

Thank you, Mr. Chairman.

Chairman JOHNSON. Thank you, Senator Shelby.

Are there any other Members who wish to make a brief opening statement?

[No response.]

Chairman JOHNSON. Thank you all. I want to remind my colleagues that the record will be open for the next 7 days for opening statements and any other material you would like to submit.

Now, I will briefly introduce our witnesses. Lael Brainard is the Under Secretary for International Affairs at the U.S. Department of the Treasury.

Dan Tarullo is currently serving as a Member of the Board of Governors of the Federal Reserve System.

Elisse Walter is currently serving as a Commissioner on the U.S. Securities and Exchange Commission.

Marty Gruenberg is the Acting Chairman of the Federal Deposit Insurance Corporation.

John Walsh is the Acting Comptroller of the Office of the Comptroller of the Currency.

Jacqueline Mesa is Director of International Affairs at the U.S. Commodities Futures Trading Commission.

I thank you all again 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.

Under Secretary Brainard, you may begin your testimony.

STATEMENT OF LAEL BRAINARD, UNDER SECRETARY FOR INTERNATIONAL AFFAIRS, DEPARTMENT OF THE TREASURY

Ms. BRAINARD. Thank you, Chairman Johnson, Ranking Member Shelby, and distinguished Members of the Committee.

There is an important debate over the merits of moving slow or fast, of moving first or last. As you know, partly due to the efforts of this Committee, we moved both fast and first to reform our financial system and this strategy is already demonstrating its effectiveness, both in terms of the strength of our institutions and their ability to weather shocks and in bringing the world to our standards.

From 2009 through the end of 2011, Tier I common equity of large bank holding companies increased by more than $400 billion. Short-term wholesale funding at the four largest bank holding companies decreased from 36 percent to 20 percent. And core deposits as a share of total liabilities at FDIC-insured institutions increased from a low of 44 percent to 64 percent. Far from disadvantaging

U.S. institutions and harming credit, these early actions put U.S. banks in a stronger position as we entered the financial volatility at the end of last year and, indeed, supported credit growth of 11 to 12 percent annual rates in the third and fourth quarters.

By contrast, as you know, Europe opted to move more slowly. As a result, many Euro area banks were less resilient in the face of shocks last year, contributing to financial stress and a negative spiral.

By moving first, we led from a position of strength in setting the international reform agenda and elevating the world's standards to our own. The alternatives, either following the reform standards set by other countries or subjecting our firms to a divergent set of standards across the board, would have been unacceptable. It is also worth noting that not only the established financial centers in advanced economies but also up-and-coming emerging market financial centers are signing up for the same set of standards.

As you know, going into the crisis, too many financial institutions had too much leverage and too little liquidity. We have now gotten across the international system new global capital liquidity and leverage standards. We have identified globally systemic important banks and agreed globally to subject them to enhanced prudential measures, including a capital surcharge. We are, of course, remaining vigilant as these rules are implemented, and we are pressing to ensure banks across the world measure risk-weighted assets similarly.

Going into the crisis, few understood the magnitude of aggregate derivatives exposures in the system. Now, we have secured agreement on international standards for the OTC derivatives markets for the first time, requiring consistent reporting, moving trading onto exchanges, and requiring central clearing. Of course, as these rules are implemented, we have to guard against fragmentation or weaknesses in the global payments infrastructure and avoid geographic mandates for clearing. We are also pressing for accelerated time tables. We are also pressing, with success, to finalize a global standard for posting margin on uncleared derivatives transactions to reinforce the incentives for central clearing.

And finally, going into the crisis, countries lacked tools to resolve systemically important financial institutions, effectively rendering them too big to fail. Going forward, all major financial jurisdictions have agreed to put in place the tools to resolve large cross-border firms. Implementation is already underway. The UK, Germany, and Canada have already passed resolution legislation and the European Commission is developing a draft for the second quarter of this year. The FSB is working actively to ensure regulators and the major global banks developed cross-border living wills by the end of 2012, criteria to improve the resolvability of these institutions, and institution-specific resolution cooperation arrangements.

New laws and rules aimed at the home market of any major financial center will inevitably, as you recognized in writing the law, have cross-border implications. Regulators now have to sort out whose rules apply, how, and where. Aligning the substance the timing of reforms across jurisdictions is perhaps the first best insurance we have in that process. The greater the convergence

around high-quality standards, the greater the scope for deferring to jurisdictions that have similar regulatory regimes.

There are only one or two notable exceptions. As you know, the United States has moved ahead of others on the Volcker Rule, but it is important to recognize that other jurisdictions are grappling with the same issues pertaining to the structure of risk taking. In the UK, the Vickers Commission proposed rules to ring fence core financial intermediation activities, and in the EU, Commissioner Barnier has set up a commission to look at this issue with particular interest in studying the implementation of the Volcker Rule.

We cannot lose sight of the costs of the last crisis, nor can we lose sight of the causes. That is why we think it is critical to complete the work we have begun. Thank you.

Chairman JOHNSON. Thank you.

Governor Tarullo, please proceed.

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

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

Let me run down briefly for you my perspective on the significant international activities that are either quite directly or more generally related to the Dodd-Frank Act.

The Members of this Committee will not be surprised that I put capital at the top of the list of regulatory imperatives, both here in the United States and internationally. Basel 2.5, which deals with market risk, and Basel III, which deals with both the amount and quality of required capital, were already done or nearly done when Dodd-Frank was passed, but Dodd-Frank did add a new requirement that we have enhanced capital standards for large banking organizations. We supported what turned out to be a successful international effort to agree on capital surcharges for banking organizations of global systemic importance, and the Federal Reserve intends to implement the Dodd-Frank requirement in a manner consistent with that international agreement.

We have had a lot of progress on capital internationally, and I would say that in this area the principal task in the near term will be to ensure that these various agreements are being implemented rigorously, both at national levels and within individual banking organizations. I am pleased that the Basel Committee has now launched what is far and away its most significant effort ever to monitor implementation at both the national and firm level.

On liquidity standards, here too we would like to make the Basel agreement consistent with our implementation of the Dodd-Frank requirements of enhanced liquidity standards for large institutions. Unlike the capital standards, though, the liquidity standards are in need of further study and revision, which is currently in progress internationally.

On resolution mechanisms, Title II of the Dodd-Frank Act is fully consistent with the international standards that have been adopted, and other jurisdictions are gradually putting in place their own generally comparable mechanisms. However, even if all major financial centers follow suit, not all cross-border resolution problems will be solved. So we will continue the work that we have begun,

along with the FDIC, in addressing these continuing problems in both multilateral and bilateral fora.

On OTC derivatives, implementation of the G20 commitments for reform is proceeding internationally, but I would characterize it at a somewhat uneven pace from jurisdiction to jurisdiction. Here, I think our top international priority should be agreement on margin requirements for uncleared derivatives.

And finally, I have noted in my prepared testimony a number of specific issues implicating international interests in parts of the Dodd-Frank Act where there is less likely to be an international initiative. In these instances, we do not have the realistic option of trying to conform an international agreement to domestic practice, or vice-versa, for that matter. So here we are going to have to be considering carefully all these concerns in our own rulemaking as we move forward.

Thank you, Mr. Chairman.

Chairman JOHNSON. Thank you.

Commissioner Walter, please proceed.

STATEMENT OF ELISSE B. WALTER, MEMBER, SECURITIES AND EXCHANGE COMMISSION

Ms. WALTER. Thank you, Chairman Johnson, Ranking Member Shelby, and Members of the Committee, for the opportunity to testify on behalf of the Securities and Exchange Commission about international cooperation in the realm of financial regulation.

The impact of regulation across borders has become ever more important as business has become increasingly global. And thus, as part of our rulemaking efforts to implement the Dodd-Frank Act, the SEC has been actively engaged with our counterparts abroad to coordinate our regulatory reforms. Our international efforts include both informal and formal bilateral discussions and arrangements and working through multilateral organizations. Due to the extensive international coordination efforts undertaken by the SEC and our colleagues at other U.S. financial regulatory agencies within international bodies, the recommendations and international standards being developed by these groups are broadly consistent with the Dodd-Frank Act and the G20 objectives.

As the SEC's representative to the Financial Stability Board and the International Organization of Securities Commissions, I have detailed our international efforts in my written testimony, but I would like to highlight just a few areas this morning.

First, international coordination is particularly important in reform of the global over-the-counter derivatives markets. Following the 2008 financial crisis, Congress recognized the need to bring transparency to these markets and the G20 leaders shared this concern. SEC and CFTC staff have been working with our international counterparts to coordinate the technical issues relating to regulation of derivatives transactions. In December, global leaders and senior representatives of authorities responsible for regulation of OTC derivatives markets met to discuss significant cross-border issues related to the implementation of new legislation and rules.

Given the global nature of the market, the SEC intends to address the international implications of its Dodd-Frank derivatives rules in a single proposal in order to give interested parties, includ-

ing investors, market participants, and foreign regulators, an opportunity to consider as an integrated whole our approach to cross-border security-based swap transactions.

The second area that requires robust international coordination and cooperation is the identification and mitigation of cross-border risks. The SEC has worked to enhance its capability to spot and address proactively emerging issues before they have the potential to cause serious harm to U.S. markets and the global financial system. We have opened lines of communication and shared data with our international counterparts to discuss emerging risks and to react promptly to new developments.

A third area where international cooperation is important is the implementation of the Volcker Rule. In the proposal, we requested and received comment on several international issues. For example, the proposal, which closely tracks the statute, includes an exemption for proprietary trading in certain U.S. and municipal Government obligations, but not for foreign Government obligations. Many commenters, including some foreign Governments, have requested that such an exemption be adopted and have expressed concerns about the proposed rule's potential impact on liquidity in foreign sovereign debt markets. However, some commenters have indicated that such an exemption would not be necessary or would not meet the statutory requirement that it promote and protect safety and soundness.

The Volcker Rule's general prohibition on covered fund activities includes certain non-U.S. funds in an effort to prevent circumvention by simply relocating activities offshore. Some commenters have stated that this definition may be too broad, sweeping in foreign retail mutual funds or other types of regulated pooled investment vehicles. Our Commission staff is reviewing and considering the comments we have received, including those on the cross-border implications of Volcker.

A fourth area where we and our foreign counterparts have a common interest is market efficiency and integrity in light of the rapid development of new trading technologies and trading platforms.

Another key priority is assuring meaningful oversight of registrant firms wherever they are located. In an interconnected world, increased international supervisory cooperation is critical. Unfortunately, there currently are limitations on the ability of some U.S. regulators to achieve meaningful inspections in some foreign jurisdictions.

Finally, I would like to mention our longstanding bilateral and multilateral efforts in the enforcement arena.

In conclusion, our ability to further shared objectives and strengthen cooperative relationships with our counterparts is an increasingly critical part of our mission. We simply must work together.

Thank you again for this opportunity to testify.

Chairman JOHNSON. Thank you.

Chairman Gruenberg, please proceed.

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

Mr. GRUENBERG. Thank you, Mr. Chairman. Chairman Johnson, Ranking Member Shelby, and Members of the Committee, thank you for the opportunity to testify on international harmonization issues related to implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

While there are several issues addressed in my written testimony, I thought I would focus my oral remarks on progress we have made on cross-border cooperation on the resolution of systemically important financial institutions, the so-called SIFIs.

Section 210 of the Dodd-Frank Act requires the FDIC "to coordinate to the maximum extent possible" with appropriate foreign regulatory authorities in the event of a resolution of a SIFI with cross-border operations. The FDIC has been working on both a multilateral and a bilateral basis with our foreign counterparts in supervision and resolution to address these important cross-border issues.

In October of last year, the Financial Stability Board of the G20 countries released the Key Attributes of effective resolution regimes for financial institutions. These Key Attributes set out the features of a legal and regulatory regime that would allow authorities to resolve financial institutions in an orderly manner without taxpayer exposure. They address such critical issues as the scope and independence of the resolution authority and how jurisdictions can facilitate cross-border cooperation in resolutions of significant financial institutions. The FDIC was deeply involved in the development of the Key Attributes and many of them parallel the provisions of the U.S. resolution regime under Title II of the Dodd-Frank Act.

In November of last year, the G20 endorsed these Key Attributes, and as a result, financial regulators from the G20 member Nations are required to move toward a resolution framework to resolve SIFIs in an orderly manner that protects global financial stability.

Now, in addition to the Key Attributes, the FDIC and its U.S. and foreign financial regulatory counterparts have formed what have been called Crisis Management Groups under the auspices of the Financial Stability Board for each of the internationally active SIFIs. These are the so-called G-SIFIs, or Global SIFIs, identified by the G20 at the November meeting last year. These Crisis Management Groups, consisting of both home and host country authorities, are intended to enhance institution-specific planning for possible future resolution.

The FDIC has participated in Crisis Management Group meetings hosted by authorities in various foreign jurisdictions. In addition, the FDIC has hosted Crisis Management Group meetings for the five largest U.S. G-SIFIs and met with specific foreign regulators to discuss the progress these firms have made on their recovery and resolution plans as well as other related cross-border issues. These meetings assist the FDIC in developing and refining its own resolution strategies for these institutions and helps regulators in identifying and overcoming impediments to cross-border resolution.

Finally, the FDIC is also actively reaching out on a bilateral basis to the foreign supervisors and resolution authorities with jurisdiction over the foreign operations of key U.S. firms. The goal is to be prepared to address issues regarding cross-border regulatory requirements and to gain an in-depth understanding of the cross-border resolution regimes and the concerns that face our international counterparts.

It is worth noting that although U.S. SIFIs have foreign operations in dozens of countries around the world, these operations tend to be concentrated in a relatively small number of key foreign jurisdictions, particularly the United Kingdom. While the challenges to cross-border resolution are formidable, they may be more amenable than is commonly thought to effective management through bilateral cooperation.

Our initial work with foreign authorities has been encouraging. In particular, the U.S. financial regulatory agencies have made substantial progress with authorities in the UK in understanding how our respective resolution regimes and resolution strategies would work. To facilitate bilateral discussions and cooperation, the FDIC is negotiating Memoranda of Understanding pertaining to resolutions with regulators in various countries.

In conclusion, through multilateral and bilateral engagement, we believe we have made significant progress in developing a foundation for effective cross-border cooperation in the event of a future failure of an internationally active systemically important financial institution. Thank you.

Chairman JOHNSON. Thank you.

Comptroller Walsh, please proceed.

STATEMENT OF JOHN G. WALSH, ACTING COMPTROLLER, OFFICER OF THE COMPTROLLER OF THE CURRENCY

Mr. WALSH. Thank you. Chairman Johnson, Ranking Member Shelby, and Members of the Committee, I appreciate this opportunity to provide my perspective on the international implications of the Dodd-Frank Act and on efforts currently underway to harmonize U.S. regulatory requirements with international standards.

My written testimony provides greater detail on the intersection of Dodd-Frank and international efforts in five key areas: Capital standards, liquidity requirements, orderly resolution of large complex firms, derivatives activities, and the Volcker Rule.

Since the financial crisis of 2008, much has been accomplished to improve the safety and soundness of financial systems and institutions. Internationally, the G20 Governments, the Financial Stability Board, the Basel Committee on Banking Supervision, and other international bodies have developed and are introducing standards to increase capital and liquidity, create better mechanisms for resolving large financial institutions, centralize derivatives clearing, and strengthen supervision in a number of other areas. Implementation of this reform agenda is underway in all the G20 countries.

Within the United States, the Dodd-Frank Act encompasses many important parts of the international reform agenda. It enhances the resiliency of the U.S. financial system, requires higher capital and liquidity standards for large financial institutions, and

imposes steps to preclude future taxpayer bailouts. The Act also seeks to strengthen operations and safeguards pertaining to derivatives activities by enhancing transparency and reducing counterparty credit risks.

Most of these efforts are still works in progress and I believe paths are available for international harmonization in many of these areas. However, even where there is broad international consensus, there will be areas where policy makers in individual countries have chosen to tailor standards to their countries' specific circumstances rather than adopt the totality of the international approach.

In the U.S., for example, the Dodd-Frank Act has added two requirements that will cause our implementation of international capital standards to differ from those of other countries. For example, the Collins Amendment requires the same generally applicable minimum capital requirements to be applied to bank holding companies as to banks, and places a floor under the capital requirement for large banks, applying Basel's advanced approaches capital framework. This goal is to ensure that capital requirements for large banks do not decline below generally applicable minimum capital requirements, but it also means that U.S. banks pursuing safer loans or lower-risk securities would not obtain a capital benefit for doing so.

Section 939(a) of Dodd-Frank requires all Federal agencies to remove references to and reliance on credit ratings from their regulations and replace them with appropriate alternatives for evaluating creditworthiness. Basel III, in contrast, continues to rely on credit ratings in many areas, so implementation of those provisions of Basel III will differ from international standards and generally be more stringent in that U.S. credit ratings are referenced in various places, including in noncapital regulations. While we fully agree that blind reliance on credit ratings should be stopped, the cumulative impact of precluding any reference to credit ratings, even in conjunction with other factors, will be challenging, particularly for community banks.

The Dodd-Frank Act also contains certain provisions that have no foreign equivalent, and unlike capital and liquidity requirements, currently are not the subject of international harmonization efforts, most notably the Volcker Rule. This provision generally prohibits a bank from engaging in proprietary trading and from making investments in and having certain relationships with a hedge fund or private equity fund. This is a policy aimed at the organization of activities within the U.S. banking system, not part presently of a broader international policy consensus, and as such the legislation reflects a determination that these policy objectives need to predominate over competitive considerations.

The OCC is committed to consistent implementation of the Dodd-Frank Act and international financial regulatory agreements, and as we move forward with implementing Dodd-Frank, we must be mindful of the need to strike an appropriate balance between enhanced regulations, better supervision, and market restrictions. Achieving a level playing field for internationally active institutions is an important objective, but it is never fully achieved and some-

times national policy choices place other important national objectives above competitive equity.

Thank you for the opportunity to discuss the international obligations of Dodd-Frank and to update the Committee on efforts underway to harmonize U.S. regulatory requirements with international standards and frameworks. I am happy to answer your questions.

Chairman JOHNSON. Thank you.

Ms. Mesa, please proceed.

STATEMENT OF JACQUELINE H. MESA, DIRECTOR OF THE OFFICE OF INTERNATIONAL AFFAIRS, COMMODITY FUTURES TRADING COMMISSION

Ms. MESA. Good morning, Chairman Johnson, Ranking Member Shelby, and Members of the Committee. Thank you for the opportunity to testify today regarding international aspects of the Dodd-Frank Act.

The financial crisis has generated international consensus on the need to strengthen financial regulation by improving transparency, mitigating systemic risk, and protecting against market abuse. In September 2009, the G20 leaders agreed that OTC derivatives contracts should be reported to trade repositories, standardized contracts should be cleared and traded on exchanges or platforms, and noncleared contracts should be subject to higher capital requirements.

In 2010, less than 1 year following that G20 commitment, Congress broadened the CFTC's and SEC's jurisdiction to include oversight of the previously unregulated swaps and security-based swaps market. The CFTC is developing regulations to implement the Dodd-Frank Act and to establish a regulatory framework for swaps.

As CFTC rulemakings have progressed, one issue that has arisen is how Dodd-Frank requirements might apply to swap activities occurring on a cross-border basis. The CFTC recognizes that the swaps business flows across national borders with agreements negotiated and executed between counterparties in different jurisdictions and individual transactions often booked and risk managed in other jurisdictions.

In addressing cross-border issues, the CFTC is charged with implementing Section 722(d) of the Dodd-Frank Act, which provides that Title VII provisions shall not apply to swaps activities outside the United States unless those activities have a direct and significant U.S. connection or contravene anti-evasion regulations. The CFTC plans to provide guidance on the application of Title VII and the Commission's regulations to non-U.S. entities and to swaps activities occurring on a cross-border basis and we will seek public input on that guidance.

In line with the G20 commitments, efforts to regulate OTC derivatives are underway not only in the United States, but also abroad. Japan has already passed reform legislation and the EU is finalizing legislation that provides for mandatory clearing, reporting, and risk mitigation for OTC derivatives. Other countries, such as Canada, Hong Kong, and Singapore, have published consultation documents on the regulation of OTC derivatives. The global

and interconnected nature of the swaps market makes it imperative that the United States consult and coordinate with foreign regulators.

The fact that all major market jurisdictions are developing their OTC requirements pursuant to the G20 directive provides an opportunity to create a harmonized framework. Congress directed the CFTC and other U.S. regulators to consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards. The CFTC is fulfilling this statutory mandate through comprehensive and ongoing bilateral consultation and global coordination. The CFTC has considered international standards and principles in developing regulations, and staff has shared our rulemaking drafts with international counterparts throughout this process.

The CFTC Chairman and Commissioners have met with foreign regulators to discuss financial reform, and Chairman Gensler and I have traveled to Brussels several times to discuss implementation of Title VII. Chairmen Gensler and Schapiro have met with Canadian, European, and Asian regulators last December to discuss cross-border issues related to OTC derivatives, and an even broader group of regulators will meet again in May.

At a staff level, the CFTC and SEC are holding an unprecedented number of meetings to coordinate regulatory approaches, specifically with counterparts in Canada, the EU, Hong Kong, Japan, and Singapore. These discussions will continue as other jurisdictions develop their own regulatory requirements for OTC derivatives. In addition, CFTC staff is participating in the several standard-setting initiatives and cochairs the IOSCO task force on OTC derivatives.

Throughout implementation of the Dodd-Frank Act, the CFTC is working with foreign regulators in an effective way to coordinate regulatory approaches and requirements to the greatest extent possible.

Thank you, and I would be happy to answer any questions.

Chairman JOHNSON. Thank you for your testimony.

As we begin questions, I will ask the Clerk to put 5 minutes on the clock for each Member.

Secretary Brainard, I believe the U.S. has led the way with the comprehensive package of Wall Street reforms as to the financial crisis. Do you agree, and going forward, how will the U.S. continue to lead while working toward a level playing field internationally?

Ms. BRAINARD. Mr. Chairman, I have participated in multiple international negotiations, both at the G20 and the FSB, where our goal has been to bring the world to convergence around the very strong protections put in place under Dodd-Frank in order to guard against a competitive disadvantage and also to protect the safety and soundness of our system.

I would say that, having participated in a lot of international negotiations over the years in a whole number of subject areas, we have achieved remarkable success across the whole host of areas where convergence is seen to be critically important. OTC derivatives in the area where there really is no international regulation at all, we now have commitments across the Financial Stability

Board members to put in place protections that are really modeled in many respects on the protections under the Dodd-Frank Act.

As Governor Tarullo mentioned, we have a very strong agreement on capital liquidity and leverage across internationally active banks, and, for the first time, agreement that the largest, most complex institutions should be subjected to additional prudential standards as well as a capital surcharge that will be equivalent across countries.

Chairman JOHNSON. Chairman——

Ms. BRAINARD. I am sorry.

Chairman JOHNSON. Chairman Gruenberg, can you give us your assessment of the progress made with foreign regulators on how to address cross-border resolution issues.

Mr. GRUENBERG. Thank you, Mr. Chairman. I think it is fair to say we have made significant progress in what is admittedly a very challenging area. I outlined in my testimony the international set of standards that have been agreed to, the so-called "Key Attributes," which sets sort of a baseline for Governments across the world to use in establishing resolution regimes, and that simply has not existed before. So, the international acknowledgement of the importance of the issue of having cross-border cooperation and a capacity to place large systemically significant institutions into an effective resolution process, I would suggest, is really an important step forward.

And, there has been tremendous attention to the systemic institutions of particular importance. The Crisis Management Groups—organized under the auspices of the Financial Stability Board—bringing together the multiple regulators of these globally significant financial institutions has been really a valuable tool in getting mutual understanding among us about the operations of these companies.

And I will tell you, we do put particular importance on developing bilateral relationships. When you are dealing with a systemic company that gets into difficulty, you have got to be able to work as an operational matter with your counterpart, the supervisor of the country where the foreign operations are. At the end of the day, that really comes down to the relationship of our regulators here with the individuals in the other country. And if you do not have that personal relationship established, an understanding of the respective legal requirements that apply, and some common understanding of the strategies we are considering for resolving these companies, it becomes very difficult to carry out the authorities of the Act.

I think what is encouraging is that we have the authorities here in the United States. We are developing the capability. And I think we are making progress in terms of establishing the relationships with our key counterparts to enable us to manage an orderly resolution of one of these companies.

Chairman JOHNSON. Governor Tarullo, on the Volcker Rule, will the agencies provide any formal guidance detailing what current or prospective activities banks need to unwind or stop in July, and what will happen during the 2-year conformance period? Also, since the Volcker Rule amends the Bank Holding Company Act, will the

Fed lead the ongoing supervision, interpretation, and enforcement of the final rule?

Mr. TARULLO. Mr. Chairman, with respect to the implementation and what happens with enforcement in any intervening period, I think there are a couple of things to say.

First, the Dodd-Frank Act required the Federal Reserve to promulgate a conformance period regulation within 6 months of passage, which we did. But, of course, that was promulgated before we knew what the substantive proposed rule was going to look like and so it was a bit in the dark as to what activities the firms were actually going to have to conform.

And I would say that some of the issues that have been raised by a number of you, a number of your colleagues on the House side, and by some of the institutions themselves have led a lot of people to think we probably need to provide some clarification in light of the proposed rule itself. We do not have Board action, so I cannot speak to what that would be specifically, but I can tell you people are aware of the issue.

With respect to the July 21 issue, that would presumably arise if, first, we do not get a final rule out by then, and second, regardless of whether we do, whether there is a question about something being immediately effective and, therefore, enforceable as opposed to falling under the conformance period. There is obviously a real possibility that we do not meet the July 21 date, although I personally think we should keep trying to do so. However, if we are not going to, I think it is incumbent on all the regulators to provide some guidance for firms to let them know exactly what the expectations will be and not let this hang out there as an unknown, and I think we should be able to do that, if needed.

You also asked about Volcker Rule implementation. The Volcker Rule is a joint enterprise. It is actually going to be two different rules—one, the three prudential regulators, the other, the two market regulators—so we are obviously trying to coordinate the terms of the rule and I hope that we would coordinate our data gathering and enforcement efforts thereafter.

But I would not say that we would be in the lead, particularly because in terms of the actual activity to be regulated, the Federal Reserve would be supervising a relatively small group of the activities in question. Since the broker-dealers are primarily regulated by the SEC, the national banks by the OCC, the Federal Reserve has the nonbank, non- broker-dealer affiliates of holding companies which do engage in trading activities, but not in the amounts that those other two groups do.

Chairman JOHNSON. One more question. Commissioner Walter and Director Mesa, I am concerned that the SEC and the CFTC may not take a unified approach to the potential application of U.S. swap rules abroad. How will the CFTC and the SEC harmonize efforts in this area, and would not a unified approach improve compliance? When will your agencies release these plans?

Ms. WALTER. Mr. Chairman, the efforts are ongoing between our two agencies to reach a harmonized solution. Although we have taken different procedural approaches, we have been actively engaged in discussions about what we are going to suggest, and there will be public comment on which people will be able to react to

both the SEC proposal and the CFTC proposal. Those discussions are not only concerning broad principles, but also digging down into the details, and our efforts so far both in that area and in other areas of cooperation and coordination under Dodd-Frank are going forward quite smoothly.

Chairman JOHNSON. Director Mesa.

Ms. MESA. I would just add to that to say, as a point of fact, we even had a meeting between high-level staff at the SEC and CFTC this week to coordinate our approaches, and I think as conversations are ongoing, we are going to get closer and closer on our approaches.

Chairman JOHNSON. When will your agencies release these plans?

Ms. WALTER. For our part, our international release raising the cross-border issues, which will cover all of Title VII, is being drafted as we speak and should be out in the public domain in a relatively short period of time, although I cannot give you a precise date.

Chairman JOHNSON. Ms. Mesa.

Ms. MESA. Staff is working very hard to complete something to provide to our Commission. We think that in the coming weeks, we will actually be able to provide something for our Commission to then provide staff feedback and eventually release to the public.

Chairman JOHNSON. Senator Shelby.

Senator SHELBY. Thank you, Mr. Chairman.

Governor Tarullo, as I mentioned in my opening statement, as I understand it, Dodd-Frank fails to exempt foreign Government securities from the prohibition on proprietary trading by banks. A lot of Governments, such as Japan and Canada, have filed comments stating that this provision of Dodd-Frank could—could—adversely affect the liquidity and pricing of foreign Government bonds. Do you believe there is any merit to these concerns, and have you performed any analysis at the Fed of the proposed rule's potential impact on Government bond markets, and if not, why not?

Mr. TARULLO. Mr. Chairman, I certainly understand the foreign Governments' observation of the asymmetric treatment and, as you noted, there have been a lot of comments filed with the agencies in response to the proposed rule.

We have, in fact, tried to start collecting information, which goes to several points. First—actually, we also tried to provide some information, because there is some misconception among at least some of the foreign observers—not all, but some who, for example, were not aware of the fact there is a market making exception and were not aware of the fact that if a foreign sovereign debt obligation is held for investment and not a matter of short-term trading, then that is not covered, either.

So we have tried to provide that information and then, in turn, ask for information about the holdings by U.S. entities, or the holdings by U.S. affiliates of foreign parents of the sovereigns in question. That is, we are trying to figure out how much is market making, how much is held for longer-term investment, and what proportion of those bonds were arguably part of a proprietary trading operation. To date, at least, I think there has not been as much information breaking things down in that way as would be useful,

but I am hopeful we will get more of that and, thus, be able to make a better judgment as to what kind of impact this may have.

The other thing I would add, of course, is there are other firms that are not subject to the Volcker Rule who are out there who may take up any slack that does exist.

Senator SHELBY. In a recent speech, Secretary Geithner defended Dodd-Frank claiming that there is, and I will quote him, "no credible evidence to support the argument that these reforms are having a material negative effect on the economy," end quote. Secretary Brainard, do you believe that Dodd-Frank's imposition of price controls on debit interchange rates has had a positive impact on the economy?

Ms. BRAINARD. Well, I think, generally speaking, many of these reforms are being implemented. It is a little early to speak to them. I do not think—we have looked across a variety of areas and have not seen a negative impact. As I said earlier, arguably, the inclination to move early, we have already seen a test of why it put our firms in a better position to withstand financial stresses and actually supported the recovery at a time when in Europe we saw a retreat of credit.

So I think we, obviously, have to be very careful as we are moving forward to be looking carefully at the potential impact on the economy and to be vigilant to ensure there are not unintended consequences. But the flip side of that, as I said earlier, is that by moving forward with this framework, we really set the terms for the international debate and were able to move other countries to our framework at a time when if we had not, we would have been on the defensive and been reacting to their proposals.

Senator SHELBY. Has there been any quantitative evidence that you know about that Dodd-Frank actually has had a material positive effect on the economy? If you have, would you furnish that to the Committee.

Ms. BRAINARD. I do not think there have been, as I said systematic empirical studies either on the negative or on the positive side. It is still very early days in terms of the implementation. There have been attempts to look, for instance, in the international context at the potential long-term implications of the new capital standards, where a negative effect was not found. But again, these are not backward-looking. There has not yet been enough time to have a systematic empirical analysis of rules that are really only now being implemented in many cases.

Senator SHELBY. Commissioner Walter, the SEC's Inspector General recently conducted a review of cost-benefit analyses in Dodd-Frank rulemaking. Among the many troubling findings, the report by the Inspector General found that the SEC did not consider that its proposed rules for securities-based swaps might cause market participants to move swaps trading from the U.S. to foreign jurisdictions. In light of the Inspector General's findings, the Inspector General of the SEC, what specific actions has the SEC taken or plan to take to ensure that swap trading does not move out of this country to other jurisdictions?

Ms. WALTER. I can assure you, Senator, that both in that context and in other contexts, we do consider issues of competitiveness and what happens to the marketplace. Perhaps we did not reflect that

as well as we might have liked in the documents that the—our Inspector General issued. But in light of his report as well as other external input on cost-benefit analysis from the D.C. Circuit, from the GAO, we have undertaken a fairly continual review process of how to enhance our efforts to adequately consider those issues.

Senator SHELBY. I would like to direct this question back to you, Commissioner Walter, and also Secretary Brainard. Section 763 of the Dodd-Frank law includes a provision that requires swap data repositories and clearinghouses to obtain an indemnification from regulators before sharing critical data with them. This indemnification requirement makes it difficult for foreign regulators to obtain information on swap transactions. Should Congress repeal the indemnification requirement in 763?

Ms. WALTER. Yes, we do support that. It is problematic for data that takes place in a global business to be available only easily to certain regulators.

Senator SHELBY. In other words, I know a SEC staffer testified yesterday that the SEC recommends that Congress consider repealing the indemnification requirement. Is that what your testimony is?

Ms. WALTER. Yes. We do agree that that should be done.

Senator SHELBY. OK. Secretary Brainard, do you agree?

Ms. BRAINARD. Well, I certainly share the observation that our market regulators are trying to work through this issue with foreign market regulators and it is challenging. I think more broadly, we believe that we are still in early stages of the implementation of the Dodd-Frank Act. There are a few areas of technical challenge, but that we think, generally speaking, that we should push ahead on implementation of the Dodd-Frank Act, try to work through some of these changes——

Senator SHELBY. I was not asking——

Ms. BRAINARD. ——and give ourselves a little more time——

Senator SHELBY. I was not asking you——

Ms. BRAINARD. ——before we contemplate any changes to the——

Senator SHELBY. ——a general question. Do you disagree with the Commissioner?

Ms. BRAINARD. We generally share the observation that this presents challenges to the market regulators, but we are not recommending a legislative fix to any of the provisions that—in Dodd-Frank at the moment.

Senator SHELBY. So you disagree with the SEC.

Governor Tarullo, one more question. In a recent speech, Secretary Geithner said, to provide a fair and level playing field for U.S. firms, we need a more level playing field globally. This is particularly important in the reforms, that is, in the global derivatives markets. These are the Secretary's words. Is there any class of OTC derivatives on which you do not expect European and other foreign regulators to impose margin requirements comparable to those required by Dodd-Frank, and is there any aspect of derivatives or bank regulations where you believe that foreign regulators have adopted a better approach than the approach set forth in Dodd-Frank?

Mr. TARULLO. Senator, I think the discussions are at too early a stage to make a judgment as to whether any of the eventualities that you hypothesize may come to pass. As I said in both my written and oral testimony, I think for us as a country, the highest priority internationally with respect to derivatives ought to be the harmonization of margin rules, and at least as of this moment, I have not detected any important divergence in the potential views of countries as to how they would apply those rules.

On the second part of your question, I think this is a case in which the United States has been leading, and as I said in my statement, I think that other countries are implementing the best practices and the kind of commitments that have been made. At this juncture, though, the pace of implementation does vary some. The Europeans are probably closest to us, but they, too, are somewhat behind. So I think on this one, we will have to come back next year for you to ask the same question. I suspect we will have a better sense then.

Senator SHELBY. I will not get the same answer, will I?

Mr. TARULLO. Well, I hope not. I hope by then either something will have been agreed to or we will be able to say, yes, here are a few areas in which agreement looks hard to achieve.

Chairman JOHNSON. Senator Bennet.

Senator BENNET. Thank you, Mr. Chairman, and thank you for holding this hearing. I want to just underscore an observation you made a minute ago, that as we think about this international harmonization, it also is, I think, the interest of many people on this Committee that our agencies reach harmonization domestically, as well. So anything we can do to move ourselves forward in that direction, I would support.

I also want to pick up just where the Ranking Member left off, Governor Tarullo. As you know, financial institutions under the Wall Street Reform bill who use the Fed's discount window or deposit insurance must create separate entities to engage in certain types of swap dealing. This was typically referred to as the push-out rule. And in your written testimony, you noted that it was unlikely that this was going to be followed in other places. I wonder whether you could talk a little bit about the consequences of that potential gap.

Mr. TARULLO. Certainly, Senator. On that one, I think there are consequences probably on both sides, both for U.S. firms and for foreign firms. For the U.S. firms, I think the potential consequences are fairly self-evident, meaning that they will not be able to have all their derivatives trading concentrated in the insured depository institution, usually a large national bank. And that means they would have to have separate risk management capabilities and separate capitalization for the different derivatives activities. It also means that the counterparty with whom they deal would not obviously be able to net their trading with the two different parts of the same bank holding company.

The other side of it, the impact on the foreign firms——

Senator BENNET. Is that—just on that side, does that present something unworkable, or is it just——

Mr. TARULLO. The amount of derivatives from many institutions that would have to be pushed out is relatively small, meaning it

is not like 50 or 60 or 70 percent. But what I said a moment ago is that it would presumably increase the costs of that kind of trading because you would have to duplicate some of your risk management and you would not have the counterparty netting arrangements that you do when it is a single counterparty.

On the other side, the push-out requirement does provide that insured depository institutions in the United States get an exemption for activities which are basically bank compliant or for derivatives activities which involve instruments that the Federal banking laws allow banks to engage in. But because it applies only to insured depository institutions by the terms of the statute, it seems not to apply to the branches of foreign commercial banks here in the United States. And as a result, seemingly, those branches will be subject to the rule but without the exemption that applies to U.S.-insured depository institutions, and I say "seemingly" because there is at least one interpretation that that would not be the case, but that, I think, is the concern that has been expressed.

Senator BENNET. And what are the implications of that?

Mr. TARULLO. The implications of that would be that the branch of a foreign commercial bank here in the United States would not be able to engage in the kinds of derivatives activities in which a U.S. commercial bank located here in the United States, one of Comptroller Walsh's supervised institutions, would be able to engage.

Senator BENNET. Director Mesa, as you know, the derivatives title of the bill was generally limited to transactions within the United States, and the law, as you said in your testimony, can be applied on an extraterritorial basis when the international activities of U.S. firms have a direct and significant effect on U.S. commerce. You mentioned that you are working on this, that you are going to be seeking public comment on it. I wonder if you could talk just a little bit for the Committee about how the CFTC is going to implement this provision and what are we likely to hear in the public comment.

Ms. MESA. I can speak about what staff may recommend to the Commission, but ultimately, the Commission will make the final decision. At a staff level, we clearly need to give guidance on what is a direct and significant effect to the U.S. commerce or activities in the U.S., and so an example of that would be if there is a foreign-based entity that has a significant amount of transactions with a counterparty in the U.S. How many transactions make that significant and direct, and that is the kind of guidance that we seek to put forward. But once there is a direct and significant connection with the U.S., then what regulations and rules will apply to that entity?

Also, the CFTC has had a long history of reliance on comparable regulation abroad if there is comparable regulation to the U.S. regulation. I think we are also considering some aspects of that in this release.

Senator BENNET. Thank you, Mr. Chairman.

Chairman JOHNSON. Senator Crapo.

Senator CRAPO. Thank you, Mr. Chairman.

I want to return to the question that the Chairman raised earlier with regard to the implementation of the Volcker Rule and the

problem that we see with the July 21 deadline. Federal Reserve Chairman Ben Bernanke recently stated before the Senate Banking Committee and the House Financial Services Committee that the interagency Volcker Rule will likely not be ready by the July date, and I think you confirmed that is a likelihood today, Mr. Tarullo, although you say you would like to keep working toward that objective.

He also said that we certainly do not expect people to obey a rule that does not exist and that the agencies will certainly make sure that firms have all the time they need to respond. And again, Mr. Tarullo, you said today that you think that somehow the agencies have got to address this issue in the process.

But it is not that simple. The problem is that this section of the Dodd-Frank Act is self-executing and has an effective date of July 21, irrespective of whether the final rules are in place. And market participants are understandably concerned about what they should do on the July 21 deadline if the agencies have not been able to coordinate effectively and promulgate a final rule. I know that there has been a 2-year conformance period raised and some have suggested that that should allay all concerns.

But many commenters have raised the discrepancy between the 2-year conformance period and the statute and the pending proposed rule, which states that the agencies expect full compliance as soon as practicable after the effective July 21 date. A lot of folks are raising concerns about the fact that legal experts are advising their clients now that if the July 21 date arrives and we do not have a final promulgated rule, that the banks, in order to be safe, are going to have to start shutting down significant securitization activities that are expected to be authorized in the rule and we could have significant disruption in the market in the United States.

As a result of that concern, earlier today, Senators Warner, Corker, Toomey, Hagan, and Carper and I have introduced legislation, bipartisan legislation, that corrects this aspect of the statute and simply links the effective date of the Volcker Rule to 12 months after the issuance of a final rule. It just changes two words in the statute so that instead of saying the earlier of, it says the later of the dates, which would provide the kind of clarity to the marketplace, and I would think provide the kind of support to the agencies as they try to move forward with these deadlines looming to enable us to calm the waters and proceed more effectively with the rulemaking process.

Mr. Tarullo, I would like to ask you first whether you see any concern or problem with this kind of legislation and whether it would be helpful or not.

Mr. TARULLO. Senator, we should be able to address the concerns through two means. One is, as I mentioned earlier, guidance provided by the agencies, and this, by the way, is not unprecedented. There have been occasions in the past where a statutory provision by its terms takes effect and the implementing regulation has not yet been enacted. So there is some precedent for the way this could be dealt with, and that would deal with any gap between the promulgation of the rule and July 21.

With respect to the applicability, scope of the conformance period, what it covers and what it does not cover, again, I think that we, the Federal Reserve Board, have the authority to change that conformance period regulation in order to clarify the questions which have arisen, as I say, because I think that when we promulgated the conformance period regulation, we did not know what the substantive regulation was going to look like.

So that is a long way of saying I think we can deal with both issues here without legislation and we will try to go ahead and do so regardless of what legislative path is followed.

Senator CRAPO. Is there any reason why legislation would not assist in that process, though? I understand that you think you can clarify everything, but the statute is self-executing. Why would it not be helpful for us to have that clarification made?

Mr. TARULLO. I think you alluded to this. The statute says it becomes effective, but then in the next subsection it says, the activities need to be conformed within the conformance period that is provided for in the statute. So I think that the coverage can be achieved through that mechanism, but there may be other readings of the statute. That is the one I think that we are proceeding under.

Senator CRAPO. Mr. Walsh, could you comment on the same issue.

Mr. WALSH. Certainly, Senator. As to the logic of what is being proposed, the suggestion is to do in this area what the statute does in other areas, which is link the application to a time period after issuance of a regulation. But it is certainly true that there are a variety of places in the Dodd-Frank Act where we will have to deal among the agencies and administratively with problems of this kind and I do not disagree with Governor Tarullo that we will make the effort to make sure that the banks both understand—those affected understand what our expectations are and the conformance period does provide a period of breathing room, if you will, during which banks are expected to comply.

Senator CRAPO. Would the clarification of the statute's impact of the nature that I just described have any negative impact on the rulemaking process and the conformance period that the agencies are working on?

Mr. WALSH. There is always the pressure of deadlines to keep people focused, and the suggestion that we continue to work toward this deadline even though it is approaching and seems increasingly challenging to meet. But the pressure of deadlines is a meaningful pressure.

Senator CRAPO. But a deadline that is executing a rule that has not been created yet may be a difficult deadline that creates legal difficulties in the marketplace. It seems to me that we would not be changing the deadline of the implementation of the rule, which it has already been acknowledged is going to be passed without meeting that deadline. The question remains, as I see it, why would we not want to try to fix the problem and make it clear legally that there is not going to be the kind of disruption of our markets that could happen if the statute self-executes. Mr. Walsh.

Mr. WALSH. Well, Senator, Congress has set the deadlines. If Congress changes the deadline, we will adapt to the change. But

in the meantime, we will continue to try to work toward both meeting the deadline and providing guidance so that during this period of what will be hopefully a brief period of potential uncertainty, that those affected will understand how to respond.

Senator CRAPO. Thank you.

Chairman JOHNSON. Senator Merkley.

Senator MERKLEY. Thank you very much, Mr. Chair, and thank you all for your testimony and for helping us wrestle with how the work we are doing here interacts with the international environment.

I want to start by noting a letter from Finance Watch that was received by Committee Members and ask if it can be entered into the record.

Chairman JOHNSON. Without objection.

Senator MERKLEY. Thank you. Finance Watch is a European group set up by European parliamentarians to help wrestle with some of these same issues and they note in this letter, let me assure you, European financial regulators are committed to adopting critical elements of the financial reform agenda set out under your leadership in the Dodd-Frank Wall Street Reform and Consumer Protection Act. These include higher capital requirements across the banking system, and toward clearing, transparency—transparent trading, margin and capital for derivatives regulation of hedge funds and private pools of capital, orderly restriction for failing—resolution for failing firms, reform of credit rating agencies and shadow banking, retail investment products, and so forth, many of the things that this Committee has been working on for quite some time.

I found it interesting in the third page of the letter. They turned to the failure of MF Global. The recent failure of MF Global helped remind us of the grave dangers that highly leveraged bets can pose to a firm. Fortunately, because MF Global was a small nonbank of little significance to the broader financial system, the consequences of its mistakes did not ripple far. If, however, the U.S. were to not press forward with implementation of the Volcker Rule, these very same activities would continue eating away at the integrity of the global banking system, endangering not only your large firms and threatening much more consequences for the broader economy, but also putting intense pressure on European regulators not to address the issue of structural reform of the European Union banking sector.

Indeed, I think in some ways, MF Global sums up the situation of why you have tried to put a firewall between hedge fund style activities and deposit taking, loan making, banking essential to providing liquidity for families and businesses across America. So I just wanted to remind folks that, somehow, we lose track of what the Volcker Rule is all about. That is the hedge fund firewall issue that it was addressing.

And some of these conversations about, well, why not trade in foreign currencies as a liquidity provision in between making loans, well, that puts exactly, basically—that has opened the door exactly to what MF Global was doing, and if you want that problem inside our banking system, we have been there. It was destructive and let us not do it again.

Turning to some of the recent news, I want to understand your all's perspective on Goldman's announcement that they are—let me see if I can capture this—they have announced that they are looking to become a monoline bond insurer, that is, a group that writes insurance on bonds and presumably executes trades with revenues from the premiums, not unlike CDS. What do you make of that? Let me see. Yes, here is the title, "Goldman Eyes Monoline Move". Is this an effort to open the door to proprietary trading? Any thoughts or insights on what is going on with that?

Mr. TARULLO. For reasons you will understand, Senator, I am not going to address any comments to a particular institution that the Federal Reserve supervises, but maybe I can make a couple of general comments, one about the Fed and one about financial institutions.

So the one about the financial institutions is, I think, as everybody recognizes, firms are still in the process of adjusting to what the nature of financial services is going to be in the postcrisis, postrecovery, postadaptation period. So I think you see a number of firms, banks, nonbank financial institutions—regulated and unregulated—trying to determine where there are opportunities which will provide them with profit opportunities, on the one hand, while on the other hand fitting within the new regulatory framework that will exist. And I think we have seen any number of instances of that, some of which the institutions follow through on, some of which they appear not to follow through on.

From the Federal Reserve's point, with respect to any regulated financial institution that is proposing to or does get into any new line of business, we do apply close supervisory scrutiny with respect to the capacity of the firm prudently to engage in the business in question, to the relative degree of risk that will be associated with that business, and obviously, to the capital and liquidity levels of the firm. So while, again, I am not commenting on anything specifically, I can assure you that as firms, for the first reason I mentioned, begin to think about different activities, we will be applying the same kind of prudential supervisory scrutiny that should always be applied in such instances.

Senator MERKLEY. Thank you. Let me ask another quick question on recent news, and that is today's news in the *Financial Times* that the Deutsche Bank is dropping its U.S. bank holding company in order to minimize capital that must be held under U.S. rules, which leaves only its highly leveraged investment bank inside the U.S. Sheila Bair is quoted as saying she is concerned, because when a bank fails, it is principally the capital that is located within the country that is available for resolution. Does this undermine or change our U.S. resolution authority or capability?

Mr. TARULLO. As Chairman Gruenberg said a few moments ago, there are a lot of multilateral, and now some bilateral efforts to get a better understanding between countries of how resolution would proceed in the event that a firm fails—that is, what host countries would do with respect to operations of their firms in other countries. Having said that, as I think about the appropriate modes of regulation and supervision of foreign banking organizations in the United States, the development to which you just alluded has certainly affected my thinking about how we do structure regulation

of foreign bank organizations, and I think we will need to respond to that.

Senator MERKLEY. Thank you.

Chairman JOHNSON. Senator Corker.

Senator CORKER. Thank you, Mr. Chairman, and I thank all of you as witnesses. I think this has been a very good hearing, and I know in your opening comments, Mr. Chairman, you talked about a technical corrections bill. I do think that this hearing and many others have pointed out the need for that and I just want you to know that should you and the Ranking Member decide that you are going to go forward with one, I would look forward to working with you in a way that really is just a technical corrections bill and not some political statement. So if you decide to do that, please let me know, OK.

Speaking of that, I know, Mr. Tarullo, you talked a little bit about the swap desk issue and as it relates—the impact it is having on foreign banks here, which, by the way, provide about 18 percent of the commercial industrial loans here in the United States. We have an amendment to try to correct that, and should the Chairman and Ranking Member decide to go forward with a technical corrections bill, I hope you would support that.

But I want you to, if you will, comment on the MSR issue, the mortgage servicing rights issue. I know that when you all meet with international folks, there is a spirit of collegiality, if you will, and you try not to create exemptions that are different for the U.S., and I understand that. But we have a very unique situation in our country where, because of the GSEs, when the large institutions originate loans, they have to hold 25 basis points as mortgage servicing rights and it ends up affecting capital. I know you all talked about limiting the amount of capital that that can go forward, and I know we have had numbers of institutions coming in and talking to us about how it is going to handicap them over time. I am just wondering if you might comment on that and the exception we might create in that regard.

Mr. TARULLO. Senator, that was one of many quality of capital related issues that were discussed during Basel III negotiations and they are incorporated in the Basel III agreement. So the flip side of that, if you will, is the limitation that Basel III places upon the capital treatment of minority interests held in other financial firms, which is something that particularly affects a lot of European institutions.

On the mortgage servicing rights issue, the limitation on the amount of MSRs that can be treated as capital derives from the basic premise that common equity really does need to be the true buffer against losses that can be suffered from any activity of any sort, seen and unforseen, and events that are seen and unforseen. The issue of MSRs, of course, arises because, by and large, a firm cannot treat a receivable as if it is part of capital. You have a contractual obligation that says, I am going to be paid in the future such and so much money. Therefore, I can include it as capital. When you get the money, then it can be treated as capital.

MSRs were traditionally treated differently, presumably on the rationale that they were readily marketable and, thus, like a secu-

rity, there would be funding available in the event that the firm needed it.

Senator CORKER. Let me—so I do not——

Mr. TARULLO. I am sorry. If I can just finish. But the rationale for the limitation is that it is not at all clear that a firm could readily market MSRs, a huge amount of MSRs, and thus there should be a limit on the degree to which they can count as capital, not completely eliminating them.

Senator CORKER. So I think we ought to at least look at maybe should it be 25 basis points, and I know that is something we need—it is a whole another subject——

Mr. TARULLO. Right. It is.

Senator CORKER. But maybe it is 12-and-a-half basis points, maybe it is something else, but that is something we should wrestle with here.

You know, the Volcker Rule, we talked about a great deal. I know Senator Crapo offered a semi-solution. We know it is creating lots of issues and we have talked about it a great deal. You alluded to some market making exemptions. I know you were in our office recently. And obviously, I think, now that Volcker is part of the mantra here, I think most of us just want to make sure that market making is not excluded. We understand about prop trading.

You mentioned an exemption. So are you feeling like you have—there is going to be really no issue as it relates to institutions here in the United States of America being able to deal with central market making activities? Is that your present stance? It is, I think, a little different than when you were in our office a few weeks ago.

Mr. TARULLO. No, I would not say that, Senator. I think my perspective on it is the following. Volcker explicitly excludes market making from the definition of prop trading. Then the regulatory exercise is to distinguish between proprietary trading and market making, and to take the extreme example, if someone just took their prop trading desk and then said, oh, this is market making——

Senator CORKER. Yes——

Mr. TARULLO. ——we presumably would not allow that. Now, there are going to be——

Senator CORKER. But let me just—I want to have a two-way conversation here. The market making piece, then, you think that there is going to be no issue with ultimately having rules that allow market making, real market making within banking institutions, is that what you are saying?

Mr. TARULLO. No, I would not say there will be no issues. I think that just in the structure of the interagency rules, you can see that issue of distinguishing between market making and proprietary trading is not a straightforward one and it is one that varies from instrument to instrument because of the different liquidity characteristics, like——

Senator CORKER. You mentioned other firms would take up the slack. Would not those mostly be other firms that were unregulated taking up the slack if much of this moved out of the regulated——

Mr. TARULLO. For pure prop trading, yes.

Senator CORKER. Let me ask you, would we not come up with a much better rule, would the regulators not be engaged together a little bit more if we did not exclude Treasuries and mortgage-backed securities, that all debt instruments were treated equally? Would that not be a much better place for us to be in creating these rules? Why have we decided to differentiated between Treasuries, which you can lose your shirt on, or mortgage-backed securities, which you certainly can lose your shirt on? Why have we left them out of this particular area, do you think?

Mr. TARULLO. That was not our decision. That was a Congressional decision to do that——

Senator CORKER. Would you be open to that coming back in so we came up with a real fair—we would not have countries like Japan and Canada and others worried about it? Would you be OK with that?

Mr. TARULLO. I think one does have to bear in mind the role that Treasuries and their equivalents in other countries play—both the relationship of financial institutions to the Government—the finance ministry, the central bank, or both—and to the use of those instruments in a lot of the regulatory apparatus of the firms. I suspect that was the motivation for excluding Treasuries and that what we are hearing from other countries is, yes, there is a good rationale there. Why do you not exclude our sovereign bonds, as well, for the same reason.

Senator CORKER. Mr. Chairman, I have a number of questions, but I know Senator Johanns is here and I would like to have a second round, so thank you.

Chairman JOHNSON. Senator Johanns.

Senator JOHANNS. Thank you, Mr. Chairman. To all of you, thank you for being here today.

Let me follow up on a question or observation offered by Senator Merkley, and it is a good one and it gets to the heart of what I think the problem is here with Dodd-Frank. And I am going to quote from a *Wall Street Journal* article that just popped up within the last hour or so. It points out that Deutsche Bank changed the legal structure of its huge U.S. subsidiary to show that from new regulations that would have required the German bank to pump new capital into the U.S. arm, it points out that the bank on February 1 reorganized its subsidiaries so that it is no longer classified as a bank holding company, according to disclosures by the bank. It goes on to point out that they are not the first. As you know, Deutsche Bank is at least the second large European bank to make such a change following in the footstep's of UK's Barclays.

It is something we talked about a lot and I warned about, and that is the more aggressively you regulate, because you have been directed to do so by Dodd-Frank, the more tempting it is for somebody to say, see you around. We do not have to be in the United States. And they do not.

So let me just ask a specific question. Can anybody on the panel name three countries that have passed into law, signed by their leader, Dodd-Frank-type regulations? Oh, that is not so good.

Mr. TARULLO. Secretary Brainard may want to address this. Certainly, I do not think anybody has had something that looks like Dodd-Frank. Several people have already alluded to the UK's set

of initiatives, which includes the Vickers Commission proposals that would work a substantial change in the structure of the UK financial services——

Senator JOHANNS. But they have not been passed into law.

Mr. TARULLO. No, they have not, and again, Secretary Brainard should comment on this because it is in the realm of political spheres of their Government—but my understanding is there is support for that, and, I should add, under its existing regulatory authority, the Financial Services Authority has already promulgated some constraints upon relationships among different parts of their firms which do not apply in the United States, are not included in Dodd-Frank. They just did not need legislation to do it.

Senator JOHANNS. You know, I cannot even begin to describe how meaningless that last statement is to me, and here is why. Our institutions are being regulated under a whole new set of rules and principles that you folks cannot even agree on, that you debate. How will you ever administer these things in a sensible way so people know what they can and they cannot do, irrespective of the issue that folks are just going to say, why bother with the United States any more? And that is exactly what is happening here.

Now, let me just say, Mr. Gruenberg, I heard your comments about the importance of bilateral relations. Not to be disrespectful, but to me, that is just happy talk, and here is why I believe that. I will tell you, as Secretary of Agriculture, I think I had great bilateral relations with countries like Japan. I could call their Secretary of Agriculture on the phone and address them by first name and on and on. It did not stop them 1 minute from doing the things that they wanted to do. They would close their country to our beef. And I could go country after country and describe that.

So I am glad you get along with your colleagues well, but it still does not solve the problem we have here, and that is I am now seeing evidence that folks are just deciding not to do business in the United States because of what is happening with Dodd-Frank. Do you agree with that?

Mr. GRUENBERG. Well, Senator, just to respond specifically to the point you made, you know, in my comments, I was referring to the relationships we are developing with respect to the resolution authorities in the United States and other countries in regard to systemically important financial institutions.

I guess the reference I was making was particular to the United Kingdom, where there is a significant concentration of the foreign operations of our major institutions. Among the countries of the world in regard to the specific area of resolution authority, I think it is fair to say that the U.S. and the UK have actually adopted statutory provisions that provide powers that did not exist before and there seems to be a commitment on both sides by the policy makers to make effective use of those authorities.

I could not agree with you more that just because people are polite or friendly to each other, it does not necessarily mean you are going to get the outcome at the end of the day, particularly if problems develop. So I do not mean to——

Senator JOHANNS. But would you agree with me that no country—you know, I think I asked for three—but no country has passed anything anywhere near what Dodd-Frank has required?

Mr. GRUENBERG. Yes. I think it is fair to say I am not aware of an individual country that has passed the sort of comprehensive legislation that we have undertaken here, so——

Senator JOHANNS. So if you are—let us say you are an insurance company and in the effort here to regulate them, and you reach the conclusion that they present a systemic risk to the U.S. economy, all of these additional burdens are placed on them, why would they not just leave? Why would they not locate someplace else where the regulatory atmosphere is better for them? And what would stop them?

Mr. GRUENBERG. Well, if you are talking about the foreign operations of a U.S.—of a company here in the United States that is based in some country that is overseas, there is the balancing issue raised in terms of the obligations we impose here and how it might impact foreign companies and their willingness to operate here.

I do believe that the core issues that the Dodd-Frank legislation tries to address in terms of a set of prudential standards on our biggest systemically important financial institutions, particularly in the area of capital, and the expanded authorities relating to resolution so that we can hold these, effectively, too big to fail companies accountable to a certain market discipline, I think those are the core authorities and I think those were important authorities to enact in the aftermath of what we have been through.

Senator JOHANNS. Let me just wrap up with this, because this is very important. Not only is it the competitive disadvantage we have placed the United States in at a time where our economy is struggling, but second, as a former Secretary, as a former cabinet member, there is a point at which these regulations become so impossible to interpret that you cannot train your employees to the result you are trying to get, and that is what your employees are telling me and, I will bet, other Members of this Committee, is how do we ever train to get to this result, because nobody understands it, whether it is the Volcker Rule or whatever. And even if we could get that far, how are we ever going to get the people up to speed to get the job done?

That is what they are saying. They are saying, how do we train our people to get there? And I think that is a very serious problem. That is not even addressing the fact that we do not even have agreement with our own agencies and departments about what Dodd-Frank says and does not say. I think it is a serious problem.

Ms. BRAINARD. Can I just jump in to answer his first question?

Chairman JOHNSON. Yes, you may.

Ms. BRAINARD. Thanks. So on resolution, Canada, the UK, Germany have already passed legislation to put in place resolution authorities that they did not have before. Jurisdictions have moved actually quicker than we have in many cases to promulgate rules to put in place Basel III new capital requirements. In the case of Switzerland, they are imposing an additional surcharge, very substantial, on capital.

So I think, generally, the pattern is that jurisdictions are moving at different paces on the core reforms, but what, again, is quite remarkable is that we have heads of State of all the jurisdictions that are significant in the international financial system committed to a set of rules that converge to our own and that all of the jurisdic-

tions, including in Japan, for instance, where they have also moved forward with legislation, for instance, on derivatives very quickly, that all of those jurisdictions are actually moving forward on all the core elements in a way that we have never seen before.

Chairman JOHNSON. Senator Hagan.

Senator HAGAN. Thank you, Mr. Chairman, and I want to thank all of our witnesses here for testifying today and for all that you do.

I just wanted to ask a question on gas prices, because everybody is—we are all so concerned about the increase and the rise of gas. And as you know, American companies use derivatives to hedge the risk inherent in their daily operations. For example, airlines are using the derivatives contracts to hedge their cost for fuel. And currently, banking entities are the primary source of commodities hedging liquidity for our large corporations.

Have you thought about what impact the Volcker Rule will have on the price of fuel prices for U.S. airlines and U.S. consumers at the gas pumps? Ms. Mesa, if you could start, and anybody else who would like to address this issue.

Ms. MESA. Well, the CFTC is not a price-setting agency, but we do ensure that the markets are open, transparent, competitive, and free from fraud and manipulation. Given what is going on currently in the prices, it is no different from normal practice that we have heightened surveillance in these markets to make sure that those things—free from fraud and manipulation—our regular surveillance is going on.

I might not talk about the Volcker Rule and might let Dan Tarullo do that if he wants to take that one on, but tell you that on an international scale, on a global scale, we are making sure that regulation is consistent because oil markets are global. They trade on not only U.S. exchanges, but other exchanges around the world. Last year, there was a global consensus on managing positions in the markets, on having daily large trader reports like the CFTC does so that we can surveil who is in the market on a daily basis, and I am making sure all authorities—that the regulators have all necessary authorities, including attempted manipulation, to attempted manipulation, and I think that is an important one, because prior to 2012, European Union Nations did not have attempted manipulation authority and I think that is an important matter to know.

Mr. TARULLO. Senator, on the overall issue of the impact of both Volcker and, I would say, probably the derivatives push-out rule——

Senator HAGAN. Right.

Mr. TARULLO. ——is where you are probably going to see the effect here. On the derivatives push-out, I had mentioned earlier that there was a relatively small proportion of derivatives that would need to be pushed out of most national banks, but commodities is one of those areas. And so if we are going to see an effect——

Senator HAGAN. Is one of those areas that needs——

Mr. TARULLO. That would have to be pushed out, that is right. The commodities derivatives would have to be pushed out. So there, if there is an effect, I think that is probably where you are going to see it.

Senator HAGAN. And when you say pushed out——

Mr. TARULLO. The derivative cannot be written within the national bank. And the reason why that has an effect is that you are going to need to set up a separate operation for your derivatives in your nonbank affiliate. The relative amount of cost associated with that is presumably going to vary from organization to organization because there may be a holding company that does a lot of derivatives work already in a nonbank affiliate, and thus for them the cost would be fairly incremental. But one can imagine, at least, that there would be an institution which would have to set up a separate apparatus and thus the cost would be higher.

Senator HAGAN. How much do you think that jobs would be lost overseas in this scenario?

Mr. TARULLO. I do not think we have the kind of precise data that would allow us to project that. I think probably from our perspective the concern is, are you making what are otherwise safe and sound transactions more costly than they otherwise would be. And even if you cannot trace that through to a particular job number, that is not a circumstance you usually want to have, when you are just increasing costs where it is not necessary to achieve safety and soundness.

Senator HAGAN. Well, obviously, we are concerned about safety and soundness, but I, too, am concerned about jobs in the U.S. on a daily basis.

Legislation has been proposed that would exempt certain interim affiliate transactions of swap dealers from meeting margin and clearing requirements, and if these contracts are classified as separate transactions, there is a concern that it will increase cost for the customers of these products to appropriately manage the business risk. Has the CFTC acted to provide this exemption for interaffiliate transactions, and if not, if you have not acted in this area, can you provide an explanation about when you expect the CFTC to act.

Ms. MESA. We have not provided such an exemption in this area, but it is something that the industry has heavily commented to the agency about and it is something we are considering at a staff level and the Commission is fully aware that staff is developing something in this area.

Senator HAGAN. Well, it is my understanding that the SEC may treat interaffiliate transactions differently than the CFTC, and does it make sense for market participants to have to comply with two different sets of rules for similar products.

Ms. MESA. As mandated under Dodd-Frank, we are, of course, coordinating, consulting with the SEC, and we will work with them as we think through this issue.

Senator HAGAN. I think there are a lot of issues that are arising because of the two different entities regulating the same transactions.

And then I understand that certain aspects of Basel III with respect to regulatory capital intersect with changing accounting standards in the U.S. and internationally, and it has been brought to my attention that if such changes are adopted in the U.S., as proposed, it may produce several unintended consequences, such as a narrowing of the investor base for longer-term debt, public debt

instruments, including our U.S. Treasuries, mortgage-backed securities, and municipal bonds. Prior to U.S. implementation, do Treasury, FDIC, and/or the OCC intend to study the issue or to propose alternatives in light of the above-mentioned concerns? Governor Tarullo, do you want to start that one.

Mr. TARULLO. There has been a series of accounting issues that have an impact on capital. I think our aim—at least the Federal Reserve's aim, I will let the other prudential regulators speak for themselves—has been to maintain substantial if not overwhelming congruence between the accounting standards that FASB applies for purposes of investor protection and transparency, on the one hand, and regulatory capital on the other, the reason for that being that otherwise you have got different sets of books, in essence, that investors have to look at.

Having said that, there have been some areas in which I think the accounting standards do not—have not—or at least some of the proposals have not well reflected the reality of certain assets. The proposal that was floating around for a while to insist on fair value treatment for loans written by a community bank and held to maturity, I think, was sort of a stunning example of that.

So my own sense is that our effort as regulators ought to be to try to take our observations on what are sensible accounting standards for all investors and to urge those in appropriate channels on the FASB, and I think FASB is listening to those kinds of arguments. Our chief accountants from the three agencies frequently get together to talk about these kinds of issues and then try to make representations, as appropriate.

Chairman JOHNSON. Neither Senator Shelby nor I have any further questions, but does Senator Corker have a concluding question?

Senator CORKER. I do. I have several concluding questions. Thank you.

[Laughter.]

Senator CORKER. And I took a lot less time than most of our questioners, so thank you for the time now.

Mr. Tarullo, I thought your answer on MSRs was actually a very good one and I think that we should deal with how much—what the basis point set-aside should be. That is something that has nothing to do with you, but I thought that was very good. Sometimes I think they are wrong answers, but it was a very good one.

But let us move to the Treasuries. You were talking about them playing a very unique role, Treasuries and mortgage-backed securities, and, therefore, we should treat them differently than other types of debt instruments, and Volcker does that, of course. Should we really have a bias in our private banking system toward Government debt, or should all debt not be treated the same? I mean, is this bias something that is healthy for us in this free enterprise economy that we have?

Mr. TARULLO. Senator, the special treatment of U.S. Treasuries, for example, is grounded in substantial part on the risk-free character of those Treasuries and, thus, they serve as both a capital and liquidity backstop for firms——

Senator CORKER. But they are not risk-free as it relates to interest rate changes.

Mr. TARULLO. No. No.

Senator CORKER. OK.

Mr. TARULLO. You are absolutely right, and that is why we have interest rate risk supervision. But I would say, I do not think—so the argument for a preference, for an identification, I think, is very strong. But it is not all encompassing.

And so, for example, on liquidity regulation, which basically looks to make sure that a firm could sustain a major market shock and keep operating long enough to allow order to be restored—I do not think we want to rely solely on U.S. Government securities or, indeed, any Government securities. There, I think we do want to look to the actual experience. We now have, unfortunately, a real world experiment, which is to say 2008, 2009, where we can see how different instruments—the liquidity value of different instruments was realized over that period of time. And in the revision of the liquidity coverage ratio internationally, that is the position we have urged, is to look and see how instruments actually performed and give credit where nongovernments are, in fact, liquid, even in times of stress.

Senator CORKER. Thank you very much.

Mr. Gruenberg, we yesterday spent a good deal of time with Sheila Bair just talking a little bit about orderly liquidation. I was on a panel a few weeks ago and there are portions of Title II that I am really proud of because I was highly involved in, and other portions, not so much.

But there has been a lot of discussion about the SIFI piece which precludes that, I think maybe in Title I, and people are concerned as they look at orderly liquidation. And if you are a SIFI—we have had numbers of people who deal with financial institutions—their thinking is that if orderly liquidation occurred with a significantly important financial institution, then they would be treated differently than if they were creditors to a smaller institution, and their fears are that if an institution starts going bad and it is not a significantly important institution, that it is going to be like a run of people away from that institution.

I am not seeing that myself, but we certainly had an hour yesterday with Sheila talking about that. I am wondering if you have bumped into that or have any comments in that regard.

Mr. GRUENBERG. Well, you know, it is an important issue, Senator. I would note that the premise of the legislation is that the orderly liquidation authority would be invoked only if, for some reason, there was a judgment that the bankruptcy courts could not handle the failure without some systemic consequences——

Senator CORKER. And on that note, would you urge some changes in the Bankruptcy Code to make the Bankruptcy Code work even better for institutions?

Mr. GRUENBERG. Well, I do not know that I have changes to suggest. I think we are certainly open, and we have talked about this in the past, to engaging with you on that issue.

But just to the point of the treatment of creditors, I think in the first instance, the effort will be to utilize the bankruptcy process as it would normally be used. If you had an extraordinary circumstance where the failure of a company, it would appear, could not be handled by the bankruptcy process without some larger sys-

temic consequence, then we have these admittedly extraordinary authorities under Title II. But even then, the directive in Title II in terms of the treatment of creditors is to try to follow, as a general practice, the practices under the bankruptcy process.

So I think the goal would be to be as consistent with that as we possibly can and that is certainly the premise of all the planning we have done in terms of our resolution authority.

Senator CORKER. One of the nuances that I just recently—and I am embarrassed to say this—have picked up, but orderly liquidation really would only be used in a case where the bulk of the assets were of a banking nature. And if that were not the case, then if the assets were generally not of a normal depository institution, you would probably lean toward bankruptcy in those cases instead of orderly liquidation. Is that the way you understand——

Mr. GRUENBERG. I am not sure that is—I think the proviso of the statute is really a judgment, and it is a joint judgment of the Federal Reserve and the FDIC making determinations and recommendations to the Treasury Department, which would then have to make a judgment in consultation with the President, and that authority could apply to any financial company, and the key there is whether the failure of the company would cause significant disruption to the financial system. So that authority, while, I think, in the most likely case would apply to a bank holding company, given the nature of the large and systemically important institutions in our country, it could be applied to a nonbank financial company, as well.

Senator CORKER. I know the Chairman——

Mr. TARULLO. Is that the question you were asking, Senator? I thought you were asking about whether the authority was likely to be applied only to bank holding companies where most of the assets were traditional commercial——

Senator CORKER. That is what I was asking.

Mr. TARULLO. Yes. So that is not your intention, right?

Mr. GRUENBERG. Where most of the assets are not in traditional—whether they were in the bank or not——

Mr. TARULLO. No, I think the Senator was asking whether Title II is likely to apply only to bank holding companies where traditional commercial banking assets are the preponderance——

Senator CORKER. Are the majority of the assets, yes.

Mr. GRUENBERG. I do not think that is necessarily the case.

Senator CORKER. It would still be, in each case, solely—we have had differing responses to this, but in your mind as the chief liquidator——

[Laughter.]

Senator CORKER. ——our Nation's "chief liquidator"—that is quite a title—it would be a judgment call made relative to whether this institution would create a lot of problems throughout the banking industry if it went through bankruptcy instead of orderly liquidation.

Mr. GRUENBERG. Yes, sir.

Senator CORKER. Mr. Chairman, thank you for your generosity. I think the witnesses have been outstanding and I do hope we will pursue a technical corrections bill at the right time.

Chairman JOHNSON. Senator Merkley.

Senator MERKLEY. Thank you, Mr. Chair.

I wanted to begin, Ms. Mesa, with following up on Senator Hagan's thoughts. Under Dodd-Frank, CFTC was given power to establish position limits and there has been a lot of frustration with how slowly the CFTC has moved, and although you have got the rule done, you still have not implemented it. And we have seen growth from 30 percent of folks trading in the market not having an end use, if you will, to 70 percent. In recent months, a lot of folks seeing the conflict in the Middle East and the conflict regarding Iran have said, well, a lot of other folks are going through the same thing and they are going to worry about oil and they are all going to bet, so I will get in and bet, too. So we see this huge surge in speculation and the CFTC sitting on your hands. Can you explain why you have been so slow and missed the deadline and at great cost to American consumers at the pump?

Ms. MESA. We have, actually, as you noted, passed our final rule on position limits. The final rule talks about aggregating futures positions with swaps positions, and in the final rule, we said that we would collect 1 year of data of swaps positions before the position limits would be effective, and so that 1 year has not run yet. When it does, they will go into effect. So that——

Senator MERKLEY. All right. Well, there is a big sense in America that while CFTC fiddles, the American consumer is getting burned, and I just want to express that concern because I hear my constituents on each and every trip——

Ms. MESA. I will take that concern back.

Senator MERKLEY. ——back home. Thank you.

Ms. Walter, I wanted to address a little bit the issue of crowdfunding. We are going to be voting on it later today. The House laid out a strategy for folks being able to invest over the Internet in small dollar amounts that involved no requirements on companies for information, no accountability for whatever information the companies did put out there, full legal permission for companies to hire people to pump their stocks with no consequences, and it looked to me like a path, really, a paved path to predatory activity that would damage a lot of folks who are thinking they are participating in a fair market but would not be. Do you share any of those concerns about the House legislation?

Ms. WALTER. Well, first, I must say that the Commission itself has not voted on this, so I am speaking for myself. I welcome adding investor protection provisions to the crowdfunding aspect. I see some value in crowdfunding itself, but I do think it should be done with appropriate investor protections attached to it, and those are terribly important.

Senator MERKLEY. Have you had a chance to look at the bill, the amendment that Senator Bennet and I have worked on to provide those investor protections?

Ms. WALTER. Unfortunately, I have not. I have been told about certain aspects of it, but I have not had the opportunity to read it.

Senator MERKLEY. Well, we are going to be voting—I was going to get your wisdom before I vote on my own amendment this afternoon.

Ms. WALTER. And I have missed my opportunity to influence you.

[Laughter.]

Senator MERKLEY. Well, I do appreciate your general sentiment, we should add some investor protections, and we do require three different levels of information, depending on how much a company is raising. We hold the officers and directors accountable for the accuracy of that information. We set up a streamlined Web portal of structure so people cannot simply sell without any structure, which was true in the House bill, and a number of other factors.

But one of the things that we also do is set up a cycle for the SEC to be right on top of predatory practices that develop and be able to develop rules to address those predatory practices because this is a new, uncharted territory, and to make capital formation work well, it has to be something investors believe that they are getting a fair shake on. And so we are going to be counting on you all.

Ms. WALTER. We will do our best, as always.

Senator MERKLEY. Thank you very much, and Mr. Chair, thank you for holding the hearing and I appreciate you all's input on these very complicated and very important issues for capital across the planet and the strengthening of our collective economies.

Chairman JOHNSON. Thank you all, all the witnesses for your testimony and for being here today.

There is no doubt that continued cooperation and harmonization of financial regulatory reforms is important to the stability of our global economy. The recent years have highlighted the interconnected nature of the global financial system and the importance of international coordination. I look forward to continuing to work with all of you and the Members of the Committee to ensure the successful implementation of these important reforms.

This hearing is adjourned.

[Whereupon, at 11:51 a.m., the hearing was adjourned.]

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

PREPARED STATEMENT OF LAEL BRAINARD

UNDER SECRETARY FOR INTERNATIONAL AFFAIRS, DEPARTMENT OF THE TREASURY

MARCH 22, 2012

Chairman Johnson, Ranking Member Shelby, and Members of the Committee, thank you for the opportunity to discuss our international financial reform agenda.

In the wake of the financial crisis, the United States responded swiftly and aggressively. We took forceful measures to stabilize financial markets, including through transparent and groundbreaking stress tests. Congress moved rapidly to enact the Dodd-Frank Act—which provides the most significant set of financial reforms in generations. And in parallel we secured unprecedented commitments from our international partners in the G20 and the Financial Stability Board—the same commitments from the emerging economies as from the advanced economies.

There is a vigorous debate over the merits of moving slow or fast—of moving first or last. This is an important debate with direct bearing on the pace and tone of the recovery, the safety and soundness of our financial system, and the fairness of the international playing field. The United States moved fast and first to repair and reform our financial system, and we believe that strategy is already beginning to demonstrate its effectiveness.

Some argued that strengthening the safety and soundness of our financial institutions should wait until after the recovery is complete. I disagree. A strong and stable financial system is a precondition for a growing and competitive U.S. economy. It was important to take action while the urgency of the crisis was still fresh in our memories. There are substantial lead times built into many of these reforms, allowing markets time to adapt. Now is not the time to increase uncertainty in the market by backtracking.

Making Our Financial System Stronger, Safer, and More Transparent

U.S. supervisors responded early and forcefully by compelling U.S. financial institutions to build capital, reduce leverage, and strengthen liquidity buffers. Far from disadvantaging U.S. institutions and harming credit, these early actions built greater resilience and helped to safeguard credit flows in the face of elevated financial stress in the second half of 2011.

Because we acted early and fast, U.S. banks built larger and higher-quality capital buffers. Tier 1 common equity at large bank holding companies increased by more than $400 billion to $960 billion from the first quarter of 2009 through the fourth quarter of 2011, a more than 70 percent increase. The ratio of Tier 1 common equity to risk-weighted assets at these institutions has increased from 6 percent to over 10 percent during this period.

U.S. financial institutions have strengthened their funding models: short-term wholesale financial debt has decreased as a share of total financial institution assets from a peak of 29 percent in 2007 to 17 percent in the fourth quarter of 2011, and regulatory filings show that short-term wholesale funding at the four largest bank holding companies has decreased from a peak of 36 percent of total assets to 20 percent over this period. Depository institutions have built a more stable base of funding. Core deposits as a share of total liabilities at FDIC-insured institutions increased from a low of 44 percent in 2008 to 64 percent in the fourth quarter of 2011.

Risks have diminished outside of the banking sector as well. The size of the U.S. shadow banking system has fallen substantially, with prime money market funds shrinking by 32 percent and the triparty repo market shrinking by nearly 40 percent since their peaks in 2008.

And credit availability has improved during this time, even as safety and soundness have materially strengthened. Bank credit to U.S. companies increased by annual rates of 11–12 percent in the third and fourth quarters of 2011.

By contrast, Europe opted to move more slowly on stress test disclosures and measures to build capital and improve funding. As a result, many euro area banks were less resilient in the face of shocks last year, putting pressure on funding and credit and raising financial stress in a negative spiral. Since that time, European authorities have taken steps to strengthen the capital position of euro area banks. These actions, and the critically important actions taken by the European Central Bank to strengthen liquidity, have helped to reduce financial stress.

Far from disadvantaging our firms, the early actions to strengthen bank balance sheets and improve funding put U.S. banks in a stronger position to withstand financial stress relative to many of their international peers, while supporting credit flows to U.S. households and businesses at a critical time for the recovery.

International Convergence on Financial Reform

Some argue that by moving first, we have put the United States at a competitive disadvantage. To the contrary, by moving early, we have been able to lead from a position of strength in setting the international reform agenda and elevating the world's standards to our own. The alternative would have been to follow the reform standards set by other countries or subject our firms to a divergent set of standards. Of course, we will need to be vigilant in addressing the inevitable inconsistencies and lags on implementation. But this should not detract from the remarkable degree of convergence we are seeing on a comprehensive reform agenda spanning bank capital and liquidity, resolution, and over-the-counter (OTC) derivatives markets for the first time. This common, comprehensive set of reform commitments encompasses not only the established financial centers in advanced economies but also up-and-coming financial centers in emerging markets. Moving first and ensuring that others enact reforms consistent with our own are the best ways to reduce opportunities for regulatory arbitrage and a race to the bottom, to prevent firms from exploiting gaps in regulation, to provide a fair and level playing field for U.S. firms, and to protect our economy from risks emanating beyond our shores.

Going into the crisis, too many financial institutions had too much leverage, too little liquidity, and inadequate loss absorbing capacity. This led to a downward spiral in confidence among counterparties. Going forward, we have agreed to new global capital standards that raise the quality and quantity of capital so that banks can withstand losses of the magnitude seen in the crisis and reduce the risks of financial system collapse as a result of financial excesses. We have also secured agreement internationally to strengthen liquidity standards and limit leverage. We have identified the globally systemically important banks, agreed to a capital surcharge for these institutions, and developed a comprehensive set of enhanced prudential measures to address risks from globally active financial institutions.

However, there is much more work that needs to be done. We must remain vigilant against attempts to soften the national application of new capital, liquidity, and leverage rules. It is essential for banks across the world to measure risk-weighted assets similarly, to ensure that markets and investors can be confident that the capital adequacy ratios stated by banks are consistent across borders. The United States is pursuing comparability by urging greater visibility into supervisors' scrutiny of how banks measure risk-weighted assets. We are pleased that the Basel Committee has added this important work to its agenda for 2012.

Going into the crisis, few understood the magnitude of aggregate derivatives exposures in the system because derivatives such as credit default swaps (CDS) were traded over the counter on a bilateral basis and without transparency. Going forward, we have agreed to stronger international standards for the OTC derivatives markets, including requiring greater transparency, moving their trading onto exchanges, and requiring them to be centrally cleared.

Now we must ensure that national authorities continue to coordinate closely to align implementation; our frameworks for derivatives must be tightly aligned or differences could lead firms to move activities to jurisdictions with lower standards, increasing risks to the global financial system. We must guard against fragmentation of the global payments infrastructure, ensuring that global infrastructure is adequately safeguarded, and avoid geographic mandates for clearing. It is critical that others across the globe follow the U.S. lead and accelerate timetables where needed.

We must also finalize work on a global standard for posting collateral (or margin) on uncleared derivatives transactions. To reinforce the push towards central clearing and enhance safety and soundness, the charges associated with uncleared derivative transactions must exceed those on cleared transactions. Both the United States and the European Commission are developing margin requirements for OTC derivatives that are not centrally cleared, and the G20 and the FSB have committed to developing a global standard.

Going into the crisis, countries lacked tools to resolve systemically important financial institutions, effectively rendering them too big to fail. Going forward, we have reached an important agreement that all major financial jurisdictions should have the tools to resolve large cross-border firms without the risk of severe disruption or taxpayer exposure to loss. The FSB is working actively to see that this international commitment is implemented on a national level to ensure that in addition to national resolution regimes, regulators and the major global banks develop cross-border recovery and resolution plans by the end of 2012; develop criteria to improve the "resolvability" of systemically important institutions; and negotiate institution-specific cross-border resolution cooperation arrangements.

Strengthening cross-border resolution is a difficult issue given the diverse national laws and the infeasibility of a single global bankruptcy regime. The UK, Ger-

many, and Canada have already passed resolution legislation, and the European Commission is developing a draft for the second quarter of 2012. We are working to put in place cross border cooperation agreements; establish cross border crisis management groups for the largest, most complex institutions; and finalize recovery and resolution plans by the end of this year.

Going into the crisis, supervisors and market participants did not have adequate visibility into the buildup of concentrations of risky activities in the financial markets. Going forward, a global Legal Entity Identifier (LEI) system will uniquely identify parties to financial transactions, ensuring greater transparency and more efficient data collection across the global financial system, and enabling better understanding and management of systemic risk. Working with our international counterparts and the financial industry, we must finalize the global LEI framework and the reporting systems to support it by the G20 Leaders Summit in June.

New laws and rules aimed at the home market of any major financial center will inevitably impact other jurisdictions, given the globalized nature of cross-border flows. In these circumstances, aligning the substance and timing of reforms across jurisdictions will be critical. Regulators will have to sort out whose rules apply, how, and where. We need to figure out sensible ways to apply and enforce rules across major jurisdictions in consistent ways. The greater the degree of convergence around high quality standards, the greater the scope for deferring to foreign jurisdictions that have regulatory regimes as strong as that of the United States.

Regulators are grappling with common issues pertaining to the structure of risk-taking in their national markets. The Volcker rule, which limits proprietary trading and hedge fund activities for banks, is a good example of where the United States has moved ahead of others, continuing in a long tradition of recognizing structural differences across countries, reflecting national history and laws. The U.S. Federal depository insurance net—which has served our country well—was not designed to be extended to the riskiest trading activities of U.S. banks. But even in this instance, while regulators are sifting through the 16,000 comments that were submitted on the rule, other jurisdictions are grappling with the same issues. In the UK, the Vickers Commission proposed rules to insulate core financial intermediation activities from riskier business lines in order to promote financial stability. In the European Union, Commissioner Barnier has assembled a commission to explore possible regulations for proprietary trading.

Conclusion

With financial markets that are more globally integrated than ever, we need financial reforms that are more globally convergent than ever.

In today's highly interconnected global financial markets, the risk of regulatory arbitrage carries real impact. It means the potential loss of jobs if firms seek to move overseas where regulation is weaker. It means a race to the bottom for standards and protections. And it may mean a heightened risk of a future financial crisis if riskier activities migrate to areas with less transparency and laxer supervision.

In cooperation with the regulatory agencies represented here today, Treasury is intensely focused on ensuring global convergence on regulation and resolution of large, complex financial institutions and on regulation of derivatives markets—the three areas with the greatest potential for discrepancies in national regulations to create disproportionate dislocations in global markets that could negatively impact our economy and our firms. This is a necessary response to the crisis.

Since the outset of the crisis, the G20 and the FSB have played an increasingly critical and welcome role, alongside the international standard setting bodies, in shaping the international regulatory reform agenda and promoting sound regulation and more resilient financial markets. Recognizing there will be discrepancies when it comes to implementation at the national level, the Treasury and U.S. regulatory agencies buttress our cooperation through the G20 and the FSB with extensive bilateral engagement. Each day, we talk with our colleagues in Europe and conduct ongoing dialogues across the major financial centers. This helps us get the details right. Additionally, the FSB and the standard-setting bodies have jointly developed an implementation monitoring framework that will report annually on our collective progress to the FSB, the G20, and the public.

Undoubtedly, we will not attain perfect alignment and we will not get everything right. Despite this, nothing could be more costly than backtracking on reforms. We cannot lose sight of the costs of the last crisis—millions of jobs and trillions of dollars in lost wealth. Nor can we lose sight of the causes—inadequate risk management, imprudent-risk taking, opaque instruments whose risks were not understood or overseen, and failures by our regulators. This is why it is necessary to complete the work that is underway in the United States and internationally. The system is

stronger today and will continue to strengthen in the future as a result of our efforts.

PREPARED STATEMENT OF DANIEL K. TARULLO

MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

MARCH 22, 2012

Chairman Johnson, Ranking Member Shelby, and other Members of the Committee, thank you for the opportunity to testify on implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act) and its international implications.

Although banking regulation has long included an important international dimension, the recent financial crisis has brought renewed attention, both in the United States and abroad, to the interconnectedness among national financial markets and, consequently, the importance of international cooperation in safeguarding those markets. In recognition of the fact that financial distress can quickly and dramatically cross national borders, we seek to protect our own financial system by promoting the global adoption of strong, common regulatory standards and effective supervisory practices. Such common standards and practices should also help prevent major competitive disadvantages for U.S. firms.

Today I will touch on several aspects of the implementation of the Dodd-Frank Act that have significant international implications: regulation of systemically important financial institutions (SIFIs), reform of the over-the-counter (OTC) derivatives market, and a number of discrete issues that are arising as we work to implement the Dodd-Frank Act.

Regulation of SIFIs

The Dodd-Frank Act and postcrisis international regulatory reform efforts both place great emphasis on containing the systemic risk potentially posed by major financial institutions. The most important points of intersection include efforts to strengthen capital requirements, to develop international quantitative liquidity standards, and to put in place mechanisms for the orderly resolution of these firms.

Capital Regulation

Strong capital requirements remain the cornerstone of prudential regulation because capital can provide a buffer against losses at financial firms from any source or activity. The best way to safeguard against taxpayer-funded bailouts in the future is for our large financial institutions to have adequate capital buffers, sized to reflect their own risk profiles and the damage that would be done to the financial system were such institutions to fail. Achievement of this aim requires both improvement of the traditional, firm-based approach to capital regulation and creation of a more systemic, or macroprudential, component of capital regulation.

With respect to improving the traditional approach to capital regulation, international work on common, global standards was already quite advanced by the time the Dodd-Frank Act was enacted in July 2010. The so-called Basel 2.5 agreement, which strengthened the market risk capital requirements ofBasel II, had already been finished. Just a few months after the Dodd-Frank Act was enacted, agreement was reached on the Basel III reforms, which require improvement of the quality of regulatory capital, an increase in the quantity of minimum required capital, maintenance of a capital conservation buffer, and—for the first time internationally—compliance with a minimum leverage ratio. In the coming months, the banking agencies will be finalizing regulations to implement Basel 2.5 in the United States and will be proposing regulations to implement Basel III in the United States.

With respect to macroprudential capital regulation, section 165 of the Dodd-Frank Act mandated that the Board establish enhanced risk-based capital standards for large bank holding companies that would be graduated based on the relative systemic importance of those companies. Consistent with this requirement, we espoused proposals in the Basel Committee for capital surcharges on the world's largest, most interconnected banking organizations based on their global systemic importance. Last year, agreement was reached on a framework for such surcharges, to be implemented during the same transition period applicable to Basel III. The Board's aim has been to fashion the enhanced capital requirements of section 165 and the associated international framework in a simultaneous and congruent manner. Both the Dodd-Frank Act provision and the Basel systemic surcharge framework are motivated by the fact that the failure of a systemically important firm would have dramatically greater negative consequences on the financial system and the economy than the failure of other firms. Stricter capital requirements on sys-

temically important firms should also have the benefit of helping offset any funding advantage these firms derive from their perceived status as too-big-to-fail and providing an incentive for such firms to reduce their systemic footprint.

If the benefits of all these improvements to existing capital requirements are to be realized, it is crucial that capital standards be not only agreed upon globally, but also implemented consistently across jurisdictional boundaries. We have strongly supported efforts within the Basel Committee to monitor implementation—not only in the laws and regulations of member countries, but also at the level of individual large banking organizations, including an assessment of the consistency of risk-weighting practices by banks. We look forward to the evolution of the Basel Committee's new plans for conducting this monitoring exercise, which are considerably more ambitious than any pursued in the past.

Liquidity Standards

In recognition of the fact that liquidity squeezes at some financial institutions played a key role in the financial crisis, the Basel III agreements also introduced, for the first time, quantitative liquidity requirements for application to internationally active banks. One standard, the Liquidity Coverage Ratio (LCR), is designed to ensure a firm's ability to withstand short term liquidity shocks through adequate holdings of highly liquid assets. The other standard, the Net Stable Funding Ratio (NSFR), is intended to avoid significant maturity mismatches over longer-term horizons. Again, there is a parallel to this international initiative in section 165 of the Dodd-Frank Act, which calls for enhanced, graduated liquidity standards for large bank holding companies.

Precisely because this was the first effort on quantitative liquidity regulation by the Basel Committee, there were some questions about potential unintended consequences, as well as a desire to ensure that the new standards reflected actual experience with the stability of various funding sources and the relative liquidity of different financial instruments during the financial crisis. For these reasons, the Federal Reserve, with support from a number of other central banks and supervisors, suggested at the time of adoption of Basel III in 2010 a multiyear study period before the rules take effect. Since then, the U.S. banking agencies and a Basel Committee working group have been collecting data, analyzing the potential effects of the LCR on financial markets and the broader economy, and considering what amendments might be warranted. The Basel Committee will likely suggest a set of changes to the LCR later this year, with a goal of introducing the LCR in 2015. Work on the NSFR is on a considerably slower track; the current plan is for implementation in 2018.

Resolution of SIFIs

A third core regulatory reform goal of both the Dodd-Frank Act and international policy makers is to enhance the ability of regulators to resolve failing SIFIs. The Basel Committee and the Financial Stability Board (FSB) have set forth standards for national resolution regimes that will allow resolution of SIFIs in an orderly fashion, without taxpayer exposure to losses through solvency support. Here in the United States, the Dodd-Frank Act provides for an orderly resolution process to be administered by the Federal Deposit Insurance Corporation (FDIC), and resolution planning by SIFIs to be overseen by the FDIC and the Federal Reserve. Together these provisions of the Dodd-Frank Act are fully consistent with the Basel Committee and FSB standards.

In developing the orderly liquidation authority established by Title II of the Dodd-Frank Act, the FDIC has recently expressed a preference for resolving a failed SIFI under a single receivership and internal recapitalization model. Under this model, the parent company of the failed SIFI is placed into receivership; all, or substantially all, of the assets of the parent company are transferred to a bridge entity; the parent company and its residual assets are liquidated; and the bridge entity is capitalized, in part, by converting the holders of long-term unsecured debt of the parent company into equity holders in the bridge. Under the single receivership model, the major subsidiaries of the SIFI continue to operate as going concerns. This approach holds great promise, but ensuring its viability as a resolution option requires, among other things, that each SIFI maintain an amount of long-term unsecured debt that is sufficient to absorb very significant losses at the firm.

Some other jurisdictions have, or are planning to, put in place special resolution mechanisms that conform to the emerging international standards. But even continued progress along this path may not solve all the possible problems associated with failure of a SIFI. The coexistence of internationally active firms with nationally based insolvency regimes means that there could be important cross-border legal complications when a home jurisdiction places into receivership a firm with signifi-

cant assets, subsidiaries, and contractual arrangements in other countries. A comprehensive, treaty-like instrument for a global bank resolution regime to address these issues is surely an unrealistic prospect for the foreseeable future. The Federal Reserve and the FDIC are working together with counterparts from other countries to identify opportunities for more limited cooperation agreements, coordinated supervisory work on resolution plans, and other devices to make the orderly resolution of a large, internationally active firm more feasible.

OTC Derivatives Regulatory Reforms

Another key part of the Dodd-Frank Act that involves significant international considerations is OTC derivatives reform. In the United States, administrative agencies are implementing the requirements of the Dodd-Frank Act to strengthen the infrastructure and regulation of the OTC derivatives market. This task includes enhancing the role of central counterparties, which can be an important tool for managing counterparty credit risk in the derivatives market; improving regulation and supervision of dealers and key market participants; introducing minimum margin requirements for certain derivatives transactions that are not cleared with a central counterparty; and increasing transparency.

A roughly parallel international initiative got under way in 2009, when the Group of Twenty (G20) leaders set out commitments related to reform of the OTC derivatives markets. Since work on the G20 commitments is being pursued in a number of international groups and foreign jurisdictions, continued attention will be required to ensure that the global convergence process continues in a timely fashion. Such attention will be particularly important in areas where international convergence is desirable to avoid a significant fracturing or regionalization of the existing global structure of the swaps market, or to prevent undue constraints on the ability of U.S. firms to compete in foreign markets. A good example of this is the introduction of margin requirements for uncleared derivatives. U.S. and foreign regulators have formed a joint working group of the Basel Committee and the International Organization of Securities Commissions (IOSCO) to develop internationally consistent margin standards that appropriately address the risks of uncleared derivatives while ensuring that U.S. and foreign firms compete on a level playing field.

Other key areas of OTC derivatives reform present similar international challenges and will demand similar levels of international collaboration. These areas include the creation and regulation of central counterparties, swap execution facilities, and swap data repositories, including mutual recognition by U.S. and foreign regulators where appropriate. Issues also arise around the treatment of governmental entities in derivatives reforms in the United States and abroad. For example, title VII of the Dodd-Frank Act generally exempts from swaps regulation any transaction to which the Federal Reserve is a party, but does not contain a similar exemption for transactions to which a foreign central bank is party. Foreign central banks have expressed concerns that the application of certain parts of title VII may interfere with the manner in which they conduct their national monetary policies.

In addition to its involvement in specific derivatives reforms related to the Dodd-Frank Act, the Federal Reserve also participates in a variety of international groups that serve as broader forums for coordinating policies related to the participants and the infrastructure of derivatives markets. These forums include the Basel Committee, which has recently enhanced international capital, leverage, and liquidity standards for derivatives, as well as the Committee on Payment and Settlement Systems, which is working with IOSCO to update international standards for systemically important clearing systems, including central counterparties that clear derivatives instruments, and trade repositories. These collaborative exercises are intended to support the development of a consistent international approach to the regulation and supervision of derivatives products, dealers, and market infrastructures. Here, as in other international contexts, our aims are to promote the financial stability of the United States and fair competitive conditions for U.S. financial institutions.

Other Implementation Issues

As noted in the preceding discussion, even where there is broad international consensus to adopt a particular regulatory approach, there can be discrete issues raised as countries implement that approach in the context of their own legal, financial, and political systems. This circumstance is hardly unique to the area of financial regulation; it is familiar to anyone who has worked on virtually any regulatory issues that affect international trade and investment. There are also some elements of the Dodd-Frank Act that are unlikely to be pursued internationally in any comparable form. These areas of U.S.-only regulatory reform can present particular challenges in implementation, both in terms of the potential impact that they may

have on the ability of U.S. financial institutions to compete abroad and the extent to which they may affect the activities of foreign financial institutions in U.S. markets and with U.S. counterparties. In these instances of regulatory reforms being pursued only in the United States, there are not likely to be obvious answers to the resulting international complexities.

For example, there has been considerable recent attention paid to the international aspects of section 619 of the Dodd-Frank Act, more commonly known as the "Volcker Rule". Concerns have been expressed about the Volcker Rule's potential international implications in three principal areas. First, because the Volcker Rule applies to the worldwide operations of U.S. banking entities, but only to the U.S.-connected operations of foreign banks, concerns have been raised regarding the relative competitiveness of U.S. firms that have significant operations in overseas markets. Second, and conversely, because the Volcker Rule also applies to the activities of foreign banks unless such activities are "solely outside the United States," several foreign banks and their supervisors have expressed concern regarding the potential extraterritorial impact that those restrictions may have on trading or fund activity of foreign banks that has both U.S. and non-U.S. characteristics. Third, because the Volcker Rule includes a statutory exemption for proprietary trading in U.S. Government debt securities, but not in foreign sovereign debt securities, several constituencies have raised concerns regarding this asymmetry. In each of these areas, U.S. regulators will need to carefully consider the concerns that have been raised and the broader international implications of the Volcker Rule as we work to finalize our implementing rules.

Similarly, the swaps "push-out" requirement in section 716 of the Dodd-Frank Act also appears unlikely to be pursued internationally. Under section 716, U.S. insured depository institutions and U.S. branches and agencies of foreign banks will be required to "push out" certain types of derivatives dealing activities to affiliated entities. The global effects of the swaps push-out provision are multifaceted. On the one hand, the provision will require U.S. banking firms to restructure their global derivatives dealing activities in ways that will not be required of foreign banks abroad. At the same time, the provision may require U.S. branches and agencies of foreign banks to restructure their derivatives dealing activities in ways that will not be required of U.S. banks.

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

PREPARED STATEMENT OF ELISSE B. WALTER

MEMBER, SECURITIES AND EXCHANGE COMMISSION

MARCH 22, 2012

Chairman Johnson, Ranking Member Shelby, and Members of the Committee, thank you for inviting me to testify on behalf of the Securities and Exchange Commission (SEC) about international cooperation in the realm of financial regulation.

Markets are global, and regulators have long been mindful that domestic changes can have an impact outside their own countries. The impact of regulation across borders has become ever more important as business has become increasingly global. As part of our rulemaking efforts to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the SEC has been actively engaged in discussions with our counterparts abroad to encourage international coordination of regulatory reforms.

Our international efforts include both informal and formal bilateral discussions and arrangements, and we also work through multilateral organizations, where we have leadership roles in several task forces and working groups.

My testimony will highlight some of the key areas in which the SEC is working internationally to identify risks to the global markets, what regulatory responses might be desirable, and how to best coordinate such cross-border regulatory responses.

International Coordination Efforts

Since the financial crisis began, the G20 has identified major financial issues it believes should be addressed by the individual member jurisdictions to mitigate risks in the global financial system. As an independent agency, the SEC does not participate directly in G20 Leaders' or Finance Ministers' meetings, but we coordinate with our domestic and international counterparts who participate in these meetings to identify concerns in the global capital markets that are relevant to the work we do.

The G20 often asks other multilateral organizations to conduct in-depth studies of the concerns that impact the global financial markets, which have taken the form of surveying various approaches in different jurisdictions and developing broad policies or principles to guide regulatory authorities as they develop their own rules and regulations consistent with their unique national mandates.

In recent years, the Financial Stability Board (FSB) has played an increasingly active role in coordinating international efforts to implement G20 objectives. The FSB includes officials from banking supervisors and capital markets regulators around the globe, along with representatives from finance ministries and central banks and the international financial institutions, and aims to identify and discuss broad trends affecting the financial system.

Currently, I represent the SEC in the FSB. My colleagues from the Federal Reserve Board and the Department of the Treasury, Governor Tarullo and Under Secretary Brainard, respectively, also represent the United States in the FSB. The SEC staff regularly communicates with staffs of these agencies as well as the staffs of the Office of the Comptroller of the Currency, the Commodity Futures Trading Commission (CFTC), and the Federal Reserve Bank of New York in order to present unified positions in FSB policy discussions and working groups.

The G20 and, in turn, the FSB also seek input from other international bodies, including the International Organization of Securities Commissions (IOSCO) and other standard setters. I also serve as the SEC's Head of Delegation to IOSCO.

Due to the extensive international coordination efforts undertaken by the SEC and other U.S. financial regulatory agencies within the context of these international bodies, the recommendations and international standards being developed by these groups are broadly consistent with the Dodd-Frank Act and the G20 objectives.

The SEC also participates in multilateral discussions with regional authorities, and the SEC facilitates targeted, multilateral discussions with key jurisdictions on its highest priority topics. For example, the SEC is active in the Council of Securities Regulators of the Americas (COSRA) on issues of regional importance in the Americas.

We also recognize the need and value of holding discussions outside of the FSB and IOSCO with regulators from other jurisdictions. While bodies such as the G20, FSB, and IOSCO play an important role in the international policy dialogue, national regulatory bodies such as the SEC continue to exercise the authority granted to them in a manner that is necessary and appropriate to carry out their statutory missions and legislative mandates. International bodies, such as the G20, FSB, and IOSCO, neither legislate nor write governing rules; rather, mandates for regulation come from national authorities. In addressing the risks identified by the G20, all jurisdictions do not necessarily follow the same approach. Additionally, not all jurisdictions are members of the G20 and FSB. Within IOSCO, market regulators from around the world participate, but not all entities with the authority to shape relevant rules and regulations are members.

Because of the detailed nature of the discussions required or the country-specific nature of the issues involved, certain regulatory initiatives have proven to be managed more effectively in smaller forums or on a bilateral basis. To this end, the SEC has several ongoing bilateral dialogues with regulators in key international regulatory jurisdictions, including the United Kingdom, India, China, Korea, Turkey, and Japan.

These dialogues are intended to facilitate identification and discussion of common issues of regulatory concern, enhance enforcement cooperation, and, in some cases, expand on existing training and technical assistance efforts. The dialogues have taken on increasing importance as regulators around the globe engage in financial regulatory reform efforts in their respective jurisdictions.

For example, the SEC participates alongside the Department of the Treasury and the Federal Reserve Board in the Financial Markets Regulatory Dialogue (FMRD) with the European Union. The FMRD was created in 2002 as a forum to discuss regulatory initiatives in their early stages with a focus on avoiding unnecessary conflicts of law between the United States and the European Union. It has evolved into a vehicle for in-depth discussion of regulatory issues of mutual concern, enhancement of understanding of each other's regulatory systems, and exploration of areas of regulatory cooperation and convergence in the development of high-quality regulation.

OTC Derivatives

One area where international coordination is particularly important is reform of the global OTC derivatives markets. After the 2008 financial crisis, Congress recognized the need to bring transparency to these markets, and the G20 Leaders shared

this concern. At the Pittsburgh Summit in September 2009, the G20 Leaders called for global improvements in the functioning, transparency and regulatory oversight of OTC derivatives markets. Specifically, the G20 stated that:

> [a]ll standardized OTC derivative contracts should be traded on exchanges or electronic trading platforms, where appropriate, and cleared through central counterparties by end-2012 at the latest. OTC derivative contracts should be reported to trade repositories. Noncentrally cleared contracts should be subject to higher capital requirements. We ask the FSB and its relevant members to assess regularly implementation and whether it is sufficient to improve transparency in the derivatives markets, mitigate systemic risk, and protect against market abuse. [1]

In subsequent summits, the G20 Leaders have reiterated their commitment to OTC derivatives regulatory reform and have asked the FSB to monitor OTC derivatives reform progress.

Congress also recognized the need for coordination in this area and directed the SEC to consult with its foreign counterparts, as appropriate, in several key areas under Title VII of the Dodd-Frank Act. Specifically, the Dodd-Frank Act states that

> in order to promote effective and consistent global regulation of swaps and security-based swaps, the CFTC, the SEC, and the prudential regulators . . . , as appropriate, shall consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation (including fees) of swaps, securities-based swap, swap entities, and security-based swaps entities and may agree to such information-sharing agreements as may be deemed to be necessary or appropriate in the public interest or for the protection of investors, swap counterparties, and securities-based swap counterparties. [2]

The SEC and the CFTC have conducted staff studies to assess developments in OTC derivatives regulation abroad. For example, as directed by Congress in Section 719(c) of the Dodd-Frank Act, [3] on January 31, 2012, the SEC and CFTC jointly submitted to Congress a "Report on International Swap Regulation" (Swap Report). [4] The Swap Report discusses swap and security-based swap regulation and clearinghouse regulation in the Americas, Asia, and European Union and identifies areas of regulation that are similar and other areas of regulation that could be harmonized. The Swap Report also identifies major clearinghouses, clearing members, and regulators in each geographic area and describes the major contracts (including clearing volumes and notional values), methods for clearing swaps, and the systems used for setting margin in each geographic area. [5] In addition, on April 8, 2011, SEC and CFTC staff submitted a joint study to Congress on the feasibility of requiring the derivatives industry to adopt standardized computer-readable algorithmic descriptions which may be used to describe complex and standardized financial derivatives. [6] In preparing this report, staff coordinated extensively with international financial institutions and foreign regulators.

SEC and CFTC staff have also been working on a bilateral basis with counterparts from Canada, the European Union, Hong Kong, Japan, and Singapore to coordinate technical issues that are in the interest of leveling the playing field for the regulation of derivatives transactions. In December, leaders and senior representatives of the authorities responsible for the regulation of the OTC derivatives markets in these jurisdictions met in Paris to discuss significant cross-border issues related to the implementation of new legislation and rules governing the OTC derivatives markets, including concerns about possible regulatory gaps, conflicts, arbitrage, and duplication. In addition to agreeing to continue staff-level bilateral technical dialogues, the leaders are planning to meet again as a group this spring.

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[1] G20 Meeting, Pittsburgh, 25 September 2009. Available at *http://www.treasury.gov/resource-center/international/g7-g20/Documents/pittsburgh_summit_leaders_statement_250909.pdf.*

[2] Dodd-Frank Wall Street Reform and Consumer Protection Act §752 (Pub. L. 111-203, H.R. 4173) (2010).

[3] Dodd-Frank Wall Street Reform and Consumer Protection Act §719(c) (Pub. L. 111-203, H.R. 4173) (2010).

[4] Available at *http://www.sec.gov/news/studies/2012/sec-cftc-intlswapreg.pdf.*

[5] The Swap Report points out that major dealers could not be identified as of the date of the report because rules requiring swap dealers to register as such had not been adopted yet. Neither could any major swap exchanges be identified in the report as no exchange was offering swaps or security-based swaps for trading as of the date of the report.

[6] Available at *http://www.sec.gov/news/studies/2011/719b-study.pdf.*

We also have worked through multilateral organizations to facilitate further international cooperation. SEC staff represents IOSCO as a cochair of the FSB's OTC Derivatives Working Group (ODWG). The FSB published a report on implementing OTC derivatives market reforms in October 2010.[7] This report, which was endorsed by the G20 Leaders,[8] includes 21 recommendations addressing practical issues that authorities may encounter in implementing the G20 commitments concerning standardization, central clearing, exchange or electronic platform trading, and reporting OTC derivatives transactions to trade repositories. The ODWG conducts semi-annual reviews of jurisdictions' efforts to implement the G20 objectives for OTC derivatives reforms and submits reports on its findings to the G20.

In October 2010, IOSCO formed a Task Force on OTC Derivatives Regulation to take a leading role in coordinating market regulators' efforts to work together in the development of supervisory and oversight structures related to the derivatives markets. Representatives from the SEC, CFTC, United Kingdom Financial Services Authority (UK FSA), and the Securities and Exchange Board of India (SEBI) serve as cochairs of this Task Force. The Task Force was formed primarily to assist regulators in coordinating their derivatives legislative and regulatory reform efforts and in developing consistent regulatory standards, with a focus on derivatives clearing, trading, trade data collection and reporting, and the oversight of certain derivatives market participants.

In February 2011, the Task Force published a "Report on Trading of OTC Derivatives" (Report on Trading).[9] The Report on Trading sets out a framework for international regulators to consider when implementing the G20 Leaders' commitment to trade all standardized OTC derivatives on exchanges or electronic trading platforms, where appropriate, by the end of 2012. The Report on Trading analyzes the benefits, costs, and challenges associated with increasing exchange and electronic trading of OTC derivative products and contains recommendations aimed at assisting the transition of the trading of standardized derivatives products from OTC venues onto exchanges and electronic trading platforms (organized platforms) while preserving the efficacy of those transactions for counterparties. Following on that effort, earlier this year, the Task Force completed the "Follow-On Analysis to the Report on Trading", which describes the different types of organized platforms currently available for the execution of OTC derivatives transactions in IOSCO member jurisdictions and seeks to highlight the different approaches global regulators are taking or envisage taking to mandate the use of organized platforms for trading OTC derivatives.[10]

The Task Force also collaborated with the Basel-based Committee on Payment and Settlement Services (CPSS) to publish the "Report on OTC Derivatives Data Reporting and Aggregation Requirements" earlier this year (Data Report).[11] The Data Report specifies minimum requirements for the reporting of data to trade repositories and for trade repositories reporting to regulators, as well as types of acceptable data formats, and discusses issues relating to authorities' and reporting entities' access to data and the dissemination of OTC derivatives data to the public. The Data Report also describes data aggregation mechanisms and tools needed to enable authorities to aggregate data in a manner that fulfills their regulatory mandates, including methods, rationales and possible tools to implement data aggregation, such as legal entity identifiers. The Task Force plans to complete its work later this year when it finalizes reports setting forth international standards for mandatory clearing and the oversight of derivative market intermediaries.

Additionally, the SEC is working through IOSCO to review and improve international standards for financial market infrastructures. This project is a joint effort of IOSCO and the CPSS. In March 2011, CPSS–IOSCO issued a "Consultation Report on Principles for Financial Market Infrastructures" (FMI Report).[12] The FMI Report proposes new and more demanding international standards for systemically important payment systems, central securities depositories, securities and settlement systems, central counterparties and trade repositories (collectively, financial market infrastructures, or FMIs).

The new standards (referred to as principles) presented in the FMI Report are designed to ensure that the essential payment and settlements infrastructure sup-

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[7] Available at *http://www.financialstabilityboard.org/publications/r_101025.pdf.*

[8] G20 Leaders' Meeting, Seoul, Korea, 12 November 2010. Available at *http://www.treasury.gov/resource-center/international/Documents/1%20%20FINAL%20SEOUL%20COMMUNIQUE.pdf.*

[9] Available at *http://www.iosco.org/library/pubdocs/pdf/IOSCOPD345.pdf.*

[10] Available at *http://www.iosco.org/library/pubdocs/pdf/IOSCOPD368.pdf.*

[11] Available at *http://www.iosco.org/library/pubdocs/pdf/IOSCOPD366.pdf.*

[12] Available at *http://www.iosco.org/library/pubdocs/pdf/IOSCOPD350.pdf.*

porting global financial markets is more robust and better placed to withstand financial shocks. The FMI Report contains a comprehensive set of 24 principles designed to apply to all systemically important FMIs and five responsibilities for central banks, market regulators, and other relevant authorities. CPSS–IOSCO plans to publish the final report this spring.

Finally, given the global nature of the derivatives market, the SEC intends to address the international implications of its rules arising under Subtitle B of Title VII in a single proposal in order to give interested parties, including investors, market participants, and foreign regulators, an opportunity to consider as an integrated whole our approach to the registration and regulation of foreign entities engaged in cross-border security-based swap transactions involving U.S. parties. We understand that our approach to the cross-border application of Title VII must both achieve effective domestic regulatory oversight and reflect the realities of the global derivatives market. As we do so, the SEC is continuing to actively coordinate with our counterparts in other jurisdictions to help achieve consistency and compatibility among approaches to derivatives regulation.

Identification and Mitigation of Systemic Risk

A second area that requires robust international cooperation is the identification and mitigation of risks that could have cross-border impact on markets. The SEC has worked to enhance our capability to spot emerging issues and to address proactively these issues before they have the potential to cause serious harm to the U.S. financial markets and the global financial system. For example, we have open lines of communication with our international counterparts to discuss emerging risks and to promptly react to new developments. In addition, our bilateral efforts and work in multilateral organizations also give us insight into concerns faced by other jurisdictions.

The ability to collect and share compatible data is also essential to regulators' efforts to identify and mitigate systemic risk. An example of this information sharing is the Commission's work with other regulators, including the UK FSA and the Hong Kong Securities and Futures Commission, to develop an internationally agreed upon template that would form the basis for future data collection efforts to better understand the hedge fund industry.

We worked through IOSCO first, to survey the role of hedge funds in other markets and to develop high-level, international general principles for regulation of the hedge fund sector. The template was published in February 2010 and contains a list of broad proposed categories of information (with examples of potential data points) that regulators could collect for general supervisory purposes and to help in the assessment of systemic risk (including, for example, product exposure and asset class concentration, geographic exposure, liquidity information, extent of borrowing, and credit counterparty exposure).

After the Dodd-Frank Act was passed, we continued to work closely with the UK FSA, the EC, and the European Securities and Markets Authority (ESMA) to discuss cross-border issues that have emerged as we implemented Title IV, including the development of Form PF. At the same time we were developing Form PF, which was finalized on October 31, 2011,[13] ESMA was developing its data collection form, which was published on November 11, 2011, as part of ESMA's formal advice to the EC on implementation of its Alternative Investment Fund Managers Directive. Given that each regulator must develop its reporting requirements based on its unique mandates, policies, and objectives, the forms are understandably not exactly the same. Nevertheless, due to our extensive coordination efforts, the two forms generally are compatible and will facilitate international efforts to compare, aggregate, and learn from the data.

In addition to our bilateral coordination efforts, we have worked in multilateral organizations to ensure that future efforts to identify and mitigate risk will benefit from international coordination. For example, early last year, IOSCO published a discussion paper entitled "Mitigating Systemic Risk—A Role for Securities Regulators" (Systemic Risk Paper), which focused on the role securities regulators play in addressing systemic risk.[14] The Systemic Risk Paper was intended to promote discussion among securities regulators on the ways in which systemic risk intersects with their mandates and to provide insight on how IOSCO and its members can better identify, monitor, mitigate, and manage systemic risk. We are also playing a lead role in IOSCO's new Standing Committee on Risk Research, created to bring together economists from major market regulators to discuss these issues on a reg-

[13] Summary and final rule are available at *http://www.sec.gov/news/press/2011/2011-226.htm* and *http://www.sec.gov/rules/final/2011/ia-3308.pdf.*

[14] Available at *http://www.iosco.org/library/pubdocs/pdf/IOSCOPD347.pdf.*

ular basis. We continue to work internationally to facilitate dialogue about systemic risk among securities regulators as well as with the broader international regulatory community.

Volcker Rule

Section 619 of the Dodd-Frank Act, commonly referred to as the Volcker Rule, may also have international implications. The Volcker Rule generally prohibits a banking entity from engaging in proprietary trading and having certain interests in, or relationships with, a hedge fund or private equity fund (covered funds), subject to certain exemptions. The defined term "banking entity" determines the scope of entities subject to the Volcker Rule and includes any: (i) insured depository institution, (ii) company that controls an insured depository institution, (iii) foreign bank with a branch, agency or subsidiary in the United States, and (iv) affiliates and subsidiaries of the foregoing entities. The Commission proposed a rule jointly with the Federal banking agencies to implement the Volcker Rule in October 2011 (Proposed Rule), and the CFTC issued its proposal in January 2012.

In the Proposed Rule, the five regulatory agencies requested and received comment on several international issues. For example, the Proposed Rule, which closely follows statutory construction, includes an exemption for proprietary trading in certain U.S. and municipal Government obligations, but does not establish an additional exemption for proprietary trading in foreign Government obligations. Many commenters, including some foreign Governments, have requested that such an exemption be adopted and have expressed concerns about the proposed rule's potential impact on liquidity in foreign sovereign debt markets. Moreover, consistent with the statute's exemptive authority, some of these commenters have suggested ways that such an exemption would promote and protect the safety and soundness of banking entities and the financial stability of the United States. However, some commenters have indicated that such an exemption would not be necessary or would not meet such standards.

In addition, the proposal also includes the statutory exemptions for foreign banking entities' activities conducted "solely outside of the United States." The Proposed Rule sets forth certain requirements for these exemptions that are intended to give effect to the statutory language. Some commenters have stated that the exemption's requirements may result in unintended extraterritorial application of the Volcker Rule's restrictions on a foreign banking entity's offshore activity. The proposed definition of "covered funds" also includes certain non-U.S. funds, and this may have international implications. In an effort to prevent circumvention of the Volcker Rule's general prohibition on covered fund activities by simply relocating covered fund-related activities offshore, the proposal defined "covered fund" to include certain types of non-U.S. funds. Some commenters have stated that this definition may be too broad and could include foreign retail mutual funds or other types of regulated pooled investment vehicles.

Commission staff is reviewing and considering the comment letters that we have received on this proposal, including comments on the international implications of the Proposed Rule. I anticipate that staffs of the five regulatory agencies will have in-depth discussions about these topics as they work together through the next steps of the rulemaking process.

Market Efficiency and Integrity

A fourth area where we and our foreign counterparts have an interest is market efficiency and integrity. In early 2010, the SEC issued a Concept Release on Equity Market Structure to begin an in-depth review to ensure that the U.S. equity markets remain fair, transparent and efficient in light of new technology and trading strategies.[15] Not surprisingly, many other jurisdictions face similar challenges. The rapid developments in trading technologies and trading platforms have had a profound impact on the structure of markets around the world.

As we have considered these issues, the EC also has been reviewing its Markets in Financial Instruments Directive (MiFID) in light of new technology, and in October 2011, the EC issued proposals to amend MiFID, focusing on developing safeguards for algorithmic and high frequency trading activities. Throughout this process, we have had ongoing discussions with our international counterparts.

On October 14, 2011, Chairman Schapiro and her regulatory counterparts in Europe, the Americas, Asia, and Australia spent a full day discussing the impact of advances in technology, new trading strategies, and the increasing integration and globalization of markets as part of an international roundtable of regulators that the SEC cohosted with the UK FSA in London. The discussion focused on sharing views

[15] Available at *http://www.sec.gov/rules/concept/2010/34-61358fr.pdf.*

about automated trading strategies, high frequency trading, market fragmentation, and dark pools.

Last year, the SEC also adopted a large trader reporting system, providing us with access to better data to help us assess the impact of high frequency traders and other major market participants on the quality of our markets, as well as to assist in our surveillance and enforcement efforts.[16] In addition, we are continuing to work toward the adoption of a consolidated audit trail system to further help regulators keep pace with new technology and trading patterns in the markets.[17] As we utilize and develop new tools, we are also coordinating with our international counterparts to share knowledge and develop complementary strategies that will ultimately facilitate the sharing of information for supervisory and enforcement purposes.

To that end, SEC staff also is engaged actively with IOSCO to address the continuing challenges that technological changes pose for regulators in their market surveillance, including: the fragmentation of markets and the resulting dispersal of trading information; the increased speed of trading; and regulators' ability to gather and process the increased volume of trading data.

In addition, in the fall of 2010, the G20 Leaders asked IOSCO to develop "recommendations to promote markets' integrity and efficiency to mitigate the risks posed to the financial system by the latest technological developments." In response, IOSCO undertook a review of global perspectives on the impact of technological developments, including work on trading halts, direct electronic access, dark liquidity, and high frequency trading. In April 2011, IOSCO published principles to assist regulators in minimizing the potential adverse effects of the increased use of dark liquidity, focusing on transparency and price discovery, market fragmentation, knowledge of trading intentions, fair access, and the ability to assess actual trading volume in dark pools.

In October, IOSCO published the "Report on Regulatory Issues Raised by the Impact of Technological Changes on Market Integrity and Efficiency" (Technological Changes Report).[18] The Technological Changes Report analyzes significant technological developments and related microstructural issues that have arisen in financial markets in recent years, notably high frequency trading, and their impact on market structure, participants' behavior, price discovery and formation, and the availability and accessibility of liquidity. In addition, the Technological Changes Report recognizes the benefits of technology, including facilitating the establishment of globally competitive markets, enabling market participants to reduce transaction time, generation of electronic audit trails, enhancement of order and trade transparency, enabling markets and market participants to develop and apply (and regulators to monitor) automated risk controls.

Supervisory Cooperation

Another key priority for the G20 is increasing the effectiveness of global supervision of financial institutions and other market participants. In a world with interconnected markets and actors with cross-border operations, more effective supervision will require increased international supervisory cooperation.

The SEC has long recognized the importance of international cooperation to its own supervisory mission, especially in our examination program. The SEC staff has been developing arrangements and, where possible, entering into formal Memoranda of Understanding (MOUs), to facilitate supervisory cooperation with foreign regulators. These agreements generally establish clear mechanisms for consultation, cooperation and the exchange of supervisory information. Such mechanisms minimize the need to address supervisory information sharing on an ad hoc basis and seek to address new information sharing needs created by globally active firms and cross-border affiliated markets.

The SEC's supervisory cooperation agreements can vary in scope and purpose. To date, the SEC has entered into bilateral MOUs that cover information sharing and cooperation related to, among other things, firms registered with both the SEC and a foreign authority; the oversight of markets in the U.S. and a foreign jurisdiction affiliated through common ownership structure; and the sharing of nonpublic issuer specific information relating to the application of International Financial Reporting Standards.

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[16] *See,* Securities Exchange Act Release No. 64976 (July 27, 2011), 76 FR 46960 (August 3, 2011).

[17] *See,* Securities Exchange Act Release No. 62174 (May 26, 2010), 75 FR 32556 (June 8, 2010).

[18] *See, http://www.iosco.org/library/pubdocs/pdf/IOSCOPD361.pdf*

This month, the SEC entered in a supervisory MOU with the Cayman Islands Monetary Authority (CIMA) Concerning Consultation, Cooperation and the Exchange of Information Related to the Supervision of Cross-Border Regulated Entities (CIMA MOU). The CIMA MOU covers those entities that are regulated by the SEC and the CIMA and operate or provide services across our respective borders. It also sets forth the terms and conditions for the sharing of information regarding regulated entities, such as broker-dealers and investment advisers. The scope of the CIMA MOU is broad, allowing our cooperation to evolve and adapt to a changing regulatory landscape and covers not only regulated entities that currently operate on a cross-border basis, but also those that may come under our respective jurisdictions in the future.

In September 2011, the SEC entered into an expanded supervisory MOU with its Canadian counterparts. The Canadian MOU is a comprehensive arrangement that will help to facilitate the supervision of regulated entities that operate across the U.S.–Canadian border. The SEC and Canadian provincial securities authorities have a long history of cooperation, particularly in securities enforcement matters. The Canadian MOU extends this cooperation beyond enforcement by establishing a framework for consultation, cooperation, and information sharing related to the day-to-day supervision and oversight of regulated entities. The supervision of regulated entities is critical to encouraging compliance with the securities laws, which in turn helps to protect investors and the securities markets generally.

The SEC is also actively engaging its regulatory counterparts abroad to develop new supervisory cooperation tools. For example, the SEC and the European Securities Markets Authority recently concluded an MOU that would allow us to share information regarding the oversight of credit rating agencies that are registered in both our markets. The MOU lays out the processes by which we could conduct examinations of the offices of credit rating agencies located in each other's jurisdictions. In addition, the MOU provides a clear mechanism by which the SEC and ESMA staffs can share observations about the compliance cultures of registered credit rating agencies to better inform both agencies.

The SEC also has comprehensive supervisory MOUs with the securities regulators in the United Kingdom, Germany, and Australia, as well as several tailored arrangements and protocols for information sharing with other regulators.[19] Under these agreements, SEC staff is increasingly able to obtain and exchange documents and information about cross-border regulated entities and globally active market participants. SEC staff has also conducted many on-site examinations of SEC registrants located overseas in cooperation with foreign authorities. These types of arrangements improve our ability to share information at the operational level and to have frank, open discussions with our counterparts abroad about the entities we regulate, such as broker-dealers and investment advisers.

To complement our bilateral supervisory cooperation efforts, the SEC worked within IOSCO to establish a Task Force on Supervisory Cooperation. This SEC-led task force developed principles for supervisory cooperation and a model MOU that was endorsed by IOSCO's Technical Committee and published in 2010.[20] The model MOU was designed to assist securities regulators in building and maintaining cross-border cooperative relationships with one another and has proven helpful in our ongoing efforts to expand the number of bilateral agreements focused on supervision.

With the SEC's authority under the Dodd-Frank Act to supervise additional market participants such as hedge fund advisers, security-based swaps dealers, and major security-based swaps participants, SEC staff will seek to expand its cooperative networks with foreign counterparts on supervisory matters. We also anticipate that the FSB and IOSCO will continue to consider ways to improve international supervisory cooperation, and we will continue to work in these multilateral forums to support our bilateral efforts and fulfill our supervisory mission.

In addition to enhancing our ability to oversee registrants that operate cross-border, SEC staff has assisted other U.S. regulators in carrying out their mandates. As you know, the SEC also has oversight responsibilities for the Public Company Accounting Oversight Board (PCAOB), which oversees both foreign and domestic public accounting firms that audit U.S. public companies. The Commission continues to work closely with the PCAOB on efforts to achieve meaningful inspection of PCAOB registered firms overseas.

Unfortunately, at the present time, the PCAOB is unable to conduct inspections in a number of European countries, as well as the People's Republic of China. While the PCAOB continues its efforts to enable inspections of registered firms to be con-

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[19] *See,* Cooperative Arrangements With Foreign Regulators at *http://www.sec.gov/about/offices/oia/oia_cooparrangements.shtml.*

[20] Available at *http://www.iosco.org/library/pubdocs/pdf/IOSCOPD322.pdf.*

ducted in these countries, the Board has taken a number of interim steps to help protect investors. These steps include regularly publishing information that provides transparency around the status of firms' ability to be inspected, such as the jurisdictions that are not allowing PCAOB inspections, the firms that are overdue for inspections and are in jurisdictions that will not allow those inspections to go forward, as well as a list of companies whose audit firms have not been inspected by the PCAOB. In addition, the PCAOB has reevaluated its approach to considering registration applications from firms in jurisdictions where the PCAOB is unable to conduct inspections. The inability to conduct inspections can and has resulted in the PCAOB determining to disapprove a registration application. The PCAOB continues to work, with SEC support and at the urging of the Commission, to achieve the goal of accomplishing meaningful oversight of registrant firms wherever they may be.

Enforcement Cooperation

Finally, the cornerstone of any effective regulatory regime is its enforcement. In global markets, bad actors can wreak havoc both at home and abroad, and the proceeds of their violations can and do move throughout our global marketplace. No matter how robust and coordinated global regulation and supervision may be, if those rules are not enforced, or if investors are not confident that the markets are fair, the global financial system will not function efficiently. The SEC has over 35 bilateral MOUs with its counterparts for information sharing for enforcement purposes. These agreements vary in scope, but generally allow for broad information sharing, including provisions for assistance with locating individuals of interest and conducting testimony abroad.

While international enforcement cooperation has long been important to our mission, and many of our enforcement cooperation agreements are now more than 20 years old, I want to highlight our international enforcement cooperation for two reasons. First, now more than ever, it is essential to the success of our enforcement program. Last year, nearly 30 percent of the SEC's enforcement cases had an international element that required the agency to reach out to foreign authorities. As just one example, in a major insider trading case where we charged a doctor in France with tipping a U.S. hedge fund manager about clinical drug trials, the French Autorité des marchés financiers (AMF) accomplished the important task of helping us obtain bank records, phone records, and compelled testimony—key evidence crucial to our success in the case.[21]

During fiscal year 2011, the SEC made 772 formal requests to foreign authorities for enforcement assistance, and frequently conducted informal discussions with our partners about investigations with cross-border elements. Importantly, our cooperation is not one-way; in the same year, the SEC responded to 492 requests from abroad. We are less than halfway through FY2012 and are well on track to meet or exceed these record numbers yet again.

Second, our international enforcement cooperation efforts also illustrate the efficacy of the multifaceted international coordination strategies we employ. In May 2002, IOSCO developed a Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information (MMoU). The MMoU is a multilateral enforcement information-sharing and cooperation arrangement. It provides an international benchmark for the types of information securities regulators should have authority to share as well as the terms under which information sharing should occur. The MMoU provides a baseline as to what is expected of a regulator in order to cooperate fully in global efforts to combat securities fraud. When a jurisdiction applies to become a signatory, IOSCO conducts a rigorous review to assess the jurisdiction's ability to fulfill its obligations under the MMoU.

This multilateral effort also has expanded significantly the number of securities regulators who have the ability to gather information and share information with the SEC for enforcement investigations and proceedings. The international pressure on nonsignatory jurisdictions increased after the financial crisis, when IOSCO set a goal of January 1, 2013, for all of its members to acquire the powers and authorities necessary to become full signatories to the MMoU. As of the 2011 IOSCO Annual Meeting, over 80 securities regulatory authorities have become signatories to the MMoU, and another 30 have made the necessary commitment to seek national legislative changes to allow them to do so by the 2013 deadline.

Similarly, the FSB is actively encouraging global cooperation in information sharing. In 2010, the FSB launched an initiative to encourage the adherence of all coun-

[21] *SEC v. Yves Benhamou,* Lit. Rel. No. 21721 (November 2, 2010), available at *http://www.sec.gov/litigation/litreleases/2010/lr21721.htm; see,* also related action *SEC v. Joseph "Chip" Skowron* Lit. Rel. No. 22158 (November 17, 2011), available at *http://www.sec.gov/litigation/litreleases/2011/lr22158.htm.*

tries and jurisdictions to international cooperation and information exchange standards. As part of this initiative, the FSB reviewed the policies and practices of 61 jurisdictions to evaluate and rate compliance with international cooperation and information exchange standards. This past November, the FSB published the results of its review, including the names and categories of the evaluated jurisdictions. The United States was referenced as a jurisdiction demonstrating sufficiently strong adherence.

In addition to participating in multilateral efforts to raise standards for cooperation, the SEC has a long-standing commitment to training foreign regulatory and law enforcement officials in enforcement strategies and techniques. Every fall, we hold an International Enforcement Institute (Enforcement Institute), a flagship event for securities enforcement professionals worldwide that provides an excellent opportunity to develop important relationships with our counterparts, while serving to strengthen their capacity to conduct effective enforcement in their respective jurisdictions. Similarly, we also host an annual International Institute on Securities Market Development, which is a key part of our efforts to strengthen global capital markets and lays a strong foundation for bilateral engagement around the world. In addition to these successful outreach efforts, we continue to work bilaterally and regionally to provide technical assistance to regulators around the world in many topic areas.

Finally, I want to highlight one of the SEC's major current efforts focused in the enforcement arena, the Cross-Border Working Group, an interdivisional team that brings various experiences and expertise to address risks associated with U.S. issuers whose primary operations are located overseas. This team emerged out of an SEC proactive risk-based inquiry into U.S. audit firms with a significant number of issuer clients with primarily foreign operations. That inquiry revealed serious accounting irregularities among certain U.S. issuers based abroad. The efforts of this group have resulted in a wide array of actions to protect U.S. investors, including suspending trading in at least 20 foreign-based entities because of deficiencies in information about the companies, instituting stop orders against foreign-based entities to prevent further stock sales under materially misleading and deficient offering documents, revoking the securities registration of at least a dozen foreign-based issuers, and instituting administrative proceedings to determine whether to suspend or revoke the registrations of 27 more. The majority of issuers in the United States whose operations are primarily overseas are located in the PRC region; accordingly, most of these actions have involved companies based in China. The Cross-Border Working Group's endeavors also extend outside of the enforcement area and include reaching across borders to enhance cooperation with SEC counterparts.

Conclusion

Our ability to develop shared objectives and cooperative relationships with our counterparts abroad is a critical part of our mission, and increasingly more so every year. Since the 2008 financial crisis, through the SEC's work in the FSB and IOSCO, participation in bilateral dialogues, and discussions with SEC staff who work on these issues on a day-to-day basis, I have observed a reinvigorated global commitment to the core objectives shared by securities regulators: protecting investors; promoting fair, efficient, and transparent markets; and facilitating capital formation to fuel global economic growth. However, shared objectives alone are not sufficient. We must also pursue a shared commitment to work together to identify compatible regulatory approaches in pursuit of those objectives. The SEC works tirelessly to pursue such commitment through cooperation with counterparts throughout the international regulatory landscape and will continue to pursue and promote international cooperation.

Thank you for the opportunity to testify today on this important set of issues. I am happy to answer any questions you may have.

PREPARED STATEMENT OF MARTIN J. GRUENBERG

ACTING CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

MARCH 22, 2012

Good morning Chairman Johnson, Ranking Member Shelby, and Members of the Committee. Thank you for the opportunity to testify on international harmonization issues related to Wall Street reform.

The financial crisis of 2008 exposed a number of serious vulnerabilities in the U.S. financial system and in other financial systems around the world. In the years leading up to the crisis, misaligned incentives, excessive leverage and risk taking, and gaps in regulation all contributed to a serious and, at the time, unrecognized in-

crease in systemic risk. The financial crisis that followed in 2008–09 led to the most severe economic downturn since the 1930s.

In the immediate wake of the financial crisis, the Group of Twenty (G20) Nations, through the Financial Stability Board, jointly resolved to strengthen financial regulation across jurisdictions and enhance cross-border cooperation among financial regulators.[1] This broad-based commitment to reform recognized both the highly interconnected nature of the global financial system and the enormous economic costs of the financial crisis. The intended result is to reduce the likelihood and severity of future financial crises, and to enhance the effectiveness of the international regulatory response should crises occur. As implementation of the Dodd-Frank Act proceeds in the United States, the FDIC continues to work with our international counterparts to undertake reforms that will be needed for a stronger and more stable global financial system in the future.

My testimony today will discuss three key areas where the postcrisis implementation of financial reforms in the United States have an important international component: (1) the cross-border resolution of large, systemically important financial institutions; (2) capital standards; and (3) capital market reforms.

Cross-Border Resolution of Large, Systemically Important Financial Institutions (SIFIs)

Section 210 of the Dodd-Frank Act requires the FDIC to "coordinate, to the maximum extent possible" with appropriate foreign regulatory authorities in the event of a resolution of a covered financial company with cross-border operations. The FDIC has been working diligently on both multilateral and bilateral bases with our foreign counterparts in supervision and resolution to address these crucial cross-border issues.

The FDIC has participated in the work of the Financial Stability Board through its membership on the Resolution Steering Group, the Cross-border Crisis Management Group and a number of technical working groups. The FDIC also has co-chaired the Basel Committee's Cross-border Bank Resolution Group since its inception in 2007.

Key Attributes

In October 2011, the Financial Stability Board released "Key Attributes of Effective Resolution Regimes for Financial Institutions". The Key Attributes build on the set of recommendations developed by the Cross-border Bank Resolution Group that were published in March 2010 following its assessment of lessons learned during the crisis. The Key Attributes set out the parameters of a legal and regulatory regime that would allow authorities to resolve financial institutions in an orderly manner without taxpayer exposure to loss while maintaining continuity of vital economic functions. They address such critical issues as the scope and independence of the resolution authority, the essential powers and authorities that a resolution authority must possess, and how jurisdictions can facilitate cross-border cooperation in resolutions of significant financial institutions. The Key Attributes also provide guidelines for how jurisdictions should develop recovery and resolution plans for specific institutions and for assessing the resolvability of their institutions. The FDIC was deeply involved in the development of the Key Attributes and many of them parallel the provisions of the U.S. resolution regime under Title II of the Dodd-Frank Act. The United States has been recognized for its leadership in developing a credible resolution process for large nonbank financial companies.

In November 2011, the G20 endorsed the Key Attributes. As a result, financial regulators from the G20 member Nations are required to move toward a resolution framework to resolve SIFIs in an orderly manner that protects global financial stability. A methodology to assess countries' progress toward implementing the Key Attributes is now under development.

Crisis Management Groups

The FDIC and its U.S. and foreign financial regulatory counterparts have formed Crisis Management Groups under the auspices of the Financial Stability Board for each of the internationally active SIFIs (termed Global SIFIs or G–SIFIs) identified by the G20 at their November 4, 2011, meeting. These Crisis Management Groups, consisting of both home and host country authorities, are intended to enhance institution-specific planning for possible future resolution. These groups allow regulators

[1] The G20 is comprised of the finance ministers and central bank governors from 19 countries (including the United States) and the European Union, with representatives of the International Monetary Fund and the World Bank. Collectively, the countries represent more than 80 percent of the global gross national product.

to identify impediments to a more effective resolution based on the unique characteristics of a particular financial company.

The FDIC has participated in Crisis Management Group meetings hosted by authorities in various foreign jurisdictions. These meetings have focused on crisis management, recovery and resolution planning, and implementation issues associated with G–SIFIs from those jurisdictions. The FDIC has also hosted Crisis Management Group meetings for the five largest U.S. G–SIFIs and met with specific foreign regulators to discuss the progress these firms have made on their recovery and resolution plans as well as other related cross-border issues. The Crisis Management Group meetings have provided opportunities for the exchange of information on resolution planning and policy. We expect these meetings to assist the FDIC in developing and refining its resolution strategies for G–SIFIs and to help regulators in identifying and overcoming impediments to resolution, particularly with respect to cross-border issues.

FDIC Bilateral Discussions and Agreements

Since G–SIFIs present complex international legal and operational issues, the FDIC is also actively reaching out on a bilateral basis to the foreign supervisors and resolution authorities with jurisdiction over the foreign operations of key U.S. firms. The goal is to be prepared to address issues regarding cross-border regulatory requirements and to gain an in-depth understanding of cross-border resolution regimes and the concerns that face our international counterparts in approaching the resolution of these large international organizations. As we evaluate the opportunities for cooperation in any future resolution, and the ways that such cooperation will benefit creditors in all countries, we are forging a more collaborative process as well as laying the foundation for more reliable cooperation based on mutual interests in national and global financial stability.

It is worth noting that although U.S. SIFIs have foreign operations in dozens of countries around the world, those operations tend to be concentrated in a relatively small number of key foreign jurisdictions, particularly the United Kingdom (UK). While the challenges to cross-border resolution are formidable, they may be more amenable than is commonly thought to effective management through bilateral cooperation.

The focus of our bilateral discussions is to: (i) identify impediments to orderly resolution that are unique to specific jurisdictions and discuss how to mitigate such impediments through rule changes or bilateral cooperation and (ii) examine possible resolution strategies and practical issues related to implementation of such strategies with respect to particular jurisdictions. This work entails gaining a clear understanding of how U.S. and foreign laws governing cross-border companies will interact in any crisis. Our initial work with foreign authorities has been encouraging. In particular, the U.S. financial regulatory agencies have made substantial progress with authorities in the UK in understanding how possible U.S. resolution structures might be treated under existing UK legal and policy frameworks. We have engaged in in-depth examinations of potential impediments to efficient resolutions and are, on a cooperative basis, in the process of exploring methods of resolving them.

To facilitate bilateral discussions and cooperation, the FDIC is negotiating the terms of memoranda of understanding pertaining to resolutions with regulators in various countries. These memoranda of understanding will provide a formal basis for information sharing and cooperation relating to our resolution planning and implementation functions under the legal framework of the Dodd-Frank Act.

Resolution Planning Progress in the United States and Impact on Foreign Banking Organizations

In the United States, we are far along in the process of implementing the SIFI resolution provisions of the Dodd-Frank Act. We issued a final rule on our Title II orderly liquidation authority (OLA) in July 2011, and a joint final rule with the Board of Governors of the Federal Reserve System (Federal Reserve Board) on Title I financial company resolution plans in November 2011. These combined provisions give the FDIC new authorities and responsibilities for planning and implementing the orderly liquidation of a SIFI.

Since the enactment of the Dodd-Frank Act in 2010, the FDIC has been developing detailed resolution plans pursuant to our Title II resolution authorities. In addition, Title I of the Dodd-Frank Act requires SIFIs to submit resolution plans for review by the FDIC and the Federal Reserve Board. These plans detail how the firms could be resolved under the U.S. Bankruptcy Code. The FDIC would act under the Dodd-Frank Title II orderly liquidation authority only where the necessary parties agree that resolution under the Bankruptcy Code would have serious adverse

effects on U.S. financial stability. If the firms are successful in their resolution planning, the likelihood of such action would be greatly reduced.

Similar to its application to U.S. based G–SIFIs, Section 165(d) of the Dodd-Frank Act requires foreign banking organizations (FBOs) with $50 billion or more in total consolidated assets to submit resolution plans. However, the plans submitted by the FBOs and any other specified foreign-based covered companies will focus their information and strategic analysis upon the firms' U.S. operations.

Submission of resolution plans will be staggered based on the asset size of a covered financial company's U.S. operations. Financial companies with $250 billion or more in U.S. nonbank assets must submit plans on or before July 1, 2012. All of the SIFIs in this initial group have been designated G–SIFIs by the Financial Stability Board. Companies with $100 to $250 billion in total U.S. nonbank assets must submit plans on or before July 1, 2013; and all other covered financial companies must submit plans on or before December 31, 2013. A company's plan is required to be updated annually or as directed by the FDIC and the Federal Reserve Board.

As with U.S. G–SIFIs, FBOs are to submit their plans in phases according to the size of their U.S. nonbank assets. Thus, FBOs with a U.S. footprint of $250 billion or more in U.S. nonbank assets will be required to submit plans by July 1, 2012. Those having $100 billion or more in U.S. nonbank assets will be required to submit plans by July 1, 2013, and the remaining covered FBOs will submit their plans by December 31, 2013.

If a resolution plan does not meet the statutory standards, after affording the covered company an opportunity to remedy its deficiencies, the agencies may jointly decide to impose more stringent regulatory requirements—such as increased liquidity requirements or limits on credit exposures—on the covered company. Further, after 2 years following the imposition of the more stringent standards, if the resolution plan still does not meet the statutory standards, the FDIC and the Federal Reserve Board may—in consultation with the Financial Stability Oversight Council (FSOC)—direct a covered financial company to divest certain assets or operations.

In addition, in January 2012, the FDIC issued a final rule requiring any FDIC-insured depository institution with assets of $50 billion or more to develop, maintain, and periodically submit contingency plans outlining how depository institutions could be resolved under the FDIC's traditional authority in 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 requirements are designed to ensure comprehensive and coordinated resolution planning for the insured depository institution, its holding company and any affiliates in the event that an orderly liquidation is required. Both of these requirements will improve efficiencies, risk management and contingency planning at the institutions themselves. The process of developing resolution plans also provides the FDIC important information for the refinement of our potential resolution strategies for SIFIs under the OLA.

FSOC Joint Rulemaking and Guidance on SIFI Designations

While all bank holding companies with more than $50 billion in assets are automatically designated as SIFIs by the Dodd-Frank Act, the Act also authorized the FSOC to determine whether a nonbank financial company is systemically important. The FDIC has been working with the other FSOC members to finalize the rule and interpretative guidance to implement this authority. When the rule and guidance are finalized, which is expected in the near future, the FSOC will begin the process of evaluating nonbank financial companies to determine whether material financial distress at one or more of them would pose a threat to the financial stability of the United States. The nonbank designation rule applies to U.S. nonbank financial companies and to foreign nonbank financial companies operating in the United States. Once designated as a SIFI, a nonbank financial company will be subject to all the supervisory and resolution requirements that apply to systemically important bank holding companies.

Improvements in Capital Standards

In the aftermath of the financial crisis, there has been an intensive international effort to strengthen bank capital standards. The result of these efforts is the Basel III capital agreement. In broad terms, the Basel III capital standards aim to improve the quality and increase the level of bank capital. Collectively, Basel III and other standards published by the Basel Committee address a number of features of capital regulation that allowed for an excessive use of leverage in the years leading up to the crisis. There are a number of such issues that are being addressed by Basel III and in a complementary way by the Dodd-Frank Act.

One of the lessons of the crisis was that high quality, loss-absorbing capital is essential to ensuring the safety and soundness of financial institutions. Basel III addresses this by establishing regulatory capital as "common equity tier 1." This results in a measure that is much closer to pure tangible common equity than the present tier 1 definition. Meeting regulatory requirements for common equity tier 1 capital will provide a much more realistic and meaningful assurance of a bank's ability to absorb losses.

In addition to the definition and quality of capital, Basel III also addresses the level of capital. At the beginning of the crisis, as today, the minimum tier 1 risk-based capital requirement was 4 percent of risk-weighted assets. Tier 1 capital was required to be "predominantly" equity. Thus, equity could comprise as little as 2 percent of risk-weighted assets.

Basel III increases the numerical minimum risk-based capital ratios. For the new concept of common equity tier 1, the Basel III minimum ratio is 4.5 percent of risk-weighted assets. For tier 1 and total capital the Basel III minimums are 6 percent and 8 percent, respectively. Capital buffers comprising common equity equal to 2.5 percent of risk-weighted assets are added to each of these minimums to enable banks to absorb losses during a stressed period while remaining above their regulatory minimum ratios.

Basel III also includes a "countercyclical buffer" intended to act as a stabilizer against significant asset bubbles as they develop. Specifically, regulators could increase the capital buffers by up to an additional 2.5 percent if they deem the economy to be in a period of excessive credit creation.

Basel III establishes, for the first time, an international leverage ratio. The Basel III leverage ratio is an important tool to ensure that capital exists to cover losses that the risk-based rules may categorize as minimal, but that can sometimes materialize anyway. The Basel Committee has also agreed that the largest internationally active banks should be subject to additional capital charges ranging from 1 percent to 2.5 percent of riskweighted assets to account for the additional risk they pose to the financial system should they experience difficulties.[2]

In addition, to strengthen capital standards for trading book risk, the U.S. banking agencies issued a Notice of Proposed Rulemaking (NPR) in January 2011, to implement important reforms agreed to by the Basel Committee. These reforms will increase capital requirements to levels more appropriate for trading book assets. A second Market Risk NPR was issued in December 2011 to respond to section 939A of the Dodd-Frank Act. This NPR provides an alternative to credit ratings in computing trading book capital requirements. We are committed to working with our fellow regulators to finalize the important reforms to trading book capital requirements as soon as possible upon reviewing and appropriately addressing the public comments we receive.

The Basel Committee agreed that Basel III would be phased-in over a 5-year period starting in 2013, and the banking agencies are drafting an NPR to implement Basel III in the United States. We believe that most U.S. banks currently hold sufficient capital to meet the Basel III capital standards. Banks that need more time by and large appear well positioned to meet the standards far ahead of the Basel timeline and mostly with retained earnings. Now that agreement has been reached on a more robust international capital standard, it is vital that the standard be implemented in a uniform manner. A comprehensive monitoring framework will be coordinated by the Basel Committee's Standards Implementation Group and will rely on peer reviews. It entails a review of members' domestic adoption and implementation timelines for the Basel regulatory capital framework.

Capital Market Reforms in the Dodd-Frank Act

Beyond the development of an effective resolution regime for SIFIs, and the capital reforms of Basel III, two provisions of the Dodd-Frank Act with potential international implications are Section 619, relating to proprietary trading, and the margin and capital requirements for over-the-counter derivatives found in Title VII.

The Volcker Rule

Section 619 of the Dodd-Frank Act, known as the Volcker Rule, is designed to strengthen the financial system and constrain the level of risk undertaken by firms that benefit, either directly or indirectly, from the Federal safety net provided by Federal deposit insurance or access to the Federal Reserve's discount window. The Volcker Rule prohibits proprietary trading by banking organizations and limits investments in hedge funds and private equity funds that they organize and offer,

[2] The Basel Committee also established an "empty bucket" with a 3.5 percent additional capital charge designed to discourage banks from becoming more systemic.

subject to certain exemptions for such permissible banking activities as underwriting, market making, and risk-mitigating hedging.

The challenge for regulators in implementing the Volcker Rule is to prohibit the types of proprietary trading and investment activity that Congress intended to limit, allowing banking organizations to provide legitimate intermediation in the capital markets and maintain market liquidity.

Last November, the FDIC, jointly with the Federal Reserve Board, the Office of the Comptroller of the Currency (OCC), and the Securities and Exchange Commission (SEC), published an NPR requesting public comment on a proposed regulation implementing the Volcker Rule requirements. On December 23, 2011, the agencies extended the comment period for an additional 30 days until February 13, 2012. The comment period was extended as part of an interagency effort to allow interested persons more time to analyze the issues and prepare their comments, and to facilitate coordination of the rulemaking among the responsible agencies.

The agencies have received a significant number of comments from international banking organizations and foreign financial services regulators regarding concerns about the potential extraterritorial reach of the Volcker Rule and the proposed regulations. Commentators have raised concerns about the proposed regulation's potential effects on foreign sovereign debt markets, the ability of foreign organizations to continue to utilize U.S. market infrastructure, and the difficulties associated with properly distinguishing permissible foreign funds from impermissible funds. The agencies are in the process of reviewing and carefully considering all of the comments received as we work toward the development of a final regulation.

As of February 13, 2012, the agencies had received approximately 17,500 comment letters from a wide variety of stakeholders. The FDIC is committed to developing a final rule that meets the objectives of the statute while preserving the ability of banking entities to perform important underwriting and market-making functions, including the ability to effectively carry out these functions in less-liquid markets.

Margin and Capital Requirements for Covered Swap Entities

In June 2010, the G20 leaders reaffirmed a global commitment to clearing standardized OTC derivatives through a clearinghouse, and this commitment was incorporated into the Dodd-Frank Act. For derivatives that lack sufficient standardization for clearing, the Dodd-Frank Act requires dealers and major participants in such transactions to register with the Commodities Futures Trading Commission or SEC, as applicable. The Dodd-Frank Act also requires the prudential regulators—the FDIC, the Federal Reserve Board, the OCC, the Farm Credit Administration, and the Federal Housing Finance Agency—to jointly adopt margin requirements for uncleared OTC derivatives entered into by entities they regulate that also fall within the Dodd-Frank Act's dealer and major participant terms. In May 2011, the prudential regulators published an NPR proposing these margin requirements and have received numerous comments that are being carefully considered.

Since the issuance of the NPR, the Federal Reserve Board has initiated an effort to develop an international convergence in margin requirements for uncleared OTC derivatives and has asked the Basel Committee, in conjunction with the International Organization of Securities Commissions, to develop a consultation document by June 2012. Staffs from the FDIC and the other banking agencies are actively participating in the Working Group on Margin Requirements initiative. In order to reduce competitive concerns, the agencies intend to take into consideration, to the extent possible, the margin recommendations in the consultative document in the development of a final uncleared OTC derivative margin rule.

Conclusion

Today's testimony highlights the work of the FDIC, in conjunction with other U.S. regulators and our international counterparts, to improve resolution and regulatory regimes for the global financial system. As the global reach of the financial crisis made clear, cross-border cooperation and harmonization are essential for effective implementation of reforms. The FDIC is committed to working with our fellow Federal agencies as well as our foreign counterparts to achieve this important goal.

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

PREPARED STATEMENT OF JOHN G. WALSH

ACTING COMPTROLLER, OFFICE OF THE COMPTROLLER OF THE CURRENCY

MARCH 22, 2012

Chairman Johnson, Ranking Member Shelby, and Members of the Committee, I appreciate the opportunity to provide the Committee with the Office of the Comptroller of the Currency's (OCC) perspectives on the international implications of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) and on efforts currently underway to harmonize U.S. regulatory requirements with international standards and frameworks for the financial services sector.* In particular, the Committee's letter of invitation requests that I testify about areas of reform that have international implications, such as orderly liquidation authority, derivatives oversight, and the prohibitions on proprietary trading and private equity and hedge fund investments commonly known as the Volcker Rule.

Since the 2008 financial crisis, the international regulatory community has taken many steps to strengthen the global financial system. In particular, the G20 Governments, the Financial Stability Board, the Basel Committee on Banking Supervision, and other international regulatory bodies embarked upon an ambitious series of reforms. Standards have been developed and are being introduced to increase capital and liquidity, create better mechanisms for resolving large financial institutions, centralize derivatives clearing, and strengthen supervision in a number of other areas. National implementation of this reform agenda is underway in all the G20 countries.

The Dodd-Frank Act encompasses the U.S. response to the crisis and implements important parts of the international reform agenda. It seeks to enhance the resiliency of the U.S. financial system, among other ways, by requiring higher capital and liquidity standards for large U.S. financial institutions. In the event that a bank failure were to occur, the Dodd-Frank Act imposes steps to preclude future taxpayer bailouts and abolish "too big to fail" by requiring orderly resolution regimes for such institutions. The Dodd-Frank Act also seeks to strengthen operations and safeguards pertaining to derivatives activities through a variety of mechanisms, including enhanced transparency through increased reporting and reduced counterparty credit risks through centralized clearing arrangements and higher margin for over-the-counter swap transactions.

Given the intersection of U.S. and international efforts, many of the Dodd-Frank Act mandates in these areas complement work underway by regulators internationally to enhance the resilience of the global financial system. While most of these efforts are still works in progress, I believe paths are available for international harmonization in many of these areas. However, even when broad consensus on international standards is reached, there will be areas of difference where policy makers in individual countries have chosen to tailor standards to their country and institutions rather than adopt the totality of the international approach. This is the case in the U.S., for example, where the Dodd-Frank Act has established certain standards—such as the prohibition on the use of credit ratings in our regulations—that will cause our implementation of the international capital standards to differ in some aspects from those of other countries.

Other provisions of the Dodd-Frank Act that impose structural and operational requirements for conducting certain financial activities have no equivalent in international workstreams or efforts to harmonize approaches. The most notable, in terms of potential international effects, is the Volcker Rule prohibitions on proprietary trading and private equity and hedge fund investments. The lack of a parallel international workstream and the resulting implications for both U.S. and foreign firms are areas of concern that have been raised in comment letters that the OCC and other agencies have received on our proposed rulemaking.

My testimony today will describe in greater detail the intersection of Dodd-Frank and international efforts in five key areas: capital standards, liquidity requirements, orderly resolution of large and complex firms, derivatives activities, and the Volcker Rule.

I. Capital Standards

Since the 1980s, the Federal banking agencies have worked with their international counterparts through the Basel Committee on Banking Supervision (Basel Committee or BCBS) to develop and implement regulatory capital requirements. In 1989, the Federal banking agencies first implemented minimum risk-based capital

* 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.

requirements for U.S. banking organizations based on the "International Convergence of Capital Measurement and Capital Standards" (Basel I), which was published by the Basel Committee in 1988.[1]

In 1997, the OCC, FDIC, and Federal Reserve Board implemented revisions to their risk-based capital rules, consistent with revisions to Basel I published the previous year by the Basel Committee. These provisions added a market risk framework requiring banks to address exposures to market risk associated with foreign exchange and commodity positions and positions located in the trading account.

On December 7, 2007, the Federal banking agencies implemented the advanced approaches risk-based capital rules for the largest internationally active banks based on a new international capital adequacy framework (Basel II).[2] The advanced approaches rules were intended to promote improved risk measurement and management processes and better align minimum risk-based capital requirements with risk by incorporating certain Basel II approaches (advanced internal ratings-based approach for credit risk and the advanced measurement approaches for operational risk).

These longstanding international cooperative efforts were stepped up in response to the financial crisis, resulting in a broad consensus across jurisdictions that it was necessary to further enhance the quality and quantity of bank capital. The OCC has been an active participant in these efforts and is working with the other Federal banking regulators to implement regulations domestically.

In 2009 and 2010, the Basel Committee published revisions to both the market risk framework and the treatment of certain securitization exposures (collectively, these revisions are referred to as Basel II.5),[3] and in December 2010, the Basel Committee published Basel III, which represents the collective work of numerous country participants to develop new capital standards for promoting a more resilient banking sector.[4] As I will describe, many of the key provisions and objectives of Basel III complement key capital provisions of the Dodd-Frank Act.

Among the more significant changes in Basel III is the introduction of a new common equity tier 1 minimum risk-based capital ratio that will require banks to hold a minimum amount of common equity to total assets. The financial crisis demonstrated that common equity is superior to other capital instruments in its ability to absorb losses. Therefore, this new requirement should enhance banks' ability to withstand periods of financial stress. As envisioned, common equity capital requirements will increase substantially from levels preceding the financial crisis.

The existing tier 1 and total risk-based capital requirements also will become more rigorous due to a narrower definition of regulatory capital that excludes funds raised through hybrid capital instruments, such as trust preferred securities, that generally do not absorb losses to the same extent as common equity. This provision is broadly consistent with section 171(b) of the Dodd-Frank Act that directs the Federal banking agencies to remove these types of instruments from the definition of regulatory capital. Basel III also places strict limits on the amounts of mortgage servicing assets and deferred tax assets that may count as regulatory capital.

The amount of capital that a bank is required to hold also is a key feature of the Basel III reforms, and implementation is to be achieved, in part, through substantial increases to a bank's overall minimum required risk-based capital ratios. The Basel III reforms set higher capital requirements that essentially will move the common equity tier 1 ratio from a minimum of roughly 2 percent under current rules to 4.5 percent. These increases are to be supplemented by two regulatory capital "buffers"—a capital conservation buffer of 2.5 percent common equity tier 1 (bringing the minimum common equity tier 1 requirement to 7 percent), which a bank would be expected to draw down during times of economic stress, and a countercyclical buffer, which banking supervisors can activate to curb excessive credit growth. As a bank's capital levels near the minimum requirements and dip into the buffers, the bank will face progressively more stringent restrictions on its ability to make capital distributions (including dividends) and to make discretionary bonus

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[1] BCBS, International Convergence of Capital Measurement and Capital Standards (July 1988), available at: *http://www.bis.org/publ/bcbs04a.htm.*

[2] BCBS, "International Convergence of Capital Measurement and Capital Standards: A Revised Framework", (June 2006), available at: *http://www.bis.org/publ/bcbs128.htm.*

[3] The Basel Committee published the revisions in two documents in 2009 and then updated them in June 2010. The 2009 documents included: Revisions to the Basel II Market Risk Framework, Guidelines for Computing Capital for Incremental Risk in the Trading Book, and Enhancements to the Basel II Framework. The June 2010 revisions are available at: *http://bis.org/press/p100618/annex.pdf.*

[4] Bank for International Settlements, Basel Committee on Banking Supervision, Basel III: A global regulatory framework for more resilient banks and banking systems (December 2010, revised June 2011).

payments. The largest U.S. banks have already made meaningful progress in reaching the higher thresholds under Basel III as evidenced by the recently announced stress test results.

In the U.S., the leverage ratio has always been a key component in assessing a bank's capital adequacy, acting as a back-stop to the risk-based capital requirements. Basel III also adds an international leverage ratio requirement for the first time. The international requirement is broader than the current U.S. requirement because it will include certain off-balance sheet exposures. During the recent financial crisis it became apparent that some banks had built-up excessive on- and off-balance sheet leverage while continuing to present strong risk-based capital ratios. In fact, some of the largest financial institutions significantly increased their off-balance sheet exposures, which were not captured in the U.S. leverage ratio calculation. This led to a build-up of leverage that moved onto banks' balance sheets and, in the most critical periods of the crisis, banks were forced by the markets to reduce their leverage in a manner that significantly increased downward pressure on asset prices, exacerbating losses and leading to a reduction in capital levels and a contraction in credit availability. The scope of the Basel III leverage ratio is broadly consistent with the provisions in section 165 of the Dodd-Frank Act that directs that off-balance-sheet activities be included in the regulatory capital calculation for bank holding companies with total consolidated assets equal to or greater than $50 billion.

Another way in which the capital framework was strengthened in response to the crisis is reflected in section 171 of the Dodd-Frank Act, the "Collins Amendment," which requires bank holding companies to be subject to strict bank-level capital requirements. In the lead up to the crisis, capital requirements applicable to banks were more rigorous in certain respects than those applied to bank holding companies. The Dodd-Frank Act requires the application of the same requirements to both banks and bank holding companies. This is important because even though banks were generally well capitalized leading up the financial crisis, their holding companies suffered substantial losses, and it is the bank holding companies that were the primary focus of efforts to shore up the financial system at that time and of the Dodd-Frank Act's new enhanced resolution framework.

Finally, the financial crisis focused attention on the risk that large internationally interconnected firms present to global financial stability. Both Basel III and the Dodd-Frank Act address this concern, but they take different approaches. Basel III calls for adopting a capital surcharge that would apply only to the 29 largest global, systemically important banks, 7 of which are U.S. entities. Section 165 of the Dodd-Frank Act requires the Federal Reserve Board to consult with the other Federal banking regulators and implement heightened prudential standards, including capital requirements, for the 34 U.S. bank holding companies with total consolidated assets of $50 billion or more.

The Federal banking agencies have been working diligently to assess the key features of Basel III and to translate them into a workable and effective set of capital standards for U.S. financial institutions. While there are many common elements between Basel III and the capital provisions of the Dodd-Frank Act, the Dodd-Frank Act introduces several capital related provisions unique to U.S. financial institutions and, therefore, the U.S. capital standards necessarily will deviate from the international standards in several significant respects.

The Collins Amendment, as previously noted, requires the Federal banking agencies to apply the same generally applicable minimum capital requirements to all banks and bank holding companies. But in addition, in a statutory requirement unique to the U.S., the Collins Amendment provides that any regulatory capital requirement that the Federal banking agencies apply to any subset of banks (such as the advanced approaches rules, which are required only for large internationally active banks) is permitted to increase the capital requirements relative to the generally applicable minimum capital requirements, but is not permitted to decrease them. Additionally, the Collins Amendment requires that the generally applicable minimum capital requirements may never be "quantitatively lower" than the current Basel I-based minimum capital requirements.

Thus, for large internationally active U.S. banks, the simpler generally applicable minimum capital rules will still govern even though they are undertaking the complex and costly task of implementing the more risk-sensitive advanced approaches risk-based capital framework. Without the risk sensitivity of the advanced approaches, banks will have less incentive to pursue safer loans or lower risk securities because they will not obtain the capital benefit of doing so. And a foreign bank pursuing the same strategy and operating without the floor would enjoy a market advantage over their U.S. counterparts.

Another divergence from Basel III arises from section 939A of the Dodd-Frank Act, which requires all Federal agencies to remove references to, and requirements of reliance on, credit ratings from their regulations and to replace them with appropriate alternatives for evaluating creditworthiness. Basel III, in contrast, continues to rely on credit ratings in many areas, making it difficult to implement those provisions domestically.

On December 29, 2011, the Federal banking agencies published a notice of proposed rulemaking to revise their market risk capital rule consistent with enhancements made by the Basel Committee and with section 939A of the Dodd-Frank Act. This proposal, which built on a proposal that the agencies published in January 2011, was the Federal banking agencies' first proposal to replace references to credit ratings in their risk-based capital regulations. The Federal banking agencies are reviewing the comments received on the December 2011 proposal and are considering how best to implement the market risk rule in final form. The agencies also expect to propose to replace references to credit ratings more generally in the coming months.

A common set of standards or rules is only one aspect of international harmonization. Equally important is how those standards or rules are implemented in practice. As I have highlighted in previous testimony, different countries have implemented the advanced approaches qualification requirements with varying degrees of rigor.[5] While many international regulators permitted large banks in their jurisdictions to move to the advanced approaches framework several years ago, the Federal banking agencies have held U.S. banks to more stringent standards and have yet to approve a single U.S. bank to apply the advanced approaches.

To address the inconsistent application of its standards across jurisdictions, the Basel Committee has initiated a peer review process to monitor, on an ongoing basis, the status of members' adoption of the Basel rules, including the Basel III agreement. Under this process, teams of banking supervisors from different jurisdictions will review the compliance of members' domestic rules or regulations with the international minimum standards and identify differences that could raise prudential or level playing field concerns.

The OCC is participating in this initiative and supports its objectives. Effective implementation of the Basel standards should be a top priority and to that end, the OCC has committed staff and resources necessary to participate in the peer review process to the fullest extent possible.

II. Liquidity Requirements

During the early phase of the financial crisis, many banks, despite adequate capital levels, still experienced difficulties because of inadequate liquidity. Consequently, the Basel Committee and the Dodd-Frank Act, through enhanced supervision and heightened prudential standards, sought to mitigate these concerns by focusing on the importance of effective liquidity management to the proper functioning of financial markets and the banking sector.

Basel III introduces two explicit quantitative minimum liquidity ratios to assist a bank in maintaining sufficient liquidity during periods of financial stress: the Liquidity Coverage Ratio and the Net Stable Funding Ratio. These ratios are designed to achieve two separate but complementary objectives. The Liquidity Coverage Ratio, with a one-month time horizon, addresses short-term resilience by ensuring that a bank has sufficient high quality liquid resources to offset cash outflows under acute short-term stresses. The Net Stable Funding Ratio is targeted toward promoting longer-term resilience by creating additional incentives for a bank to fund its ongoing activities with stable sources of funding. Its goal is to limit over-reliance on short-term wholesale funding during times of robust market liquidity and encourage better assessment of liquidity risk across all on- and off-balance sheet items.

The Basel Committee included a lengthy implementation timeline for both ratios to provide regulators the opportunity to conduct further analysis and to make changes as necessary. The Federal banking agencies currently are working together, and with the Basel Committee, to develop and recommend changes to the Liquidity Coverage Ratio to ensure that it will produce appropriate requirements and incentives, especially during economic downturns, and to otherwise limit potential unintended consequences.

As mentioned previously, the Dodd-Frank Act's heightened prudential standards are intended to address risks to the financial stability of the U.S. that may arise from large, interconnected financial institutions and includes the establishment of

[5] Testimony of John Walsh, Acting Comptroller of the Currency, before the Committee on Financial Services, United States House of Representatives (June 16, 2011), available at: *http://www.occ.gov/news-issuances/congressional-testimony/2011/pub-test-2011-73-written.pdf.*

liquidity requirements to address some of those concerns. Section 165 of the Act requires the Federal Reserve Board to establish prudential liquidity requirements for nonbank financial companies supervised by the Board and bank holding companies with total consolidated assets equal to or greater than $50 billion. The Federal Reserve Board has issued a proposal that builds on the 2010 Interagency Policy Statement on Funding and Liquidity Risk Management issued by the Federal banking agencies and the Conference of State Bank Supervisors and includes, among other things, projected cash flows, stress testing, and contingency funding plan requirements as well as provisions addressing board of director and senior management responsibilities for overseeing and implementing a company's liquidity program. The proposed standards also would require affected firms to maintain liquidity buffers of highly liquid assets and to establish limits on funding concentrations and maturities—concepts that are broadly consistent with the goals of the Basel III liquidity ratios.

Under the proposal, the liquidity requirements would increase in stringency based on the systemic risk of a covered institution. Thus, a covered company would take into consideration its capital structure, risk profile, complexity, activities, size, and other appropriate risk-related factors in implementing the proposed liquidity requirements. Furthermore, the proposal would permit the Federal Reserve Board to subject a covered company to additional or further enhanced liquidity prudential standards where the Board determines that compliance with the proposed rule does not sufficiently mitigate the risks to U.S. financial stability posed by the failure or material financial distress of the covered company.

While the OCC supports the more rigorous liquidity standards that the Basel Committee and the Federal Reserve Board's proposals would establish, we believe it is essential to calibrate these standards appropriately and to harmonize to the fullest extent possible the definitions and data upon which they are based. The OCC has stressed the need to ensure that the Dodd-Frank Act and Basel III liquidity standards being developed reflect empirical analysis and are carried out in a coordinated manner so as to enhance the safety and soundness of the U.S. and global banking systems, while not unduly restricting access to credit.

III. Cross-Border Resolutions

A key objective of the Dodd-Frank Act is ending the perception that a firm is "too big to fail" by requiring, among other things, more robust resolution planning regimes. The orderly resolution of large, complex financial institutions also is a key objective of the international supervisory community. The international efforts have focused, in large part, on the establishment of cooperative structures, including crisis management groups working alongside supervisory colleges, as a way to provide meaningful planning and timely exchange of information.

Supervisory colleges are international working groups that assist supervisors to develop a better understanding of the risk profile of an international banking group. They are not formal decision-making bodies, but rather provide a forum to discuss broader issues such as the planning of supervisory assessments and the sharing of information and perspectives by home country and host country participants relating to the risk assessment of an international banking group. Colleges facilitate effective crisis management by assisting in planning the crisis management meeting, encouraging the banking group to produce appropriate information for crisis management, and serving as a conduit for information sharing.

In November 2011, the G20 endorsed a new standard (Financial Stability Board's Key Attributes of Effective Resolution Regimes) as an internationally agreed model for reform of national resolution regimes.[6] Rather than creating a single, global legal framework for the resolution of cross-border financial institutions, the Key Attributes set out the responsibilities, instruments, and powers that all national resolution regimes should have to enable authorities to resolve failing financial firms in an orderly manner. The Key Attributes include requirements for crisis management groups, resolvability assessments, and recovery and resolution planning for global systemically important financial institutions (G–SIFIs), and for the development of institution-specific cross-border cooperation agreements so that home and host authorities of G–SIFIs are better prepared for dealing with crises.

The current U.S. legal framework, as enhanced by Title II of the Dodd-Frank Act, establishes a resolution regime that conforms with the Key Attributes in that it applies in a clear and transparent way to financial institutions whose failure could be systemically significant or critical. It also authorizes U.S. regulatory agencies to require domestically incorporated global systemically important financial companies to

[6] "Key Attributes of Effective Resolution Regimes for Financial Institutions", Nov. 4, 2011, available at: *http://www.financialstabilityboard.org/publications/r_111104cc.pdf.*

develop recovery and resolution plans, including a group resolution plan. U.S. regulatory agencies can require regular resolvability assessments for these companies and enter institution-specific cross-border cooperation agreements. Similarly, certain large insured depository institutions are required to provide plans for their resolution.

The current U.S. legal framework is also consistent with the Key Attributes provisions concerning conditions for cross-border cooperation. U.S. law generally permits U.S. resolution authorities to cooperate with resolution measures by foreign home resolution authorities. Similarly, the Dodd-Frank Act directs the Financial Stability Oversight Council (FSOC), the Federal Reserve Board, and the Secretary of the Treasury to consult with other international regulatory authorities on matters related to systemic risk and supervision of financial institutions. The Dodd-Frank Act also directs the FDIC, as receiver for a systemically important financial company, to coordinate, to the maximum extent possible, with appropriate foreign financial authorities regarding the orderly liquidation of a systemically important financial company that has assets or operations in a country other than the U.S. The Dodd-Frank Act empowers the FDIC, for purposes of carrying out liquidation and receivership authorities under the Dodd-Frank Act, to request assistance from a foreign financial authority or to assist any foreign financial authority in conducting any investigation, examination, or enforcement action.

Consistent, harmonized implementation is critical to the effectiveness of the model Key Attributes. Legislative changes will be required in many jurisdictions to implement the Key Attributes and to strengthen supervisory mandates and capabilities. Other requirements will demand a high degree of active cooperation among authorities and reviews by firms of their structures and operations. The Cross-Border Crisis Management Working Group (CBCM) of the Financial Stability Board (FSB) is conducting surveys to assess the status of work in the various jurisdictions relating to Crisis Management Groups (CMGs), recovery and resolution planning, and resolvability assessments. In addition, the FSB, with the involvement of the International Monetary Fund, the World Bank, and the standard setters, is also drawing up a methodology to assess implementation of the Key Attributes standards, and the OCC is participating in the development of the methodology. Supervisory colleges and CMGs can also complement these wider peer review processes by promoting a coherent, cross-jurisdictional approach to the consistent and effective implementation of the Key Attributes.

IV. Derivatives Regulation

In 2009, G20 leaders committed to reforming over-the-counter (OTC) derivatives markets by year-end 2012, to require clearing of standardized contracts through central counterparties, and to improve transparency of noncleared derivatives and subject them to additional capital requirements. In Title VII of the Dodd-Frank Act, the U.S. established the legislative infrastructure for these and other reforms in our derivatives markets. As the U.S. makes orderly progress through the implementation of Title VII, we also face questions about the progress of other G20 Nations.

Effective restructuring of the derivatives market, in the manner envisioned in Title VII, will be difficult to achieve if traders have the option to conduct their derivative transactions in other, less heavily regulated jurisdictions. If international efforts are successful in implementing robust restrictions in all significant market jurisdictions, we will protect U.S. institutions and markets from exposure to systemic risk in the form of market contagion from under-supervised large traders. Even with such broad harmonization, the goals of Title VII may be affected by smaller differences with other countries.

The G20 leaders have charged the FSB with regularly monitoring the progress of implementation by G20 Nations towards the 2009 commitments on OTC derivatives. The FSB, through the OTC Derivatives Working Group, is currently in the process of wrapping up its information-collection activities antecedent to publishing its fourth progress report. While the reports thus far show that the U.S. and some other major market jurisdictions have established the legislative infrastructure necessary to meet the 2012 commitment, many other jurisdictions have not yet undertaken this important step.

On the positive front, international regulators are making important progress in establishing ground rules that will support a global approach to central clearing on a cross-border basis through recognized counterparties. This has the potential to facilitate greater standardization and liquidity in derivatives, increasing the proportion of contracts that can be cleared. In November of 2011, an international working group was established to address this issue and, more broadly, coordinate other international workstreams on OTC derivatives. Other established international supervisory coordinating bodies, such as the Basel Committee, the Committee on Pay-

ment and Settlement Systems, and the International Organization of Securities Commissions (IOSCO) are preparing standards, consultative documents, and study papers on international derivatives implementation issues falling within their respective jurisdictions. The Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission also have been coordinating with international counterparts in several major jurisdictions to coordinate implementation issues with cross-border impact.

Notwithstanding these preliminary moves, U.S. regulators have been hampered in their work with regulators in other jurisdictions that have not yet established a legislative framework for OTC market restructuring. While it is understandable that these jurisdictions, which currently have smaller levels of OTC market activity, might wish to "wait and see" how the U.S. and European regulators complete their approach before proceeding with their own measures, the "wait and see" approach also creates the risk of regulatory arbitrage, and slows the pace of international coordination.

Important progress also is being made on the implementation of margin requirements backing noncleared derivatives. The OCC, along with the other U.S. banking, commodities, and securities regulators, are participating in an international supervisors' working group, established in the fall of 2011 under the auspices of the BCBS and IOSCO, to address this topic. U.S. banking and commodities regulators were the first to issue specific proposed margin requirements, in the spring of 2011. The banking agencies' proposal requested public comment on the international application of U.S. margin requirements to noncleared derivatives executed by foreign branches and subsidiaries of U.S. banks that are swaps dealers or major swap participants. Commenters expressed concerns that U.S. and foreign regulators must coordinate as to the level and effective dates of their respective margin requirements, and anticipated that unilateral U.S. implementation of margin rules would eliminate U.S. banks' ability to continue competing in foreign markets that are behind the U.S. in formulating margin rules for their own dealers. We anticipate the BCBS–IOSCO working group will be in a position to issue a consultative paper on international margin standards by this summer.

To summarize, in the key aspects of OTC derivatives market restructuring, the G20 leaders have committed to core changes, channels of communication between supervisors have been established, and the parties are working toward convergence, though the final outcome remains to be seen. Given our commitment to convergence with international standards, our primary concern with the ongoing efforts to reform OTC derivatives markets is one of timing. If the U.S. is unable to implement market reforms in a coordinated and contemporaneous fashion with all significant derivatives market jurisdictions, we face the risk that trades will move to an unregulated market. This would thwart the intended result of Title VII reforms, and negatively affect the ability of U.S. financial institutions to compete for international market share.

In addition, there is one particular aspect of Title VII for which there appears to be no equivalent policy among our foreign counterparts: the "push out" provisions of section 716, which dictates where in a U.S. bank holding company certain aspects of derivatives dealing business can be conducted. The language of the section is ambiguous in important respects, but the U.S. appears to be alone in espousing the basic approach in section 716 of limiting the flexibility of holding companies to conduct some aspects of their derivatives dealing business within depository institutions.

V. Volcker Rule

The Dodd-Frank Act contains certain provisions, like section 619 (the "Volcker Rule"), that have no foreign equivalent and, unlike capital and liquidity requirements, currently are not the subject of international harmonization efforts. Section 619 generally prohibits a banking entity, which includes a U.S. banking entity and a foreign bank with certain U.S. operations,[7] from engaging in proprietary trading and from making investments in, and having certain relationships with, a hedge fund or private equity fund. The statute excepts from these prohibitions certain activities, including market-making related activities, underwriting, risk-mitigating hedging, trading in U.S. Government obligations, and activities conducted by qualifying foreign banking entities "solely outside of the United States."

[7] Section 619 applies to any foreign bank that "is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978" and its affiliates worldwide.

On November 7, the Federal banking agencies and the SEC issued a notice of proposed rulemaking to implement the Volcker Rule (the Proposal).[8] The public comment period on the Proposal closed on February 13, and the agencies are now considering the over 16,000 comment letters received. These include comment letters from both U.S. and foreign banking entities, trade associations, and governmental authorities, including the Governments of Canada, the European Union, France, Germany, Mexico, Japan, and the United Kingdom.

It is clear from these comment letters and meetings with our foreign counterparts that the U.S. restrictions on banking entities' high-risk trading and investment activities are unique. As our foreign counterparts have pointed out, the G20 did not endorse regulation of proprietary trading and hedge and private equity fund investments as an area of the financial system requiring reform and, to our knowledge, other countries have not adopted such measures.

Instead, other countries have chosen different measures to guard against the financial and operational risks banking entities may face from businesses perceived as high risk. Most countries are relying primarily on enhanced capital and liquidity requirements and new resolution frameworks for globally systemic banks to address such risks. The United Kingdom has proposed additional measures (known as the "Vickers Proposal") to restructure its banks: its so-called "retail ring-fencing" measures would require banks to conduct retail and investment banking services in separate subsidiaries, thereby limiting capital and liquidity transfers from the retail arm of the banking group to the wholesale side of the business. The Vickers Proposal, in contrast to the Volcker Rule, would not prohibit proprietary trading in a banking organization, but rather require that it be conducted outside of the retail bank.

These comment letters also raise significant issues relating to the international implications of the Proposal by addressing the potential impact of the Proposal on competitiveness and on the extraterritorial reach of U.S. laws. Some of these issues flow from the provisions of the statute, while others are the result of how the agencies have proposed to implement the statute. For example, U.S. banking entities have expressed concern that they will be at a competitive disadvantage internationally when they conform their worldwide operations to the requirements of the Proposal because foreign banking entities not covered by the Volcker Rule would be permitted to engage in proprietary trading and make hedge fund and private equity investments, subject only to applicable foreign laws. In addition, foreign banking entities covered by the Volcker Rule may engage in proprietary trading and make hedge fund and private equity investments "solely outside of the United States" by the terms of the statute. U.S. banking entities have pointed out that this difference in treatment could result in regulatory arbitrage, regulatory uncertainty, and unfair competition and could affect the competitiveness of all U.S. companies that depend on U.S. markets for liquidity and capital formation. They have noted that reduced liquidity, on a macroeconomic level, could restrain economic development, job creation, and the international competitiveness of U.S. businesses. Many of these complaints are about the basic policy contained in the statute, but we are carefully considering these concerns to determine the extent to which they are exacerbated by the Proposal.

Foreign Governments and foreign banking entities have expressed concern about the extraterritorial impact of the Proposal, including the agencies' approach to implementing the statutory exception which permits qualifying foreign banking entities to engage in prohibited trading and covered fund activities "solely outside of the United States." Commenters have asserted that the Proposal construes this exception too narrowly, and, as a result, foreign banking entities will need to rely on other exceptions in the Proposal in order to engage in activities outside of the U.S. Commenters have maintained that these exceptions impose U.S. legal requirements on foreign banking entities operating outside of the U.S., which may conflict with applicable foreign laws and may be inconsistent with the regulatory approach adopted by foreign regulators.

Commenters also have criticized the application of the statutory backstops and the proposed compliance and reporting requirements to operations of foreign banking entities outside of the U.S. The backstops provide that a banking entity may not engage in any permitted activity that would involve or result in a material conflict of interest or a material exposure to a high-risk asset or trading strategy or threaten the safety and soundness of the banking entity or the financial stability of the U.S. Section 619 requires the agencies to issue rules regarding internal controls and record keeping to ensure compliance with the statute. The Proposal im-

[8] The CFTC published a notice of proposed rulemaking implementing section 619 on February 14, 2012. The CFTC proposal, which adopts the same rule text as the Proposal, is open for comment through April 16, 2012.

poses the statutory backstops, a detailed compliance program, and extensive reporting requirements on all banking entities subject to section 619, including foreign banking entities. Commenters have urged the agencies to limit the scope of these requirements to foreign banking entities' U.S. operations.

Finally, commenters have objected to the preferential treatment afforded to U.S. Government obligations as compared to obligations issued by foreign Governments. They have urged the agencies to treat foreign sovereign bonds like U.S. Government obligations by creating an exception for trading in foreign sovereign debt. Commenters have argued that foreign sovereigns are used as collateral and for asset liability management purposes and that disrupting their trading will jeopardize banking entities' safety and soundness. In addition, they have noted that making sovereign debt harder to trade, especially by primary dealers, will make the market for that debt less liquid. This could hinder central monetary operations and thereby decrease financial stability. Moreover, the commenters have suggested that providing preferential treatment to U.S. sovereign debt may result in retaliatory efforts by other countries.

We plan to carefully consider all comments received in implementing the regulation. In particular, we plan to consider both the extraterritorial reach of the Proposal and the potential for regulatory overlaps and inconsistencies the Proposal may create for banking entities' worldwide operations.

Conclusion

The OCC is committed to effective implementation of international financial regulatory agreements and the Dodd-Frank Act. As we move forward with Dodd-Frank Act implementation and toward convergence with international standards, we must be mindful of the need to strike an appropriate balance between enhanced regulation, better supervision, and market restrictions.

Achieving a level playing field for internationally active institutions is an important objective, but it is never fully achieved, and sometimes national policy choices, like a number of those I have noted in the Dodd-Frank Act, place other national objectives above competitive equity. Still, it is important to appropriately reconcile the enhanced U.S. requirements with the enhanced international standards wherever possible, or run the risk of placing U.S. banks at a competitive disadvantage that may drive important elements of financial services and financial intermediation out of the banking system or out of the United States.

Thank you for the opportunity to discuss the international implications of the Dodd-Frank Act and to update the Committee on the efforts currently underway to harmonize U.S. regulatory requirements with international standards and frameworks. I am happy to answer your questions.

PREPARED STATEMENT OF JACQUELINE H. MESA

DIRECTOR OF THE OFFICE OF INTERNATIONAL AFFAIRS, COMMODITY FUTURES TRADING COMMISSION

MARCH 22, 2012

Good morning Chairman Johnson, Ranking Member Shelby, and Members of the Committee. I am Jacqueline Mesa, the Director of the Office of International Affairs at the Commodity Futures Trading Commission. Thank you for the opportunity to testify today regarding international aspects of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). This morning, I will provide an overview of global commitments for over-the-counter (OTC) derivatives reform, an update on Dodd-Frank Act implementation efforts at the Commodity Futures Trading Commission (CFTC or Commission), global initiatives to bring financial reform to OTC derivatives, and coordination with international regulators in regulating the swaps market.

G20 Commitment for OTC Derivatives Reform

The financial crisis generated international consensus on the need to strengthen financial regulation by improving transparency, mitigating systemic risk, and protecting against market abuse. As a result of the widespread recognition that transactions in the OTC derivatives market increased risk and uncertainty in the economy and became a significant contributor to the financial crisis, a series of policy initiatives were undertaken to better regulate the financial markets.

In September 2009, leaders of the Group of 20 (G20)—whose membership includes the European Union (EU), the United States, and 18 other countries—agreed that: (1) OTC derivatives contracts should be reported to trade repositories; (2) all standardized OTC derivatives contracts should be cleared through central counterparties

and traded on exchanges or electronic trading platforms, where appropriate, by the end of 2012; and (3) noncentrally cleared contracts should be subject to higher capital requirements. In addition, the Financial Stability Board (FSB) issued a report in October 2010 that set forth a detailed set of assignments to financial standard-setting bodies in order to meet the G20 directives, and the FSB continues to publish semi-annual reports concerning progress by major market jurisdictions to meet the G20 mandates by the end-2012 deadline.

Dodd-Frank Act Implementation

In 2010, less than 1 year following the G20 commitment to lower risk and increase transparency in the OTC derivatives market, Congress broadened the CFTC's jurisdiction to include oversight of the previously unregulated swaps marketplace and also broadened the jurisdiction of the Securities and Exchange Commission (SEC) to cover security-based swaps. With respect to the CFTC, Title VII of the Dodd-Frank Act: (1) provides for the registration and comprehensive regulation of swap dealers and major swap participants; (2) imposes clearing and trade execution requirements on standardized swaps, subject to certain exceptions; (3) creates record keeping and real-time reporting regimes; and (4) enhances the CFTC's rulemaking and enforcement authorities with respect to certain products, entities, and intermediaries subject to the Commission's oversight.

The CFTC is developing regulations to implement the Dodd-Frank Act and to establish a regulatory framework for overseeing the swaps market, which is seven times the size of the futures market and far more complex. Last summer, the CFTC moved forward from the proposal phase for rulemaking to finalizing its regulations. The Commission has completed 29 final rulemakings, with approximately 20 regulations remaining.

Section 712 of the Dodd-Frank Act calls on the CFTC to consult and coordinate with the SEC and the prudential regulators for purposes of assuring regulatory consistency and comparability of rulemakings under the legislation. The SEC has jurisdiction over security-based swaps, and the CFTC is working closely with the SEC in developing regulations. In certain areas, the CFTC and SEC are issuing joint regulations. The Commission also is working closely with the prudential regulators, which are charged with developing capital, margin, and other requirements for banking entities.

One example where we are coordinating with our sister agencies is the procedure to implement the Volcker Rule, where there is a specific requirement in the Dodd-Frank Act mandating consultation and coordination between the banking regulators and the CFTC and the SEC. Section 619 of the Dodd-Frank Act prohibits certain banking entities from engaging in proprietary trading, yet also permits certain activities such as market making and risk-mitigating hedging. The Office of the Comptroller of the Currency, Federal Reserve Board, Federal Deposit Insurance Corporation, and SEC published proposed regulations last November to implement this statutory provision. The CFTC is charged with promulgating rules to implement Volcker Rule requirements for CFTC-registered affiliates and subsidiaries of banking entities. The Commission issued proposed regulations in January, with a comment period that closes on April 16th. U.S. regulators are working together to coordinate their approaches.

As CFTC rulemakings have progressed, one issue that has arisen is how Dodd-Frank Act requirements might apply to swaps activities occurring on a cross-border basis. In connection with the CFTC's and SEC's joint proposed regulation to further define the term "swap dealer," for example, public input has been received in connection with a range of concerns related to the application of Title VII and the Commission's regulations to transactions in which a foreign swap dealer is transacting with U.S. persons or to certain activities of a U.S. swap dealer operating from a foreign location.

The CFTC recognizes that swaps business currently flows across national borders, with agreements negotiated and executed between counterparties in different jurisdictions and individual transactions often booked and risk-managed in other jurisdictions. CFTC and SEC staff held a public roundtable last August to discuss international issues related to implementation of Title VII. The roundtable agenda included cross-border transactions, global entities, and market infrastructure. As required by Section 719(c) of the Dodd-Frank Act, CFTC and SEC staff conducted a study and released a report in January that examined international swap regulation and set forth several issues for further monitoring across jurisdictions.

In addressing cross-border issues, the CFTC is charged with implementing Section 722(d) of the Dodd-Frank Act, which amended the Commodity Exchange Act (CEA) to provide that Title VII provisions "shall not apply to activities outside the United States unless those activities: (1) have a direct and significant connection

with activities in, or effect on, commerce of the United States; or (2) contravene such rules or regulations as the Commission may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of [the CEA] that was enacted by the [Dodd-Frank Act]". The CFTC plans to provide guidance regarding the application of Title VII and the Commission's regulations to non-U.S. entities and to swaps activities occurring on a cross-border basis, seeking public input on that guidance.

Another issue that has arisen involves the indemnification requirement for registered swap data repositories in Section 21(d) of the CEA. Some foreign regulators have raised concerns regarding their ability to directly access information maintained in such repositories due to the indemnification requirement. The CFTC is working to ensure that both domestic and international regulators have access to swap data to support their regulatory mandates, and the Commission continues to review the indemnification provisions of the CEA. Recently, the Chairman directed Commission staff to draft, for the Commission's consideration, proposed interpretative guidance stating the Commission's view that access to swap data reported to a trade repository that is registered with the CFTC will not be subject to the CEA's indemnification provisions if such trade repository is regulated pursuant to foreign law and the applicable requested data is reported to the trade repository pursuant to foreign law. Subject to the Commission's approval, this proposed interpretative guidance would be published for public comment.

Global Reform in the OTC Derivatives Market

In line with the G20 commitment, efforts to regulate OTC derivatives are under way not only in the United States but also abroad. Japan has passed reform legislation, and the EU is finalizing the European Market Infrastructure Regulation (EMIR) that includes mandatory clearing, reporting, and risk mitigation for OTC derivatives. Last October, the European Commission published two draft proposals, the Markets in Financial Instruments Directive (MiFID) and the Markets in Financial Instruments Regulation (MiFIR), that provide for additional requirements for swaps that will further align U.S. and EU swaps reform. Others, such as Canada, Hong Kong, and Singapore, have published consultation documents to gather public comment on the appropriate regulation of OTC derivatives. CFTC staff will continue to monitor international developments and to work with the foreign regulators to establish consistent standards for OTC derivatives regulation.

International Coordination

The global and interconnected nature of the swaps market makes it imperative that the United States consult and coordinate with foreign regulators. Market participants domiciled both inside and outside of the United States regularly enter into swaps transactions with one another and engage in cross-border swap activities that could be subject to U.S. and non-U.S. regulatory oversight.

The fact that all major market jurisdictions are developing their OTC requirements at the same time and in a coordinated fashion pursuant to the G20 directives also provides an opportunity to create a consistent framework. Congress directed the CFTC, SEC, and prudential regulators in Section 752(a) of the Dodd-Frank Act to "as appropriate . . . consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards with respect to the regulation . . . of swaps, security-based swaps, swap entities, and security-based swap entities" in order to "promote effective and consistent global regulation of swaps and security-based swaps." The CFTC is fulfilling this statutory mandate by reaching out internationally—in a comprehensive approach and on an ongoing basis—to promote robust and consistent standards and to avoid conflicting requirements wherever possible.

The CFTC has considered international standards and principles in developing regulations, and staff has consulted and coordinated with international counterparts throughout the rulemaking process. Commission staff has shared comment summaries and drafts of proposed and final regulations with the international community, and has carefully considered the constructive feedback we have received. As the Commission moves forward in finalizing regulations, we will continue to do so.

CFTC Chairman Gary Gensler and Commissioners have met with foreign regulators to discuss financial reform in the United States and abroad. Commissioner Jill Sommers, as Chair of the CFTC's Global Markets Advisory Committee and the Commission's representative to the International Organization of Securities Commissions (IOSCO), has organized advisory meetings to discuss international coordination of financial reform. In addition, Chairman Gensler, SEC Chairman Mary Schapiro, and senior representatives of the CFTC and SEC met with regulators from Canada, the EU, Hong Kong, Japan, and Singapore last December to discuss

cross-border issues related to OTC derivatives, and an even broader group of regulators will meet again in May. Last week, the CFTC hosted a meeting with 28 foreign regulators on access to swaps trade repository data, regulation of the OTC derivatives market and participants, and customer fund protection.

At the staff level, ongoing bilateral discussions and technical dialogues with foreign regulators are designed to increase the understanding of our respective regulatory approaches and to coordinate regulatory proposals to the greatest extent possible. CFTC and SEC staffs have been holding an unprecedented number of dialogues with counterparts in Canada, the EU, Hong Kong, Japan, and Singapore. These staff discussions will continue as Dodd-Frank Act implementation progresses and as other jurisdictions develop their own regulatory requirements for OTC derivatives.

CFTC staff is participating in the FSB OTC Derivatives Working Group, which monitors progress being made in implementing OTC derivatives market reforms. The CFTC also cochairs the IOSCO Task Force on OTC Derivatives, which recently completed work on three reports and currently is developing a report relating to the oversight of OTC derivatives market intermediaries. The published reports address mandatory clearing, exchange and electronic platform trading, and reporting to trade repositories.

CFTC staff also is engaged in several other international projects related to OTC derivatives. For example, the Committee on Payment and Settlement Systems and IOSCO are developing principles for financial market infrastructures, including derivatives central counterparties and trade repositories, which are expected to be published next month. In addition, IOSCO and others have established a working group on international standards regarding margin requirements for noncentrally cleared derivatives, with a consultative report expected in June.

Regulators also are coordinating internationally with regard to limits on speculative positions. Last September, IOSCO adopted a commodity markets report that embraces a position management regime. The report also includes recommendations for more transparency, similar to aggregated position reports (Commitments of Traders) that are published weekly by the CFTC, and enhanced enforcement authority to pursue attempted manipulation.

Conclusion

The CFTC is working with foreign regulators in an effective way to coordinate regulatory approaches and requirements to the greatest extent possible. On a number of different issues, the CFTC already has used the process of international consultation to highlight possible differences and to work out a solution that addresses the concerns of each jurisdiction involved in the discussion. We are committed to working closely with our international counterparts in this effort.

Thank you, and I would be happy to answer questions.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR HAGAN FROM LAEL BRAINARD

Q.1. Primary dealers serve as trading counterparties of the New York Fed in its implementation of monetary policy set by the Federal Open Market Committee. These dealers distribute debt issued by the U.S. Treasury in exchange for revenue generated through the appreciation of financial positions they take on at weekly auctions.

It is common for primary dealers to enter into derivative transactions to hedge the risks that arise from participation in an auction; however the nature of an auction makes it difficult for dealers to perfectly predict the specific risks that they will hold following the auction.

The Volcker Rule limits the ability of primary dealers to trade in derivatives on Government obligations and the ability of primary dealers to hedge risks in advance of a U.S. Treasury auction.

Is the Treasury Department concerned that the inability of primary dealers to use derivatives on Government obligations could lead to lower bids and higher yields at auctions?

A.1. Primary dealers play an important role in the auction process and market for U.S. Treasury obligations, including through their underwriting and market making activities. In addition to the Volcker Rule's exemption for trading in obligations of the United States, the Volcker Rule also explicitly permits market making, underwriting, and risk-mitigating hedging. Regulators are in the process of analyzing public comments, including comments from primary dealers, and Treasury is working to coordinate the interagency effort to develop a final rule that includes appropriate exemptions that protects deep and liquid markets for U.S. Government obligations.

Q.2. The list of primary dealers includes both banking entities subject to the Volcker Rule and broker dealers that are not subject to the rule. How would the implementation of the Volcker Rule, as currently drafted, impact the competitive landscape among primary dealers?

A.2. A primary dealer will generally be subject to the Volcker Rule if it is, or is an affiliate or subsidiary of, an insured depository institution, a company that controls an insured depository institution, or a foreign company treated as a bank holding company. In addition, nonbank financial companies supervised by the Board of Governors of the Federal Reserve System are subject to certain provisions of the Volcker Rule. Thus, the rule provides regulators the ability to regulate banking entities and certain nonbank financial companies in a similar manner.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR TOOMEY FROM LAEL BRAINARD

Q.1. Do you anticipate a situation where a U.S. company is not designated a SIFI by FSOC but is designated a G–SIFI by the Financial Stability Board? If that would occur, how would you regulate that institution?

A.1. U.S. financial institutions will be regulated in accordance with U.S. laws and regulations. Through active participation in the G20 and FSB, Treasury and U.S. regulators work to ensure that international standards of the highest quality are aligned with our national framework. For example, the FSB tasked the International Association of Insurance Supervisors (IAIS) with proposing the criteria and methodology for identifying globally systemically important insurers (G–SIIs). Through its membership on both the Financial Stability Oversight Council (Council) and IAIS committees involved with development of the criteria and methodology, Treasury's Federal Insurance Office (FIO) is pursuing an international consensus that aligns the IAIS criteria, methodology, and timing with the Council.

Q.2. Do property-casualty insurers regulated in the business of insurance pose a systemic risk? If not, have you made those arguments to the Financial Stability Board and what has been their response?

A.2. The example of AIG illustrates that nontraditional activities undertaken within an insurance group can expose an insurance affiliate to harm and pose a threat to the broader financial system. Rather than exempt an entire industry, the FSB has tasked the insurance sector regulators, through the IAIS, with proposing the criteria and methodology for identifying G–SIIs. It would be inappropriate to prejudge the work of the IAIS, especially prior to the public consultation period through which the IAIS will obtain input from interested parties. Through FIO, Treasury is participating in the IAIS process and working to align the criteria, methodology, and timing of the IAIS approach with that of the Council. To the extent that the IAIS proposes a criteria and methodology inconsistent with Treasury's expectations, then, working with other FSB members, Treasury will modify or force reconsideration of the IAIS proposal.

Q.3. The proposed Volcker Rule applies to all companies that own an insured depository, and all subsidiaries and affiliates. In addition to traditional banks and bank holding companies, the rule seems to fully cover commercial companies that own a thrift or an industrial loan company, as well as all of the companies in which these covered entities may have a significant investment that makes the recipient of the investment an "affiliate." (Under the Bank Holding Company Act, investments as low as 5 percent can trigger affiliate status.) The so-called goal of the Volcker Rule was designed to limit risks at insured depositories so that banks wouldn't be using Government insured deposit funds to "gamble" through proprietary trading or fund investing. But it seems that in reality, the rule will cover all sorts of industrial and commercial companies just because they are in some way "affiliated" with a depository. Similarly, the rule would cover a company that makes a large investment in another company that controls a depository, dissuading these types of strategic investments for fear of the investor becoming "infected" with the Volcker Rule.

Does it make any sense to apply the full restrictions and regulatory requirements to nonfinancial companies?

A.3. Congress amended the Bank Holding Company Act to include the Volcker Rule. The statute defines "banking entities," which are subject to the Volcker Rule, to include any affiliate or subsidiary of an insured depository institution or of a company that controls an insured depository institution. The proposed rule reflects this statutory mandate.

Q.4. What can your agencies do in the regulations, particularly regarding your standards for determining what is an "affiliated" company, to make sure that the Volcker Rule does not burden nonfinancial companies in a way that was completely unintended by Congress?

A.4. While the Secretary of the Treasury, as Chairperson of the Financial Stability Oversight Council, is coordinating the regulations to be issued under the Volcker Rule, Congress did not provide the Treasury Department with rulemaking authority for the Volcker Rule. The rulemaking agencies—the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Commodity Futures Trading Commission, and the Securities and Exchange Commission—have rulemaking authority to implement the Volcker Rule, including with respect to the definition of terms and any additional exemptions.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR TOOMEY FROM DANIEL K. TARULLO

Q.1. Do you anticipate a situation where a U.S. company is not designated a SIFI by FSOC but is designated a G–SIFI by the Financial Stability Board? If that would occur, how would you regulate that institution?

A.1. In considering whether to determine that a nonbank financial company could pose a threat to U.S. financial stability and subject the company to Federal Reserve Board (Board) supervision and prudential standards, the Financial Stability Oversight Council (FSOC) is required by statute to consider various factors set forth in the statute that could result in a different determination (either including or excluding a firm) by the FSOC under the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) than a determination that may be made by the Financial Stability Board (FSB). For instance, one factor that the FSOC must consider is the degree to which a firm is already regulated by another financial regulatory agency.

The Board and the FSOC are working with the FSB on a number of initiatives, including the process for identifying globally systemically important financial institutions and financial market infrastructures. Furthermore, the Board and the FSOC are working to ensure the consistency of the approaches used by the FSB and the FSOC for assessing whether a nonbanking company is systemically important and to better understand the potential for different determinations.

Systemically important nonbank firms designated by the FSOC and bank holding companies with total consolidated assets greater than $50 billion will be subject to enhanced prudential standards

established by the Board. By contrast, firms that are not designated by the FSOC and are not bank holding companies with total assets greater than $50 billion that are designated as G–SIFis by the FSB would be subject to internationally agreed-upon standards.

Q.2. Do property-casualty insurers regulated in the business of insurance pose a systemic risk? If not, have you made those arguments to the Financial Stability Board and what has been their response?

A.2. Section 113 of the Dodd-Frank Act authorizes the FSOC to subject a nonbank financial company to supervision by the Board and prudential standards if either the company's material financial distress, or the company's activities, could pose a threat to the financial stability of the United States. The statute requires the FSOC to consider the potential threat to U.S. financial stability posed by an individual nonbank financial company rather than by a particular financial industry.

When the FSOC issued its final rule and interpretive guidance earlier this year regarding nonbank financial company designations, the FSOC noted that many commenters on the FSOC's proposed rule and guidance suggested that nonbank financial companies operating in particular financial industries do not pose a threat to U.S. financial stability and should not generally be subject to FSOC designation. In response to these comments, the FSOC stated that any designation of a nonbank financial company will be based on an evaluation of whether the nonbank financial company meets the statutory standards, taking into account the statutory considerations set forth in section 113 of the Dodd-Frank Act. The FSOC has not made any determinations under section 113 of the Dodd-Frank Act but is continuing to consider whether any nonbank financial company could pose a threat to U.S. financial stability.

Q.3. Federal Reserve Chairman Bernanke indicated in an appearance before the House Financial Services Committee last month that the final rules implementing Section 619 of the Dodd-Frank Act, commonly known as the "Volcker Rule," would not be ready by July 21, 2012. However, this section of the Dodd-Frank Act is self-executing and has an effective date of July 21, irrespective of whether or not the final rules are in place. This creates a great deal of confusion and legal uncertainty among companies that are impacted by the Volcker Rule or that may be impacted by the Volcker Rule.

How do you plan to deal with this circumstance and do you anticipate that the Fed and other prudential regulators will make a formal announcement delaying enforcement of the Volcker Rule until the final rules are published?

A.3. Section 619 required the Federal Reserve to adopt rules governing the conformance periods for activities and investments restricted by section 619, which the Federal Reserve did on February 9, 2011. The conformance rules may be found at *http://www.federalreserve.gov/newsevents/press/bcreg/2011_0209a.htm.* In its final rule establishing the conformance periods, the Federal Reserve explained that it would revisit the conformance period rule

in light of the requirements of the final rule implementing the substantive provisions of the Volcker Rule. Subsequently, the Federal Reserve received a number of requests for clarification of the manner in which this conformance period would apply and how the prohibitions would be enforced. On April 19, 2012, the Federal Reserve announced its approval of a statement clarifying that an entity covered by section 619 has the full 2-year period provided by statute to fully conform its activities and investments to the requirements of section 619 and any implementing rules adopted in final under that section, unless the Board extends that conformance period. All of the Federal agencies charged with implementing and enforcing the provisions of section 619 (*i.e.,* the Federal Reserve, OCC, FDIC, SEC, and CFTC) announced that they plan to administer their oversight of banking entities under their respective jurisdictions in accordance with the Federal Reserve's conformance rule and the April statement.

Q.4. At a Dodd-Frank anniversary hearing held at the Committee last summer, Chairman Bernanke indicated that if European and other regulators did not impose comparable margin requirements for uncleared swaps, U.S.-domiciled financial institutions would be placed at a significant competitive disadvantage. Chairman Bernanke suggested that the best solution was a global agreement.

What progress has been made towards such a global agreement?

A.4. In October of 2011, an international group of regulators was constituted to reach an international agreement on margin requirements for uncleared swaps. The proposal by the Basel Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO) was developed in consultation with, and with the active participation of, the Committee on Payment and Settlement Systems (CPSS) and the Committee on the Global Financial System (CGFS). This group has been meeting regularly since October to formulate a global proposal for margin requirements on uncleared derivatives.

The BCBS/IOSCO issued its proposal in July 2012. The proposal is articulated through a set of key principles that primarily seeks to ensure that appropriate margining practices will be established for all noncentrally cleared OTC derivative transactions. These principles will apply to all transactions that involve either financial firms or systemically important nonfinancial entities. The BCBS/IOSCO requested comments on the proposal by September and expects to finalize the proposal later this year.

Q.5. The proposed Volcker Rule applies to all companies that own an insured depository [institution], and all subsidiaries and affiliates. In addition to traditional banks and bank holding companies, the rule seems to fully cover commercial companies that own a thrift or an industrial loan company, as well as all of the companies in which these covered entities may have a significant investment that makes the recipient of the investment an "affiliate." (Under the Bank Holding Company Act, investments as low as 5 percent can trigger affiliate status.) The so-called goal of the Volcker Rule was designed to limit risks at insured depositories so that banks wouldn't be using Government insured deposit funds to "gamble" through proprietary trading or fund investing. But it

seems that in reality, the rule will cover all sorts of industrial and commercial companies just because they are in some way "affiliated" with a depository. Similarly, the rule would cover a company that makes a large investment in another company that controls a depository, dissuading these type of strategic investments for fear of the investor becoming "infected" with the Volcker Rule.

Does it make any sense to apply the full restrictions and regulatory requirements to nonfinancial companies?

What can your agencies do in the regulations, particularly regarding your standards for determining what is an "affiliated" company, to make sure that the Volcker Rule does not burden nonfinancial companies in a way that was completely unintended by Congress?

A.5. Section 619 by its terms applies to any affiliate or subsidiary of any company that controls an insured depository institution. See 12 U.S.C. 1851(h)(l). In formulating the proposed rule, the Agencies sought to limit the potential impact of the proposed rule on banking entities that engage in little or no activity prohibited by the Volcker Rule provisions of the Dodd-Frank Act, including nonfinancial companies that meet the definition of banking entity. In particular, the Agencies proposed to reduce the effect of the proposed rule on these banking entities by limiting the application of the reporting, record keeping, and the compliance program requirements of the proposed rule, to those banking entities that engage in little or no covered trading activities or covered fund activities and investments. The Agencies also requested comment on whether an alternative definition of banking entity would be more effective in light of the language and purpose of the statute, the costs and burdens associated with the proposal, and any significant alternatives that would minimize the impact of the proposal on smaller, less-complex banking entities. The Federal Reserve will carefully consider the public comments received on these points and take those comments into account in crafting a final rule consistent with the statute.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR HAGAN FROM ELISSE B. WALTER

Q.1. Companies form joint ventures and wholly owned subsidiaries in order to engage in ordinary course investing and lending—including making extensions of credit, providing internal funding within an organization, and hedging risks. Such transactions should not be disallowed simply because they are made through a subsidiary that relies on the exclusion contained in section 3(c)(1) or 3(c)(7) of the Investment Company Act.

Corporate subsidiaries allow these normal corporate activities to be properly overseen within the larger corporate structure, allow nonaffiliated companies to partner to spread risk beyond a single entity, and help reduce risk.

The proposed rule provides some recognition that banking entities form joint ventures and wholly owned subsidiaries in order to engage in ordinary course investing and lending and acknowledges that forcing companies to divest of these entities would not achieve any reduction in risk.

I appreciated that in our December 6, 2011, Dodd-Frank Oversight hearing, Chairman Schapiro acknowledged that the agencies sought to create exemptions there for joint ventures that are "operating companies or vehicles that are used to merge an entity with or into a banking entity or its affiliates." However, the proposed rule still appears to leave certain questions:

A. The Volcker rule was clearly not intended to disrupt ordinary course investing and lending activities without an offsetting reduction in risk to taxpayers and depositors.

- Why should these activities be disallowed or significantly impaired simply because they are made through a corporate subsidiary?
- It seems indisputable that conducting these transactions through a corporate subsidiary permits proper oversight, spreads risk beyond a single entity and reduces the risk to the larger corporate entity by any individual transaction. Accordingly, is it possible that the elimination of these structures could increase risk at the institutions the rule is intended to protect?

B. The proposed rule provides exceptions for on-balance sheet, wholly owned subsidiaries that provide liquidity management services. Is it correct that this exception covers a small fraction of the wholly owned subsidiaries that would suffer disruption under the rule?

C. The proposed rule makes exceptions to the prohibitions contained in the Volcker rule instead of simply removing these corporate structures from the definition of "covered funds." This approach leaves these entities subject to the prohibition on "covered transactions," as defined in Section 23A of the Federal Reserve Act, without incorporating any of the provisions in Section 23A that provide exemptions from the prohibitions in that section for certain types of covered transactions.

- Wouldn't this approach, as a practical matter, render the excepted entities largely useless, in effect allowing the maintenance of the entity but prohibiting the entity from conducting business transactions within the larger corporate structure?
- Wouldn't the better approach be for the agencies to determine that these corporate vehicles—which look and act nothing like a hedge fund or private equity fund—simply are not "covered funds" in the first place?

A.1. The proposed definition of covered fund adheres closely to the statutory text and includes vehicles that rely solely on the exclusion in section 3(c)(1) or (7) of the Investment Company Act. To the extent that a corporate vehicle relies solely on one of these exclusions, it would be a covered fund under the proposed rule.

The proposed rule recognizes that banking entities may engage in traditional banking activities through the use of vehicles that rely on the exclusions in sections 3(c)(1) and (7), but that do not raise the safety and soundness concerns the statute was intended to address. Therefore, the proposal permits a banking entity to invest in or sponsor certain wholly owned subsidiaries, joint ventures and acquisition vehicles. However, as you point out, transactions

between the banking entity and these structures would be subject to Section 23A of the Federal Reserve Act—a consequence of the agencies' decision to closely track the statute.

The questions you have raised also were identified by commenters on the proposed rule. The SEC will carefully consider these comments before moving forward with implementation of the Volcker Rule.

RESPONSES TO WRITTEN QUESTIONS OF SENATOR TOOMEY FROM ELISSE B. WALTER

Q.1. The proposed Volcker Rule applies to all companies that own an insured depository, and all subsidiaries and affiliates. In addition to traditional banks and bank holding companies, the rule seems to fully cover commercial companies that own a thrift or an industrial loan company, as well as all of the companies in which these covered entities may have a significant investment that makes the recipient of the investment an "affiliate." (Under the Bank Holding Company Act, investments as low as 5 percent can trigger affiliate status.) The so-called goal of the Volcker Rule was designed to limit risks at insured depositories so that banks wouldn't be using Government insured deposit funds to "gamble" through proprietary trading or fund investing. But it seems that in reality, the rule will cover all sorts of industrial and commercial companies just because they are in some way "affiliated" with a depository. Similarly, the rule would cover a company that makes a large investment in another company that controls a depository, dissuading these types of strategic investments for fear of the investor becoming "infected" with the Volcker Rule.

Does it make any sense to apply the full restrictions and regulatory requirements to nonfinancial companies?

What can your agencies do in the regulations, particularly regarding your standards for determining what is an "affiliated" company, to make sure that the Volcker Rule does not burden nonfinancial companies in a way that was completely unintended by Congress?

A.1. As you know, section 13 of the Bank Holding Company Act (BHC Act), commonly referred to as the "Volcker Rule," applies to any "banking entity." The term "banking entity" is defined in section 13(h)(1) of the BHC Act to include any: (i) insured depository institution (other than certain limited purpose trust institutions), (ii) company that controls an insured depository institution, (iii) company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978, and (iv) affiliate or subsidiary of any of the foregoing entities. Section 13 of the BHC Act does not separately define the terms "affiliate" or "subsidiary," but the BHC Act includes definitions of these terms in section 2 of the Act. The agencies proposed to incorporate these existing definitions of "affiliate" and "subsidiary" in the Volcker proposal.

The SEC has rule-writing authority for the types of "banking entities" for which we are the "primary financial regulatory agency," as defined in section 2(12)(B) of the Dodd-Frank Act, which includes SEC-registered broker-dealers, SEC-registered investment

advisers, and SEC-registered security-based swap dealers. Thus, the SEC's proposed rule would not cover commercial companies that own a thrift or an industrial loan company.

That said, the Commission and staff appreciate the many detailed comment letters we have received concerning these important issues and will continue to carefully review and analyze the comment letters as we consider further action on the proposal.

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

LETTER SUBMITTED BY SENATOR MERKLEY FROM THIERRY PHILIPONNAT, SECRETARY GENERAL, FINANCE WATCH

Finance Watch

Making finance serve society

Brussels, 22 March 2012

Hon. Tim Johnson, Chairman
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, DC 20510
U.S.A.

Hon. Richard Shelby, Ranking Member
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, DC 20510
U.S.A.

Dear Chairman Johnson and Ranking Member Shelby,

I write on the occasion of your Committee's hearing on "International Harmonization of Wall Street Reform: Orderly Liquidation, Derivatives, and the Volcker Rule." This is an important matter and I am pleased that your Committee is attending to it carefully. I respectfully ask that this letter be noted during your hearing and entered into the official Committee record.

As the Secretary General of Finance Watch, the leading financial reform advocacy organization in Europe, I wish to offer several observations regarding how American efforts on financial reform are viewed here in Europe and how European financial reform efforts are affected by what you do in the United States.

In the simplest terms, let me assure you that European financial regulators and national governments are fully committed to adopting the critical elements of the financial reform agenda set out under your leadership in the Dodd-Frank Wall Street Reform and Consumer Protection Act. These include higher capital requirements across the banking system; mandatory clearing, transparent trading, and margin and capital for derivatives; regulation of hedge funds and private pools of capital; orderly resolution for failing firms; reform of credit rating agencies; shadow banking; retail investment products; and possibly structural reform depending on the conclusions that will emerge from the work done by the High-level Expert Group on structural reform of the

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E.U. banking sector recently appointed by Commissioner Barnier and led by Erkki Liikanen. American determination to move these issues forward has been fundamental, and the Dodd-Frank Act began building the foundation for a safer, more stable financial system. It is essential that you press forward with these urgent reforms.

It is true that as we move toward a more modern regulatory regime, some segments of the industry will have to change. Certainly, those who must change have been vocal in letting legislators and regulators know of their concerns. They have done so in Europe as well as the United States, and their arguments have been the same in both places. In the U.S., they say the Europeans are not following your lead and U.S. rules will put U.S. firms at a disadvantage. In the E.U., we hear that the U.S. did not adopt Basel II and will not finalize their other rules and that Basle III will put European banks at a competitive disadvantage as it favors the "American banking model". You know as well as I that these arguments do not stand – unless industry succeeds in convincing regulators and legislators on both sides of the Atlantic to slow down or stop needed reform. I strongly urge you not to let that happen.

Certain banks in the U.S. augment their arguments with a threat of flight to Europe or even Asia, where supposedly lower standards and bigger opportunities for risk-taking would make for a more attractive banking environment. These threats fool only the uninformed for a number of different reasons: firstly, certainly for Europe, the assertion of lower regulatory standards is not founded; secondly, major banks take on a national characteristic, and their ability to pick up and flee to a foreign capital is highly limited; finally, it is ironic to also hear the very same argument put forward by banks to European authorities when they threaten to leave the E.U. to operate exclusively from the U.S. or Asia. Despite their public threats, big banks simply cannot extract themselves from their national backers.

Let me also emphasize that the E.U. and the U.S. can be on the same page without reading exactly the same lines. Our two jurisdictions have long had somewhat different approaches to regulating a range of financial activities – the most notable example being the period during the Glass-Steagall Act enforced separation of investment banking from commercial banking. Academic research suggests this separation actually helped make U.S. investment banks more competitive. So those who would argue that certain differences in approaches to regulation will make one nation's banks less

competitive (whether it be the U.S. from the Volcker Rule, Switzerland from much higher capital requirements and contingent capital, or the U.K. with Vickers Commission ring fencing) should carefully consider historical precedent. Moreover, we are convinced that the enormous economic and social cost of financial crises, and therefore the benefit of financial stability, should also be considered.

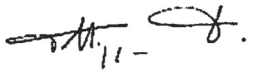
Indeed, industry's arguments continue to overlook the competitive advantages arising from a sound banking sector. If market disclosure is properly robust, well-capitalized banks that avoid high-risk activities and conflicts of interest will attract more demand from investors, customers, and depositors. Corporate treasurers will think twice before putting large deposits with banks that take high risks, and investors will think twice before conducting trades with institutions that bet against them.

The recent failure of MF Global helped remind us of the grave dangers that highly-leveraged bets can pose to a firm. Fortunately, because MF Global was a small non-bank of little significance to the broader financial system, the consequences of its mistakes did not ripple far. If, however, the U.S. were to not press forward with implementation of the Volcker Rule, these very same activities would continue eating away at the integrity of the *global* banking system, endangering not only your large firms and threatening much more dire consequences for the broader economy, but also putting intense pressure on European regulators not to address the issue of structural reform of the E.U. banking sector.

From my work with European regulators, I am convinced that Europe has no intention of becoming a safe haven for banks that engage in unwise and inefficient risk-taking. On the contrary, provisions such as the Volcker Rule offer a useful model for us to build on as Europe, too, seeks to strengthen its banks and safeguard its economies. Indeed, despite what you may hear from some banks, there is now a real push in Europe to join the United States in structurally reforming our financial system. As clearly stated in its mission statement, the High-level Expert Group on structural reform of the E.U. banking sector will be carefully studying the work you are doing in the U.S. on the Volcker Rule and similar efforts in the U.K. and will be making recommendations on reforms of E.U. banking structures that could contribute to the objective of establishing a safe, stable and efficient banking system serving the needs of citizens and of the E.U. economy. This is a topic that Finance Watch will be following very closely.

The legislative and regulatory process in Europe has sometimes been described as being slower than in the U.S.. The reality is that, due to a different institutional and legal environment, it takes a different form. I would also note that nearly two years since the passage of the Dodd-Frank Act, many of your most critical reforms are yet to be finalized by the regulatory agencies when the E.U. has already adopted a number of important legislations. I should hope that Europe does not beat America to the finish line as it did with Basel II. In conclusion, I would like to make mine the advice delivered by Commissioner Barnier during a speech in Washington in 2011: "I have heard calls here in the United States that the Dodd-Frank implementation should be postponed or weakened.... Delay is not the answer. Europe is committed. We will deliver. And I call on the United States to do the same."

Best regards,



Thierry Philipponnat
Secretary General
Finance Watch

cc: Members of the Senate Banking Committee