WHO IS TOO BIG TO FAIL: DOES DODD-FRANK AUTHORIZE THE GOVERNMENT TO BREAK UP FINANCIAL INSTITUTIONS?

HEARING

BEFORE THE

SUBCOMMITTEE ON
OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRTEENTH CONGRESS

FIRST SESSION

APRIL 16, 2013

Printed for the use of the Committee on Financial Services

Serial No. 113–14

U.S. GOVERNMENT PRINTING OFFICE

80–880 PDF WASHINGTON : 2013

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

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WHO IS TOO BIG TO FAIL: DOES DODD-FRANK AUTHORIZE THE GOVERNMENT TO BREAK UP FINANCIAL INSTITUTIONS?

Tuesday, April 16, 2013

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON OVERSIGHT
AND INVESTIGATIONS,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:29 p.m., in room 2128, Rayburn House Office Building, Hon. Patrick T. McHenry [chairman of the subcommittee] presiding.

Members present: Representatives McHenry, Fitzpatrick, Duffy, Grimm, Hultgren, Ross, Wagner, Bachus; Green, Cleaver, Ellison, Delaney, Sinema, Beatty, and Heck.

Also present: Representative Rothfus.

Chairman MCHENRY. The subcommittee will come to order.

And without objection, the Chair is authorized to declare a recess of the subcommittee at any time.

Also, without objection, members of the full committee who are not members of this subcommittee may sit on the dais and participate in today's hearing.

So, welcome. This is the second in a series of hearings on ending "too-big-to-fail" and actually defining "too-big-to-fail." And this hearing is entitled, "Who is Too Big to Fail: Does Dodd-Frank Authorize the Government to Break Up Financial Institutions?"

With that, I will now recognize myself for 5 minutes for an opening statement. Let's start the time here.

The Dodd-Frank Act was enacted in July of 2010, nearly 3 years ago. The Dodd-Frank Act's drafters claimed that the Act would end the phenomenon of "too-big-to-fail" by, among other things, authorizing the regulators to take certain actions to reduce both the likelihood that a large financial company would fail and the impact if such a failure were to occur.

Our last hearing exploring "too-big-to-fail" focused on the Financial Stability Oversight Council's failure to get up to speed in a timely manner, as well as its inability to identify and respond to emerging threats that risk the stability of the U.S. financial system.

Today's hearing focuses on two sections of Dodd-Frank, Sections 121 and 165. Our witnesses represent the two agencies given what we believe to be enormous power under these provisions, the FDIC and the Federal Reserve.

Section 121 of the Dodd-Frank Act authorizes the Federal Reserve Board to act, with the approval of the FSOC, to restrict a large financial company's activities or to require it to divest assets or operations if the company imposes "a grave threat" to the U.S. financial system, "grave threat" being used only one time within the Dodd-Frank Act, making it potentially a special phrase.

Those who interpret this section broadly question whether the Fed could use this authority against an institution that may not presently pose a threat but, due to their size, structure, or interconnectedness or perhaps some other reason that we have not even dreamed up yet, they could pose a future threat to the economy.

Section 165 gives the FDIC and the Federal Reserve authority to demand so-called living wills to ensure that large financial companies provide on a yearly basis how they can be quickly resolved, and safely done so, under the Bankruptcy Code in the event of financial distress. It also states, in the event of a deficient living will, that the FDIC and the Fed "may jointly impose more stringent capital leverage or liquidity requirements or restrictions on the growth, activities, or operations of a covered company." And then it further continues, giving authority that it "may jointly direct by order to divest certain assets or operations."

To date, the Fed and the FDIC have not judged a living will deficient. However, certain Federal officials have indicated that the Fed and the FDIC are prepared to use their authority under Section 165 to impose substantive changes on company structures. Even some government officials, interest groups, news media sources, and other parties have argued that the government should order certain large financial institutions to divest assets or operations, break them up, as a means to further reducing systemic risk. Large banks, they argue, derive an unfair competitive advantage relative to firms that are not deemed "too-big-to-fail" because their status allows them to secure lower borrowing costs.

Now, we have heard these arguments before, and this is certainly not news to our witnesses today, at least I would hope not, based on their roles. This hearing is one of a series of hearings to better understand the authority vested in the Federal Reserve and the FDIC to order large interconnected financial institutions to divest assets or operations, and the potential legal ramifications of those actions that could result from attempting to carry out this authority; also, for the panel to be able to clarify whether respective agencies view these provisions within Dodd-Frank as a broad authority to break up financial institutions or, alternatively, a narrower interpretation of this authority to operate in limited circumstances.

Now, there is a lot to understand from policymakers on the Hill about the ramifications of the law as written, not what we had hoped the law to be, the phrases that we had hoped the law would have, but to actually tell us what that text, how you and the respective agencies interpret that, your planning for it, and the process going forward. We need some clarity on this. And this is why we are having this Oversight and Investigations Subcommittee hearing, for both oversight purposes and to investigate the actions that you have taken.

So, with that, I will recognize the ranking member of the subcommittee, Mr. Green of Texas, for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman.

I also want to thank the witnesses for appearing today.

Also, Mr. Chairman, if I may, I would like to take just a moment and express my deepest sympathies for those who are victims of this horrific tragedy that has occurred in Boston. My prayers are with them. And I believe that our government is doing all that it can as quickly as it can to bring justice to this situation.

Mr. Chairman, "too-big-to-fail" is the right size to regulate, not replicate. Please allow me to explain.

GAO has reported that the 2008 crisis cost the United States $13 trillion in lost economic output and $9.1 trillion in home equity and wealth. In 2008, the options were less than few, there were two: bankruptcy or bailout. Lehman's collapse proved that bankruptcy didn't work. And in addressing the bailout option, columnist Allan Sloan stated it well in the title of his July 8, 2011, article. It was styled, "It was a lowdown, no-good, god-awful bailout. But it paid." And although taxpayers came out ahead, tax dollars should not have been put at risk.

Dodd-Frank takes taxpayers off the hook. It does so by repealing the Fed's Section 13(3) lending authority. It explicitly prohibits any taxpayer loss. It provides bankruptcy as a first option. Some things bear repeating: It provides bankruptcy as a first option. And I emphasize this because it seems to get lost in the messaging that bankruptcy is still an option.

With FDIC-like orderly liquidation, FDIC-like—prior to Dodd-Frank, we did not have the ability to wind down these huge institutions that we had with banks, generally speaking, because with banks, we had the FDIC. We could go in on Friday and close a bank, and open it up on Monday under a new name. But we didn't have that type of authority. Well, now we do. We have FDIC-like orderly liquidation authority if bankruptcy would result in a Lehman-like broad, systemic disruption. In the event of these huge institutions possibly creating systemic disruption, we have this wind-down authority.

It provides the Financial Stability Oversight Council with authority to minimize and/or downsize "too-big-to-fail" institutions. It requires lending institutions to provide living wills to demonstrate how they would be resolved under bankruptcy laws. It limits the amount of their Tier 1 capital—that is their core capital, primarily common stock—it limits the Tier 1 capital a bank can invest in hedge and private equity funds.

Some want to eliminate or undermine Dodd-Frank. To do so will not end "too-big-to-fail." Ending Dodd-Frank would take us back to a future without the tools to deal with "too-big-to-fail," the same future that produced a $13 trillion loss in economic output and a $9.1 trillion loss in home equity and wealth.

"Too-big-to-fail" is the right size to regulate, not replicate. And, quite frankly, that is what Dodd-Frank does: It regulates the "too-big-to-fail" institutions.

I yield back the balance of my time.

Chairman McHENRY. I thank the ranking member.

And, with that, I will recognize Mr. Ross of Florida for 3 minutes.

Mr. ROSS. Thank you, Mr. Chairman. I appreciate you holding this important hearing today.

Today's hearing explores the authority of the Federal Reserve and the Federal Deposit Insurance Corporation to break up financial institutions under Sections 121 and 165 of the Dodd-Frank Act. After over 2½ years, the Fed and the FDIC have yet to clarify this authority and the circumstances under which they would use it. Today, I look forward to hearing how the Fed and the FDIC view their authority to break up financial institutions under Dodd-Frank.

It is particularly important that we hold this hearing today because, as recent congressional actions seem to acknowledge, "too-big-to-fail" still exists, and Dodd-Frank did not end "too-big-to-fail." Under Section 121 of Dodd-Frank, if the Fed determines that a bank holding company with $50 billion or more in assets or a systemically important nonbank financial company poses a "grave threat" to U.S. financial stability, the Federal Reserve, with a two-thirds vote of the FSOC, can take certain actions to limit or restrict a company's activities. As a last resort, if restricting those activities doesn't work, the Federal Reserve must require the company to sell assets or off-balance-sheet items.

I, and I think the American people, have many questions about how the Federal Reserve would decide if a company poses a grave threat to our economy, since the term is not defined in the Dodd-Frank Act. I also have many questions about whether and under what circumstances the Federal Reserve will use this authority. Unfortunately, the written testimony of the Federal Reserve witness today does not reveal how the Fed construes this power.

I look forward to the witnesses' answers to these questions, and I thank the witnesses for testifying today.

Mr. Chairman, I yield back the balance of my time.

Chairman McHENRY. I thank the gentleman.

I now recognize Mrs. Maloney for 3 minutes for an opening statement.

Mrs. MALONEY. Thank you very much, Chairman McHenry, and Ranking Member Green.

And welcome to all of our witnesses today.

This is the second hearing we have had on the question of "too-big-to-fail" and whether Dodd-Frank ended the implicit government guarantee. And while the last hearing looked at the role of the FSOC and the OFR in identifying systemic risk, this hearing is looking at the amendment that came to be called the Kanjorski Amendment, Section 121, probably the most debated one during the conference committee. We are also looking at Section 165, which imposes heightened prudential standards on larger institutions, requiring them to complete living wills and to present their plans for orderly liquidation.

So this is an important hearing as we look at these two proposals and the specific tools that regulators are given now through Dodd-Frank. During the crisis, they basically had two roads they could go down. They could either close down an institution, as we did with Lehman—not a good choice—or you could bail them out. We bailed out AIG, again, not a good choice.

This basically gives regulators the ability to go into a troubled institution and force them to unwind and restructure and really confront the crisis. The FDIC had these tools during the crisis, and I believe they performed incredibly well in taking steps to really stabilize the economy and to help institutions to survive to continue serving the public.

So I look forward to this hearing—I think it is a very important one—and to listening to the comments today. Thank you for calling it, Mr. Chairman, and Mr. Ranking Member.

I yield back. Thank you.

Chairman MCHENRY. I certainly appreciate that.

And I appreciate the Members' timeliness for opening statements, since we were delayed with the votes.

We will now recognize our distinguished panel of witnesses.

From the Federal Reserve Board of Governors, we have Mr. Scott Alvarez, who serves as General Counsel of that institution, and previously served as the Board's Assistant General Counsel from 1989 to 1991. He earned a B.A. in economics from Princeton, and a J.D. from Georgetown Law Center.

Mr. James Wigand is the Director of the FDIC's Office of Complex Financial Institutions, where he oversees planning for resolving systemically important financial companies. He previously was Deputy Director within the FDIC's Division of Resolutions and Receiverships for 14 years. He received a B.S. from the University of Maryland, and an MBA, with a specialization in finance, from the University of Chicago. I appreciate an ACC school being represented on the panel.

And Richard Osterman is currently serving as acting General Counsel for the FDIC, and is otherwise the Deputy General Counsel for the FDIC's Litigation and Resolutions Branch. He has held several positions within the FDIC's Legal Division. Before the FDIC, he worked at the Federal Home Loan Bank Board and the Interstate Commerce Commission. He has a B.A. from Swarthmore, and a J.D. from the University of Baltimore School of Law.

Because we have two institutions represented today, and by prior agreement, we will only have two testimonies today. We will recognize Mr. Alvarez first for 5 minutes for his oral opening statement, and then we will recognize Mr. Wigand for 5 minutes to give an opening statement on behalf of the FDIC.

And, without objection, each of your written statements will be made a part of the record.

You know the deal with the lights: green means go; yellow means hurry up; and red means stop. We want to make sure Members have time to ask questions.

With that, Mr. Alvarez, you are recognized for 5 minutes.

STATEMENT OF SCOTT G. ALVAREZ, GENERAL COUNSEL, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. ALVAREZ. Chairman McHenry, Ranking Member Green, and members of the subcommittee, thank you very much for the opportunity to testify on the provisions of the Dodd-Frank Act, designed both to address the risks posed by systemically important financial institutions and to ensure that no institution is “too-big-to-fail.”

The perception that an institution is “too-big-to-fail” reduces the incentives of the firm and its shareholders, creditors, and management to limit risk-taking and distorts competition by enabling the firm to fund itself more cheaply than its competitors.

Dodd-Frank contains a number of provisions that address the risks posed by these systemically important institutions. The goal of the Federal Reserve in implementing these provisions is to substantially reduce the probability of failure of our largest, most complex financial firms and to minimize the social losses if such a firm should fail. The steps we are taking would also minimize the advantage these firms enjoy based on perceptions of their systemic importance.

A critical way to reduce distortions from “too-big-to-fail” is for our most systemic banking firms to have substantial capital buffers. We are, therefore, strengthening the basic bank regulatory capital framework and specifically increasing capital requirements on the most systemic banking firms.

Last year, the Federal Reserve and the other U.S. banking agencies issued proposals to implement BASEL III capital standards. These proposals would introduce a new common equity requirement, raise the existing Tier 1 capital requirement, implement a capital conservation buffer, and improve the quality of regulatory capital. The largest banking firms would also be subject to a supplementary leverage ratio, a countercyclical capital buffer, and higher capital charges for derivatives and trading exposures.

In addition, the Federal Reserve conducts an annual stress test of the largest U.S. bank holding companies. Our stress-test regime has helped produce a significant strengthening of the capital bases of the largest U.S. banking firms since the onset of the crisis. The aggregate Tier 1 common equity ratio at the 18 largest banking firms has more than doubled, from 5.6 percent at the end of 2008 to 11.3 percent at the end of 2012, reflecting an increase of about $400 billion in capital.

Dodd-Frank also requires the Federal Reserve to establish enhanced prudential standards for large bank holding companies that increase in stringency based on the systemic footprint of those companies. Consistent with this mandate, the Federal Reserve helped negotiate an international framework of capital surcharges for the most systemic global banking firms and will soon issue capital surcharge proposals for systemic U.S. bank holding companies.

In addition, the Federal Reserve has proposed a broad set of enhanced prudential requirements for the largest U.S. banking firms and foreign banks operating in the United States.

Another Dodd-Frank provision empowers the orderly liquidation of a major financial firm to reduce the potential damage to the broader economy from the failure of the firm. The Federal Reserve continues to work with the FDIC on the development of the FDIC’s OLA framework and is considering the requirement that firms maintain a minimum amount of long-term, unsecured debt to facilitate use of the OLA. The Federal Reserve and the FDIC also are working together to review firm resolution plans which will help identify and address impediments to an orderly resolution.

Finally, the Dodd-Frank Act contains several provisions that limit the size and growth of financial firms. For example, Section 622 prohibits a firm from growing through acquisition, with very limited exceptions, once the firm reaches a specified size. And Section 121 authorizes the Federal Reserve, with the consent of two-thirds of the Financial Stability Oversight Council, to impose a variety of restrictions if a large bank holding company or designated nonbank financial company poses a grave threat to U.S. financial stability.

The Federal Reserve has made significant progress in the past few years to address the risks posed by systemically important financial institutions and to help ensure that no institution is "too-big-to-fail." However, more work remains to be done, and the Federal Reserve, working along with the FDIC and others, remains hard at work.

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

[The prepared statement of Mr. Alvarez can be found on page 44 of the appendix.]

Chairman MCHENRY. I now recognize Mr. Wigand for his oral statement.

STATEMENT OF JAMES R. WIGAND, DIRECTOR, OFFICE OF COMPLEX FINANCIAL INSTITUTIONS, FEDERAL DEPOSIT INSURANCE CORPORATION, ACCOMPANIED BY RICHARD J. OSTERMAN, JR., ACTING GENERAL COUNSEL, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. WIGAND. Chairman McHenry, Ranking Member Green, and members of the subcommittee, thank you for the opportunity to testify on behalf of the Federal Deposit Insurance Corporation on Sections 165 and 121 of the Dodd-Frank Act. My oral remarks this afternoon will summarize the FDIC's role and progress in implementing the resolution plan requirements of Section 165.

Under the Dodd-Frank Act, bankruptcy is the preferred resolution framework in the event of a systemic financial company's failure. To make this prospect achievable, Title I of the Dodd-Frank Act requires that all large, systemic financial companies prepare resolution plans, or living wills. These plans must demonstrate how the company would be resolved in a rapid and orderly manner under the Bankruptcy Code in the event of a company's material financial distress or failure.

The FDIC intends to make the living will process under Title I of the Dodd-Frank Act both timely and meaningful. The living will process is a necessary and significant tool in ensuring that large financial institutions can go through an orderly resolution under bankruptcy.

In November 2011, the FDIC and the Federal Reserve Board issued a joint rule to implement Section 165(d) requirements for resolution plans. The Section 165(d) rule sets out the information to be included in a firm's resolution plan. Under the rule, among other requirements, each firm must identify critical operations and core business lines, map those operations and core business lines to each firm's material legal entities, and identify the impediments to a rapid and orderly resolution in bankruptcy.

In addition to the resolution plan requirements under the Dodd-Frank Act, the FDIC issued a separate rule for all insured depository institutions, or IDIs, with greater than $50 billion in assets. This group of IDIs must submit resolution plans to the FDIC for their orderly resolution under the Federal Deposit Insurance Act.

The Section 165(d) rule and the IDI resolution plan rule are designed to work in tandem by covering the full range of business lines, legal entities, and capital structure combinations within a large financial firm.

Bank holding companies and foreign banking organizations with $250 billion or more in nonbank assets submitted their initial resolution plans on July 1, 2012. The FDIC and the Federal Reserve Board have reviewed this first set of resolution plans for informational completeness to ensure that all information requirements of the rule were addressed in the plans. The 11 firms that submitted initial plans in 2012 will be expected to revise and update their plans in their 2013 submissions.

Yesterday, the FDIC and the Federal Reserve Board issued guidance which provides significant detail on our expectations for the revised plans. The guidance focuses on key issues and obstacles to an orderly resolution in bankruptcy, including global cooperation and the risk of ring-fencing and other precipitous actions. The revised plans must also address the risk of multiple competing insolvency proceedings and the firm's global liquidity management, including a detailed understanding of funding operations and cash flows. Finally, the revised plans should assure the continuity of critical operations, particularly maintaining access to shared services and payment and clearing systems, and address the potential systemic consequences of counterparty actions.

In addition to informational content, the FDIC and the Federal Reserve Board must review each plan's strategic analysis. If, as a result of their review, the FDIC and the Federal Reserve Board jointly determine that the resolution plan is not credible or would not facilitate an orderly resolution of a firm under the Bankruptcy Code, then the company must resubmit the plan with revisions. The resubmitted plan may, if necessary, include proposed changes in business operations or corporate structure.

If the company fails to resubmit a credible plan that would result in orderly resolution under the Bankruptcy Code, the FDIC and the Federal Reserve may jointly impose more stringent capital, leverage, or liquidity requirements; restrict growth, activities, or operations; or 2 years after the imposition of such requirements and in consultation with the FSOC, order the company to divest certain assets or operations if the company has failed to resubmit the resolution plan as required.

The FDIC's goal is to ensure that firms that could pose a systemic risk to the financial system can undergo a rapid and orderly resolution in bankruptcy. Achieving the goal that any institution, regardless of size, complexity, or interconnectedness, can be effectively resolved through a bankruptcy process will contribute to the stability of our financial system and will avoid many of the difficult choices regulators faced in dealing with systemic institutions during the last crisis.

That concludes my opening statement. I would be glad to respond to your questions.

[The joint prepared statement of Mr. Wigand and Mr. Osterman can be found on page 52 of the appendix.]

Chairman MCHENRY. Thank you very much.

And to restate the title of the hearing we are having today, "Who is Too Big to Fail: Does Dodd-Frank Authorize the Government to Break Up Financial Institutions?" This is about Sections 121 and 165 of the Dodd-Frank Act.

I now recognize myself for the purpose of questioning the witnesses. So, with that, we will begin.

Mr. Osterman, does Dodd-Frank give your agency the authority to break up big banks under Sections 121 or 165?

Mr. OSTERMAN. Thank you for the question, Chairman—

Chairman MCHENRY. Thanks. If you will pull your microphone closer?

Mr. OSTERMAN. Certainly. Can you hear me better now?

Chairman MCHENRY. Yes.

Mr. OSTERMAN. Thank you for your question.

Section 121, of course, is the Federal Reserve's—

Chairman MCHENRY. You don't have to define it. I understand. I'm sorry. Then I will—

Mr. OSTERMAN. Section 165 requires the filing of living wills and resolution plans to determine whether an institution can be resolved in bankruptcy. The purpose of the provision—

Chairman MCHENRY. You don't have to tell me the purpose. I just wanted to know your authority under that section. Do you have the authority to break up large financial institutions?

Mr. OSTERMAN. The authority is to resolve them in bankruptcy, to determine whether they can be resolved in bankruptcy. If the institution can be resolved in bankruptcy, then it is not going to cause a systemic risk to the United States financial system. That is the way the statute is being—

Chairman MCHENRY. So let me actually re-pose this—

Mr. OSTERMAN. Yes.

Chairman MCHENRY. —okay? Does the FDIC have the authority, in conjunction with the Federal Reserve, to force the institution to sell assets?

Mr. OSTERMAN. The FDIC and the Fed through the—

Chairman MCHENRY. It says in the text of the law that you do.

Let me move on, to Mr. Alvarez.

Mr. Alvarez, let me pose the same question to you. Under Sections 121 or 165, does Dodd-Frank give your agency the authority, in conjunction with the FDIC, if you will, to break up big banks?

Mr. ALVAREZ. So, as you read, Section 121 allows the Federal Reserve, in consultation with the FSOC, not the FDIC, to require large firms to sell assets.

However, it imposes a high hurdle on the requirement. We must find and the FSOC must agree, two-thirds of the FSOC must agree, that the institution poses a grave threat, not just any threat, a grave threat, to financial stability. And we are required by statute to consider a variety of alternatives first, including restrictions on growth, restrictions on activities, conditions on operations, many other things, as precursors to the sale of assets. The sale of assets is the last on the list.

Chairman MCHENRY. Okay. Have you defined the term "grave threat?"

Mr. ALVAREZ. No, we have not. We think that would be a determination that is going to depend very much on the facts and circumstances of the case. It will depend very much on the activities the institution is engaged in, whether the institution is unique or has a special place in the financial system. Obviously, size would be one of the factors, the way in which it conducts activities. There is a variety of things. And we think because of that variety of circumstances, it is very difficult to have a uniform rule that would be clear in all circumstances.

Chairman MCHENRY. So it would be situational?

Mr. ALVAREZ. Yes.

Chairman MCHENRY. Could it be based on what the market is doing at that moment, as well?

Mr. ALVAREZ. It could take into account the economics at the time, that is correct.

Chairman MCHENRY. Okay.

Now, can you utilize this? Does the Federal Reserve believe, in your legal judgment, that it can use this authority outside of moments that are financial crises?

Mr. ALVAREZ. Section 121 does not impose the requirement that it only be used in a financial crisis. It is very open-ended. At any point at which the Fed and the FSOC agree that an institution poses a grave threat to the financial stability, then it could be used.

Chairman MCHENRY. Okay. Now, is there a size challenge here? Are certain institutions more the focus of your view from the Fed?

Mr. ALVAREZ. Oh, absolutely. Section 121 applies just to institutions that are $50 billion or larger or have been designated by the FSOC as systemically important. It would not apply to community banks or even regional banks.

Chairman MCHENRY. So a grave threat could happen in times of relative peace and harmony and accord?

Mr. ALVAREZ. It could.

Chairman MCHENRY. Okay.

All right. With that, I will now recognize—at the direction of the ranking member, I will recognize Mr. Cleaver for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman, and Mr. Ranking Member.

Mr. Alvarez, would you agree that with some different, more stringent accounting standards, that the so-called "too-big-to-fail" banks are actually twice as large as they appear in the rearview mirror on the passenger side?

Mr. ALVAREZ. Congressman, I am not an expert on accounting. The accounting changes since the crisis, in the last 2 years, have required institutions to bring onto their balance sheet many assets that before the crisis were not counted. So, for example, a lot of securitizations are now reflected on the balance sheet of banks, so their size is more transparent than it once was.

And the capital requirements that we are designing, the BASEL III capital requirements, also take into account off-balance-sheet items in a more robust way. So we are beginning to take that into account as we design higher capital requirements.

Mr. CLEAVER. So would you or Mr. Wigand agree that—let me ask you this: Did Dodd-Frank rule out the cause of the 2008 financial crisis which resulted in massive losses in the U.S. economy? Was it repaired?

Mr. ALVAREZ. I think what Dodd-Frank did was to provide the agencies with far better tools to both prevent the problems of large institutions and then, if there is a problem, to resolve the institution. So the enhanced prudential capital standards, Section 165, the orderly liquidation authority in Title II are two very valuable tools that we think help.

Mr. CLEAVER. Okay. Mr. Wigand, go ahead, and then, I have a follow-up.

Mr. WIGAND. Yes, sir. I would echo Mr. Alvarez's comments. There are two key elements that I think are substantial tools in ending "too-big-to-fail." One is the set of enhanced prudential supervisory standards found in Section 161, which go to reducing the probability that one of these systemically important companies will fail.

The second tool is the orderly liquidation authority, or Title II, which in the event that bankruptcy cannot handle a failure, serves as a backstop which then allows for a systemically important financial company to fail in a manner without cost to taxpayers, and imposes market discipline by forcing losses upon the creditors and shareholders of the institution, and also results in the management of the company being held accountable for the failure itself.

These are elements that didn't exist in the early parts of—or at all during the 2008 crisis.

Mr. CLEAVER. But most of these banks are larger than they were when the crisis began, and the community banks in the BASEL III are experiencing much more pain and difficulty in operating.

So, if the deposits are going with the larger banks and the smaller banks are struggling, what have we done?

Mr. ALVAREZ. Congressman, that is a very good point, and that is one of the motivators for some of the capital and other requirements that we are imposing. That puts back to the large institutions some of the cost of their size and takes away some of the advantage they have as a result of their size, thereby more equalizing competition. So, they are no longer able to rely on lower capital requirements and better funding. They have higher capital requirements, which make up for their better—

Mr. CLEAVER. Those higher capital requirements have also been imposed by the regulators on community banks.

Mr. ALVAREZ. To that point, we have—

Mr. CLEAVER. Unfortunately and tragically. But go ahead.

Mr. ALVAREZ. We do have a special set of requirements that we are imposing only on the largest institutions, not on community banks, so $50 billion and up.

We also understand that the BASEL III proposal we put out has had some effects on smaller institutions in ways we hadn't anticipated. We have been working with those smaller institutions to understand how to address that, and we are fully thinking through ways to address those problems.

Mr. CLEAVER. Yes, I appreciate that. My time is running out. But they don't seem to know it.

Mr. ALVAREZ. We haven't finished the rulemaking yet. So when it is complete, they will know.

Mr. CLEAVER. All right. Thank you.

Chairman MCHENRY. With that, we will recognize the former chairman of the full Financial Services Committee, Mr. Bachus of Alabama, for 5 minutes.

Mr. BACHUS. Thank you.

This question, I think, will be for you, General Counsel Alvarez. And I am specifically referring to Section 165(b), where you require foreign banks, if they are operating U.S. subsidiaries, to have an intermediate holding company.

Mr. ALVAREZ. Yes.

Mr. BACHUS. All right. I think you have acknowledged that this might increase the cost to capital and the liquidity requirements may cause them to have some—in some cases, requirements that their U.S. competitors may not have, for instance, if they are broker-dealers.

Is there a negative to requiring this? I understand that this was in response to some of the runs, because at least some of these U.S. subsidiaries did rely on a lot of short-term lending. But is there another way to address that? Do you have any concerns over the fact that we may lose some of their services and their capital?

Mr. ALVAREZ. We have a proposal out for comment, as you alluded to, and we are receiving comments now. The comment period is actually still open, so we expect we will get quite a lot of advice on how best to regulate the U.S. operations of foreign banks.

The motivation for that proposal is that with foreign banks, if they are allowed to operate in the United States while maintaining capital back home in the foreign country, that capital may not be available in the United States at a time when the U.S. operations need the capital. And so the idea—

Mr. BACHUS. That would be centralized with their home country?

Mr. ALVAREZ. Correct.

Mr. BACHUS. But isn't that true of our domestic banks operating in other countries, they tend to keep their capital here? And I am just wondering if we might—I know some of the international banking associations have talked about that. Could this cause some sort of a—those regulators in those countries to require that we increase capital in our subsidiaries operating in those countries?

Mr. ALVAREZ. Yes, and that is something that we have asked for comment about. It is worthy of note, though, that some foreign countries have already begun that process. The United Kingdom, for example, is already requiring some subsidiarization in the U.K., which is a place where a lot of U.S. entities have operations.

So we definitely want to be sensitive to the possibility that this might encourage more ring-fencing. On the other hand, we also have to balance that with the need to protect the financial stability of the United States and ensure that institutions in the United States have adequate capital. So it is a difficult question, and that is why we put a proposal out for comment, to see how best to balance those needs.

Mr. BACHUS. Because I think you do agree that it could affect banking competition in the United States and the competitiveness of our U.S. banks abroad if the regulators in those countries respond to it.

Mr. ALVAREZ. Right. The competition is interesting in both places. So it could affect the way U.S. entities compete abroad, but the other thing to keep in mind is how foreign entities compete in the United States. And if they are allowed to compete in the United States without the same capital requirements and without the same prudential limits that apply to other U.S. organizations in the United States, that could give the foreign entities a competitive advantage here, as well as exposing our system to more financial risk.

So, there are competitive balances on both sides that we have to weigh.

Mr. BACHUS. Yes. But you are aware of their concerns and, I think, are at least trying to address those in a way that at least addresses their concerns and at the same time protects our national interest not to have a—

Mr. ALVAREZ. Yes. If they have visited you, you can be sure they have visited us at least twice as often.

Mr. BACHUS. Okay. Thank you very much.

Chairman MCHENRY. I thank the former chairman.

We will now recognize Mr. Ellison of Minnesota for 5 minutes.

Mr. ELLISON. Thank you, Mr. Chairman.

Mr. Chairman, and Mr. Ranking Member, I guess I have a few kind of basic questions for the panel.

One is, having gone through some of the rulemaking requirements, would you say that Dodd-Frank takes an arbitrary or an objective approach to determining which financial institutions are "too-big-to-fail?"

Mr. OSTERMAN. I will take a first shot at your question.

I think Dodd-Frank takes a very thoughtful approach to addressing "too-big-to-fail." There is the living will process, which requires promulgated regulations that would require resolution plans which outline how the institution could be resolved in the bankruptcy process.

The resolution plan is jointly reviewed by both the Fed and the FDIC to determine if it meets that standard. If it does not, then we go back and we advise the institution of the things that need to be done to meet the standard of whether the plan is credible and shows the institution can be resolved in bankruptcy.

If the resubmitted plan comes back and it doesn't meet that standard, again, we have to jointly determine that it doesn't meet those standards, and then we apply additional requirements such as higher capital or leverage or liquidity requirements, restrictions on growth. And if the plan comes back and it still doesn't meet that standard, then we get to the situation of potential divestiture.

Mr. ELLISON. But have any of the three of you ever heard the saying that the government should not "pick winners and losers?" Have you ever heard that terminology before?

Mr. ALVAREZ. Yes.

Mr. ELLISON. I guess my question to you is, in the situation where you have a "too-big-to-fail" financial institution, one might argue that Dodd-Frank is trying to pick winners and losers, but if a firm were to be in the criteria of "too-big-to-fail" and therefore draw additional scrutiny from the government—and the government wouldn't be picking that company out. That would be the features and the attributes and the size and the interconnectedness of that company. Am I right about that?

Mr. OSTERMAN. That is correct.

Mr. ELLISON. Would you like to add to that, Mr. Alvarez?

Mr. ALVAREZ. I guess I don't think about Dodd-Frank as picking firms as "too-big-to-fail."

Mr. ELLISON. Okay.

Mr. ALVAREZ. The idea is actually to get rid of "too-big-to-fail."

Mr. ELLISON. Correct.

Mr. ALVAREZ. And so what Dodd-Frank does is say for large institutions, in order to ensure that no one believes they are "too-big-to-fail,"we are going to do at least two things, two major things.

The first is, we are going to regulate them more because they pose more risk, large firms pose more risk. Whether they are "too-big-to-fail" or not in some person's mind, they deserve extra supervision and regulatory requirements.

And then second, we have an orderly liquidation authority so that no one is "too-big-to-fail." We now have a mechanism for closing down and making shareholders take losses for any institution, no matter what their size.

Mr. ELLISON. But you would agree that it is not just some arbitrary bureaucrat saying, "You are too-big-to-fail. We are going to go after you." There are specific criteria that might make a firm hit that criteria.

Mr. ALVAREZ. So the small piece of arbitrariness is the $50 billion cutoff for most of the provisions that are in the statute. The statute sets the $50 billion requirement. Once you are—

Mr. ELLISON. Right. But that requirement is not different for different firms. It is $50 billion, right?

Mr. ALVAREZ. Right. Plus, it also gives the agencies authority to tailor things as they get larger—

Mr. ELLISON. Right.

Mr. ALVAREZ. —so we take away some of that arbitrariness.

Mr. ELLISON. The Sunlight Foundation noted that the top 20 banks and banking associations met with just 3 agencies—the Treasury, the Federal Reserve, and the Commodity Futures Trading Commission—a total of 1,298 times over a 2-year period from, say, July 2010 to July 2012. That is an average of about 12 meetings a week. Financial reform groups met with regulators significantly less than that.

How do you assess just the amount of contact that the entire financial services world is getting with the Federal Government? Do you have any concern that the larger banks are just flat out getting more attention from agencies like Treasury, the Fed, and the CFTC?

Mr. ALVAREZ. Of course, you can do a lot with statistics, and how you group things makes a difference. That said, it doesn't surprise me that financial institutions meet more with those three agencies. We are all doing a lot of rulemaking that affects them directly. By law, we have to get comments from people who are affected by those rules. So, they are the most affected and would want to have the most meetings.

I would say that the Federal Reserve, in particular, has an open-door policy of meeting with folks. We meet with community groups, we meet with consumer advocacy groups. We meet with a lot of folks on our rulemakings. So it is not limited to or even focused on financial institutions.

Mr. ELLISON. Thank you.

I yield back.

Chairman MCHENRY. Mr. Ross of Florida is recognized for 5 minutes.

Mr. ROSS. Thank you, Mr. Chairman.

Let's talk about "grave threat."

Mr. Alvarez, you say that it is institutional as to how we really assign "grave threat," but really we haven't defined it. So it really isn't only institutional, but it is also environmental. In other words, it depends on the current economic environment at the time. Wouldn't you say that is correct?

Mr. ALVAREZ. Yes, I think those are both factors.

Mr. ROSS. So it is more or less a game-time decision as to determine whether a grave threat exists. How else would you anticipate it?

Mr. ALVAREZ. Yes.

Mr. ROSS. And if that is the case, then let me ask you, are there any particular financial institutions today, without naming names, is there presently any company that poses a grave threat to the U.S. financial system within the meaning of Section 121 today?

Mr. ALVAREZ. So, the other part that fits into—

Mr. ROSS. But are there—you have had 2½ years.

Mr. ALVAREZ. I'm sorry?

Mr. ROSS. You have had 2½ years to determine whether there is a grave threat by any institution or any company. So are there any today, again without naming names, that you would consider pose a grave threat to the financial stability of the United States?

Mr. ALVAREZ. Remember, the other thing we have to take into account in deciding grave threat is whether the mitigants, that the higher capital, restrictions on activities, other regulatory and statutory factors—

Mr. ROSS. But absent—

Mr. ALVAREZ. —have reduced the risk of the institution.

Mr. ROSS. But absent the—

Mr. ALVAREZ. So we are in the process of still doing those rules and getting those requirements—

Mr. ROSS. So there aren't any? Essentially, there aren't any, then? There are no—

Mr. ALVAREZ. We have made no findings of that so far.

Mr. ROSS. Okay. Why? Because there are no quantitative metrics existing as to how to apply grave threat?

Mr. ALVAREZ. Because we have still the Dodd-Frank Act provisions, the preliminary requirements to get completed and imposed, and then react to—

Mr. ROSS. So let me ask you this point blank. Do you have any quantitative metrics that you use now to determine whether a company may be a grave threat?

Mr. ALVAREZ. We do not have a quantitative measure. That is—
Mr. ROSS. Do you anticipate having any?
Mr. ALVAREZ. That is a possibility.
Mr. ROSS. Within the next year?
Mr. ALVAREZ. It is a real—we are in the process of doing what the statute requires, which is to put in place the mitigants that then are applied to all large institutions to see—
Mr. ROSS. I understand the logic and reason here. How can you quantify the expense associated with mitigating a threat you can't even quantify?
In other words, this is a situation where you have no standard; there is no standard, as we know, that exists for grave threat. You determine based on, I guess, discretion at the moment that what may be considered to be a grave threat today may not be a grave threat tomorrow.
So if there are no quantitative metrics and there are no standards, what all has the Fed done in the last 2½ years in discussing what would constitute a grave threat?
Mr. ALVAREZ. As I indicated, we are following the process Congress has set out for us. That includes establishing these mitigating factors, which are higher capital, restrictions on growth, restrictions on activities—
Mr. ROSS. So, it could be size. It could be capitalization. It could be a number of things.
Mr. ALVAREZ. Yes.
Mr. ROSS. And who would the grave threat be to? Consumers?
Mr. ALVAREZ. To the financial stability of the United States economy.
Mr. ROSS. And how did you determine that? Have you had discussions as to how you would determine the grave threats to the United States?
Mr. ALVAREZ. Certainly, we think about many things at the Federal Reserve, including what we will do with grave threat, but we have not made any proposals or made any findings at this time.
Mr. ROSS. So does it take—under Section 121, does it require that a company must first be in bankruptcy as a precondition to be considered a grave threat?
Mr. ALVAREZ. No, it doesn't.
Mr. ROSS. Under Section 165, then, you can really be a grave threat if you just don't have an appropriate living will? Is that correct? If it doesn't meet your standard?
Mr. ALVAREZ. You mean, required to sell assets?
Mr. ROSS. Right.
Mr. ALVAREZ. There is no connection between the grave threat and Sections 121 and 165.
Mr. ROSS. Right. Grave threat is under Section 121, but—
Mr. ALVAREZ. Under Section 121, the institution has to have a plan that is not credible and refuse—and the agencies have to jointly determine that. We then have to impose other requirements on the firm. The firm has to not only not live up to those requirements but not put in another credible capital plan. And then there is a—
Mr. ROSS. But—
Mr. ALVAREZ. —2-year waiting period.

Mr. ROSS. Really quick; I only have a couple of seconds. I guess what I am getting at, and my point is, that there are no standards available right now to determine grave threat for either a bank SIFI or a nonbank SIFI. Is that correct?

Mr. ALVAREZ. That is right.

Mr. ROSS. And it seems to me, then, that we are not discussing whether a bank or any other institution is "too-big-to-fail." What it seems to me that we are discussing is that for 2½ years, having a lack or procedure and regulatory rule implemented, we have a situation of "too late to save." Because you are not going to be able to save these institutions if you have no standards in place by which they know how to correct what they don't even know is incorrect.

I believe my time is up, so I will yield back.

Chairman MCHENRY. I thank the gentleman.

Mr. Heck is recognized for 5 minutes.

Mr. HECK. Thank you, Mr. Chairman.

Depending on how you count, last Friday or Saturday was our 100th day in the 113th session. I sometimes feel as though I have been sentenced to sit in a darkroom exposed to a continuous loop of the old beer commercial in which the two sides yell at each other: "Less filling," "Tastes great," "Less filling," "Tastes great."

Look, here is what I hear when I listen to people back home about what all of this "too-big-to-fail" business means. The average person, they look at this and they want to know the answer to two questions. And the two questions are: First, what can you say to assure me that I am not going to have to dig into my pocket in order to bail out a company again, a bank that is teetering? And second, what can you tell me to assure me that some bank, either through its own imprudent business practices or lack of regulatory oversight will not fail so miserably that it materially harms the economy and I lose my job or I lose net worth through lower home value or whatever?

So, gentlemen, my only question to each of the three of you is, what can you say to assure that person, who really only defines "too-big-to-fail" from where I sit in those two ways, what is it that you can say to assure them that they are not going to have to dig in their pocket to bail out a bank again, number one? And, number two, what can you say in succinct and cogent terms to assure them that no bank is ever going to do a face-plant again sufficient to cost them their home or their job?

Mr. OSTERMAN. In terms of your first question about no bailout, the statute now provides that no taxpayer funds can be used to resolve an institution.

We have Title I that provides for living wills so we can try to address these institutions so they can be resolved in bankruptcy. And if they cannot be, we have the backup of Title II, which allows us to use the powers that the FDIC has used for the last 80 years to successfully resolve institutions and maintain confidence in the financial system.

Mr. WIGAND. I would reiterate Mr. Osterman's remarks that Title II contains a provision which explicitly prohibits any losses being borne by taxpayers associated with the use of Title II authority. With respect to orderly liquidation authority and its application, a provision within the statute itself prohibits the use of taxpayer dollars in the application of that authority. With respect to at least an application of Title II, there is an assurance that authority will not use taxpayer funds in a resolution process.

Additionally, what is important—and I think all of the panelists spoke to this at some level—is that Title I puts enhanced prudential supervisory requirements and regulatory requirements upon institutions to reduce the probability or the likelihood that these institutions will fail. And—

Mr. HECK. Sir, is that what you would recommend I say to my constituents back home? Using those words, that is what you would recommend I say to assure them?

Mr. WIGAND. Title I imposes new standards upon these institutions that they were not subject to before. Hopefully, as a result of those standards, the probability or the likelihood that these companies will fail has changed.

Mr. ALVAREZ. I think that is the answer we are using, all the powers Congress gave us in the Dodd-Frank Act to reduce the likelihood that a large firm is going to fail. And the things we are doing are very substantial: the higher capital requirements; liquidity requirements; new stress tests; new management requirements; the living will provisions to have a glide path towards resolution. Those are all very important. They are all new.

I think the second part is we can't guarantee that a large firm is not going to fail. Something will go wrong someday, somewhere. But what we have now that we did not have in 2008 is an orderly liquidation authority. We can now put a large firm into a resolution authority and cause the shareholders to take those losses, the creditors to take those losses, reduce the cost to society of that failure, and do it without taxpayer expense.

Mr. HECK. Thank you, gentlemen, very much.

Chairman MCHENRY. Mr. Hultgren of Illinois is recognized for 5 minutes.

Mr. HULTGREN. Thank you, Mr. Chairman.

Thank you all for being here.

I think the one thing that has become clear to me over the last few minutes is how much still is unclear in this, and that concerns me. Really, there is a lot of uncertainty even in how this is going to be applied. I know there is a lot of power that you all have, but how it is actually going to be applied, I think, pushes off a great amount of uncertainty on the markets and I think adds to some of the instability out there.

So I am hoping just to get a few more answers to my questions. And really following up on some of Mr. Ross' questions, we have already talked a little bit about under Section 121, how FSOC must approve the Federal Reserve's determination to restrict a company's activities or divest assets by a two-thirds vote. My question, and I will address this to Mr. Alvarez, is what information will the Federal Reserve provide to the FSOC to justify the Federal Reserve's actions under Section 121?

Mr. ALVAREZ. We have a very good relationship with the FSOC. Of course my chairman is a member of the FSOC, so we share information with the FSOC and its member agencies on a regular basis. As we move towards making the determination to Section

121, we will be sharing all the information we have that would provide a basis for the determination of grave threat with the FSOC so we can make a reasonable determination.

Mr. HULTGREN. Particularly beyond that, will the Federal Reserve prove to the FSOC that a company poses a grave threat? Is there a proof standard?

Mr. ALVAREZ. Proof is a very legal term and it has a context in a court—

Mr. HULTGREN. But I think it also provides some certainty. I get back to people understanding where are we at, and I think that is where we need. So, we need to know what to expect.

Mr. ALVAREZ. The way I think about it is the FSOC will have to have enough information that it is satisfied that it can make this determination. The FSOC has not been and will not be a rubber stamp. It will make its own determination, and we will provide whatever information we have so that the FSOC can make that determination, and it will agree or disagree as it wants.

Mr. HULTGREN. So you provide information from your perspective that would prove that an action should be taken to follow up whether it is again divesting or whatever, but proving the grave threat, but it is up to them if they actually will agree with you or not with the information that you provide, but you are not sure what that information is right now.

Mr. ALVAREZ. Right. The other thing I would point out is the FSOC has its own independent source of information. It can use the OFR, which is set up by Congress to gather information as well about markets and individual participants. And the other members of the FSOC agencies have windows into these firms as well, so they would be able to provide information. So the FSOC is not going to be narrowly limited to just what the Federal Reserve decides to provide it. We will share robustly with them, but they will have many sources of information.

Mr. HULTGREN. Let me move on quickly. The gentlemen from the FDIC, either one of you, whoever is better equipped to answer this, the FDIC does not have authority under Section 121, however FSOC does have authority and the FDIC's Chairman, as Mr. Alvarez said, is a voting member. He talked about more of the Fed side, but also the FDIC's Chairman is a voting member of the FSOC.

Accordingly, what does the FDIC Chairman understand his obligation to be when voting to authorize an action by the Federal Reserve under Section 121? And does the Chairman believe that the FSOC must make particular findings or determinations before authorizing that action?

Mr. OSTERMAN. I will attempt to answer your question, sir. I can't speak for our Chairman, but knowing him, he is very thoughtful, and I am sure that we will look at both the information that the Fed provides, as well as our own information. We have our own research group which will provide information, and it will have to meet standards of showing that there is a grave threat to the financial stability of the United States.

In the last crisis, we addressed systemic risk several times in determining that there was a grave threat to the financial stability of the United States but it was only after very careful—

Mr. HULTGREN. Okay. So it is unclear, but you trust that he would use that authority well.

Let me switch really quick; I only have 45 seconds left. Mr. Alvarez, a quick question for you, how does the Federal Reserve's authority to restrict a company's activities or to order it to divest assets under Section 121 differ from its authority under other statutes that it administers? Is it broader? And how so?

Mr. ALVAREZ. We have authority under the Bank Holding Company Act, 5(e) of the Bank Holding Company Act, to require bank holding companies to divest subsidiaries or assets. The two authorities are different, though, because under 5(e), we can only require divestiture if the nonbank activities or affiliate poses a risk to the safety and soundness of an insured depository institution affiliate. So, it is a very narrow authority.

Mr. HULTGREN. So you would say authority under Section 121 is broader?

Mr. ALVAREZ. Broader. Yes.

Mr. HULTGREN. Okay. My time is up. I yield back, Mr. Chairman. Thank you.

Chairman MCHENRY. I thank my colleague.

We will now recognize the ranking member for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman.

Let me start with Section 121 and the grave threat authority. Is it true that this requires a two-thirds vote? I think it has been said, but I just like to make sure that we agree. Let's talk about two-thirds and who are we talking about when we say two-thirds vote? Would you list the members of the FSOC, so that there can be some clarity as to who would be casting these votes?

Mr. ALVAREZ. Certainly. First of all, you are right that it requires a two-thirds vote in the affirmative by the FSOC. The FSOC voting members include the Secretary of the Treasury, the Chairman of the Federal Reserve, the Chairman of the FDIC, the Comptroller of the Currency, the Director of the CFPB, the Director of the FHFA, the Chairman of the SEC, and the Chairman of the CFTC. There is an independent insurance member, and there is one more that I have forgotten.

Mr. OSTERMAN. The Chairman of the NCUA.

Mr. ALVAREZ. The Chairman of the NCUA.

Mr. GREEN. And suffice it to say that we are talking about persons—

Chairman MCHENRY. If the gentleman would yield—and I will give you the time—it is pretty amazing that he actually went through that. I think we could put that in the record. And I will yield back.

Mr. GREEN. Thank you. I thought he would have a written list myself to be quite candid with you. So my compliments to you as well.

But the point is that the two-thirds vote comes from the heads of these various Federal agencies, and this is done only after some deliberation, after reviewing empirical evidence. And this is an evolving system. You are right now in your infancy, and you are currently drafting and crafting these various rules, regulations and standards. Is that a fair statement?

Mr. ALVAREZ. That is correct.

Mr. GREEN. And is it true that as you go through this process, you do allow input from various other agencies or entities?

Mr. ALVAREZ. Yes. There are several nonvoting members of the FSOC, including State banking and securities and insurance regulators.

Mr. GREEN. And one can conclude that you don't do this arbitrarily and capriciously, that you are doing it in a systematic way so as to come to reasonable conclusions?

Mr. ALVAREZ. That is right.

Mr. GREEN. Let's move now to the notion of divestiture. This was mentioned. There is a 2-year window involved with divestiture, is that correct?

Mr. ALVAREZ. That is under Section 165, the living wills provision.

Mr. GREEN. Yes. Explain that please, so that we can understand that this does not just happen overnight.

Mr. WIGAND. I will take the question. There has to be a joint finding by the FDIC and the Federal Reserve Board of Governors that the living will is deficient, meaning that it does not provide for or facilitate an orderly resolution under the Bankruptcy Code or is otherwise not credible.

Upon that finding of deficiency, the firm has an opportunity to correct their deficiency. If the firm fails to do, so the first course of action is for the FDIC and the Federal Reserve to jointly impose higher capital or liquidity requirements, and restrict growth activities or operations. These actions are what we characterize as customary supervisory enforcement actions that could be undertaken.

If, upon after the imposition of those actions, there is a failure still to remediate the problem associated with the firm's lack of resolvability, then the FDIC and the Federal Reserve Board, after consultation with the FSOC, may order divestiture of assets or operations of a firm.

Mr. GREEN. And we are talking about institutions that have assets at above $50 billion, is that right?

Mr. WIGAND. Those are the only ones that are subject to this provision.

Mr. GREEN. And a billion is still a thousand million, is that correct?

Mr. ALVAREZ. It still is.

Mr. GREEN. Still a thousand million. So, you are talking about 50,000 million companies.

Mr. ALVAREZ. Yes.

Mr. GREEN. And we can also note now that prior to Dodd-Frank, we didn't have a means of dealing with these 50—what did I say?—50,000 million. That seems like a rather large number, and it seems like we ought to have the ability to wind down a $50,000 million business that may pose a threat to the economic order, we call it a grave threat. But it just seems that we have provided that. And with this, I will yield back the balance of my time.

Chairman MCHENRY. I thank the ranking member.

I now recognize Mrs. Wagner from Missouri.

Mrs. WAGNER. Thank you. Thank you, Mr. Chairman. I would also like to take this opportunity to welcome our newest member of the Financial Services Committee, the gentleman from the 12th

District of Pennsylvania, Keith Rothfus, who has joined us today as a new Member of the 113th Congress freshman class. Welcome to you, Congressman Rothfus.

In our quest for more clarity here, Mr. Alvarez, let me take a little different tack. During the debate over Dodd-Frank, the Financial Times described an early version of Section 121, the Kanjorski Amendment, as having “potential parallels with the Sherman Antitrust Act of 1890,” creating the legal basis for preemptive action against overly powerful big business, and also noted that the early version of Section 121 would allow regulators to break up even healthy financial companies.

In your view, are there potential parallels between Section 121 and the Sherman Antitrust Act, sir?

Mr. ALVAREZ. If you look hard enough, there are parallels between any two things.

Mrs. WAGNER. So, that is a “yes?”

Mr. ALVAREZ. I think that there are some parallels. It is true that Section 121 can apply to institutions that are healthy and not failing, so there is a parallel there. I think it is also true that the Sherman Act prohibits monopolization, so it is a forward-looking as well as backward-looking statute. I think the difference there is that Section 121 requires that the institution actually pose a grave threat. It is not, “might pose a grave threat” or “could at some time pose a grave threat.”

Mrs. WAGNER. Let me pick up on that, then. Does it have to pose a grave threat, Mr. Alvarez, or in fact does Section 121 give regulators the authority to break up a healthy financial company?

Mr. ALVAREZ. Only if it actually poses a grave threat. That is the standard set out in the statute.

Mrs. WAGNER. And going back again to the definition of grave threat, as so many have tried to get some kind of clarity on here, do you still agree with your comment that it is in fact a very open-ended definition?

Mr. ALVAREZ. I don’t think I said that it was open-ended in the sense that it has no meaning. I think it has to be considered in the context of the other parts of the Dodd-Frank Act. There are a number of provisions, and the chairman alluded to this in his opening remarks. “Grave threat” is unique in its use in Section 121. The rest of the Dodd-Frank Act speaks about risks to financial stability. And so, those standards are much less. We are allowed to take actions under other provisions if there is a risk to financial stability; Section 121 says not a risk to financial stability, a threat to financial stability, and not any threat, but a grave threat to financial stability. So it is a very high standard in comparison to the other standards.

Mrs. WAGNER. A standard that has no quantitative measure at this point in time.

Let me move on, Mr. Alvarez. Dodd-Frank opened a whole host of issues when it comes to interacting with foreign-based financial institutions and foreign regulators. And I would like to address some of those here as well. What are the challenges, Mr. Alvarez, of applying Section 121 to foreign SIFIs and how is the Federal Reserve addressing those challenges?

Mr. ALVAREZ. The challenge in applying any of the Dodd-Frank provisions to foreign organizations is the difference in their organizational structure. Foreign organizations tend to have their capital and liquidity outside the United States. They could be very, very large, $1 trillion, $2 trillion, $3 trillion, so as large as U.S. organizations, but have only a small piece in the United States. So you have to take into account both their large size worldwide and their presence in the United States. That requires a different kind of balancing than, for example, looking at a U.S. organization.

Mrs. WAGNER. And to that point, Section 165 of Dodd-Frank, regarding it, does the Federal Reserve plan on consulting with home regulators of foreign-based companies when determining whether that company's living will, for instance, is deficient?

Mr. ALVAREZ. The living will provision is under Section 121 and can take care of that.

Mrs. WAGNER. Under Section 165, correct?

Mr. ALVAREZ. But under Section 121, I would expect we would have consultations with foreign supervisors because a condition of Section 121 is that we take a variety of steps short of requiring breakup before we are allowed to even consider breaking up the firm. So we would want to have discussions with foreign supervisors before we took those steps.

Mrs. WAGNER. My time is running out, but what if the Fed imposes sanctions as a result of a deficient living will? Would you consult with those home regulators?

Mr. WIGAND. Yes.

Mrs. WAGNER. Thank you.

Mr. Chairman, I yield back.

Chairman MCHENRY. I thank my colleague.

We will now recognize Mr. Grimm for 5 minutes.

Mr. GRIMM. Thank you, Mr. Chairman. And I thank the witnesses for being here today.

Just to throw it out there to get the frame of mind of where we are, and I will ask all three of you, in your opinion should we break up the banks?

Mr. ALVAREZ. The Dodd-Frank Act lays out a game plan for dealing with the large institutions. It includes a lot of provisions, and Section 121 is one of them, but Section 165 has a variety of steps that the agencies must take in order to reduce the probability that firms, large firms, will fail, and to improve the chances that if they do fail, they won't harm the economy—

Mr. GRIMM. I was actually asking just your opinion in general.

Mr. ALVAREZ. My opinion is that we can make a lot of progress in addressing "too-big-to-fail" if we implement the program that is in Dodd-Frank.

Mr. GRIMM. That is a nice way of saying, "I am not answering your question." Is anyone else willing to answer my question?

Mr. WIGAND. I think it is an open question. It is a very important question, and it is certainly beyond my pay grade. And this issue I believe was debated when financial reform legislation was being discussed, and I think that perhaps the Congress is the appropriate place, given the importance of that question, for that type of debate.

Mr. OSTERMAN. I would concur with Mr. Wigand's statement.

Mr. GRIMM. Okay. So it is okay to say you are not going to opine. But that is fine. I appreciate your candor.

Looking at Section 165, is there any concern if the Federal Reserve, these enhanced prudential standards, I want to make sure I use the right terminology, for the foreign banking organizations, is there a concern that it is going to make it very challenging, if not, some would say impossible, for foreign firms to manage their capital effectively across borders? I know it was touched on before, but I would like to dive into that a little bit more. Mr. Alvarez?

Mr. ALVAREZ. I don't think that makes it impossible. It certainly raises the costs for foreign firms. There is no question about that. Just as it has raised the costs for U.S. firms in the foreign jurisdictions that have taken this approach. So it is more expensive for U.S. firms operating in London—

Mr. GRIMM. So that begs the question, does it concern you that some of these organizations will just not do as much business here in the United States, which will lead to less product and less availability for Americans?

Mr. ALVAREZ. We have very competitive markets here and very many institutions that are competing in these markets. So competition is clearly something we have to take into account. But there is also on the other side the need to ensure financial stability and that there isn't a failure of institutions in the United States.

We could greatly increase competition if we removed all our restrictions on folks competing here, and that would be something for Congress to decide. Right now, we are implementing the rules that Dodd-Frank requires us to do, and trying to do it in both a fair way and a way that protects the financial stability here in the United States.

Mr. GRIMM. Is there any concern, and are you speaking about the fact that some of these other foreign sovereigns may increase their requirements on U.S. banks, making it much more difficult for the U.S. banks to compete abroad?

Mr. ALVAREZ. Yes, there is concern about that. As I mentioned, some have done that before the Federal Reserve proposal was put out. But that is something we have to weigh and something we have to consider and something we are watching.

Mr. GRIMM. Okay. Most of the other stuff was already covered on Section 121, so I am going to yield back, Mr. Chairman.

Chairman MCHENRY. Would my colleague yield to me?

Mr. GRIMM. Absolutely, Mr. Chairman.

Chairman MCHENRY. I appreciate it. Thank you.

Mr. Alvarez, I asked this before, but just to make sure we have this on the record correctly, has the Federal Reserve developed a set of metrics to evaluate whether a firm poses a grave threat?

Mr. ALVAREZ. No, sir. We have not.

Chairman MCHENRY. Okay. Do you anticipate putting together metrics for that?

Mr. ALVAREZ. As I mentioned earlier, this is a decision that depends very much on the facts and circumstances, so it is very hard in this area to set a uniform rule. I don't know whether the Board will at some point do that. My immediate expectation is that we would not.

Chairman MCHENRY. I would assume the Board would ask you and your staff to define that term?

Mr. ALVAREZ. Yes, if we wanted to go in that direction, that is correct.

Chairman MCHENRY. Okay. I will now recognize my colleague from Wisconsin, Mr. Duffy, for 5 minutes.

Mr. DUFFY. Thank you, Mr. Chairman.

Going back to the chairman's last question, you are saying you are not going to set out metrics, and it is very complicated. Isn't all of this complicated? All of the metrics that are set out within Dodd-Frank, it is all very complicated stuff. But are you telling us that you guys can't come forward with a metrics that is going to set up a standard for a grave threat? Explain that. Is this more complicated than everything else that we have seen in Dodd-Frank?

Mr. ALVAREZ. Some things are easier to measure than others, even though they are complicated. Capital is something, for example, that we have been measuring and restricting for many years. I think folks have a very good understanding of how to make capital rules, even though they are complicated, effective.

We don't have experience with the grave threat idea. That is something we will have to gain some experience on, and think through carefully. We also, as I mentioned, are required by the statute to put in place these other provisions and see if those mitigate the risks that these large firms pose, and it is only if they don't mitigate the risks—

Mr. DUFFY. Reclaiming my time, so you don't have a standard, and you don't have metrics. It has been 2½ years since the law was passed, and you have no intent of setting forth standards or metrics for a grave threat under Section 121?

Is the standard really that, "I will know it when I see it?" When I see it, I will know it, and then I am going to put it under the grave threat category? Isn't that what the standard is?

Mr. ALVAREZ. "Grave threat" is a standard itself. So just like many other—

Mr. DUFFY. Isn't that metrics? You will know it when you see it?

Mr. ALVAREZ. We do not have a metric.

Mr. DUFFY. So when you see it, you will know it, right?

Mr. ALVAREZ. And it may depend on many things—

Mr. DUFFY. Is that it? When you see it, you will know what a grave threat is? You can't tell me today what a grave threat is because there is no metrics for it. When you see it, you will know it.

Mr. ALVAREZ. Yes.

Mr. DUFFY. The answer is yes?

Mr. ALVAREZ. Yes.

Mr. DUFFY. And so for those who want to breed stability within the sector, does your standard of, when I see it, I will know it, really breed that stability and certainty?

Mr. ALVAREZ. I think stability gets built by the other pieces of Dodd-Frank that we are putting together, the enhanced prudential standards, the capital requirements, liquidity requirements, building up and working out details on the orderly liquidation authority, the resolution plans, those things are what build stability.

Mr. DUFFY. I think people who are subject to Section 121 would disagree with you.

Listen, there is the ability to have a written hearing or an oral hearing, oral testimony, right?

Mr. ALVAREZ. That is correct.

Mr. DUFFY. And have you set up a standard for which someone would get a written hearing versus an oral hearing with oral testimony?

Mr. ALVAREZ. The Board's rules provide for a written hearing as a default matter, for most matters presented to— decisions—

Mr. DUFFY. What is the standard to get an oral hearing or oral testimony?

Mr. ALVAREZ. Oral testimony is something the Board allows whenever the circumstances indicate that you can't provide the arguments effectively in writing.

Mr. DUFFY. When you see it—

Mr. ALVAREZ. We had oral hearings before, but very few institutions actually ask for oral hearings. Almost all institutions—

Mr. DUFFY. There is no standard in place. There is no standard to dictate when it is written and when it is oral.

Mr. ALVAREZ. There is a standard.

Mr. DUFFY. What is the standard?

Mr. ALVAREZ. The standard is when the Board believes that oral testimony would be most useful.

Mr. DUFFY. So the standard is when the Board believes.

Mr. ALVAREZ. Yes.

Mr. DUFFY. And that is a standard that you think people can readily understand and use?

Mr. ALVAREZ. Yes.

Mr. DUFFY. Okay. I think many of us would disagree with that standard.

Mr. ALVAREZ. It is has worked very effectively for the last 50 years at the Federal Reserve.

Mr. DUFFY. I am sure it has.

With regard to Section 121, it is fair to say that this section doesn't really work in times of crisis, right? When we have a crisis, we have a review process, 30 days, a hearing process. So if, for instance, Lehman took place, this Section 121 wouldn't really work. This is really a pre-crisis mechanism to find those SIFIs or large banks that are a grave threat, yes?

Mr. ALVAREZ. I think Congress did set up Section 121 more as a pre-crisis arrangement and Title II as the crisis management stage.

Mr. DUFFY. I am sure you have seen this petition by Public Citizen, yes?

Mr. ALVAREZ. I don't know.

Mr. DUFFY. You haven't seen a petition that has been made with regard to Public Citizen in regard to a very large bank, Bank of America?

Mr. ALVAREZ. I have not.

Mr. DUFFY. You haven't seen that. Have you guys responded to any petitions that have been filed under Section 121?

Mr. ALVAREZ. No, we have not.

Mr. DUFFY. I yield back.

Chairman MCHENRY. I thank my colleague. And at this point, we will now recognize Mr. Rothfus for his first series of questions as a brand new member of the Financial Services Committee.

Mr. GREEN. Mr. Chairman, just a point of clarification please. Mr. Delaney has arrived, and he has not been heard from. May he now be heard?

Chairman MCHENRY. I'm sorry, I didn't recognize his arrival. I'm sorry, Mr. Rothfus, you are going to have to wait 5 minutes. Welcome to the committee. Mr. Delaney, go right ahead.

Mr. DELANEY. Thank you, Mr. Chairman.

My question is slightly more of a high-level kind of lift-up question dealing with the orientation of the various regulators in light of the general concern that the actions within Dodd-Frank have somehow made the notion of "too-big-to-fail" permanent in our financial system. Whether people agree or disagree with that concept, there is obviously a fair amount of discussion, and this hearing is first evidence of that.

So the question I have—and I have been hearing a lot from the industry about a sense of kind of capital creep that is occurring with respect to the regulations of individual institutions. In other words, the new normal for well-capitalized institutions with respect to a capital standard continues to move up both as reflected in specific rulemaking, but also but in practice in terms of being implemented with the regulators.

In other words, the new normal for a well-capitalized institution is 8 percent in terms of capital to assets, but there is a sense that number is moving to 10, but that is not specifically memorialized in any set of rulemaking or legislation.

And so I am interested in the panelists' view as to whether they think that is actually occurring in the industry, in other words, are regulators moving up capital in light of the concern that we have somehow made "too-big-to-fail" permanent as a way of mitigating concerns that we have, in fact, done that. I will let each of the panelists respond to that.

Mr. ALVAREZ. Congressman, we clearly are intentionally raising the capital requirements on large institutions. We are doing that in rulemakings; it is a very public process. We have already done that in several areas, for example institutions that have large trading books have had their capital increase. We have proposed various surcharges, increases in the quality and type of capital at a variety of levels, and we are negotiating some further increases with Basel that we probably will put out for comment shortly.

So the capital requirements are being increased. It is focused on the large institutions. There are some capital proposals that are more broad. And to anticipate part of where you were heading with your question, we are considering whether some of those proposals need to be modified to address small banks that haven't had the same problems as the large banks.

But I would say that we have been up front about the capital increases that we are doing at the large institutions. We haven't done those behind the scenes.

Mr. DELANEY. Where do you think the standard for an under $10 billion in assets institution is to be considered well-capitalized right now in terms of capital as a percentage of assets, not risk-based capital but just—

Mr. ALVAREZ. What is the leverage ratio—

Mr. DELANEY. Yes. What do you think the well-capitalized ratio is right now?

Mr. ALVAREZ. I think the minimum leverage ratio is 4 percent.

Mr. DELANEY. But what is considered well-capitalized for an under $10 billion in your judgment?

Mr. ALVAREZ. I have no judgment on that. And we don't have a definition for well-capitalized for a leverage ratio for well-capitalized.

Mr. DELANEY. Maybe one of the other panelists?

Mr. WIGAND. I echo Mr. Alvarez's comments.

Mr. OSTERMAN. Addressing the "too-big-to-fail" issue, the capital requirements are part of the heightened prudential standards that Title I addresses. In the last crisis and before we had these Dodd-Frank provisions, we didn't have these tools. We were left with either the bailout situation or the bankruptcy situation, neither of which worked. I do think we have the tools now to address "too-big-to-fail," and I find it interesting that people think Dodd-Frank actually institutionalizes what I think we had before.

Mr. DELANEY. So, Mr. Alvarez, back to your earlier comment, you think 4 percent is the minimum capital standard for an under $10 billion institution?

Mr. ALVAREZ. The leverage ratio. You said putting aside the risk-based ratio.

Mr. DELANEY. Right. So 4 percent capital as a percentage of the total assets on an institution?

Mr. ALVAREZ. Right.

Mr. DELANEY. And so the notion that is common in the regulatory world that 8 percent is considered well-capitalized, where do you think that comes from? Just kind of—

Mr. ALVAREZ. A large part of capital, particularly at the smaller institutions, under $10 billion institutions, depends on their activities and their needs. I am hesitant to try to answer that without reference to the risk-based capital—

Mr. DELANEY. Right. So what do you think the risk-based capital minimum is?

Mr. ALVAREZ. The risk-based capital minimums are 6 and 8 percent, and they are—

Mr. DELANEY. 6 and 8 percent?

Mr. ALVAREZ. Yes.

Mr. DELANEY. Okay. Do you think those are moving up?

Mr. ALVAREZ. Yes, they are.

Mr. DELANEY. Okay. Where do you think they are going to?

Mr. ALVAREZ. That is what we are doing a rulemaking about. So we will—

Mr. DELANEY. I see.

Mr. ALVAREZ. So we are in the process of thinking that through.

Chairman MCHENRY. The gentleman's time has expired.

We will now recognize Mr. Rothfus for his first round of questions. Delayed but not deterred, Mr. Rothfus.

Mr. ROTHFUS. Thank you, Mr. Chairman, and thank you to our panel for being here today and going through some fairly complicated issues.

I wanted to focus a little bit on, again, the grave threat as we try—or as I personally try to get my arms around it. As part of Dodd-Frank, several clearing and settlement financial utilities were deemed systemically important financial institutions that are now eligible to receive government support in the event of a potentially destabilizing failure.

One of these "too-big-to-fail" institutions, the National Securities Clearing Corporation (NSCC), after consultation with its regulators, has put forward a proposal where many of our Nation's biggest banks will be able to make a loan commitment to the NSCC as part of a program to enhance collateral at the utility, while the banks broker-dealer competitors, who also clear through the facility, would have to post cash in the amount of billions of dollars. Posting cash is clearly a much more burdensome requirement.

Mr. Alvarez, isn't the proposed cash collateral requirement from the broker-dealers to collateralize the NSCC simply another bank subsidy?

Mr. ALVAREZ. If I could back up just a little bit to talk about the facts that you have presented, Dodd-Frank requires that there be more clearing on exchanges. And so, it is requiring institutions to do more business on these exchanges.

In order to do that safely, the exchange has to require collateral by the institutions. These central clearing organizations take away risks and make the system safer because they are able to get good collateral and they deal with each counterparty separately with the clearing corporation in the middle.

Dodd-Frank recognized that. Dodd-Frank builds quite a lot on that. It is not unusual that counterparties would provide collateral, but the central institution itself would not be.

Mr. ROTHFUS. But there is different collateral there. The broker-dealers are going to be asked to put up cash—

Mr. ALVAREZ. Because they are clearing on—they are clearing.

Mr. ROTHFUS. —versus the bank would be able to—

Mr. ALVAREZ. I think they deal with all of their counterparties in the same way. So perhaps because this is a complicated issue, it may be one that is best—that maybe we could talk with you about and provide you some information on how—

Mr. ROTHFUS. Absolutely. But it appears that the banks are being asked for a different type of collateral. It is not a direct collateral. And wouldn't the Fed's apparent unwillingness to ask banks for direct collateral be an indication that the banks can't spare the collateral?

Mr. ALVAREZ. I don't think that is quite right. I think there isn't a difference between the broker-dealers and the banks when they are dealing with these central counterparties.

Mr. ROTHFUS. Again, I looked at it, okay, the types of collateral that are going to be put up, and if the banks are not able to have the direct collateral that the broker-dealers are going to be required to do, would that indicate that the banks pose a grave threat because they don't have that capacity for the direct collateral?

Mr. ALVAREZ. I think the premise of the question is not correct as a factual matter. So that is why I think it might be helpful if we had a discussion, because I don't understand the situation to be the way you presented it.

Mr. ROTHFUS. Thank you. I look forward to following up with you.

I yield back, Mr. Chairman.

Chairman MCHENRY. I thank my colleague for yielding back. We will now move on to an additional round of questions. I recognize myself for 5 minutes.

So, Mr. Alvarez, does Section 121 allow regulators to determine the ideal size of a financial institution?

Mr. ALVAREZ. I think Section 121 was designed to be a fact-specific determination about a particular institution and whether that institution, its activities, the risks of its activities, the capital complexity, size, all of the various factors for that institution pose a grave threat to the economy. So I think that makes it difficult to say one size fits all institutions because complexity and risk and other things would factor into the determination.

Chairman MCHENRY. So, a very complex institution. Let me ask this in a different way: Does Section 121 allow regulators to determine, in essence, the ability of a financial institution to do what it is doing? I am trying to ask this in a different way to elicit a different answer from you. Your blank look tells me I am not succeeding. So, I am going to try again.

The question about an ideal size of an institution, or, in a different way, a cap on a size of an institution, is that a decision that could be contemplated under Section 121 and therefore limit the size of an institution or institutions?

Mr. ALVAREZ. Congress has already set caps on the size of financial institutions, so I would expect that Section 121 would apply to institutions that are below the caps set by Congress. There are two already. One is a longstanding cap on interstate banking.

Chairman MCHENRY. Yes, cap on deposits.

Mr. ALVAREZ. That is in the Bank Holding Company Act. And then the second cap is one put in Dodd-Frank, that no institution may have more than 10 percent of the total liabilities of financial institutions in the United States. So, the caps have already been set by Congress.

Chairman MCHENRY. Let me, because you are not saying no, it cannot be provided, so under Section 121, you say you could set a lower cap than that?

Mr. ALVAREZ. As I said, I think that Section 121 is designed to be an institution-by-institution kind of determination. A universal cap doesn't fit very well there. In order to meet a universal cap, the Board would have to show and the FSOC would have to agree that everybody who meets that size automatically poses a grave threat to the economy, so that would be a difficult decision.

Chairman MCHENRY. But would that be one they would be able to make under the existing law? If your boss comes to you and says, do I have the legal authority to cap the size of all institutions because I deem them to be a grave threat to the financial—I am sorry—stability, I thank my colleague—would you advise him or her, whoever it may be, whatever time it may be, that is something under operation of law that they could do?

Mr. ALVAREZ. So, as I said, the other thing that we have to take into account—and Section 121 requires this—is how that particular institution has mitigated the risks of its activities through restrictions that we impose on activities, through conditions we impose on the institution. I find it very hard in that context to see how a blind cap could work well. As a policy, I have a hard time seeing how it would work.

Chairman MCHENRY. Okay. Let me ask you a different question. Is there a law that prevents you from setting a maximum size for an institution?

Mr. ALVAREZ. Of course, we have to be able to sustain ourselves under Section 121, and that would be the authority. So if an institution were to challenge our determination on Section 121 because we didn't take into account the characteristics of the firm, that would be very difficult.

Chairman MCHENRY. So you would say it is very difficult but not barred?

Mr. ALVAREZ. I am having a hard time imagining a world where it would work.

Chairman MCHENRY. Okay. But under operation of law, there is no limitation on the Federal Reserve from setting a maximum size for an institution?

Mr. ALVAREZ. Congressman, I resist because I don't think that is a fruitful way to think about Section 121.

Chairman MCHENRY. I understand. And your answer is actually answer enough.

And so with that, I will now yield to my ranking member for 5 minutes.

Mr. GREEN. Thank you very much, Mr. Chairman.

A lot has been said today about the grave threat. And in my opening statement I mentioned that we accorded FSOC, or Dodd-Frank accords FDIC-like authority. And I would like to just talk a moment about the FDIC. It was formed in 1933, about 80 years ago, and there are people who would like to know when a bank is going to fail. The FDIC does not announce that a bank is going to fail.

Similarly, the power granted under Dodd-Frank would not require, and I don't think they should announce that an institution is "too-big-to-fail" or about to fail.

The point is it seems to me that there is a desire to be able to predict certain things with a certain definition. But with the FDIC, many things will go into deciding whether or not a bank will fail. And no one has ever lost any insured deposits in 80 years, and we still don't—we cannot predict what FDIC will do. It is done on a Friday, banks open up on Mondays, usually. Now, is this a fair statement, Mr. Osterman?

Mr. OSTERMAN. Yes, it is, sir.

Mr. GREEN. And with 80 years of experience and the FDIC not predicting or you can't really predict when a bank will fail—you can't always, sometimes you can. In fact, there are rating agencies that try to do this, and they fail in trying to do it.

So my point is we are not going to be able to codify a definition that is going to allow onlookers to predict how FSOC will behave when it is confronted with a possibility of a grave threat. FSOC will have to do some internal thought processes, and after this, after having an internal thought process, a deliberation, then a decision will be made, and it can't just depend on the size of an institution.

One of our very capable and competent assistants has indicated to us that complexity has a lot to do with it, how it fits into the financial markets.

So with all of these things going into the equation, it is very difficult to have one metric that is going to give an onlooker an absolute indication as to whether or not an institution will be declared a grave threat.

Mr. Osterman, since I brought the FDIC into this, I would like for you to respond, please.

Mr. OSTERMAN. Yes. We have, as you indicate, had the authority to resolve failing financial institutions for the last 80 years. Actually, we are not even the entity that determines whether the institution is going to fail. It is typically the primary Federal regulator or the State regulators who make that call. Then, we come in and we have to determine the least costly approach for addressing that failure under the law, which requires either a payout of deposit insurance or a purchase and assumption agreement.

The bottom line is that through this process—and I think during this last crisis we handled over 470 failures—no one has lost a penny of their insured deposits. I think one of the things that Dodd-Frank does is it gives us the ability now, which we did not have when this crisis began, to resolve one of these large systemically important financial institutions, and we now have the tools to address "too-big-to-fail."

Mr. GREEN. Thank you.

Would anyone else care to respond? Yes, sir?

Mr. WIGAND. I would just add to Mr. Osterman's remarks that the process that the FDIC has used to resolve failing depository institutions is one that now has become actually predictable in that there is confidence by insured depositors that their funds are protected. And even though the sequence leading up to the failure itself is one that is only known to a handful of regulators and perhaps other participants or stakeholders associated with the particular failure itself, the reality is that it is the confidence of knowing how deposits will be treated and that insured depositors are protected that provides the financial stability that is the FDIC's purpose as part of our financial system.

Mr. GREEN. And Dodd-Frank provides that same confidence for taxpayers knowing that taxpayer dollars will not be used to bail out institutions, is that correct?

Mr. OSTERMAN. The law is explicit that Title II cannot use taxpayer funds in its application.

Chairman MCHENRY. I thank the ranking member.

Mr. Duffy for 5 minutes.

Mr. DUFFY. Thank you, Mr. Chairman.

I want to go back to Section 121, which obviously we have covered quite exhaustively today, and the grave threat standard and your comment that it is, "I will know it when I see it."

One of my concerns, and I think this was brought up in the initial hearings on Dodd-Frank, is that when we don't have a clear standard, when we can't point to clear, bright line specifics, it can allow for situations that don't provide for good governance.

And so, could you use Section 121 to apply political pressure? I am not saying that you would. But political pressure could be applied just by the threat of finding that a financial institution is a grave threat. That is substantial pressure on that institution to do what the Fed would like it to do.

Can you strong-arm them into doing something that they may not ordinarily want to do but for the threat of being a grave threat under Section 121? That is pretty powerful stuff, and I am not saying, I am not accusing anyone of doing that. But when you don't have clear standards in place, I think it opens the door for bad governance.

And the fact that you guys haven't put out a clear standard and there is no intent to put out a clear standard, that concerns me. And then when we look and say, well, petitions have been filed and they haven't been answered, we are really sitting here in the dark. And I don't think that bodes well for anybody who sits in your seat or sits in the seat of one of these financial institutions.

Mr. Alvarez?

Mr. ALVAREZ. I take your point. I understand that very well and I understand that uncertainty can be very difficult for firms to deal with. There are some protections in Section 121 that I think help in this regard. One is you have the FSOC and a two-thirds vote of the FSOC. That is a very strong protection against the Federal Reserve being arbitrary in what it does.

I think the second protection is actually that Congress requires us to go through this list of other mitigants before we can get to selling assets. So we have to start with the idea of restricting their activities, or imposing conditions on operations, or limiting growth. They are expressly laid out in the statute. So that helps, too, because a firm will know if we are moving down this path because we have a long road to go to before we can get to selling assets.

Mr. DUFFY. And I understand there is a long road and I understand the protection of FSOC—

Mr. ALVAREZ. And then, there is the hearing requirement which Congress has built in. So there is a lot of protection in Section 121.

Mr. DUFFY. There is, but the threat of Section 121, to have to go down that path is a very, very powerful threat. I don't know anyone who would minimize the threat of Section 121. And that is my concern. I am not saying that we would get through a two-thirds vote on FSOC, but to make any organization go through it is a very, very powerful threat.

Mr. ALVAREZ. I appreciate that.

Mr. DUFFY. In regards to petitions that have been filed, you indicated there have been several, is that right? You are not familiar with any of them, but petitions have been filed under Section 121?

Mr. ALVAREZ. I am not certain of numbers. You mentioned one. I haven't read that. I can look into that.

Mr. DUFFY. But you have read others?

Mr. ALVAREZ. No, I have read none.

Mr. DUFFY. Okay. If you would look into that and give me your opinion on the one I referenced? I can ask that to you in writing so you have the information on it. I would appreciate that. Is that a yes?

Mr. ALVAREZ. I will do the best that I can. I am a staff person. My opinion on a particular thing may have no value whatsoever. As long as you keep that in mind.

Mr. DUFFY. You were sent here today, so it must have some value.

Just quickly to get your opinion on this one, and for its value, if the Fed concluded that a large financial company paid less to borrow funds because the market perceived that the government would bail out the company if it became distressed, would that benefit be relevant in determining whether the company posed a grave threat under Section 121? So if we have this benefit of saying, hey, if I fail, I have a government guaranty here, is that a characteristic that could—

Mr. ALVAREZ. First of all, we are doing an awful lot of work to remove that potential advantage, to reduce that subsidy. And that is where I think the Section 165 provisions that we have been talking about today are really important.

Mr. DUFFY. But could that be a trigger?

Mr. ALVAREZ. I would have to think about that. I don't see how that itself poses a grave threat.

Mr. DUFFY. In itself, it does pose a grave threat, right?

Mr. ALVAREZ. No. If a firm has some operational benefit because of its size, the subsidy itself may be an indication that it is large and may be an indication that it is viewed by the markets as important and having government support, but I am not sure how that indicates that it poses a grave threat.

Chairman MCHENRY. The gentleman's time has expired.

Mr. DUFFY. I yield back.

Chairman MCHENRY. Mr. Cleaver for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman.

Mr. Osterman, if you had a kind of sleazy cousin who was interested in going into banking, would you advise him to try to get hired at the Kansas City Community Bank or at the Bank of Universality? Understanding he is sleazy.

Mr. OSTERMAN. I would advise him not to get into banking, because that is something that we really don't want or need. It is a very important position, and it is one that we review in terms of the standards. We provide training for people who are interested in getting into banking, in terms of directors and officers and other professionals, so that they can understand the very important undertaking that they are assuming and the responsibilities that they take on when they take on those important positions.

Mr. CLEAVER. But do you agree that complexity is the slick, sleazy person's greatest friend in banking?

Mr. OSTERMAN. I see. Certainly, complexity makes it a lot easier to slip things by somebody. If it is complex, it is a lot harder to understand, and that definitely can complicate things.

Mr. CLEAVER. The Attorney General has said that one of the obstacles to prosecuting folks who might have done things that resulted in the 2008 economic collapse in this country is complexity, that these banks are so huge and complex that they can't prosecute. So you swindle money in a little bank and you are going to probably get caught. And so in the big banks, the Attorney General is saying it is tough to find out what someone did and how they did it. Go ahead?

Mr. OSTERMAN. We certainly don't agree that the fact that somebody is involved in a large institution means that they shouldn't be prosecuted. We think—

Mr. CLEAVER. Of course, they haven't.

Mr. OSTERMAN. Understood. But that is certainly not something that we would agree with.

Mr. CLEAVER. My fear is that when all of this is over, nothing will have happened to the people who did the greatest amount of damage to the U.S. economy, that they are going to get—they will be buying new homes on Venus and living the grand life because they knew how to rip off the biggest financial institutions while community banks—I am really concerned about what is happening to community banks. As Moses would say, let my community banks go. They are getting beat up. They have all of the problems and the burdens, and the bigger banks seem to be getting away with everything.

The other issue that I am somewhat concerned about is that the rulemaking is seemingly very slow. And I know Mr. Alvarez talked about how you are trying to get things worked out. But many of these banks, at least in my district and the rural parts of Missouri, are just being overwhelmed, and survival depends on how much time it is going to take. I have a photograph in my office—I didn't bring it with me—of one of my bankers holding up regulations so thick that he needs to hire new people to come in. This is a little, small bank. And if we continue to do that, I think it is just one of the great shames of our time.

Mr. Chairman, I would like to yield back the balance of my time to the ranking member.

Mr. GREEN. Thank you, Mr. Cleaver.

Let's talk for a moment about the living wills. This is something that we are currently putting in place, and it is a part of the process. And I would like for you to explain how the living will can help us to determine whether or not banks or large institutions are subject to being declared a grave threat.

Mr. ALVAREZ. To start with, the living wills don't tie into the grave threat provision directly. But what the living wills do provide is a supervisory tool for the Federal Reserve, it may be slightly different for the FDIC, but for the Federal Reserve it is a window into how firms think about their resolution. We know a lot about how they plan for their healthy operation, that has been the focus of our supervision over the last few years. Now, we are getting a view into how they plan for their death. And that is a different way of thinking about the supervisory problems. It focuses you on structure, on complexity, on internal operations, on resiliency of operations. All those things help point out, help you, help accent the way firms might fail. So we are learning a lot about that. And that could provide information that would help us understand if the firm poses a grave threat, because we would know more about the likelihood of its failure, the spillover effects of its failure and things like that, which I think is important.

At the same time, the living wills give us an opportunity to fix some of those problems. And we in the FDIC are very focused on translating what we learn from the living will process into changes in our examination process to require institutions to simplify themselves, to remove obstacles for their resolution, and to become safer institutions.

Chairman MCHENRY. The gentleman's time has expired.

Mr. Heck?

Mr. HECK. Thank you, Mr. Chairman. First of all, I want to say how very, very sorry I am that Congressman Rothfus has left, insofar as his arrival renders me no longer the 61st most senior member out of 61 members of this committee. I welcome him.

Chairman MCHENRY. Congratulations. I sat next to Debbie Wasserman Schultz on your side of the aisle. That was my first seat—

Mr. HECK. Peas in a pod.

Chairman MCHENRY. Yes. And so, I will give you back your time.

Mr. HECK. It is all right.

Mr. Alvarez, in your submitted testimony you said the following: Our goal in working with other U.S. regulators and our counterparts around the world is to produce a well-integrated set of rules and supervisory practices that substantially reduce the probability of failure of our largest, most complex financial firms and that minimizes the losses to the financial system and the economy if such a firm should fail.

These steps also force large firms to internalize the costs that their failure would impose on the broader financial system, minimize the advantage these firms enjoy due to market perceptions of their systemic importance, and give the firms regulatory incentives to reduce their systemic footprint.

My question, Mr. Alvarez, is if your objective is to manage the regulatory process to reduce the advantage in the marketplace, I assume that you have some quantifiable notion as to what that advantage is that you are trying to manage to, and I would ask you to talk about that if you would, please, sir.

Mr. ALVAREZ. We do not have a quantitative measure that we are managing to, as far as the advantage that a firm might have. In fact, I think the way we think about it is we are trying to make the—the overall objective is to end "too-big-to-fail" and to make firms more resilient against failure even in bad economic times. There are various ways you can measure the kind of subsidy that firms get or have—

Mr. HECK. Do you have a range? Can you look at a range?

Mr. ALVAREZ. You can look at CDS spreads. You can look at a variety of different metrics of that. And we are concerned that they have a subsidy, and we are trying to eliminate that subsidy by imposing higher capital requirements, which cost the firms some money and makes them more resilient against failure. We are trying to reimpose liquidity requirements, which make them more resilient against failure, but also come with a cost. Those things all reduce their subsidy.

But the goal here isn't just to eliminate the subsidy. The goal here is to make the firms more resilient. And what I have in mind here is, even if you reduce the subsidy to zero, the failure of these large firms will have a cost on society. And so we want to minimize the potential that society will have to bear the cost of a failure of an institution. Even if they put it through OLA, it will have ramifications for the economy, and you want to minimize as much as possible that failure.

So that would indicate you should have prudential requirements and financial stability requirements that may be greater than would be necessary to eliminate the subsidy. We want to get instead to making them as resilient as possible while allowing them to operate efficiently. So that is why we focus less on the—we do not manage to the elimination of that subsidy.

Mr. HECK. Your point here, however, in your presented testimony is that it would in fact minimize—

Mr. ALVAREZ. It does do that.

Mr. HECK. —the subsidy, but if you don't know how large it is, how will you know whether or not it has been minimized?

Mr. ALVAREZ. There is a variety of ways to look at how it is being reduced. For example, as we have begun already with Dodd-Frank, we have noticed that the uplift that the credit rating agencies give to large firms, so the subsidy they get on the credit rating side, has been reduced. So that is one thing we will look at.

My point is that, suppose we eliminate the credit rating uplift altogether? Does that mean, and I took your question to mean you have now managed to get rid of that subsidy. Should you stop? And at that point, I think we have to assess whether there is another goal, and the goal is the protection of the financial system.

Mr. HECK. Understood. Thank you, sir.

Chairman MCHENRY. I thank my colleague. And without objection, we will have 5 additional minutes of questioning on each side. Thank you. And so with that, I will recognize myself for 5 minutes.

Mr. Alvarez, since you are a representative from the Federal Reserve, I will ask you a question. I sent Chairman Bernanke a letter dated March 20th and asked for a response by April 3rd. We had spoken with the Federal Reserve's legislative affairs staff on April 9th. They said the response has not been finalized, and they would advise when it is ready. Any ideas on when this response will be ready?

Mr. ALVAREZ. So this is the letter that you have written on—

Chairman MCHENRY. I will give you the details. Yes. I wrote Chairman Bernanke to get more information on the analysis relied upon by the Justice Department making prosecutorial decisions in cases involving large financial institutions.

Governor Powell testified before the Senate that the Justice Department asked the Federal Reserve for information about whether certain statutes would inhibit investment activity in a company that was convicted of a felony.

In my letter, I asked Chairman Bernanke to provide the names of persons who were contacted within the Federal Reserve from the Justice Department, and furthermore asked for who contacted them within the Justice Department. We have very little information on that, so we are just trying to nail down what this question that my colleague, Mr. Cleaver, asked about in terms of Attorney General Holder's comments that certain institutions were just, in essence, were a lot deemed as too big to jail.

Mr. ALVAREZ. I will look into that as soon as I get back.

Chairman MCHENRY. Okay.

Mr. ALVAREZ. And I will get you a response right away.

Chairman MCHENRY. I certainly would appreciate it. And since you are a representative of the Federal Reserve, I felt the obligation to ask you.

Mr. ALVAREZ. I would be happy to do that. Thank you very much.

Chairman MCHENRY. By any chance, have you been contacted by the Justice Department on this issue?

Mr. ALVAREZ. I have not personally been contacted by the Department of Justice. I will say I talk to them all the time about a whole variety of matters, but, no, I haven't been contacted by them.

Chairman MCHENRY. Okay. And is there anything that would prevent the Federal Reserve from providing economic analysis for the Justice Department on this issue of prosecuting large financial institutions?

Mr. ALVAREZ. We share a lot of information with the Department of Justice. If they asked for some information like that, we would do our best to provide them what we could.

Chairman MCHENRY. Okay. And would you recommend that the FSOC or the OFR instead perform this type of analysis for the Justice Department?

Mr. ALVAREZ. I think actually all the agencies should cooperate with the Department of Justice whenever they are asked by the Department.

Chairman MCHENRY. That is a good "lawyerly" answer.

Mr. ALVAREZ. It is a very difficult job to do, and we should help them.

Chairman MCHENRY. Okay. So, I covered those areas in particular. Now, I do want to just ask briefly about a deficient living will. Has the Federal Reserve determined what a deficient living will is?

Mr. ALVAREZ. We have been through one round, so far.

Chairman MCHENRY. With how many institutions?

Mr. ALVAREZ. With 11 institutions.

Chairman MCHENRY. Okay.

Mr. ALVAREZ. And we are just now starting our second round with those same 11 institutions. I think we all learned a lot from the first round. The firms have been taking this very seriously. They have been very diligent in responding to our questions and providing information, and they have provided thousands of pages of information. So this has been a good process, from our perspective. We have learned quite a lot from the institutions, and we think the firms are giving us the information that we are asking them for.

Chairman MCHENRY. Okay. Within this provision, there is the question of it is deficient if it is not credible.

Mr. ALVAREZ. Right.

Chairman McHENRY. You have two different cases here that would not result in orderly liquidation under the Bankruptcy Code.

Are those different standards, just in your opinion, Mr. Osterman?

Mr. OSTERMAN. I think they can be. The statute reads "or," so, credibility could be, for example, in the guidance we put out just yesterday, talks about certain assumptions. You can't rely on provision of extraordinary support from the United States, for example. If we had a plan that did rely on that, it wouldn't be credible.

And then in terms of resolution under the Bankruptcy Code, there it is pretty clear we are looking at how the institution would be resolved. If resolving it under the Bankruptcy Code meant that we would need our special powers to do this in order to avoid impact on financial stability. If our special powers aren't needed, then it would meet the standard. If they are, then it would not.

Chairman McHENRY. Is liquidity a part of that, though? If it is being resolved under the Bankruptcy Code, you have to have liquidity support to keep the institution going. So is liquidity a part of that?

Mr. OSTERMAN. Yes.

Mr. WIGAND. Yes. It certainly would be a factor, absolutely.

Chairman McHENRY. Mr. Alvarez?

Mr. ALVAREZ. Yes. Absolutely. We asked for a lot of information on liquidity even at the entity level throughout the organization.

Chairman McHENRY. Okay. So being resolved in a Bankruptcy Code and a requirement within the living will has to be some capacity for liquidity support as they are unwound under the Bankruptcy Code, or resolved.

Mr. WIGAND. More specifically, what is required is for the firm to outline how they will handle the liquidity management of the bankruptcy process. We aren't asking the firms to specifically identify where that liquidity support will be drawn from, but it is a liquidity analysis to indicate how the firm can unwind itself or go through the bankruptcy process without posing systemic consequences. It is a very case-by-case analysis because of the different business models these institutions operate under and their needs for liquidity and how their strategic application of the bankruptcy process affects both the sources of liquidity and the demands for it.

Chairman McHENRY. Any objection to that, Mr. Alvarez?

Mr. ALVAREZ. [Nonverbal response.]

Mr. GREEN. Mr. Chairman, allow me, as ranking member, to note that we are 6 minutes and 31 seconds into your 5 minutes.

Chairman McHENRY. I appreciate that. I certainly was generous with the ranking member and would endeavor to do so in the future. And with his kindness, I now give him 6 minutes and 39 seconds. The gentlemen can use it up.

Mr. GREEN. No, sir. I will return some of it to you.

Let me start with you, Mr. Alvarez. You were very kind, and I appreciate the way you responded to the chairman's inquiry with reference to a letter to the Chairman of the Fed. My suspicion is that you don't maintain his calendar. Is that a fair statement?

Mr. ALVAREZ. That is definitely true.

Mr. GREEN. My suspicion is that you don't write his letters or respond to his letters. Is this correct?

Mr. ALVAREZ. Sometimes, I do.

Mr. GREEN. Is it a fair statement that the best person to ask about a letter written to Mr. Bernanke might be Mr. Bernanke?

Mr. ALVAREZ. I am happy to take the message back and look for it, get a response to the letter.

Mr. GREEN. I understand. But nothing precludes the chairperson from talking to Mr. Bernanke or contacting Mr. Bernanke about his inquiry. Is that a fair statement?

Mr. ALVAREZ. That is true, but I would rather take the message back than to disturb both of them.

Mr. GREEN. I appreciate your doing so.

Now, let's go back to the living wills. The living wills have a specific purpose. They are to give us some insight as to how one of these mega-corporations can be wound down. Is this a fair statement, Mr. Alvarez?

Mr. ALVAREZ. Yes. That is right.

Mr. GREEN. Does anyone differ on that?

Mr. WIGAND. No.

Mr. OSTERMAN. No. We agree.

Mr. GREEN. And the living will also, as you have indicated, while it does not directly relate to the notion of an institution being a grave threat, but you can get some insight into how it would have to be wound down, and as a result you can understand the complexity of the institution and it would help you to understand whether or not it can become a grave threat if it is not properly capitalized or if it is not properly adhering to certain standards and regulations. Is that a fair statement?

Mr. ALVAREZ. Yes, sir.

Mr. GREEN. So what we are trying to do is give the American public the same level of confidence in these mega-institutions that we have given in banks by using the FDIC. And that is what Dodd-Frank hopes to accomplish, and I believe it is accomplishing this.

Are we better off with Dodd-Frank than without it, Mr. Alvarez?

Mr. ALVAREZ. We certainly have gotten some very useful tools in Dodd-Frank that I think were tools we asked for and tools that we think will help us to make firms more resilient.

Mr. GREEN. And do you agree, the other two witness, please? Either of you can respond, one at a time.

Mr. WIGAND. Yes. We believe there are tools that are available as a result of the financial reform legislation that the government did not have before, and that these tools can be used both to reduce the likelihood that one of these companies will fail and to lower the cost in the event that one of these companies fails.

Mr. OSTERMAN. I agree.

Mr. GREEN. And let's just quickly look at some of the tools. You have enhanced capital requirements. Is that a fair statement? You can do this?

Mr. WIGAND. Yes.

Mr. ALVAREZ. Yes.

Mr. GREEN. New liquidity requirements?

Mr. ALVAREZ. Yes.

Mr. GREEN. Enhanced prudential regulations for large banks?

Mr. ALVAREZ. Yes.

Mr. GREEN. A new resolution process for systemically important financial institutions, these SIFIs, as they are called?

Mr. WIGAND. Yes.

Mr. GREEN. Required resolution plans, the living will; capital surcharges on systemic firms; proprietary trading ban through the Volcker Rule; size limits and restrictions on mergers. So you have these new tools that you can impose and that you can use, and these will help you to prevent an institution from failing and, in the process, causing the entire economic order to have a downturn. Is that a fair statement? If properly used.

Mr. ALVAREZ. Yes. I think I would caution—

Mr. GREEN. Yes, sir.

Mr. ALVAREZ. —that doesn't mean no firm will fail. We can't make it absolutely certain that no one will ever fail.

Mr. GREEN. No.

Mr. ALVAREZ. But that is why the OLA is an important tool as well, the orderly liquidation authority.

Mr. GREEN. Right. No guarantee that you won't have a failure, but what you can do is try to minimize the impact that it will have on the economy. Is that a fair statement?

Mr. ALVAREZ. That is right.

Mr. WIGAND. Yes.

Mr. GREEN. All right. I thank you for your attendance today. And I am absolutely convinced that Mr. Bernanke will have an opportunity to come before us and respond to questions that are of concern. Thank you very much.

Chairman MCHENRY. I thank the ranking member. And I guess, at the ranking member's request, the natural request would be if the Chairman of the Federal Reserve would come before this subcommittee. Now, I am smiling, because your head of Legislative Affairs is giving a very wry smile to that.

But I thank you all for your—

Mr. GREEN. Mr. Chairman, if I may. Since you bothered to give a commentary, I would like to give one. My comment was if that he might go before the committee, and you are a part of the full committee and you will have your opportunity to ask your questions when he is before the full committee.

Chairman MCHENRY. Great.

So, I thank the witnesses for testifying today. And I want to thank the three of you for your service to your government as civil servants. I thank your staffs as well for the preparation today.

Oversight is very important, and we are trying to understand the components of Dodd-Frank and actually have a deeper conversation. This is the first hearing about Sections 121 and 165. We learned a few things today. One in particular is that the Federal Reserve has not defined grave threat nor the metrics of measurements.

Mr. GREEN. Mr. Chairman, if I may, a point of inquiry: Are we giving summaries, each of us today, as to what we have ascertained from this hearing?

Chairman MCHENRY. Well, if the ranking member doesn't wish to hear what the next hearing is, then I will stop right here, and thank the witnesses for their testimony.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

And without objection, this hearing is now adjourned.

[Whereupon, at 4:45 p.m., the hearing was adjourned.]

APPENDIX

April 16, 2013

For release on delivery
2:00 p.m. EDT
April 16, 2013

Statement by

Scott G. Alvarez

General Counsel

Board of Governors of the Federal Reserve System

before the

Committee on Financial Services

Subcommittee on Oversight and Investigations

U.S. House of Representatives

April 16, 2013

Chairman McHenry, Ranking Member Green, and other members of the Subcommittee, thank you for the opportunity to testify on the provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) designed to address the increased risks posed by systemically important financial institutions and to ensure that no institution is "too-big-to-fail". The perception that some institutions are too-big-to-fail reduces the incentives of shareholders, creditors, and counterparties of these firms to constrain excessive risk-taking. It also produces competitive distortions by enabling firms perceived as too-big-to-fail to fund themselves more cheaply than other firms. This competitive distortion is not only unfair to smaller firms and damaging to competition, but it also spurs further growth by the largest firms and more consolidation and concentration in the financial industry.

The Dodd-Frank Act contains a number of provisions that specifically address the risks posed by systemically important financial institutions. The Federal Reserve has been actively engaged in implementing these provisions. Our goal--working with other U.S. regulators and our counterparts around the world--is to produce a well-integrated set of rules and supervisory practices that substantially reduces the probability of failure of our largest, most complex financial firms and that minimizes the losses to the financial system and the economy if such a firm should fail. These steps also force large firms to internalize the costs that their failure would impose on the broader financial system, minimize the advantage these firms enjoy due to market perceptions of their systemic importance, and give the firms regulatory incentives to reduce their systemic footprint. The Federal Reserve has been working intensively for the past few years to accomplish this goal through both rulemakings and firm-by-firm supervisory efforts.

Because the Federal Reserve is primarily responsible for the supervision and regulation of banks and bank holding companies, my testimony today will focus on the steps we are taking to address too-big-to-fail in the context of banking organizations. However, it is important to note that concepts like "too-big-to-fail" can also apply to nonbank financial companies. Individual nonbank financial companies posed clear risks to financial stability during the 2007–09 crisis. In these sorts of cases, the authority of the Financial Stability Oversight Council (the Council) to designate systemically important nonbank financial companies or financial activities provides another valuable tool.

Moreover, the Dodd-Frank Act contains provisions designed to facilitate the orderly resolution of systemically important financial institutions. The ability to resolve a firm that is failing--regardless of size or systemic importance--is critical to making clear that no firm is too-big-to-fail.

Reducing the Probability of Failure of Systemic Firms

Strong capital requirements are the cornerstone of prudential bank regulation because capital provides a buffer against losses from any source or activity. A critical way to reduce the distortions associated with too-big-to-fail is for our most systemic banking firms to have substantial capital buffers, sized to reflect their own risk profiles and the damage that would be done to the financial system were such firms to fail. Achievement of this aim requires both improvement of the traditional, firm-based approach to capital regulation, and the development of a macroprudential overlay to ensure that capital requirements applicable to the most systemic banking firms are more stringent than the requirements that apply to other firms.

With respect to the traditional, firm-based approach, the Basel Committee on Banking Supervision (the Basel Committee) issued in December 2010 the Basel III package of reforms to its framework for minimum bank capital requirements, supplementing an earlier set of changes that increased capital requirements for important classes of trading assets. Last year, the Federal Reserve and the other U.S. banking agencies issued for comment a set of proposals to implement the Basel III capital standards in the United States. To help ensure that all U.S. banking firms maintain strong capital positions, the Basel III proposals would introduce a new common equity capital requirement, raise the existing tier 1 capital minimum requirement, implement a capital conservation buffer on top of the regulatory minimums, and introduce a more risk-sensitive standardized approach for calculating risk-weighted assets. Large, internationally active banking firms would also be subject to a supplementary leverage ratio and a countercyclical capital buffer, and would face higher capital requirements for derivatives and certain other capital markets exposures they hold. The U.S. banking agencies are reviewing comments on this proposal and working toward a final rule now. We are specifically focused on addressing comments that urge the agencies to reduce the burden of the proposal on community banks.

In addition to this baseline approach to capital, the Federal Reserve has undertaken several initiatives to enhance the capital protection at large firms. In particular, the Federal Reserve conducts an annual supervisory stress test and Comprehensive Capital Analysis and Review (CCAR) for the largest U.S. bank holding companies. In CCAR, the Federal Reserve requires each covered firm to demonstrate that it has rigorous, forward-looking capital planning processes that effectively account for the unique risks of the firm, and maintains sufficient capital to continue to operate through times of extreme economic and financial stress. In the 2012 and 2013 CCAR exercises, the Federal Reserve applied a separate global market shock to the trading books of the six largest U.S. bank holding companies, effectively increasing the amount of capital those firms are required to hold against their trading portfolios. The 2013 CCAR exercise revealed that the aggregate tier 1 common equity ratio--which is the strongest form of loss-absorbing capital--at the 18 firms covered by this stress test has more than doubled, from 5.6 percent at the end of 2008 to 11.3 percent at the end of 2012. That reflects an increase of about $400 billion in tier 1 common equity at these firms since the crisis.

The Federal Reserve is also working under section 165 of the Dodd-Frank Act to implement enhanced risk-based capital standards for large bank holding companies that would increase in stringency based on the relative systemic footprint of those companies. Consistent with this requirement, the Federal Reserve advanced proposals in the Basel Committee for substantial capital surcharges on the world's largest, most interconnected banking organizations. In December 2011, the Basel Committee reached an agreement on a global framework for such surcharges, and the Federal Reserve will be making forthcoming proposals to implement the capital surcharge framework for systemic U.S. bank holding companies.

In recognition of the fact that illiquidity at some financial firms played a key role in the financial crisis, the Basel III agreements also introduced for the first time quantitative liquidity requirements for large, internationally active banking firms. One standard, the Liquidity Coverage Ratio (LCR), is designed to help ensure a banking firm's ability to withstand short-term liquidity shocks through adequate holdings of high quality, liquid assets. The other standard, the Net Stable Funding Ratio, is intended to complement the LCR by preventing significant maturity mismatches over longer-term horizons. As with capital, section 165 of the Dodd-Frank Act calls for enhanced, graduated liquidity standards for the largest bank holding companies. The Federal Reserve has already proposed a set of stricter qualitative liquidity standards pursuant to section 165, and we intend to issue a U.S. proposal to implement the LCR later this year.

In addition to the enhanced capital and liquidity regulations for large bank holding companies as described earlier, the Dodd-Frank Act requires the Board to apply single-counterparty credit limits, risk management and risk committee requirements, and an early remediation framework to large bank holding companies. The Board has issued proposals to implement each of these standards for both large domestic bank holding companies and for large foreign banks operating in the United States. These standards represent a core part of the new regulatory framework for mitigating risk posed by systemically important financial firms and for offsetting benefits these firms may gain from being perceived as too-big-to-fail.

Improving Resolvability of Systemic Firms

An important goal of post-crisis financial reform has been to counter too-big-to-fail by reducing the potential damage to the financial system and the economy from the failure of a major financial firm. To this end, the Dodd-Frank Act created the Orderly Liquidation Authority (OLA), a mechanism designed to improve prospects for an orderly resolution of a systemic financial firm. Since the passage of the Dodd-Frank Act, the Federal Deposit Insurance Corporation (FDIC) has developed a single-point-of-entry preferred resolution strategy under OLA that is intended to effect a creditor-funded holding company recapitalization of the failed financial firm. Key to the ability of the FDIC to execute this approach is the availability of sufficient amounts of unsecured long-term debt at the parent holding company of the failed firm. The Federal Reserve has been working with the FDIC, both as the FDIC develops its OLA framework, and to consider the merits of a regulatory requirement that the largest, most complex U.S. banking firms maintain a minimum amount of parent-level, long-term unsecured debt that would ultimately facilitate a single-point-of-entry approach to OLA. Parent-level, long-term debt could lend greater confidence that the combination of equity owners and long-term debt holders would be sufficient to bear all losses at the consolidated firm, thereby allowing a more orderly resolution of large, complex firms, and counteract the moral hazard associated with the perception that large firms are too-big-to-fail.

The Dodd-Frank Act also required all large bank holding companies to develop, and submit to supervisors, resolution plans. The Federal Reserve has been working with the FDIC to review resolution plans submitted by the largest U.S. bank holding companies and foreign banks. The largest banking firms submitted their first annual resolution plans to the Federal Reserve and the FDIC in the summer. The initial round has yielded valuable information that is being used to identify, assess, and mitigate key challenges to resolvability under the Bankruptcy Code (Title I plans) and to support development of backup resolution plans under OLA (Title II plans). We believe that, over time, these resolution plans will help firms and the supervisors identify and address structural and other issues that could be impediments to the orderly resolution of the firms.

Limitations on the Size and Activities of Firms

The Dodd-Frank Act also contains several provisions that limit the size and growth of financial firms. For example, sections 163 and 604 of the Dodd-Frank Act require various types of large financial firms to obtain regulatory approval before growing through a merger or acquisition. In each of these cases, the reviewing agency must consider the risk of the transaction to the stability of the United States banking or financial system. In addition, section 622 prohibits a firm from growing through acquisition, with very limited exceptions once the firm reaches a specified size.

Finally, section 121 of the Dodd-Frank Act authorizes the Federal Reserve, with the consent of two-thirds of the voting members of the Council, to impose a variety of restrictions on large bank holding companies and designated nonbank financial companies if the Board finds that the firm poses a grave threat to the financial stability of the United States. These restrictions include limiting the ability of the company to grow through mergers or acquisitions, requiring the termination of any activity, and imposing conditions on the manner in which the company conducts its activities. In the event that the Federal Reserve determines that these types of actions are inadequate to mitigate the threat the firm poses to the financial stability of the United States, the firm may be required to sell assets.

Conclusion

The Federal Reserve has made significant progress in the past few years toward the goals of making all firms, including large, systemically important firms, more resistant to failure and ensuring that no firm is too-big-to-fail, but more work remains to be done.

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

EMBARGOED UNTIL DELIVERY

STATEMENT OF

FEDERAL DEPOSIT INSURANCE CORPORATION

by

JAMES R. WIGAND
DIRECTOR
OFFICE OF COMPLEX FINANCIAL INSTITUTIONS

AND

RICHARD J. OSTERMAN, JR.
ACTING GENERAL COUNSEL

on

WHO IS TOO BIG TO FAIL? EXAMINING THE APPLICATION OF TITLE I OF THE DODD-FRANK ACT

before the

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

April 16, 2013
2128 Rayburn House Office Building

Chairman McHenry, Ranking Member Green, and members of the Subcommittee, thank you for the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) on Sections 165 and 121 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). Our testimony will focus on the FDIC's role and progress in implementing Section 165, including the resolution plan requirements and the requirements for stress testing by certain financial institutions.

Section 165 of the Dodd-Frank Act

Resolution Plans

Under the Dodd-Frank Act, bankruptcy is the preferred resolution framework in the event of a systemic financial company's failure. To make this prospect achievable, Title I of the Dodd-Frank Act requires that all large, systemic financial companies prepare resolution plans, or "living wills", to demonstrate how the company would be resolved in a rapid and orderly manner under the Bankruptcy Code in the event of the company's material financial distress or failure. This requirement enables both the firm and the firm's regulators to understand and address the parts of the business that could create systemic consequences in a bankruptcy.

The FDIC intends to make the living will process under Title I of the Dodd-Frank Act both timely and meaningful. The living will process is a necessary and significant tool in ensuring that large financial institutions can be resolved through the bankruptcy system.

The FDIC and the Federal Reserve Board issued a joint rule to implement Section 165(d) requirements for resolution plans – (the 165(d) Rule) – in November 2011. The 165(d) Rule requires systemically important financial institutions (SIFIs) -- bank holding companies with total consolidated assets of $50 billion or more, and nonbank financial companies that the Financial Stability Oversight Council (FSOC) determines could pose a threat to the financial stability of the United States -- to develop, maintain, and periodically submit resolution plans to regulators.

In addition to the resolution plan requirements under the Dodd-Frank Act, the FDIC issued a separate rule which requires all insured depository institutions (IDIs) with greater than $50 billion in assets to submit resolution plans to the FDIC for their orderly resolution under the Federal Deposit Insurance Act. The 165(d) Rule and the IDI resolution plan rule are designed to work in tandem by covering the full range of business lines, legal entities and capital-structure combinations within a large financial firm.

The 165(d) Rule establishes a schedule for staggered annual filings. The first group of filers -- bank holding companies and foreign banking organizations with $250 billion or more in non-bank assets ("first wave" filers) -- submitted their initial resolution plans on July 1, 2012. Financial companies with less than $250 billion, but more than $100 billion in non-bank assets ("second wave" filers), will file their initial plans by July 1, 2013, and all other bank holding companies – those with assets over $50 billion – ("third wave" filers) are scheduled to file by December 31, 2013. While the general expectation is that firms will file annually, regulators may require that a plan be updated on a more frequent schedule, and a firm must provide notice to regulators of any event that may have a material effect on its resolution plan.

Eleven firms comprised the first wave of filers. The nine firms that submitted plans on July 1, 2012, were Bank of America Corporation, Citigroup, JPMorgan Chase, Goldman Sachs, Morgan Stanley, Deutsche Bank, UBS, Credit Suisse, and Barclays. The two other first wave filers, Bank of New York Mellon Corporation and State Street Corporation, submitted plans on October 1, 2012. The second wave filers include Wells Fargo, BNP Paribas, HSBC, and RBS. The third wave filers include approximately 115 firms, the large majority being foreign financial companies conducting business in the U.S.

The 165(d) Rule sets out the information to be included in a firm's resolution plan. The key objectives laid out in the Rule for the initial resolution plans submitted by first wave filers are identifying each firm's critical operations and core business lines, mapping those operations and core business lines to each firm's material legal entities, and identifying the key obstacles to a rapid and orderly resolution in bankruptcy. With regard to key obstacles, these might include such areas as a firm's internal organizational structure, interconnections of the firm to other systemic financial companies, management information system limitations, default and termination provisions of certain types of financial contracts, cross-jurisdictional operations, and funding mechanisms.

The 165(d) Rule provides that smaller, less complex financial institutions subject to the filing requirements may be eligible to file a less detailed, tailored resolution plan, for which the information requirements generally are limited to the firm's nonbanking operations, and the interconnections between the nonbanking operations and its IDI operations.

Section 165(d) of the Dodd-Frank Act requires the FDIC and the Federal Reserve Board to review each resolution plan. If, as a result of their review, the FDIC and the Federal Reserve Board jointly determine that the resolution plan is not credible or would not facilitate an orderly resolution of the firm under the Bankruptcy Code, then the company must resubmit the plan with revisions, including, if necessary, proposed changes in business operations or corporate structure. If the company fails to resubmit a credible plan that would result in orderly resolution under the Bankruptcy Code, the FDIC and the Federal Reserve may jointly impose more stringent capital, leverage, or liquidity requirements; growth, activities, or operations restrictions; or, after two years and in consultation with the FSOC, divestiture requirements.

Federal Reserve Board and FDIC staff reviewed the first wave filers' plans for informational completeness to ensure that all information requirements of the Rule were addressed in the plans. The initial plan submissions for the first wave filers were created using an assumption of the individual firm's failure under "baseline" economic conditions as a starting point. Subsequent submissions are required to take into account "adverse" and "severely adverse" economic conditions.

The eleven firms that submitted initial plans in 2012 will be expected to revise and update their submissions in their subsequent 2013 versions, pursuant to guidance that the FDIC and the Federal Reserve Board will provide to these companies. Resolution plans submitted in 2013 will be subject to informational completeness reviews and reviews for creditability or resolvability under the Bankruptcy Code. Going forward, the FDIC and the Federal Reserve Board expect the revised plans to focus on key issues and obstacles to an orderly resolution in bankruptcy, including global cooperation and the risk of ring-fencing or other precipitous actions. To assess this potential risk, the firms will need to provide a jurisdiction-by-jurisdiction analysis of the actions each would need to take in a resolution, as well as the actions to be taken by host authorities, including supervisory and resolution authorities. Other key issues expected to be addressed in the plans include: the risk of multiple, competing insolvency proceedings; the continuity of critical operations -- particularly maintaining access to shared services and payment and clearing systems; the potential systemic consequences of counterparty actions; and global liquidity and funding with an emphasis on providing a detailed understanding of the firm's funding operations and cash flows.

Stress Testing

Section 165 of the Dodd-Frank Act requires the FDIC to issue regulations for FDIC-supervised banks with total consolidated assets of more than $10 billion to conduct annual stress tests. The banks must report their respective stress test results to the FDIC and the Federal Reserve Board and these results also are summarized in a public document. The FDIC views the stress tests as an important source of forward-looking analysis that will enhance the supervisory process for these institutions. Furthermore, these stress tests will support ongoing improvement in a bank's internal assessments of capital adequacy and overall capital planning.

The Dodd-Frank Act requires the FDIC to coordinate with the other supervisory agencies to issue regulations that are consistent and comparable. While each banking agency issued separate final rules with respect to their supervised entities, the final rules were nearly identical across the agencies. The FDIC finalized its rule on annual stress tests on October 15, 2012. Complementing this rulemaking, the FDIC also issued proposed reporting templates that were developed jointly with the other agencies. Lastly, the agencies are working closely on proposed guidance to ensure consistent treatment for all covered financial institutions under the final rule.

Certain insured institutions and bank holding companies with assets of $50 billion or more comprised the first set of companies to conduct stress tests, which were completed in March 2013. Using September 30, 2012 financial data, institutions developed financial projections under defined stress scenarios provided by the agencies in November 2012. Each company publicly disclosed the results of their stress tests on or before March 31st of this year.

Institutions with assets greater than $10 billion, but less than $50 billion, and larger institutions that have not had previously conducted stress tests, will conduct their first round of stress tests later this fall.

Section 121 of the Dodd-Frank Act

Section 121 authorizes the Federal Reserve Board, with the concurrence of two-thirds of the voting members of the Financial Stability Oversight Council (FSOC), to take various actions with respect to a bank holding company with assets of $50 billion or more or a nonbank financial company supervised by the Federal Reserve Board, if it is determined that company poses a grave threat to the financial stability of the United States. Section 121 also grants the company, upon its request, the opportunity to request a written or oral hearing before the Federal Reserve Board to contest proposed actions.

As a voting member of the FSOC, the FDIC would participate in any discussions involving findings made by the Federal Reserve Board under this section and would carefully weigh the case and its merit in exercising our FSOC vote. To date, the FSOC has not heard any matters involving the use of this "grave threat" authority.

Conclusion

The FDIC has made significant progress in the implementation of Section 165 of the Dodd-Frank Act. Our goal is to ensure that firms that could pose a systemic risk to the financial system develop and maintain resolution plans that identify each firm's critical operations and core business lines, map those operations and core business lines to each firm's material legal entities, and identify and address the key obstacles to a rapid and orderly resolution in bankruptcy. Ensuring that any institution, regardless of size or complexity, can be effectively resolved through the bankruptcy process will contribute to the stability of our financial system and will avoid many of the difficult choices regulators faced in dealing with systemic institutions during the last crisis.

United States Senate
WASHINGTON, DC 20510

March 12, 2013

Financial Stability Oversight Council
1500 Pennsylvania Avenue NW
Washington, D.C. 20220

Dear Members of the Financial Stability Oversight Council:

I write to you today to request clarification of your interpretation of the authority to mitigate risks to financial stability granted to you under the Dodd-Frank Act.

As you likely know, Section 121 of the Dodd-Frank Act states that, upon the affirmative vote of two-thirds of the Financial Stability Oversight Council (FSOC), the Board of Governors (the Fed) shall:

> "(5) if the Board of Governors determines that the actions described in paragraphs (1) through (4) are inadequate to mitigate a threat to the financial stability of the United States in its recommendation, require the company to sell or otherwise transfer assets or off-balance-sheet items to unaffiliated entities" (12 U.S.C. 5331).

In other words, if the Fed gives notice that it does not have the ability to "mitigate" a risk to financial stability of the United States posed by a large institution, the FSOC has the authority to order the Fed to break up that bank.

Do you interpret Section 121 to mean that an institution has to be unhealthy to pose a threat to the financial system? Or is it possible for an institution that is solvent to pose a threat simply by being too large, too interconnected with other participants in the financial system, or too complex in its structure? In other words, what if an institution is solvent, but so large and complex that it could not fail without threatening the safety of the financial system? In this latter case, would you have both the authority and the impetus to force the divestiture of such a going concern?

I would also like to know if you plan to issue interpretative guidance to explain under what conditions an institution would still represent a threat to the financial stability of the United States, despite any mitigation efforts.

I look forward to your response.

Sincerely,

Bob Corker
United States Senator

The Honorable Jack Lew
Secretary
Department of the Treasury
1500 Pennsylvania Avenue NW, Room 3134
Washington, DC 20220

The Honorable Gary Gensler
Chairman
Commodity Futures Trading Commission
Three Lafayette Center, 1155 21st Street NW
Washington, DC 20581

The Honorable Thomas Curry
Comptroller
Office of the Comptroller of the Currency
250 E Street SW, Room 9048
Washington, DC 20219

The Honorable Edward DeMarco
Acting Director
Federal Housing Finance Agency
1700 G Street NW, 4th Floor
Washington, DC 20552

The Honorable Richard Cordray
Consumer Financial Protection Bureau
1500 Pennsylvania Avenue NW
Washington, DC 20220

The Honorable Ben Bernanke
Chairman, Board of Governors
The Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

The Honorable Debbie Matz
Chairman
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

The Honorable S. Roy Woodall, Jr.
Independent Member
Financial Stability Oversight Council
1500 Pennsylvania Avenue NW
Washington, DC 20220

The Honorable Martin Gruenberg
Chairman
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, DC 20429

The Honorable Elisse Walter
Chairman
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Response to Questions from the Honorable Patrick McHenry
by the
Federal Deposit Insurance Corporation

Q1: Section 165(d)(4) of the Dodd-Frank Act appears to refer to two concepts for purposes of determining whether a living will is deficient: "credibility" and "facilitating an orderly resolution under bankruptcy." In your opinion, is there a distinction between those terms? If so, please explain the meaning of each term.

A1: As Mr. Osterman indicated in his answer to this question at the hearing, read literally the statute suggests that there are two standards with respect to a plan, one as to its "credibility" and one as to whether it would "facilitate orderly resolution under the Bankruptcy Code," although they are clearly closely related. As further indicated by Mr. Osterman, an example of the former might be whether the plan impermissibly relies on the provision of extraordinary support from the United States or a foreign government, while an example of the latter would be whether resolution under the Bankruptcy Code could be achieved without an adverse impact on financial stability in the United States and without resort to the FDIC's special powers under Title II of the Dodd-Frank Act. (See Osterman Transcript, pp. 97-98.) In any event, while 165(d)(4) may be read to suggest two distinct concepts, the ultimate requirement is clear that under 165(d)(4)(B), a deficient plan must be revised to demonstrate that the plan is credible and would result in the orderly resolution under the Bankruptcy Code.

Q2: Does Section 165(d)(5) require the Federal Reserve and the FDIC to impose restrictions or heightened standards and/or divestitures after a company fails to timely submit an acceptable living will, or is that decision purely discretionary?

A2: The statute does not require the FRB and FDIC to impose such restrictions, but those are important authorities that can be used to ensure firms develop resolution plans that are credible and would result in the orderly resolution under the Bankruptcy Code or make the structural changes necessary to achieve this objective.

Q3: Does a financial company have a right to judicial review of an action by the Federal Reserve and the FDIC under Section 165(d)(5)? If so, what would be the standard of review?

A3: In general, pursuant to the Administrative Procedure Act, judicial review is available for a final agency action, under a standard of whether the action was arbitrary or capricious. For issues arising under Section 165(d), a financial company's ability to obtain judicial review, and the applicable standard of review, would be determined based upon the same well-established principles that protect the rights of private parties with respect to administrative action by the government. It is worth noting that the process under Section 165(d) necessarily involves extensive discussion between the agencies and the financial company, and there may be a range of possible interim decisions by the agencies during that process that might not constitute "final agency action."

Q4: In response to a question from Chairman McHenry asking whether the Federal Reserve and the FDIC considered a firm's liquidity when reviewing a resolution plan submitted under Section 165(d), the following exchange occurred:

> **Mr. Wigand: Yes, [liquidity] certainly would be a factor. Absolutely.**
>
> **. . .**
>
> **Mr. McHenry: Ok. So being resolved in the Bankruptcy Code and [the] requirement within the living will [there] has to be some capacity for liquidity support as they're unwound under the Bankruptcy Code or resolved.**
> **Mr. Wigand: More — more specifically what is required is for the firm to outline how they will handle the liquidity management of the bankruptcy process. So specifically, you know, I — we — we aren't asking the firms to specifically identify where that liquidity support will be drawn from.**
> **But it's a liquidity analysis to indicate how the firm can unwind itself or go through the bankruptcy process without posing systemic consequences.**
> **Source: Congressional Quarterly Transcript at p. 50.**

Is the foregoing a materially accurate transcription of your testimony? If not, please state why not. If the foregoing is materially accurate, please state the reasons why the FDIC does not "ask[] the firms to specifically identify where that liquidity support will be draw[n] from." In answering this question, please state the reasons why, in the FDIC's view, the FDIC is able to determine that a living will is credible and would facilitate an orderly resolution of the company under the Bankruptcy Code in the absence of information that identifies the sources from which a company would receive liquidity support. Please detail how companies otherwise substantiate their liquidity management plans.

A4: The portion of Mr. Wigand's answer that is quoted in the excerpt is accurate. Mr. Wigand's full answer explained that the FDIC and the FRB have asked covered companies to outline a plan or process for maintaining liquidity. This information will be available to the FDIC in determining whether or not a living will is credible and could facilitate a rapid and orderly resolution under the Bankruptcy Code. The 165(d) Rule requires a strategic analysis of liquidity and funding, including a detailed description of the

> "Funding, liquidity and capital needs of, and resources available to, the covered company and its material entities, which shall be mapped to its critical operations and core business lines, in the ordinary course of business and in the event of material financial distress at or the failure of the covered company." 12 C.F.R. §381.4(c)(1)(iii).

The Guidance provided by the FRB and the FDIC for the 2013 165(d) resolution plan submissions by the covered companies that submitted their initial plans in 2012 places further emphasis on the liquidity requirements during the period leading up to and during resolution, and calls for a description of the process for arranging debtor-in-possession financing, consents to use cash collateral and/or other means of providing liquidity to the covered company's Material Entities during the bankruptcy process. In addition to that overview, covered companies have been asked six detailed questions about funding and liquidity, including funding sources and uses by legal entity and jurisdiction, the impact of potential ring-fencing, the challenges of securing funding sources, liquidity and funding needs over time during resolution, funding requirements of each Critical Operation, and inter-affiliate funding exposures. The company would be required to describe generically the sources of liquidity that could be accessed but not the names of the specific companies that might be sources of liquidity.

<u>**Questions for Scott G. Alvarez, General Counsel, Board of Governors of the Federal Reserve System, from Chairman McHenry:**</u>

1. (To Mr. Alvarez): The Federal Reserve can only order asset divestures if it determines that less drastic restrictions on the company's activities are inadequate to mitigate the threat the company poses. In your opinion, must the Federal Reserve actually order the company to adopt the less drastic restrictions before it can "determine" that those measures are inadequate? Or are there circumstances in which the Federal Reserve may make the necessary "determination" without having first imposed the other measures?

Section 121 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) authorizes the Federal Reserve Board (Board), with the consent of the Financial Stability Oversight Council (FSOC), to take certain enumerated actions if the Board determines that a large bank holding company or a nonbank financial company supervised by the Board poses a grave threat to U.S. financial stability. In particular, the Board may limit the ability of the company to grow through mergers or acquisitions, restrict the ability of the company to offer certain financial products, require the termination of certain activities, or impose conditions on the manner in which the company conducts one or more activities.

Section 121 authorizes the Board to require the company to sell or otherwise transfer assets to unaffiliated entities under certain circumstances. This authority requires a finding that the firm poses a grave threat to U.S. financial stability. Before taking this action, section 121 also requires the Board to determine that the enumerated actions, including limiting mergers and acquisitions, restricting products, terminating or limiting activities, and imposing conditions on the manner in which activities are conducted, are inadequate to mitigate the threat to U.S. financial stability. Any action the Board proposes to take under section 121 is subject to an affirmative vote of 2/3 of the voting members of the FSOC. In addition, section 121 grants the company a right to notice and a hearing before any mitigatory action is taken pursuant to that section. Any action taken under section 121 would be made after careful consideration of the facts and circumstances of the grave threat posed by a particular company.

2. (To Messrs. Alvarez, Osterman, and Wigand): Section 165(d)(4) of the Dodd-Frank Act appears to refer to two concepts for purposes of determining whether a living will is deficient: "credibility" and "facilitating an orderly resolution under bankruptcy." In your opinion, is there a distinction between those terms? If so, please explain the meaning of each term.

Section 165(d)(4) of the Dodd-Frank Act provides that if the Federal Reserve Board and the Federal Deposit Insurance Corporation (FDIC) jointly determine that a living will is "not credible" or "would not facilitate an orderly resolution under title 11, United States Code" they must notify the filer of plan of the deficiencies in the plan. Neither of the quoted terms is further defined in the statute.

The plain language of Section 165(d)(4) and its use of the word "or" suggests two evaluations. The concept of "not credible" appears to require an assessment of the specific assumptions and conclusions of the plan while the "would not facilitate" concept appears to focus on whether the plan and its informational content would be helpful in a proceeding under title 11 of the Bankruptcy Code.

3. (To Messrs. Alvarez and Osterman): Does Section 165(d)(5) require the Federal Reserve and the FDIC to impose restrictions or heightened standards and/or divestitures after a company fails to timely submit an acceptable living will, or is that decision purely discretionary?

If a company fails to resubmit an acceptable living will, section 165(d)(5)(A) provides that the Federal Reserve Board and the FDIC may jointly impose more stringent capital, leverage, or liquidity requirements, or restrictions on the growth, activities, or operations of the company, or any subsidiary thereof, until such time as the company resubmits a plan that remedies the deficiencies the filing company.

If requirements are imposed pursuant to section 165(d)(5)(A) and the company fails to submit a satisfactory plan within two years of the imposition of the requirements, section 165(d)(5)(B) provides that the Federal Reserve Board and the FDIC, in consultation with the Financial Stability Oversight Council, may jointly require the company to divest certain identified assets or operations. The use of the term "may" in section 165(d)(5)(A) and (B) suggests that the Federal Reserve and the FDIC have discretion over whether to impose the more stringent requirements identified in the section.

4. (To Mr. Alvarez): Does a financial company have a right to judicial review of an action by the Federal Reserve and the FSOC under Section 121? If so, what would be the standard of review?

Section 121 requires the Board, in consultation with the FSOC, to provide a company written notice that it is being considered for mitigatory action. The company would then have an opportunity to request a hearing to contest the proposed action. The Board is required to notify the company of the final decision of the Board and the FSOC within 60 days of the hearing or of the notice of consideration of mitigatory action if a hearing is not requested.

Section 121 does not expressly provide for judicial review of a final decision of the Board and the FSOC. However, a company subject to an action under section 121 may be able to avail itself of the procedures set forth in the Administrative Procedure Act (APA), which provides that "final agency action for which there is no other adequate remedy in a court is subject to judicial review."[1] Agency action includes an agency order or sanction.[2] The APA also provides that a reviewing court may set side agency action that is found to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.[3]

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[1] See section 704 of the APA; 5 U.S.C. § 704.
[2] See section 551(13) of the APA; 5 U.S.C. § 551(13).
[3] See section 706(2)(A) of the APA; 5 U.S.C. § 706(2)(A).

5. (To Messrs. Alvarez and Osterman): Does a financial company have a right to judicial review of an action by the Federal Reserve and the FDIC under Section 165(d)(5)? If so, what would be the standard of review?

Section 165(d)(5) does not expressly provide for judicial review of a final decision of the Board and the FDIC. However, a company subject to an action under section 165(d)(5) may be able to avail itself of the procedures set forth in the Administrative Procedure Act (APA), which provides that "final agency action for which there is no other adequate remedy in a court is subject to judicial review."[4] Agency action includes an agency order or sanction.[5] The APA also provides that a reviewing court may set aside agency action that is found to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.[6]

6. (a) (To Mr. Alvarez): In response to a question by Mr. Duffy asking whether "you've seen this petition by Public Citizen, yes?" the following exchange occurred:

Mr. Alvarez: I don't know. I know...

Mr. Duffy: You haven't seen a petition that has been made...

Mr. Alvarez: I've seen (inaudible)

Mr. Duffy: ...with regard to Public Citizen and regard to a very large bank-U.S. Bank. I'm sorry, U.S. Bank-Bank of America?

Mr. Alvarez: I have not.

Mr. Duffy: You haven't seen that? Do you-have you guys responded to any petitions that have been filed under Section 121?

Mr. Alvarez: No, we have not.

(Source: Congressional Quarterly Transcript at p. 33.)

Question:

Is the foregoing a materially accurate transcription of your testimony? If not, please state why not.

(b) On February 10, 2012, the Federal Reserve mailed a letter on your letterhead and under your signature to Mr. David Arkush of the public interest advocacy group Public Citizen. The Federal Reserve's letter was in response to a petition made by Public Citizen

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[4] See section 704 of the APA; 5 U.S.C. § 704.
[5] See section 551(13) of the APA; 5 U.S.C. § 551(13).
[6] See section 706(2)(A) of the APA; 5 U.S.C. § 706(2)(A).

advocating that the Federal Reserve use its authority under Section 121 to mitigate risks posed by the Bank of America Corporation. In part, the letter states that "[t]he Federal Reserve takes seriously its responsibilities under the DFA [Dodd-Frank Act], and will carefully consider all the information available to it, including public comments, confidential supervisory information, and other information, in determining the actions it may take under the statute."

Did you sign the February 10, 2012 letter to Mr. Arkush?

Please clarify or otherwise supplement your above-recounted testimony.

On February 10, 2012, on behalf of Chairman Bernanke, I responded to two letters each dated January 25, 2012, sent to Chairman Bernanke by Mr. Arkush on behalf of Public Citizen. Mr. Arkush advocated that the Board and FSOC use the authorities in the Dodd-Frank Act to mitigate the risks to financial stability that Mr. Arkush asserted are posed by the Bank of America Corporation (BAC) and other large and complex financial institutions. Mr. Arkush suggested that the Board and the FSOC invoke the authority in section 121 of DFA to reform BAC into one or more smaller institutions. My response letter acknowledges receipt of Mr. Arkush's letters, but provided no analysis or review of those letters.

At the time of my testimony, which was over one year later, I did not remember that one of the letters was styled as a petition regarding BAC. I apologize for my failure of memory. As noted in the response to Mr. Arkush, the Board appreciates receiving the views of interested parties, such as Public Citizen, on issues of concern regarding the banking organizations it supervises, and welcomes further public input. In implementing its various statutory authorities under the Dodd-Frank Act, the Board considers all of the information available to it, including public comments.

7. (To Mr. Alvarez): The public interest advocacy group, Public Citizen, has interpreted Section 121 of the Dodd-Frank Act to permit the Federal Reserve to require mitigatory action "well in advance of financial distress at an institution that poses a grave threat to U.S. financial stability." Public Citizen argued that Congress intended Section 121 to be used substantially before an institution actually becomes distressed because Section 121 does not contain a mechanism to order a company to take mitigatory action on an emergency basis. In addition, it argued that the "early" use of Section 121 is appropriate in light of the Dodd-Frank Act's larger structure, because absent divestitures or other mitigatory action the FDIC may not be able to successfully resolve an institution that actually becomes distressed using the Dodd-Frank Act's orderly liquidation authority.

Thus, Public Citizen argued that the Federal Reserve and the FSOC were legally able to use their authority under Section 121 in the case of the Bank of America Corporation because the institution was "structurally unsound" even though it was not in "immediate danger." In Public Citizen's view, Bank of America posed a "grave threat" within the meaning of the Dodd-Frank Act because it was large in size and was highly interconnected

to other financial institutions, and because its size made it hard to manage and gave rise to an expectation in the marketplace of government-funded bailouts should Bank of America become insolvent in the future (thus creating moral hazard). In addition, Public Citizen argued that Bank of America was in a distressed financial condition because, among other factors, its stock price had decreased 90% since 2007; its share price was much lower than its stated tangible book value; spreads for credit default swaps on Bank of America had risen to relatively high levels; and its long-term economic condition was not favorable due to declines in income, litigation exposure, capitalization pressures, and exposure to the European financial crisis.

Question:

Based on the above facts, does Bank of America constitute a "grave threat" within the meaning of Section 121?

Mitigating the threat to financial stability posed by systemically important financial companies is a core objective of the financial regulatory community. A great deal of progress has been made by the FSOC and the financial regulatory agencies, including the Board in implementing the Dodd-Frank Act, several provisions of which were intended to mitigate the threat to financial stability posed by systemically important financial companies.

The Board has already taken a number of steps to improve the quantity and quality of capital held by large banking organizations, including by increasing the minimum risk-based and leverage capital requirements on the largest and most complex banking organizations, and implementing an annual stress test of those capital levels (CCAR). The Dodd-Frank Act also provides a number of important tools for addressing the potential threats that could be posed by systemically important financial companies to U.S. financial stability, including enhanced prudential standards for bank holding companies with total consolidated assets of $50 billion or more and nonbank financial companies designated by the FSOC for Board supervision, an orderly resolution authority for large financial firms, living wills, stress testing, and central clearing and margin requirements for derivatives, among other provisions. The Board is actively working to implement these tools with the other Federal banking agencies, as appropriate. In addition, section 121 of the Dodd-Frank Act authorizes the Board, with consent of two-thirds of the voting members of the FSOC, to take certain steps if the Board determines that a large bank holding company or a nonbank financial company supervised by the Board poses a grave threat to the financial stability of the United States.

The Board and other U.S. regulators are now in the process of implementing these reforms. While much progress has been made by the Board and the other financial regulatory agencies in implementing the Dodd-Frank Act reforms designed to address and reduce threats to U.S. financial stability, identifying and addressing risks that emerge or develop as our dynamic system and economy evolve is an ongoing process. The Board and the financial regulatory agencies will continue to monitor emerging systemic threats and risks to U.S. financial stability and deploy the tools available to the agencies designed to mitigate those threats, as appropriate, and endeavor to reduce the probability of failure of systemically important financial firms, implement procedures to resolve these firms in an orderly manner, and strengthen the financial system. A decision whether a particular banking organization poses a grave threat to financial stability is reserved by statute to the Board and the FSOC.