OVERSIGHT OF THE FINANCIAL STABILITY OVERSIGHT COUNCIL

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OF THE

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CONTENTS

OVERSIGHT OF THE FINANCIAL STABILITY OVERSIGHT COUNCIL

Wednesday, September 17, 2014

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

The subcommittee met, pursuant to notice, at 10:33 a.m., in room 2128, Rayburn House Office Building, Hon. Patrick McHenry [chairman of the subcommittee] presiding.

Members present: Representatives McHenry, Fitzpatrick, Bachus, Duffy, Fincher, Hultgren, Barr, Rothfus; Green, Maloney, Delaney, Beatty, Heck, Kildee, and Horsford.

Ex officio present: Representative Hensarling.

Also present: Representatives Garrett, Neugebauer, and Royce.

Chairman MCHENRY. The Subcommittee on Oversight and Investigations will come to order. The title of today's subcommittee hearing is, "Oversight of the Financial Stability Oversight Council."

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

The Chair will now recognize himself for 5 minutes for an opening statement.

Today, we will follow up on a hearing that this subcommittee held in March of last year where we discussed the Financial Stability Oversight Council's (FSOC's) failure to address recommendations from a 2012 U.S. Government Accountability Office (GAO) audit. Unfortunately, nearly 2 years after its September 2012 report, the GAO still concludes that the FSOC has not made satisfactory progress towards implementing many of its recommendations.

The FSOC may well be the least transparent Federal entity in the government. Of the 42 meetings held, no substantive description of discussions or members' perspectives have been provided in the meeting minutes. In fact, two-thirds of the meetings were held in executive session, completely closed off to the public.

For comparison's sake, even the Federal Reserve releases fairly detailed transcripts of meetings of the Federal Open Market Committee (FOMC), as well as background material relied on by meeting participants and lengthy minutes that describe in detail the issues considered and the participants' perspectives on those matters.

What this means for the companies that are potentially subject to the SIFI designation by the FSOC is that they must submit vast quantities of information demonstrating systemic risk and have no idea whether this information is reviewed, and if so, by whom. Furthermore, it is unclear what role, if any, the Office of Financial Research (OFR) plays in the data review process and how the information is ultimately made available to the FSOC's voting members.

Even Congress, which created the FSOC and its unprecedented authority under the Dodd-Frank Act, has been denied access to their process. The dearth of information in the FSOC's minutes makes it impossible for Congress to conduct effective oversight of the FSOC and to determine whether the agency has appropriately implemented the Dodd-Frank Act.

For example, detailed minutes from the FSOC's designation of nonbank financial companies for "heightened prudential supervision," would help Congress assess the effectiveness of the FSOC's application of the statutory criteria for designation. Detailed minutes would also help Congress assess other matters including: the nature and quality of members' discussions concerning systemic risk; the relationship between the FSOC and the several staff committees that assist it, including the extent to which the FSOC conducted independent analysis or simply served as a rubber stamp; and how the FSOC incorporated data and analysis provided by the OFR as part of its deliberations.

The FSOC has now been in existence for 3 years, yet it is still not clear how the FSOC has performed annual reevaluations of its SIFI designations, as required by the law. Although the FSOC's July 31st meeting minutes of this year do indicate that reevaluations took place for 2 firms designated over a year ago, it is unclear what standards were used to conduct these annual reviews, and it is unclear whether a review has been planned or conducted for the third company.

In fact, during a recent hearing this past July, a mere 2 weeks before the FSOC voted on the reevaluations, Chair Yellen of the Federal Reserve testified that she was unaware whether redesignation decisions were on the agenda for the FSOC consideration. This is problematic.

Therefore, it is not shocking that the GAO concluded that almost 2 years after its 2012 report, the FSOC has not made satisfactory progress in terms of complying with many of its recommendations, including those intended to ensure that the FSOC has a comprehensive set of systemic risk indicators, whether or not it is coordinating and clarifying rules with the OFR and other regulators, and whether or not it has the ability to adequately assess the effect of SIFI designations on the market and on the designated companies.

I look forward to the hearing today and the testimony from our panel of witnesses. And I hope they will address these mounting questions that have developed about the FSOC process and its considerably opaque yet very powerful actions over the last 3 years.

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

Mr. GREEN. Thank you, Mr. Chairman. And thank you for holding this important hearing to discuss the Financial Stability Oversight Council, FSOC.

The FSOC represents an important piece of the Dodd-Frank solution to the challenges we faced following the 2008 financial crises. As a result of the crises, 489 banks failed between 2008 and 2013, while only 21 banks failed from 2002 to 2007. An estimated 3.2 million foreclosures were completed from 2009 to 2011, versus about only 1.4 million foreclosures from 2006 to 2008.

An estimated $3.4 trillion in real estate wealth was lost since 2008; 26.2 percent in pension value has been lost since 2008. An estimated $7.4 trillion in stock market wealth was lost between July 2008 and March 2009.

And on September 29, 2008, when the House initially voted down TARP, the Dow dropped 778 points. An estimated 8.8 million jobs were lost between 2007 and 2009.

In 2008, the unemployment rate was 5.8 percent, versus 9.6 percent in 2010. The suicide rate quadrupled between 2008 and 2010. There were about 850,000 bankruptcies in 2007, versus 1.4 million bankruptcies in 2009.

Mr. Chairman, while we may disagree as to whether we should amend or end Dodd-Frank, there should be little disagreement regarding the lack of data and oversight of certain sectors of the financial markets, which led to overexposure and overleveraging of many large financial institutions. Some important lessons were learned that we should share with you.

One of the lessons learned was that we need greater coordination and better data to fully understand the ways in which our financial markets were changing.

Through Dodd-Frank, we created the FSOC, chaired by the Secretary of the Treasury. The FSOC is comprised of 10 voting members, our Federal regulators, and one independent member with insurance expertise, together with five non-voting members, including the Director of the Office of Federal Research, the Director of the Federal Insurance Office, a State insurance commissioner, a State banking supervisor, and a State securities commissioner. Congress empowered the FSOC to oversee the landscape of the financial markets and to designate certain financial institutions as systemically important financial institutions, or SIFIs. Through this designation, these firms could be subjected to heightened standards under the Federal Reserve to ensure the safety of our financial system.

Nonbank financial institutions of any size can be designated by the FSOC through a two-thirds vote, and to date only three firms have been so designated. Nonetheless, despite only being a few years removed from the worst financial crisis since the Great Depression, the FSOC and its SIFI designation process is under scrutiny.

Because clarity from the FSOC is important, I do not oppose companies asking for additional guidance or feedback regarding the FSOC process. Their contention that certain sectors of the financial markets are fundamentally structured differently than bank holding companies should be considered when determining an SIFI designation.

However, we must remember that Dodd-Frank has been a massive undertaking for our Federal regulators. They continue to work tirelessly to implement the law, and adjustments will be needed.

To be clear, I have always contended that I support efforts to improve Dodd-Frank, which is why I believe we should entertain questions regarding transparency in the FSOC's decision-making process. However, I do not support efforts that would ultimately undermine the FSOC's ability to monitor systemic risk in our financial system.

I thank the witnesses for appearing today. I look forward to their insights.

And I yield back the balance of my time.

Chairman MCHENRY. We will now recognize the chairman of our Capital Markets Subcommittee, the gentleman from New Jersey, Mr. Garrett, for 5 minutes for an opening statement.

Mr. GARRETT. Thank you, Chairman McHenry—or is it Chief Deputy Whip Chairman McHenry—for holding this important hearing. I am not sure I will use all that time. I very much appreciate this hearing on oversight of FSOC, the Financial Stability Oversight Council.

Conducting a thorough and robust overview of this Council is one of the most important things that this committee can be doing right now. Why is that? Because FSOC has repeatedly defied bipartisan calls to do what? To cease and desist its nonbank designations. We have asked them to improve the transparency of their operations, and also simply to use more data-driven and thorough analysis, and frankly, to be accountable to Congress.

Rarely in all my years have I seen a regulatory body that is so defiant of the demands of bipartisan Congress.

More recently, as media outlets have reported, FSOC has designated a new insurance company as a systemically important financial institution (SIFI). Designating more private companies as too-big-to-fail and turning their regulation over to the Federal Reserve and its ever-growing safety net, if you will, is not going to solve the problems of taxpayer exposure to the financial system. Now, I am sure everyone here has heard the old saying, "When you are in a hole, stop digging."

Well, sir, I would ask you to do this: When you leave here, please tell Secretary Lew to put the shovel down.

This is just not my analysis. Here is a quote from an independent financial analyst over at Guggenheim Securities, Jaret Seiberg. In a note he sent out to his clients, in referring to your most recent designation, he said, "We believe customers now will prefer to do business with an insurer that the government has said is too-big-to-fail."

So by your designation, you are driving business that way.

In conclusion, the FSOC must stop taking us down this road. It must stop expanding the taxpayer-backed safety net. It must stop distorting competitive forces in various financial markets. And hopefully, in several months, we will have in this body and in the Senate a critical legislative mass to be able to reform this agency and to stop spreading too-big-to-fail.

With that, I yield back.

Chairman MCHENRY. We will now recognize the gentlelady from New York, Mrs. Maloney, for 3 minutes.

Mrs. MALONEY. Thank you. And I thank the chairman and the ranking member for holding this hearing.

The Financial Stability Oversight Council, or FSOC, has a three-part mission: identifying risk to financial stability; promoting market discipline; and finally, responding to emerging threats to financial stability.

Dodd-Frank gave the FSOC one primary tool to mitigate systemic risk: the power to designate financial institutions as systemically important financial institutions, or SIFIs. This is an important and necessary power, and without it we would have no protection against another AIG.

But because designating companies as SIFIs is so consequential to the companies that are designated, it is imperative that the designation process be as transparent, clear, and robust as possible. In setting up the designation process, the FSOC went through a lengthy public rulemaking that included three separate public comment periods. They should be commended for actively engaging with stakeholders and the general public in creating the designation process, but this doesn't mean that the FSOC designation process is perfect and that no improvements can be made.

In fact, now that we have been through the designation process a few times, and three companies have been designated as SIFIs and one has been proposed for designation, I believe that the FSOC should review what has worked and what can be improved. And that is why in July, I sent a letter to Secretary Lew recommending four specific changes that I believe would make the designation process more fair, thorough, and transparent, without undermining the FSOC's ability to identify and mitigate systemic risk.

I ask unanimous consent to place this letter in the record.

Chairman MCHENRY. Without objection, it is so ordered.

Mrs. MALONEY. The four recommendations that I made are that first, the Council should provide notice to companies that they are in stage two and let them know what is happening, particularly if they are requesting this information.

Second, the Council should begin its engagement with a company that is under consideration. Once it has advanced to stage two, start working with them, instead of waiting until stage three.

Third, when the Council provides a company with notice that it has advanced to stage three, the Council should, to the extent feasible, identify what are the particular issues that they feel merit further review.

And fourth, the Council should adopt a policy of automatically granting an oral hearing to the company upon request. These companies need to know, for their own planning and their own internal efforts what exactly is going on.

I think these are common-sense proposals that I hope will be accepted by Treasury and FSOC. But also, it is important that we not lose sight of the problems that made FSOC necessary: the fact that no regulator prior to the crisis had responsibility for monitoring risk across the entire financial system, which allowed the huge risks to build up outside of the traditional banking sector.

So I look forward to hearing the witnesses, and I thank you very much.

Chairman MCHENRY. We will now recognize the gentleman from Maryland, Mr. Delaney, for 2 minutes.

Mr. DELANEY. Thank you, Mr. Chairman.

My colleague, Mr. Garrett, made a good observation when he read from the research report, and I think he said that the analyst said that business would be going towards companies that were designated as systemically important. But it seems to me one of two things will happen to a certain percentage of a company's business if it is designated systemically important: either business will go towards it; or business will go away from it.

Either way, this designation will affect how the market works and will affect these private enterprises, which is why I believe it is extraordinarily important that the process for designation and the communication and the transparency be done to the highest standard possible. Because in fact, every one of these enterprises that is being considered for designation is already a regulated institution, oftentimes to an extraordinarily high degree.

So I am looking forward to hearing in your testimony how you plan on addressing some of the concerns that my colleague from New York has raised, and which I have also addressed with a piece of legislation that I have co-authored with my colleague, Mr. Ross, in terms of making sure that companies who are considered as a potential SIFI have an opportunity—they and their regulators—to discuss in great detail what the strategy is for designation and what other alternatives are available for these companies to avoid a designation, if possible.

For example, if a business had an activity that the FSOC considered problematic, are we giving companies an opportunity to divest that activity so that the activity in concern could actually be removed from the institution? That seems to me to be, as an example, a better way to accomplish the objectives of FSOC.

So I care a lot about transparency; I care a lot about process; and I care about making sure these companies have a seat at the table, as do their regulators, to have a robust dialogue and to come up with alternatives for SIFI designation. Because SIFI designation will, in fact, affect how these companies participate in their market, how businesses who do business with them, and counterparties who do business with them, think about them, either positively or negatively.

Chairman MCHENRY. The gentleman yields back.

The Chair will now recognize our witnesses for today's panel.

Our first witness is Mr. Patrick Pinschmidt. He is Deputy Assistant Secretary of the Financial Stability Oversight Council. Mr. Pinschmidt was previously a Policy Advisor to the Congressional Oversight Panel created to review the current state of financial markets and the regulatory system.

He also served as vice president of U.S. equity research for both Morgan Stanley and Merrill Lynch. He has a bachelor's degree from Georgetown University and received an MBA from Columbia Business School.

Our second witness is Ms. Nicole Clowers. She is Director of the Financial Markets and Community Investment Team at the United States Government Accountability Office. Ms. Clowers has been with the GAO for over 15 years. She has a bachelor's degree from Virginia Tech and a master's in public administration from the University of Georgia.

Thank you both for being here.

The witnesses will be recognized for 5 minutes.

I know this is not your first rodeo, and so you are aware of the lighting system. You are also aware that this committee has an atrocious sound system, so if you bring the microphone uncomfortably close to your face and then speak clearly, we might be able to hear you.

And without objection, the witnesses' written statements will be made a part of the record.

Mr. Pinschmidt, you are now recognized for 5 minutes.

STATEMENT OF PATRICK PINSCHMIDT, DEPUTY ASSISTANT SECRETARY, FINANCIAL STABILITY OVERSIGHT COUNCIL, U.S. DEPARTMENT OF THE TREASURY

Mr. PINSCHMIDT. Thank you.

Chairman McHenry, Ranking Member Green, and members of the subcommittee, thank you very much for the opportunity to testify today regarding the Financial Stability Oversight Council.

Next month will mark the fourth anniversary of the Council's first meeting. Federal and State financial regulators now meet regularly to coordinate and work together to identify and respond to potential threats to financial stability. The Council has convened over 40 times, and just over the last year has considered issues including market volatility, the debt ceiling impasse, interest rate risk, developments in Europe and emerging economies, housing finance reform, operational incidents in the U.S. equity markets, and cybersecurity.

The broad range of these issues illustrates the importance of an organization charged with looking across the financial system to identify, monitor, and respond to risks to financial stability.

Congress gave the Council a number of authorities to address risks to financial stability. The Council has shown a willingness to use these authorities and a commitment to rigorous analysis.

It has designated three nonbank financial companies for Federal Reserve supervision and enhanced prudential standards. It has designated eight financial market utilities for enhanced risk management standards. It has issued for public comment proposed recommendations regarding money market mutual fund reform. And it has made specific recommendations in its annual reports regarding reforms to address vulnerabilities in the tri-party repo markets and other areas.

In its first 4 years, the Council has also worked extensively with the GAO and other oversight bodies, and we respect their role in making recommendations to help the Council fulfill its statutory responsibilities.

I want to now highlight some of the ways in which the Council has built an organization framework that supports openness and collaboration throughout its work. Beginning with its very first meeting in October 2010, the Council voluntarily adopted a transparency policy. The Council expanded that policy earlier this year to improve the flow of information to the public.

With respect to the nonbank designations process, the Council has established a rigorous and fair process for evaluating nonbank financial companies for potential designation. Although a rulemaking was not required in this context, the Council developed a rule and guidance regarding this authority and provided the public with three separate opportunities to comment on this approach.

The Council's careful analysis of individual nonbanks include extensive interactions with the companies under consideration. Together, for the three nonbank financial companies that have been designated, the firms submitted thousands of pages of information to the Council, met with the Council or staff dozens of times, and each company received a detailed written explanation of the Council's analysis before a vote on the final designation was taken.

It is important to note that much of the Council's work, particularly with regard to companies under consideration for potential designation, relies on sensitive, company-specific information that would not be shared by firms or regulators without an expectation of confidentiality. The Council has a statutory responsibility to protect the confidentiality of this information, as its disclosure could result in destabilizing market speculation.

Within this context, the Council is continually examining how it can monitor emerging threats to the financial system while also opening up more of its work to the public. In this regard, the Council's annual report is an important example of the Council's commitment to sharing information about its work with Congress and the public in a clear and transparent manner.

Since its first meeting, the Council has received a number of suggestions regarding its practices, including some from members of this committee. Although it is a relatively young organization, the Council has already demonstrated its commitment to improving the effectiveness of its work and its engagement with the public.

Consistent with that history, I expect that the Council will consider potential changes to its nonbank designations process in the coming months and will continue to evolve.

Thank you, and I look forward to your questions.

[The prepared statement of Mr. Pinschmidt can be found on page 57 of the appendix]

Chairman MCHENRY. We now recognize Ms. Clowers for 5 minutes.

STATEMENT OF A. NICOLE CLOWERS, DIRECTOR, FINANCIAL MARKETS AND COMMUNITY INVESTMENT TEAM, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Ms. CLOWERS. Chairman McHenry, Ranking Member Green, and members of the subcommittee, thank you for having me here today to discuss our work on FSOC. As you know, FSOC was created to address a regulatory weakness highlighted by the recent financial crisis—namely, a lack of an agency responsible for looking across the system to identify and respond to threats to the financial system.

In September 2012, we issued our first audit report of FSOC and made nine recommendations. Since that time, FSOC has taken steps to address some of the recommendations. However, as we reported in 2012, and our findings and recommendations made clear, additional work is needed.

Our 2012 recommendations were intended to improve FSOC's risk-monitoring functions, accountability, transparency, and collaboration. Since 2012, as I said, FSOC has taken some steps to address our recommendations.

For example, it has worked to improve communication with the public by redesigning its Web site and making more timely notices of upcoming meetings. FSOC has also developed bylaws for its deputies committee, which is an important collaboration improvement.

However, more work is needed to fully address our recommendations. With the rest of my time, I would like to highlight some key recommendations where we think additional work is needed.

First, we recommended in 2012 that FSOC develop a systematic and comprehensive approach to identify systemic risk in emerging threats. We noted that FSOC's approach might not help identify new risk that member agencies had not already identified.

Two years later, FSOC continues to rely on largely the same process. While OFR has made some progress in developing data tools to support FSOC since the 2012 report, we observe that these tools suggest that one tool is still under development and the other is not risk-focused.

Second, related to accountability and transparency, we recommended that FSOC keep detailed records of their closed-door meetings. While no specific level of detail is required for FSOC's minutes, the limited documentation of their discussion makes it difficult to assess FSOC's performance.

FSOC officials said they have attempted to improve meeting minutes that are provided to the public, but FSOC officials said they do not plan to keep more detailed minutes or have them transcribed because of the confidential information discussed. We continue to believe the lack of detailed minutes limits both transparency and accountability.

Also related to accountability, we recommended that FSOC comprehensively evaluate whether the designations of financial companies for enhanced supervision are having the intended impacts. Congress intended that the designations would lead to greater financial stability. These designations will likely have other significant benefits and costs, both for the designated firms as well as the Nation's economy.

Given these potential impacts, it is important that retrospective reviews of the designations are undertaken. FSOC has not yet begun preparations for or committed to conducting such reviews. We have previously reported on the importance of advanced planning for these reviews.

Finally, to improve collaboration and coordination, we recommended that FSOC clarify its roles and responsibilities among FSOC and its member agencies for systemic risk monitoring, and adopt practices to coordinate rulemaking across member agencies. FSOC officials told us they do not plan to implement these recommendations because the overlapping responsibilities for monitoring systemic risk has not been problematic.

They also said FSOC lacks the authority to direct independent agencies. We maintain that action within FSOC's existing authority is needed, as our past work has shown that the lack of clear roles and coordination can lead to duplication, confusion, and regulatory gaps.

In conclusion, Mr. Chairman, FSOC has taken some steps to address our recommendations, but more work is needed. We believe that fully addressing our recommendations will improve FSOC's systemic risk monitoring functions, allow Congress to hold them accountable for results, and enhance collaboration among FSOC's members.

Chairman McHenry, Ranking Member Green, and members of the subcommittee, this concludes my prepared statement. I would be happy to answer any questions at the appropriate time. Thank you.

[The prepared statement of Ms. Clowers can be found on page 38 of the appendix.]

Chairman MCHENRY. Thank you, Ms. Clowers.

And thank you both for your testimony.

I will now recognize myself for 5 minutes for questions.

Can you please describe, Mr. Pinschmidt, to what extent the FSOC and OFR have developed comprehensive mechanisms for identifying and monitoring systemic risk?

Mr. PINSCHMIDT. Yes. Thank you.

The FSOC operates a very robust committee system to—

Chairman MCHENRY. I am asking very specifically here. We only have 5 minutes, so if you can just get into the specifics here.

Mr. PINSCHMIDT. Yes. I guess what I would say is it is important to have some context in terms of the committee's structure and—

Chairman MCHENRY. I am aware of the committee's structure. I am asking, the GAO report is a pretty damning one when it comes to this question of whether or not you have a comprehensive systemic risk monitoring system, and they say you do not. So what is your response to that?

Mr. PINSCHMIDT. I believe Ms. Clowers is referring to the OFR Markets Monitor, which is a publication by the OFR that provides a systematic overview of the marketplace and key trends and developments, and it has been something that is shared on a regular basis at the FSOC Systemic Risk Committee on—

Chairman MCHENRY. Is that sufficient?

Mr. PINSCHMIDT. No. It is not really meant to be sufficient. It is one input—

Chairman MCHENRY. What are the other ingredients for sufficiency so you can measure systemic risk?

Mr. PINSCHMIDT. The other ingredients would be the other working groups, the other areas of the different regulatory communities that are focused on key areas of—

Chairman MCHENRY. So, as a matter of oversight, to make sure that is, in fact, the case, how can I know that, when the GAO in their audit says that you do not have that systemic risk assessment?

Mr. PINSCHMIDT. The systemic risk assessment that Ms. Clowers was referring to is viewed within the FSOC context as a complement to its ongoing work throughout the committee systems and the ad hoc groups that are focusing on specific risks.

Chairman MCHENRY. Okay.

Ms. Clowers, to this question, why does the GAO believe that the FSOC and OFR have failed to develop comprehensive and systemic mechanisms for identifying and monitoring systemic risk?

Ms. CLOWERS. They lack such processes. They use the Systemic Risk Committee to help identify risk, but what happens in that committee is each member brings ideas and those ideas bubble up.

What we are looking for is a comprehensive, systematic approach or a common set of indicators that would look across the system to identify potential threats, that these indicators would be forward-looking, risk-focused, and less dependent on who shows up to a meeting, rather that it be routine, everyone would know which data they are looking at.

Chairman MCHENRY. Okay.

So, Mr. Pinschmidt, I want to bring something up, and I know you are fairly well-versed in it. When you worked at Morgan Stanley, you wrote a piece in June of 2008 about Lehman Brothers. I know you have answered this question before, but the piece is entitled, "Bruised, Not Broken, and Poised for Profitability," talking about Lehman Brothers. And going in just 2 months before Lehman's bankruptcy and failure, you are touting that they are on the road for profitability.

I bring this up not to embarrass you. You have obviously written a lot. You have had a very long career. But this highlights how difficult it is to really assess systemic risk, does it not?

Mr. PINSCHMIDT. Yes. Certainly, I made the wrong call on that, and a lot of other people did too. But what I would say is, sort of more importantly, the market misjudged the impact of Lehman's failure in terms of counterparties, other institutions. And it just kind of reminds us today—and I think to Ms. Clowers' point—that we need to make sure that there are appropriate safeguards in place.

We need to make sure that there is increased transparency. To the extent that firms are large and outsized, we need to make sure that there are enhanced prudential standards and there are steps taken in terms of resolution authority to—

Chairman MCHENRY. So to that question—

Mr. PINSCHMIDT. —the risks from a firm's failure.

Chairman MCHENRY. So to that question of transparency, that is what we are here today talking about.

I want to move on. The FSOC recently announced that it is taking "a more focused analysis of industry-wide products and activities to assess potential risks associated with the asset management industry." So does this mean that the FSOC is no longer going to designate asset management companies as SIFIs?

Mr. PINSCHMIDT. Congressman, what that means is—and I think you are referring to the readout from the July 31st Council meeting. At that meeting, the Council directed FSOC staff and member agency staff to undertake an analysis of asset management activities and their products.

That decision was—is driven by a recognition that asset managers are different from other companies—

Chairman MCHENRY. Sure. But this was interpreted, so is BlackRock still at stage two in this process?

Mr. PINSCHMIDT. Companies, unless they are voted on, remain in a stage.

Chairman MCHENRY. So that is called purgatory, right? It is neither heaven nor hell. It may not be so bad. It may not be for any sort of length of time that you can determine. And you just leave people in a suspended state of animation. Is that a fair assessment?

Mr. PINSCHMIDT. The Council operates a three-stage process. Stage one is based on public metrics that each company can assess. The key threshold is $50 billion in assets, and then if you trip one of five other metrics you are in stage two. Unless the composition of the company's metrics changes, that company remains in stage two.

Chairman MCHENRY. Forevermore?

Mr. PINSCHMIDT. Unless there is a vote.

Chairman MCHENRY. Okay. And could there be a vote to put them back in stage one?

Mr. PINSCHMIDT. That would only be appropriate—a vote isn't needed to put them into stage one. They would automatically go back to stage one if the metrics changed and therefore they didn't hit the thresholds to advance to stage two.

What I would like to sort of stress on this is that stage one is purely mechanical. There doesn't have to be any analysis by the Council; it is based on publicly available data. If you trip those metrics, you are in stage two, and therefore subject to more evaluation by the Council.

Chairman MCHENRY. I have gone well over my time.

We will now go to Mrs. Maloney of New York for 5 minutes.

Mrs. MALONEY. Thank you.

I think that there may be a disconnect between the Council's duty to identify and mitigate systemic risks and the tools that they have to work on it. For example, if the Council identifies a particular company that is systemically risky, it has by statute the tools to mitigate that risk by an SIFI designation, which puts them under stronger regulation with the Fed.

But if the Council identifies an industry-wide activity which was really part of the prior financial crisis with the credit default swaps and other activities that are systemically risky, the most it can do to mitigate that risk, according to the statute, is to issue a nonbinding recommendation to other regulators.

So my question is, is it fair to ask the Council to identify activities based on systemic risk but then not give the Council the authority to do anything about any of these activities except for a recommendation? I would like a comment on that.

It seems to me that sometimes it is the activities that are the most risky in a financial situation, not necessarily the institutions, which may be reacting to a financial crisis that was created by the risky activities. To me, I think the risky activities should have more attention, really.

So my question is that, and I ask Mr. Pinschmidt.

Mr. PINSCHMIDT. Thank you, Congresswoman. What I would note is that the Council has very strong convening powers bringing regulators together across the financial system, and that in and of itself is very important when looking at activities, because activities don't necessarily impact individual institutions and individual marketplaces; they stretch across the financial system.

So in that convening power there are a number of steps that the Council could take based on the nature of the risk, to the extent risk is identified. One of the steps is just asking for more information: working with the primary regulators; working with the industry; asking for more information and getting more detail and more data. A lot of times when risks are identified it is because there is not enough information there, so that is a very logical outgrowth of that process.

Other times, to the extent a risk is identified and there is more work that a regulator can do, there are two options for the Council. It can highlight a risk in the annual report or it can issue a Section 120 recommendation to a specific regulator regarding potentially taking some action.

So again, and I think in the broader context, though, it starts a process, it focuses regulators, and there are a number of authorities that can come out of that process.

Mrs. MALONEY. Do you think that the Council should have the authority to issue binding regulations to address serious activities that are based on risk?

Mr. PINSCHMIDT. It is really not for me to answer that question, but I would defer to the Council on that.

Mrs. MALONEY. Okay.

Ms. Clowers, can you comment on whether the FSOC has the tools it needs to carry out its statutory duties?

Ms. CLOWERS. It has the tools necessary and the people necessary in the room to make decisions and carry out its duties. Where we have recommended that we think additional work is needed is work on the development of their systemic risk monitoring functions.

There has been some discussion today of the different data tools that are available, including those provided by the OFR. We think those tools could be enhanced by making them more risk-focused and forward-looking. And also, even the OFR Advisory Committee has encouraged OFR to be more aggressive in the development of their tools.

Mrs. MALONEY. I would like to ask Mr. Pinschmidt, when the Council is analyzing whether a company is systemically important, they don't measure whether the failure of the company would destabilize the system in normal times; they measure whether it would destabilize the system in a period of stress in the financial industry. Can you comment on how that standard has affected the Council's analysis of whether companies are systemically important and what are the benefits or the drawbacks of that system?

Mr. PINSCHMIDT. That guidance was built into the final rule on guidance for the nonbanks designations process, and essentially the rationale behind that was a recognition that rarely do firms fail in a vacuum; there is generally a precipitating event, there is broader market weakness, economic weakness. And so thus, it is appropriate to look at firms in the context of not perfect markets, not terrible markets, but not great markets either.

Mrs. MALONEY. What are the drawbacks of that system?

Mr. PINSCHMIDT. I'm sorry, I—

Mrs. MALONEY. What are the drawbacks of that system, of just designating it in a time of extreme stress—and the benefits? Do you think that is the right approach? Should we do it just for financial stress times or also normal times?

Mr. PINSCHMIDT. I think it is a recognition that when a firm is undergoing stress, there are generally precipitating events and the market is not functioning generally—

Mrs. MALONEY. So you support that approach. Thank you.

Mr. FITZPATRICK [presiding]. The gentlelady's time has expired. I am going to recognize myself for 5 minutes.

Good morning, and I appreciate your participation in the hearing.

In his opening statement, Chairman McHenry, I guess referring to the GAO report, identified FSOC as perhaps the least transparent agency in all of the Federal Government. And likewise, Mr. Delaney, in his comments, addressed concerns that because of the significant influence that FSOC has in the designation process, how critical it is that the thought process, the reasoning, that it all be laid out and that it be transparent.

So my question for you, Mr. Pinschmidt: Is it your position that FSOC cannot be made more transparent than it is today?

Mr. PINSCHMIDT. What I would note is the FSOC really values transparency, and—

Mr. FITZPATRICK. Could it be made more transparent?

Mr. PINSCHMIDT. Yes. I think that has been a continuous arc since the first meeting 4 years ago.

Mr. FITZPATRICK. Specifically, what actions are you prepared to take, including further clarification, more detailed meetings, minutes, and—

Mr. PINSCHMIDT. Yes. I think there have been a number of suggestions, including from this committee, and we have received suggestions from outside stakeholders. And as I noted in my oral remarks, we expect, in terms of at least the nonbanks designations process, the Council will begin to evaluate potential changes there.

And what I would note is, look, we are not—the Council shouldn't be frozen in its ways. To the extent that there is good feedback and suggestions out there that make sense, the Council is open to considering those, and I expect that, again, for—in the example of transparency, it is a balance for the Council—

Mr. FITZPATRICK. Sure. Do—

Mr. PINSCHMIDT. —because the Council—sorry.

Mr. FITZPATRICK. Through August of 2014, you have had 42 meetings. Have any of those meetings been transcribed? Have any of those transcriptions, if you have them, been released?

Mr. PINSCHMIDT. The practice of the Council has been to release public minutes following the next meeting, once they are approved.

Mr. FITZPATRICK. Where substantive matters are considered?

Mr. PINSCHMIDT. The minutes serve as the record for the meeting.

Mr. FITZPATRICK. And how about executive sessions? Are there executive sessions of the Council?

Mr. PINSCHMIDT. Certainly from time to time there—like around Hurricane Sandy there were meetings that were held on short notice to bring regulators together to respond to what was going on.

Mr. FITZPATRICK. Mr. Pinschmidt, on a slightly different matter, in testimony before the Senate Banking Committee on September 8th, Governor Tarullo expressed his, what he called, "pretty strong presumption" that traditional or core insurance activities do not pose systemic risk.

Former House Financial Services Committee Chairman Barney Frank expressed the same view earlier this summer before this, his old committee.

Do you agree with Governor Tarullo and Chairman Frank that traditional or core insurance activities do not pose systemic risk?

Mr. PINSCHMIDT. I haven't had the opportunity to speak with Governor Tarullo or former Chairman Frank on that. What I would note, in terms of the insurance analysis that has been done by the Council, that has been done at a company-specific level, looking at the designations authority. And the nature of those determinations for the two insurance companies that were identified was based on the size, interconnectedness, and leverage, and other factors of those institutions, not necessarily a reflection on core insurance products or practices that were particularly highlighted.

Mr. FITZPATRICK. So the question is, do core insurance activities—do they or do they not pose systemic risk?

Mr. PINSCHMIDT. The nature of the evaluation that was done by the Council on the specific insurance firms related to those firms' general size, structure, interconnectedness with the financial system, and the impact of their potential failure on market functioning.

Mr. FITZPATRICK. So your answer is yes?

Mr. PINSCHMIDT. What I am trying to say is the nature of the analysis undertaken by the Council on those companies was based on company-specific factors and what effect the failure of those companies would have on the broader financial system.

Mr. FITZPATRICK. Governor Tarullo also noted that AIG and Prudential were designated as systemic not because of their core insurance activities but due to what he called "nontraditional insurance activities," where runnability is more of a concern, and also with respect to things that are not insurance activities of any sort. Do you agree with Governor Tarullo that to justify designating an insurance company as an SIFI that one would have to find that the company engages in activities that are not traditional insurance activities and that do pose systemic risk?

Mr. PINSCHMIDT. I haven't had an opportunity to talk to Governor Tarullo regarding his testimony, but the analysis that was done for the insurance companies was company-specific rather than industry as a whole, and it was based on the size, leverage, and interconnections of those companies and how that makeup could transmit to the rest of the financial system.

Mr. FITZPATRICK. I now recognize Mr. Delaney for 5 minutes.

Mr. DELANEY. Thank you, Mr. Chairman.

MetLife is a 146-year-old company that has generally been a pretty well-regarded company, and it is likely that they are going to sue the United States over this designation, in part because they feel like the process was bad. Do you consider that a failure of the process?

Mr. PINSCHMIDT. I cannot comment on any specific companies that have not been designated. What I can say is the Council runs a very thorough and robust process.

I did note one example in my testimony. For one of the companies that was ultimately designated, the Council and its member agency staff met with or had phone calls with the company 20 times over a period of a year. There were 200 data submissions totaling 6,000—

Mr. DELANEY. Did the members of the Council meet with the senior management team of the company as a group?

Mr. PINSCHMIDT. Prior to a vote on the final designation, the company was offered a hearing before the Council and the company presented to the Council, yes.

Mr. DELANEY. How much before the designation was that presentation made?

Mr. PINSCHMIDT. That was 60 days before a vote on a final designation. And it is worth noting that prior to that hearing, the company was given a very detailed basis for the proposed designation, roughly 200 pages long outlining the key views of the Council.

So it wasn't the company coming in there blind, not knowing where the Council was. They kind of had all the facts in front of them; they could argue different points and present their case.

Mr. DELANEY. When you talk about the factors that went into this designation, aside from activity-based analysis, which I think your comment to the Chair was that you considered other factors, and you talk about size and leverage—when you think about leverage, do you adjust for the nature of the liabilities? Because insurance companies have very long-dated liabilities.

Mr. PINSCHMIDT. Certainly. This is not a mechanical approach by any stretch. It is very specific; it is very analytical. There is a lot of back-and-forth with the company.

There are significant questions from the Council side. There are significant questions from the company side. So to sort of force certain metrics based on where they sit and make a determination would not be the right approach.

Mr. DELANEY. When you looked at the designation of MetLife, for example, did you factor into your analysis that MetLife, if it were to be designated, or other insurance companies that would be designated, would, in fact, as a result of designation, get out of certain businesses that they are currently in that have counterparty risks associated with them and that those businesses would likely run or go from a large, heavily regulated 150-year-old company into new startup insurance companies that were being organized in fact to take advantage of the fact that certain business activities would have to leave MetLife?

Did you factor into your overall systemic risk analysis for the good of the financial system that designation actually forces activities out of large, well-regulated companies into institutions that have lighter regulation, are not as well-capitalized, and don't have as long of a track record?

Mr. PINSCHMIDT. The Council, as part of its ongoing risk monitoring, is, of course, always looking at what are the developments in the financial system, what is the impact on financial market functioning—

Mr. DELANEY. But my question is specifically as it relates to a company, did anyone sit there and say, "Well, if we designate this company, the following businesses will likely leave the company and they will go into new startup, largely unregulated or lightly regulated institutions with limited track records," and did that—did risk associated with that transfer of activities from large, safe, big, long-term to new startup, unproven, lightly regulated—did that—the risk associated with that transfer, which I view there being risk, was that factored into the risk cost, if you will, of designation?

Mr. PINSCHMIDT. In terms of the company-specific designation authority, the statute is clear on that front that the Council must consider—must identify risks in terms of kind of the remedy and what happens next, in terms of enhanced prudential standards—

Mr. DELANEY. But my question is, did someone sit at the table and say, "If we designate this company, then the following businesses will likely go into other more lightly regulated institutions or new startup companies"—yes or no, was that considered?

Mr. PINSCHMIDT. That is not part of the statutory factors. The Council is focused on risk identification—

Mr. DELANEY. So downstream risk that is created from a designation, right—because if you designate a company and it is really big, and because of your designation it cuts itself in half and it spins off a bunch of businesses and it gets spun off to small, lightly capitalized, lightly regulated businesses—the risks associated with that are not factored into the designation. That is what I am hearing, at least.

Mr. PINSCHMIDT. Certainly, if that were to be the case, it would be something that would be looked at across the broader Council work streams and efforts. But in terms of the actual designation decision, the statute is very clear that the Council has to focus on risk identification and the Federal Reserve Board is responsible for—

Mr. DELANEY. It doesn't sound like a very balanced risk approach, at least in my judgment.

I yield back.

Mr. FITZPATRICK. Mr. Bachus, the chairman emeritus of the full Financial Services Committee, is recognized for 5 minutes.

Mr. BACHUS. Thank you.

Welcome, Deputy Secretary. You concluded your oral testimony by saying the Council has received a number of suggestions regarding the process for evaluating nonbank financial companies, and that you expect that the Council will consider any potential changes in the coming months. I applaud that statement.

And I wanted to point out to you that Mr. Neugebauer and I, in 2012, asked for a GAO study, and they reported back that Dodd-Frank requires the FSOC to periodically reevaluate its designations of nonbank financial companies. Are you aware of that requirement in Dodd-Frank?

Mr. PINSCHMIDT. Congressman, I believe you are referring to the Council's intent to review at least every 5 years the metrics for stage one, in terms of kind of the initial threshold for companies that would be considered.

Mr. BACHUS. Also, they actually said that you will conduct a comprehensive assessment to determine whether the designations are having the intended impact. Well, no, they said that you don't have to do that. I'm sorry.

But they suggested that it would be a good idea that you conduct an assessment after you have made the designation to see whether that designation is having the intended consequence of improving financial stability of the company and any risks that they might have. Congressman Ross and Congressman Delaney, who was just asking questions, have introduced a bill that I am cosponsoring which calls for an assessment of intended impact, which has been suggested by the GAO.

Of course, AIG, G.E, and Prudential already have those designations made, with perhaps more on the way. Wouldn't you agree that it may be very helpful and important to know whether the designations are having the intended consequences, or whether maybe they are even having some negative consequences?

Mr. PINSCHMIDT. Congressman, certainly we share, I think, your goal on that. The Council, across all different markets, and particularly with some of the largest institutions, is constantly monitoring as to how things are playing out. Specifically for designated entities, I would note that there is an annual review process of each designation that takes place, and that would—clearly we are not that far away from the initial designations, but you could imagine scenarios going forward as company businesses change, risk profiles change, market functioning change—

Mr. BACHUS. Do you make those public? Do you mean that every year you will review the designations, and part of that is whether they are having positive or negative implications—

Mr. PINSCHMIDT. The annual review is consistent with the Council's statutory authority here focused more on the risk identification, and that would logically encompass what has happened to the profile of the firm, how are they engaging with other market players, are there any material changes in their business model and their riskiness.

Mr. BACHUS. Right. But do you understand what I am saying? Wouldn't it be a good idea once the designation is made maybe on that annual basis to also say, "Okay, after we made this designation, this is what has happened, these are some positives, these may be some negatives," where you could adjust, or at least reconsider whether or not the designation was even helpful?

Mr. PINSCHMIDT. Certainly in terms of how the designation impacts market functioning and these specific firms, that is considered on an annual basis.

Mr. BACHUS. Okay.

Mr. PINSCHMIDT. I think to the general questions of market functioning, that encompasses ongoing work at the Council—

Mr. BACHUS. I would just say maybe take a look at that legislation and give me your thoughts on it, and Mr. Neugebauer, and maybe Mr. Ross, and Mr. Delaney. It is a bipartisan thing.

Let me go quickly to AIG. Mr. Fitzpatrick was talking about the runnability, and we know that was a credit default swap thing where they wrote $430 billion, $440 billion worth of credit default swaps; they didn't buy any. A lot of people bought and sold.

So that didn't impair their insurance operations until their credit rating changed. They had a tremendous credit rating problem, and that then did impact their insurance. And I can understand that designation if you have somebody doing something over here which may be dangerous, cause credit rating problems, and then impact their insurance market.

I am not sure how that would go with a Prudential or a MetLife, and I just point that out to you. AIG really wasn't an insurance problem; it was a gambling problem. And it was being on one side of the market with $440 billion worth of debt and no money to back it up if it failed. I don't see that with G.E., Prudential, or MetLife.

If you would like to respond?

Mr. PINSCHMIDT. What I would note is that each designation is company-specific. There is a core group of—there are 10 statutory considerations in a 6-category framework that comes into play, but the factors that are looked at at each company are very company-specific.

And, generally speaking, it is a combination of issues. It is never one thing, or it hasn't been thus far one thing. So I would just note that, again, it is a company-specific analysis and it would be hard for me to kind of generalize.

Mr. BACHUS. Thank you.

Mr. FITZPATRICK. And the gentleman's time has expired. Thank you.

Mrs. Beatty is recognized for 5 minutes.

Mrs. BEATTY. Thank you so much, Mr. Chairman, and Ranking Member Green.

And thank you to our witnesses today.

We have talked a lot about being designated this morning as an SIFI, so let me ask you these two questions: Last night, a couple of my staff were singing the words to "Hotel California," and one of them said, "Is this a Hotel California scenario, where once designated a company, will you remain an SIFI forever?"

If so, why? And if not, can you describe to me the process of review, including the frequency and high-level considerations in this review?

Mr. PINSCHMIDT. Thank you for that question. Maybe if I could step back here and then sort of briefly outline the process of review of companies for designation.

It is a three-stage process. Stage one is purely mechanical, based on metrics and thresholds. To the extent a company triggers those metrics, it automatically goes to stage two.

And stage two is viewed as solely very preliminary. It will be—Council member agencies will pull the 10-Q if it is a public company, understand the company, do some initial analysis, and understand to the extent that there are potential risks here what might they be or what areas would there be opportunities for further investigation and understanding.

To the extent that there is sufficient rationale to move a company to stage three, there is a vote by the Council on that action. And once a company is moved to stage three, that is when the real work and engagement begins with the companies under consideration.

The companies are notified at the beginning of that process. As part of that notification there is a detailed information request, numbering up to 10 pages long, with potentially 100 to 150 different questions.

And that begins a very long, robust back-and-forth between the Council and the company on just drilling down on the business, understanding the risks. There is a lot of opportunity for the company throughout that process to engage with the Council, to ask questions. And certainly based on the information that the Council is requesting of the company and the nature of the review, the company will get a sense for what the Council is interested in focusing on.

So then closing out stage three, there is a vote on a proposed determination. If there is a proposed determination, then at that stage the Council delivers to the company a very lengthy basis outlining the reason why the Council is concerned or the factors that the Council is highlighting in its analysis.

And that is very important because it provides the company the opportunity to sort of understand where the Council is, to level set, what are the key issues, what are the concerns. To the extent that they feel the Council is looking at the wrong thing or is misguided, they can address that.

There is an opportunity for an oral hearing before the principals of the Council. The one company that chose to accept that offer came in, presented its case, again had a robust back-and-forth. All the principals of the Council were there and the Council took that information, incorporated it into its thoughts, and then, only then, was there a final vote.

So, it is a very lengthy process from that standpoint.

Mrs. BEATTY. Okay.

Mr. PINSCHMIDT. And then in terms of your initial question on sort of, once you are designated, what happens next, there is judicial review of a designations decision, and then annually the Council does evaluate the decision. So to the extent that the company's risk profile, footprint, and market dynamics change, and they rise to a certain level of materiality, then that would certainly come into play.

Mrs. BEATTY. Okay. I have a second part, and the clock is running out. I have several insurance companies in my 3rd Congressional District of Ohio. If one of my local State domicile's insurers were designated, can you briefly explain to me what the process would be of determining issues of regulatory jurisdiction between the Ohio Department of Insurance and the Federal Reserve?

Mr. PINSCHMIDT. Yes. The role of the Council is on risk identification. Once a company is designated, they are subject to consolidated supervision by the Federal Reserve. That supervision, as I understand it, will be mainly focused at the holding company level and understanding the profile of the firm; it will not necessarily encompass some of the insurance activities and individual insurance subs.

Mrs. BEATTY. And lastly, will the Federal Insurance Office be involved in providing the guidance to the Fed? Because under Dodd-Frank Section 120, FSOC has recommendation authority.

And we are out of time.

Mr. FITZPATRICK. The gentlelady's time has expired.

Mr. Hultgren is recognized for 5 minutes.

Mr. HULTGREN. Thank you, Mr. Chairman.

First question to Mr. Pinschmidt: I am told that during a Democrat staff briefing last week you told their staff that the FSOC principals would not meet with the entities that are under consideration for SIFI designation until an actual stage three designation was recommended. In practice, this means that companies will not have an opportunity to bring their case to the voting members until the eve of the designation, and after the decision is essentially made.

The Wall Street Journal reports that the FSOC has followed this informal policy with the two asset managers that are reported to be under consideration for SIFI designation. These groups have not been able to meet with the FSOC principals or even get confirmation from anyone at the FSOC that they are even under consideration.

How is it not contrary to basic standards of administrative procedure and due process for policymakers to draw what amounts to policymaking conclusions prior to the complete consideration of relevant facts and public input?

Mr. PINSCHMIDT. In terms of the interactions with companies during the designations process, in stage three, which I believe you are referring to, there is significant interaction between the Council member agencies and the companies that extends for a very lengthy period of time. There are significant meetings; there are conference calls; there is information flow in both directions.

And then after a proposed determination, the company has the opportunity to request an oral hearing, and the Council has noted that it expects to grant all requests for oral hearings. But more importantly, as part of that oral hearing, the company does receive a very detailed basis—sometimes 200 pages long—outlining the Council's key concerns about the company and providing the company an opportunity to respond.

Mr. HULTGREN. Your policy, to me, appears to be in direct violation of due process. It feels like the decision has already been made. There may be hearings after that point, but for them not to hear sooner than the designation seems like a direct violation of administrative procedure.

Let me move on.

Is FSOC aware that the New York Superintendent of Financial Services, which is MetLife's chief regulator, wrote Treasury Secretary Lew on July 30, 2014, to encourage FSOC to reconsider a formal SIFI designation for MetLife? Mr. Lawsky argued against an SIFI designation because: one, MetLife does not engage in non-insurance activities that create an appreciable systemic risk; two, in the event that MetLife or one or more of its insurance subsidiaries were to fail, DFS and other regulators would be able to ensure an orderly resolution; and three, MetLife is already closely and carefully regulated by DFS and other regulators.

Is it not concerning that MetLife's chief State regulator, who is no doubt intimately familiar with the company's business portfolio and any relevant risks, is so adamant against an SIFI designation? Will you commit to factoring his concerns into any final designation decision of the company?

Mr. PINSCHMIDT. Congressman, unfortunately, I can't comment on letters relating to actions that haven't necessarily been taken by the Council. What I can note is that as part of the work of the Council on the designations authority, there is broad consultation not just within the Council and the members of the Council, but also at the State level.

Mr. HULTGREN. Mr. Pinschmidt, has FSOC conducted any analysis to determine how applying risk-based capital standards to insurers will affect the amount of coverage that insurers can offer? Could this ever cause the cost of insurance to rise to a prohibitive level? May there come a time when it is impossible to obtain certain kinds of insurance coverage because insurance companies that have been subjected to bank-like capital standards simply won't be able to afford to offer it?

Mr. PINSCHMIDT. Congressman, on that front, the Council is focused on risk identification. The enhanced prudential standards for insurance companies or designated entities will be developed by the Federal Reserve Board. My understanding is that they will make efforts to tailor them to the specific characteristics of the insurance industry, but as part of that process, I would expect there would be some consultation with the Council.

Mr. HULTGREN. I hope there would also be a consideration of the risk to consumers of losing options—insurance options—that could be there because of your activity driving up the significant cost to insurance companies. Certainly, that would be a more significant risk to the marketplace.

Let me finish up with one last question. Should FSOC show greater deference to an industry's primary regulators in making SIFI designation decisions?

Mr. PINSCHMIDT. Certainly the Council looks to regulators and its members with industry expertise to hear that expertise as part of the discussion. The nature of individual company designations, however, encompasses broader market dynamics.

The companies that are considered do not necessarily solely impact the companies within their industry. They can impact market functioning across asset classes, across industries. Therefore, it is also appropriate to hear the viewpoints of the broader Council members.

Mr. FITZPATRICK. The gentleman's time has expired.

Mr. HULTGREN. My time has expired.

I yield back. Thank you.

Mr. FITZPATRICK. Mr. Heck is recognized for 5 minutes.

Mr. HECK. Thank you, Mr. Fitzpatrick—Mr. Chairman. Has a nice ring to it, sir.

Ms. Clowers, I have this bias that we are always fighting the last war with the last approach. It is like we are driving with our eyes transfixed in the rearview mirror.

That is why I was so intrigued by part of the language in your report, if I may quote briefly, "Second, in 2012 we recommended that FSOC develop more systematic, forward-looking approaches that would help in separating emerging threats to financial stability from more current risk and prioritizing them in its annual report. Since then, FSOC made some progress in addressing this recommendation but could do more."

Would you give a specific and concrete example of how they could do more in this regard?

Ms. CLOWERS. Certainly. In looking at the most recent annual reports, it does look like they have become more focused in terms of identifying current and emerging threats. But still, they continue to report them together and they are not prioritizing those threats. And in talking to FSOC officials, they don't plan to prioritize the threats because they realize that could direct people's attention to certain areas.

But that is exactly what we think should happen. There is not infinite, limitless resources, both among the regulators and the companies, and providing more specifics in terms of the priorities of the threats would be helpful in directing scarce resources.

Mr. HECK. So you think they should separate current from emerging and prioritize them?

Ms. CLOWERS. Correct.

Mr. HECK. When it relates to emerging threats, again, be specific and concrete, how would they go about that analysis and evaluation? Give me an example of the kind of thing that might manifest itself in that regard, if you would, please.

Ms. CLOWERS. Certainly. Start with what we have seen in the past is, for example, the debt of the government is listed as an emerging threat, when it was—I think it was listed in 2012 when most anyone who was reading the papers could realize that was a current threat.

There are also threats that would come and go off the list without any explanation of why. For example, modeling risk of different companies—it had appeared one year, wasn't there the next year, so you don't know why.

To go to your question about how they could do a better job, it is using the tools that are under development, particularly the financial stability monitor that is a promising tool to develop a common set of indicators that would look across the system. But again, it must be forward-looking.

To date, those—the metrics aren't forward-looking and goes to your point. It is looking at sort of what we know today and not what we know could happen in the future.

Mr. HECK. Right. Thank you.

Mr. Pinschmidt, why don't you keep transcripts?

Mr. PINSCHMIDT. The meeting minutes that are produced by the Council generally serve as the official record of the—

Mr. HECK. They are not transcripts. Why don't you keep transcripts?

Mr. PINSCHMIDT. Congressman, the challenge for the Council is, there is a clear recognition that transparency is important, and we have taken a number of steps over the years to improve our transparency—

Mr. HECK. Mr. Pinschmidt, why don't you keep transcripts?

Mr. PINSCHMIDT. As I was trying to note, the obligation to transparency has to be balanced with an obligation to protect confidential, supervisory information. The nature of the Council meetings involves generally very highly sensitive, confidential company information, broader industry information—

Mr. HECK. So does the FOMC. They keep transcripts but they retain them for a period of time. Why don't you keep transcripts?

Mr. PINSCHMIDT. The practice has been to have the official minutes serve as the record for the Council—

Mr. HECK. Why don't you keep transcripts?

Mr. PINSCHMIDT. Congressman, the practice has been to have the minutes serve as the official record for Council meetings.

Mr. HECK. So what I am hearing you say is you choose not to keep transcripts.

Mr. PINSCHMIDT. The official minutes have served in that capacity.

Mr. HECK. No, they do not. Official minutes are not transcripts.

Mr. PINSCHMIDT. Congressman, I recognize your concerns on this, but the challenge for the Council is, the Council is charged with looking across markets, looking across institutions, discussing systemic risk. Those conversations, by their very nature, are very sensitive and confidential and—

Mr. HECK. So do you believe they are—you literally believe they are even more sensitive than what the FOMC discusses?

Mr. PINSCHMIDT. I really can't comment on the—

Mr. HECK. Well, they are not. And you should keep transcripts. I yield back the balance of my time.

Mr. FITZPATRICK. The gentleman yields back.

The Chair recognizes the gentleman from Pennsylvania, Mr. Rothfus, for 5 minutes.

Mr. ROTHFUS. Maybe if we can continue with that line that my colleague was asking about on transcripts, I mean, transcripts can be kept confidential, can't they?

Mr. PINSCHMIDT. I am not really sure about that. I really have no basis to respond there.

Mr. ROTHFUS. When FSOC proposes to designate a company as an SIFI and there are meetings being held at FSOC to discuss that, there is going to be an exchange of ideas and comments back and forth, I would assume, yes?

Mr. PINSCHMIDT. Yes. So, Congressman, certainly in terms of individual proceedings regarding individual companies, the Council makes every effort, particularly in stage three, to communicate with the company, have a two-way conversation, make sure that the—

Mr. ROTHFUS. Is the company there, though, when you are discussing whether or not to designate it as an SIFI, internally?

Mr. PINSCHMIDT. After a proposed determination the company has the opportunity to present to the entire Council—

Mr. ROTHFUS. But are they there when you are making the determination and the conversations are going back and forth among the committee members?

Mr. PINSCHMIDT. Certainly the substance of the many company meetings with the Council member agencies and, in fact, presentations—

Mr. ROTHFUS. I am talking about when the determination is being made among FSOC members. And that is where we are wondering about what the conversations are. And that is why we think, personally, that it is important to have a transcript, so that after the designation is made and the company wants to come in and find out what was going on, they can look at the transcript. Wouldn't that be fair?

Mr. PINSCHMIDT. In terms of the record for the company, the Council provides a 200-page document to the company before a designation has been made.

Mr. ROTHFUS. But the company is not going to have access to the internal deliberations of the committee if they can't be looking at transcripts of what was going on.

Mr. PINSCHMIDT. But the company will have access to the key concerns and factors cited in the Council's proposed determination and has an opportunity to respond to that.

Mr. ROTHFUS. Ms. Clowers, GAO made many recommendations to FSOC in its 2012 report that would assist in shedding some light on the way FSOC makes its decisions. In your written testimony you get into some of this, but could you tell us how many have been implemented to date?

Ms. CLOWERS. We have seen progress on a few of the recommendations dealing with, for example, the communications with the public, redesigning their Web site. They have also made more information or more timely notices of their meetings with the public. We also saw steps in terms of trying to enhance collaboration among their committees by developing bylaws for their Deputies Committee, which we think is an important step.

But as I said in my oral statement, we believe additional work is needed on a number of the issues you are highlighting, from transparency and accountability issues.

Mr. ROTHFUS. So specifically, what recommendations haven't been implemented?

Ms. CLOWERS. To date, we have not closed any of the recommendations. We continue discussions with the Council on all of them.

For example, on the issue of the transparency that you have been discussing in your comments, we continue to look for additional steps by the Council to enhance the transparency of their decision-making. For example, with the minutes, if they are transcribed, that would provide a record not only for transparency but accountability, as you are suggesting, for future decision-makers to go back and to have a better understanding of the deliberations.

Mr. ROTHFUS. One of the recommendations that you made was for FSOC to more fully incorporate key practices for successful collaboration. I think that would mean that FSOC should engage with regulators, industry, and academics. Has FSOC done this, from your perspective?

Ms. CLOWERS. They have taken some steps to enhance collaboration. I know they have had different industry in for meetings, from asset managers to others. We continue to look for additional steps to be taken.

Part of that recommendation was for FSOC to play a greater role in coordinating rulemaking among member agencies. We think, given FSOC's position of bringing together all the member agencies, they have an opportunity to create a forum for that type of discussion.

Mr. ROTHFUS. Mr. Pinschmidt, is FSOC in the process of implementing any of the outstanding recommendations?

Mr. PINSCHMIDT. Yes. What I would say is, we certainly value the work of the GAO. They bring a very important perspective to our work and—

Mr. ROTHFUS. Which of the outstanding recommendations are you in the process of implementing?

Mr. PINSCHMIDT. I think we are continuing to talk to them about all of them. And we have taken some steps on a number of their recommendations.

Mr. ROTHFUS. Can you tell me one of them that you are currently implementing?

Mr. PINSCHMIDT. I would point to, back in May the Council revised its transparency policy. That was a result of a months-long review based largely on the GAO input. And as a result of that review, what we do now is we post meeting agendas one week in advance, and on the day of an actual meeting we provide a readout detailing what was discussed—

Mr. DUFFY [presiding]. The gentleman's time has expired.

The Chair now recognizes the gentleman from Nevada, Mr. Horsford, for 5 minutes.

Mr. HORSFORD. Thank you, Mr. Chairman, and Ranking Member Green.

I want to thank both of the witnesses for being here today, and I really associate myself with the comments of my colleagues on both sides of the aisle about the need for review of some of the methodology as well as greater transparency and improvement in that area.

I do want to shift my question, though, to an area that has not been discussed yet this morning, which is one of the fundamental issues that led to the economic collapse in 2008, and that was the housing crisis. I am from Nevada and our housing market has still not recovered; we have the most unstable housing market in the country, with about a third of our homes at every income bracket upside down in value, some of them as high as 50 percent or more.

It is my understanding that the GAO report, in its most recent report, noted that the FSOC should develop a systematic approach to identify potential threats to the financial stability.

So, Mr. Pinschmidt, as you continue to look at threats to the market's financial stability, can you assure us that the health of the housing market will not be ignored? And what strategies is the FSOC pursuing in that respect?

Mr. PINSCHMIDT. Certainly. The housing market has been something that has been highlighted 4 years running in the Council's annual report, and there is clearly more work to be done there in terms of the actual recovery, but also in sort of building out the structural mechanisms in the housing market following the collapse in 2008 and 2009.

In terms of the annual report, it is something that recognizes when there is a risk that is outstanding and needs to be addressed, and it serves as a good barometer for what the Council is focusing on. So to the extent that this has been highlighted as a recommendation 4 years running now clearly indicates that this is a priority and ongoing work.

Mr. HORSFORD. And so, what is being done? What discussions, what review? You said that one of the 40 meetings that you had was on the housing finance reform. What areas have you pursued and what recommendations are coming from that analysis?

Mr. PINSCHMIDT. There are two sides to, generally, the Council's engagement on this issue. Clearly, there are a number of staff working groups and regulators with specific equities in this. There is the structural issue, in terms of housing finance reform, and then there is the broader issue, which I think you were alluding to, in terms of the very slow recovery and the impact on consumer spending, the impact on the economy, and broader issues. So, it is a two-front process.

Mr. HORSFORD. Ms. Clowers, what would you suggest, from the GAO perspective, on this issue of the housing crisis as an emerging issue that is still very much a priority, or should be, for the FSOC to be working on?

Ms. CLOWERS. I think it goes to our recommendations about the need to develop a systematic and comprehensive approach to identifying both current and emerging threats, that developing a common set of indicators across the system would allow regulators to determine where there might be threats emerging. And I would encourage FSOC to continue to work with OFR to develop those tools so they are risk-focused and forward-looking.

Mr. HORSFORD. Thank you.

I would like to also ask about an issue that I have heard from one of our major industries in Nevada, which of course is gaming, and the fact that there is some concern that as a nonbank industry that does issue credit in the course of their business, that this is an area where FSOC may be pursuing. Can you give me some indication of what FSOC is thinking from the perspective of a major industry like gaming?

Mr. PINSCHMIDT. I can't really comment specifically, but what I can note is the only nonbanks that are eligible for designation—and obviously there are other metrics and thresholds, but there has to be initial determination that 85 percent of revenue or gross assets are in the business of finance or financially related. So I am not sure if that applies to the particular example that you noted, but I would throw that out there.

Mr. HORSFORD. Okay. From a transparency standpoint—

Mr. DUFFY. The gentleman's time—

Mr. HORSFORD. —it would be helpful to get that information out, because there are concerns.

Mr. DUFFY. The gentleman's time has expired.

The Chair now recognizes the gentleman from Kentucky, Mr. Barr, for 5 minutes.

Mr. BARR. Thank you, Mr. Chairman.

Mr. Pinschmidt, moral hazard is a common justification for regulation, but it can also be exacerbated by government intervention. A criticism of the SIFI designation process is that being officially identified as too-big-to-fail can actually increase the moral hazard by incentivizing increasingly risky investments since taxpayers, and not shareholders or creditors, are likely to bear the costs.

Is it possible that an SIFI designation or a designation for enhanced prudential supervision would actually exacerbate moral hazard for an investment fund, for example, rather than reduce that risk?

Mr. PINSCHMIDT. The nonbank designations authority is designed to actually recognize where companies are large, interconnected, and where their material financial distress could pose a risk to financial stability. It is not designed to prevent material financial distress.

What happens after a designation is the Federal Reserve Board issues enhanced prudential standards, and those are designed to basically put some safeguards in there. To the extent that the company was to get into trouble, they would have more capital.

But also, there are other efforts that come into play, too. If failure is inevitable, then there is a resolution authority and living wills, and those are designed to manage that failure in a more effective way by limiting the collateral consequences—

Mr. BARR. But what about this idea that designation as an SIFI actually would have the potential to increase risk because you are giving that institution a special designation that provides a layer of protection from the taxpayer and not from shareholders or creditors?

Mr. PINSCHMIDT. The tools that come into play after designation are designed to basically make it so that a company can fail without threatening financial stability.

Mr. BARR. Let me just shift gears here. Putting aside kind of exotic insurance products like credit default swaps, for traditional insurance activities like life insurance, how would traditional insurance activities pose a systemic risk to the financial system?

Mr. PINSCHMIDT. The Council, in its evaluation of certain insurance companies under Section 113, that has been a company-specific exercise, looking at the nature of those companies, the nature of their interaction, the leverage, the balance sheet exposure, understanding the impact of those specific companies if they were to get into trouble and fail and what would that impact be on the broader financial system. It didn't necessarily take into account specific activities; it was more company-focused.

Mr. BARR. Well, okay. If it is company-focused and you have a hypothetical company that, again, does not engage in exotic insurance products like a credit default swap, like an AIG, but it is just a traditional life insurance company, would FSOC in any circumstance view that as a systemically risky company?

Mr. PINSCHMIDT. It is all situational-dependent, as you can imagine. I think the key threshold for an FSOC designation is if that company's failure—it is—designation doesn't sort of contemplate, "Is the company likely to fail? Is there something going wrong?" It doesn't take any of that into account.

It is, "What happens if a company is failing? What would be the impact on the broader market system?" And certainly activities can come into play on that, but generally speaking, for the companies that have been evaluated thus far, it has been on the company-specific factors.

Mr. BARR. Final question—I want to talk about the Form PF, which has been described to me as a very onerous form. It is a form that I am told asset managers must provide to the SEC, the CFTC, and FSOC for systemic risk assessments. And the data that is required in filling out these forms and submitting these forms is apparently very voluminous and there are no clear procedures for how these forms are used by the relevant agencies.

So the question is, who is reviewing these forms? Are they materially beneficial to the regulators and to FSOC in terms of evaluating systemic risk? Because there is apparently tremendous cost associated with assembling and reporting the data associated with these so-called Form PFs. What is the benefit and what is happening with that submitted paperwork?

Mr. PINSCHMIDT. Congressman, in terms of the Form PF, those are submitted by the—generally the hedge fund industry to the SEC.

Mr. DUFFY. The gentleman's time has expired.

The Chair now recognizes the gentleman from New Jersey, Mr. Garrett, for 5 minutes.

Mr. GARRETT. Thank you.

I just have a couple of questions. In Ms. Clowers testimony she states, "Even if FSOC determines that some information should not be made public, its current practices do not provide detailed records even for policymakers, including members of FSOC, to assess decisions." Not only do I find that appalling, but obviously from a bipartisan perspective, members from both sides of the aisle find it appalling that more information does not come out and the transcripts do not come out.

So, first question: Who made the determination that detailed information and the transcripts would not be kept? Who was the person who made that determination?

Mr. PINSCHMIDT. Congressman, the practice of the Council has been—

Mr. GARRETT. I know the practices. Someone had to make the decision. Did you make the decision to do that—to keep it secret?

Mr. PINSCHMIDT. Congressman, I think it is a reflection of the nature of the—

Mr. GARRETT. Did they have a vote on it at some point in time?

Mr. PINSCHMIDT. If there was a vote, that would have been disclosed.

Mr. GARRETT. Okay. So there was never any vote, it just—you never did it.

You have heard from both sides of the aisle that we believe that information should be heard. Did you hear that from both sides, from Democrats and Republicans just now?

Yes. That is a yes.

Will you go back and now look in to see how this information can be kept confidential in the manner that you think it needs to be kept confidential but still provide the transcripts? Will you make that commitment to us today?

Mr. PINSCHMIDT. Congressman, what I will say as part of my remarks, in terms of my oral statement, was that the Council is a young organization—

Mr. GARRETT. Will you go back and make that recommendation to do so?

Mr. PINSCHMIDT. We recognize that there are areas that we—

Mr. GARRETT. Will you make that recommendation—I just need a yes or no.

Mr. PINSCHMIDT. I can go back and get you more information if that would be helpful.

Mr. GARRETT. So you are going to keep it secret until some future date.

You also talked, as far as other secret information that you continue to keep is with regard to the annual review. You told us what the annual review is and you said you have already reviewed some of these companies and you actually did it with—for G.E. and Prudential I believe, right?

That is a yes?

Mr. PINSCHMIDT. That is correct.

Mr. GARRETT. That is right.

For their annual review, I think, as far as I can tell, you simply sent out a notice to these companies saying that, "You are still an SIFI." Is that basically correct?

Mr. PINSCHMIDT. After the review, that is correct, yes.

Mr. GARRETT. After the review. Was the review the exact same process that you had for the initial review? In other words, did you go through the entire three-stage process, allow the executives to come back in and sit down and go through all that information again?

Mr. PINSCHMIDT. The annual review was based—again, we are sort of in a unique situation here because it was just under 12 months after the—

Mr. GARRETT. Okay.

Mr. PINSCHMIDT. —initial designation—

Mr. GARRETT. Right.

Mr. PINSCHMIDT. —but the annual review—

Mr. GARRETT. That is annual, 12 months.

Mr. PINSCHMIDT. Yes. So the annual review took into account the key factors that weighed on the decision to designate.

Mr. GARRETT. So they don't get a chance to come back on each annual review to say, "Well, this is our interpretation of this, and this is our interpretation of that?"

Mr. PINSCHMIDT. Each company is provided—before the annual review commences they are notified and they are offered the opportunity to submit information and—

Mr. GARRETT. Submit information, but it is not the exact same process as the first time around, to come in with the staff and what have you and sit down and go through it, just as you said for the first time?

Mr. PINSCHMIDT. At this stage, it is a different spot.

Mr. GARRETT. Will you recommend that it be changed back so that the annual review is commensurate with the first review?

Mr. PINSCHMIDT. Congressman, certainly the spirit of your remarks and the suggestion about ways to improve, I think the Council is taking a lot of that in, and to the extent that there are ways to improve certain processes, including annual—

Mr. GARRETT. The Council is taking a lot into review. Ms. Clowers and others have made recommendations, but it doesn't seem that—you may hear them, but you may not implement them, is our concern.

When you make this analysis for these companies and others and you are looking at across the horizon, as far as systemic risk, one of the items we heard from another panel is the ad hoc nature of intervention by the Fed, under Section 13-3 in the last case, that led to uncertainty in the marketplace. Is that something you look at too, as far as you look across the horizon as far as systemic risk potentialities—the ad hoc nature of the implementation of 13-3 by the Fed?

Mr. PINSCHMIDT. So you are referring to the use of 13-3 during the crisis?

Mr. GARRETT. That is what they did in the past, and they saw that that ad hoc nature some economists said led to the uncertainty in the marketplace and exasperated things. So now going forward, understanding that the Fed still has those powers, do—in a changed manner under Dodd-Frank, of course—do you look at that as being a potentiality for a systemic risk going forward?

Mr. PINSCHMIDT. There is certainly a number of factors that are considered as part of the designation process, and—

Mr. GARRETT. I am not talking about the designation process, per se. I am looking into seeing what the Fed's powers are and how that may cause a systemic risk.

Mr. PINSCHMIDT. That is not something I am directly familiar with, no.

Mr. GARRETT. You are not just looking at companies. Your own analysis shows that you are looking at monetary policy and other governmental policies and spending and what have you. You look at all those things, don't you?

Mr. PINSCHMIDT. Yes, to the extent certain issues impact the financial functioning and—

Mr. GARRETT. So is 13-3 one that you look at?

Mr. DUFFY. The gentleman's time has expired.

Mr. GARRETT. Could he just answer—

Mr. DUFFY. The gentleman may answer the question.

Mr. PINSCHMIDT. I can certainly get back to you on that one.

Mr. GARRETT. Thank you.

Mr. DUFFY. The Chair now recognizes the gentleman from Texas, Mr. Green, for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman.

And I thank the witnesses for appearing.

I would also like to thank the staff for the outstanding job that they have done in preparing us for this hearing.

Much has been said about insurance companies—about them being regulated, about them having oversight. And to some extent, I think these are some statements that merit a lot of credibility.

But we also have to remember that AIG was an insurance company. AIG was a regulated insurance company. AIG was also engaged in capital markets, credit default swaps, derivatives.

FSOC exists in great part because of an insurance company, AIG, that was ostensibly holding the world together. It is unbelievable what the length and breadth of AIG's involvement in capital markets was. And I thank God we have an FSOC that can look across the entire spectrum and spot the AIGs of the world before they become a systemic risk and have an enormous impact on our economy.

This process that FSOC has is something that Congress accorded it, for the most part, in that if a company is displeased with the decision, that company has the right to appeal. So it doesn't have to live with what FSOC concludes; it can appeal.

A part of that process means that you go back to FSOC itself, but that is not unusual. In court when you file a motion for a new trial, the judge who heard your case is the judge who determines whether you should get a new trial. If you appeal beyond that, you can go to a district court, Federal district court. We trust the court system in this country.

Appeal is a process that every person has if you are sued or if you file suit and you don't like the decision. And it is interesting to note that when people lose, people appeal. They don't always win when they appeal, but they can appeal.

And corporations are people, my friends. Corporations do what people do. When they lose, they appeal. This doesn't mean that FSOC hasn't done its job because a corporation is disenchanted with the process or disenchanted with an appeal. That is what happens. That is the American way.

Let's talk for just a moment about who really is impacted by what we are doing today, because to listen to what is being said, you would think that this is a big dispute between mega corporations and the government. But this is really about people.

It is about the people who had their homes foreclosed on—3.2 million of them when we had the crisis. And by the way, minorities were disproportionately impacted. Seventy percent of African-Americans were likely more impacted with foreclosures when this took place.

$3.7 trillion in real estate wealth lost. That hurt schools. That was an impact on the tax base.

This is what we are trying to protect with Dodd-Frank and FSOC—people, not mega corporations, not the AIGs of the world. We are trying to look into them and make sure they don't do what was done again.

26.2 percent in pension value lost. $7.4 trillion in stock market wealth lost. That is about $66,200 per household.

These are real people who suffered. I was there when we took that vote on TARP, and I saw the stock market as it took its 778-point decline. I got the calls the next day from people who were talking about their 401Ks.

Real people suffer. This is about more than mega corporations doing battle with the government. Evictions: with 8.8 million jobs lost, people got evicted.

I stand with the people, and I stand for FSOC doing its job because if it doesn't, real people will be hurt.

Thank you, Mr. Chairman. I yield back.

Mr. DUFFY. The gentleman's time has expired.

The Chair now recognizes the gentleman from California, Mr. Royce, for 5 minutes.

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

And I appreciate Mr. Pinschmidt being with us today. I will go back to something that Chairman McHenry mentioned, and that was following the FSOC's July 31st meeting, the Council announced that it would take a more focused analysis of industry-wide products and activities, and in the asset management industry they would do this this way rather than designating specific asset managers as systemically risky.

So it is my understanding there has been a working group set up, or maybe about to be set up, to look at these products and activities. I have maybe five questions here that I would just ask you, and then you can give me your response.

But if you want to list these as I go through them, the first would be, can you tell us the makeup of that working group, and the timeline for a review? Will there be a report put out for public comment at the conclusion? Does the OFR have a role in the process, I would ask? And will there be additional roundtables where all stakeholders can participate?

Mr. PINSCHMIDT. Congressman, you are right. Following the July 31st meeting, the readout for that meeting noted that the Council asked staff to undertake a detailed review of asset management activities and products. The Council has long recognized that asset managers are different than perhaps other nonbanks, and that was part of the reason in the 2012 final rule on the designations authority that the Council noted that additional work needed to be done, and that was the impetus for the OFR study, which identified certain activities.

So to the extent that work is being done there, clearly when you look at asset managers and you compare them to other nonbanks, even the largest asset managers, their balance sheets are substantially smaller than other nonbank firms. There is very little leverage.

There is an agency business model, which is quite distinct from a balance sheet business model. So to the extent that a company was in distress, they are not necessarily selling their own assets. The customers are kind of—it is their decision.

Mr. ROYCE. Right.

Mr. PINSCHMIDT. So these are different—oh, sorry.

Mr. ROYCE. But the makeup of the working group and the timeline for review, if you could give me some information on that?

Mr. PINSCHMIDT. In terms of the process going forward—

Mr. ROYCE. Right.

Mr. PINSCHMIDT. —that is a decision that is being worked out at the Council level and—

Mr. ROYCE. That decision hasn't been made yet? Will there be a conclusion put out for comment, do you think?

Mr. PINSCHMIDT. To the extent the Council recognizes the importance of engaging with the public on its work, and that was part of the reason the Council hosted an asset management conference back in May. So we would expect, to the extent that this work moves forward, additional sort of consultation and collaboration—

Mr. ROYCE. Maybe a public comment section—session at the end, then, would be appropriate, you are anticipating.

Does the OFR have a role in the process?

Mr. PINSCHMIDT. Certainly all the member agencies of the Council will be involved.

Mr. ROYCE. Have the FSOC participants agreed that they will not meet with entities under consideration until an actual stage three designation is made, or—do you know? What is going on, on that front?

Mr. PINSCHMIDT. Congressman, in terms of the nonbanks designations process, what I would note is that we did put out the final rule that was subject to three rounds of comment. We recognize that was done 2 years ago now, and we have gone through a process with three different companies for designation.

There are clearly new facts on the ground. The Council doesn't want to be frozen in its ways and its process. So as I noted in my oral remarks, certainly the Council recognizes we have received a lot of input; we have gone through the process a few times and we are evaluating—

Mr. ROYCE. Let me ask you this question: Is this policy formalized or documented? Are you putting out a documented process here that—

Mr. PINSCHMIDT. Yes. In terms of the interpretive guidance that accompanies the final rule, it notes the interaction between the Council and this is also supplemented in the hearing procedures for the designations process—it notes the interaction between the Council and companies under consideration.

Mr. ROYCE. We have talked about transparency and due process during this hearing, and I think a simple solution here would be publishing what the process actually is regarding interaction with companies in stage two, or purgatory, I think, as our colleague rightly termed it, and that might be your best way forward, if I might suggest.

Thank you.

Mr. DUFFY. The gentleman's time has expired.

The Chair now recognizes himself for 5 minutes.

Mr. Pinschmidt, I listened to your opening statement and I was taken with your commitment and support for openness, transparency in policy, and a flow of information. I think those are some of the phrases that you used in your opening statement.

As I have listened to the testimony today, I have great concern that FSOC isn't open, it isn't transparent, and there is not a good flow of information. And I think you have seen a bipartisan concern in regard to the information that flows, in regard to transcripts from the meetings, from FSOC.

And I think all of us recognize that there are things that cannot be disclosed. There is confidential information that you have access to that the companies don't want disclosed and wouldn't want to share it with you if it was to be disclosed.

But there is a lot of information and a substantial portion of a transcript that can be disclosed, and there can be redactions. And FSOC, per your testimony today, has no willingness to actually engage in a process of disclosing not minutes, but transcripts of a meeting, maybe even with a delay.

So I guess as you sit here today, you are still committed to not using the various tools even that the FOMC will use, with a delay in time and redacting sensitive information, that FSOC is still not, seeing bipartisan concern here, going to at least go back and discuss the possibility of disclosing transcripts?

Mr. PINSCHMIDT. Congressman, what I can say is that the Council recognizes it has a very important responsibility for transparency. It is a responsibility that has to be balanced, though, with the protection of confidential financial information.

Mr. DUFFY. Have you ever heard of redacting? Can you redact confidential information? That is a tool that you would have if you disclosed transcripts.

Ms. Clowers, is that a tool that could be used—redacting sensitive information?

Ms. CLOWERS. Yes.

Mr. DUFFY. Do you believe that if we had a little delay in time, as would be appropriate, and redacted sensitive information, that transcripts could be disclosed?

Ms. CLOWERS. Correct. That is one of the things we noted in our 2012 report. We looked at different models, such as the open markets, and noted that those type of tools are available for FSOC.

Mr. DUFFY. Does the FOMC discuss sensitive information like monetary policy?

Ms. CLOWERS. Yes.

Mr. DUFFY. And they still provide transcripts, yes?

Ms. CLOWERS. Yes.

Mr. DUFFY. And, Mr. Pinschmidt, you are discussing far more sensitive information? Is that your testimony here today that the FOMC can provide transcripts to the public but you can't?

Mr. PINSCHMIDT. Congressman, what I would say is that the Council is committed to getting more information out—

Mr. DUFFY. Listen, you are not. I would say I love the dance that you have done today, but you are not. You have not given us—any of us—a satisfactory answer that, listen, we are going to go back and we are going to have a hard conversation on transcripts and redacting and making sure that we send out more than—I am looking at your annual reevaluation of designation of nonbank financial companies and you wanted us to believe that your minutes, or the summary, which is a paragraph, is sufficient for the public.

That is what you wanted us to believe, and as I look at it, at the end it says, "Members of Council then asked questions and had a discussion." Nothing about the questions. Nothing about the discussion. Nothing. And then, "The Council did not either—did not rescind either company's designation."

What was the vote on this? What was the votes that were taken? How did everybody vote?

Mr. PINSCHMIDT. Congressman, the—

Mr. DUFFY. How did everybody vote?

Mr. PINSCHMIDT. —the document you are referring to is the readout from the meeting.

Mr. DUFFY. How did everybody vote? Do you disclose the votes?

Do you know that I have a card right here, and every vote I make is public. Go to the Supreme Court. Every vote is public.

How does everybody vote on FSOC? That isn't even disclosed.

And I look at the notice of proposed designation at MetLife. You had one present vote. Who was that?

Mr. PINSCHMIDT. Congressman, I am not in a position—

Mr. DUFFY. Who was it?

Mr. PINSCHMIDT. —to identify.

Mr. DUFFY. No, you are not.

Again, you came and you said, you know what? We support openness, transparency, flow of information.

You know what? I bet it was the one person who had insurance experience. And I would love to hear the conversation that he had with FSOC in those meetings, the one guy with insurance experience who voted present and probably would dissent.

Again, don't come in and tell us you are open and transparent. We all want to see the process opened up; we want to see what is happening.

Ms. Clowers, in her work—GAO has given you the same advice. So I guess I would look at the bipartisan effort and message that has been sent from this committee and go back and have a solid conversation and review the policies at FSOC.

Mr. PINSCHMIDT. Congressman, we certainly look forward to working with the committee on that going forward.

Mr. DUFFY. Thank you. I appreciate that.

My time has expired.

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 adjourned.

[Whereupon, at 12:25 p.m., the hearing was adjourned.]

A P P E N D I X

September 17, 2014

United States Government Accountability Office

GAO

Testimony

Before the Subcommittee on Oversight and Investigations, Committee on Financial Services, House of Representatives

For Release on Delivery
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FINANCIAL STABILITY OVERSIGHT COUNCIL

Status of Efforts to Improve Transparency, Accountability, and Collaboration

Statement of A. Nicole Clowers, Director,
Financial Markets and Community Investment Team

GAO-14-873T

GAO Highlights

Highlights of GAO-14-873T, a testimony before the Subcommittee on Oversight and Investigations, Committee on Financial Services, House of Representatives

September 17, 2014

FINANCIAL STABILITY OVERSIGHT COUNCIL

Status of Efforts to Improve Transparency, Accountability, and Collaboration

Why GAO Did This Study

The 2007-2009 financial crisis focused attention on weaknesses in the U.S. regulatory structure, including the lack of an agency or mechanism responsible for monitoring and addressing risks across the financial system. To address this weakness, the Dodd-Frank Wall Street Reform and Consumer Protection Act created FSOC to identify and address threats to financial stability. Among other statutorily defined authorities, FSOC may designate nonbank financial companies for heightened supervision by the Board of Governors of the Federal Reserve System. FSOC consists of 10 voting members and 5 nonvoting members. The 10 voting members include 9 federal regulators and an independent insurance expert.

In September 2012, GAO issued a report on FSOC's challenges, efforts to establish management mechanisms, activities for supporting collaboration among its members and external stakeholders, and processes for issuing reports and rules. GAO made nine recommendations to FSOC to improve the transparency and accountability of its decisionmaking, among other things.

This testimony is based on GAO's September 2012 report (GAO-12-886). It discusses FSOC's efforts to respond to GAO's 2012 recommendations. From June through September 2014, GAO obtained updated information from FSOC staff and reviewed documents related to GAO's recommendations.

View GAO-14-873T. For more information, contact A. Nicole Clowers at (202) 512-8678 or clowersa@gao.gov.

What GAO Found

The Financial Stability Oversight Council's (FSOC) has taken steps to address some of GAO's September 2012 recommendations, but additional efforts are needed. GAO made nine recommendations to FSOC in three areas: emerging threats and risks identification, transparency and accountability, and collaboration and coordination. GAO recommended, among other things, that FSOC:

- develop a systematic approach that includes collecting and sharing key financial risk indicators to help identify potential threats to financial stability;
- develop a strategy to improve communications with the public;
- keep detailed records of closed-door sessions;
- create a framework for assessing the impact of its decisions to designate nonbanks for enhanced supervision;
- develop policies to clarify when collaboration or coordination should occur;
- adopt leading practices, such as joint strategies, for collaboration; and
- clarify roles and responsibilities for monitoring threats to the financial system.

FSOC still lacks a comprehensive, systematic approach to identify emerging threats to financial stability. In 2012, GAO reported that FSOC's approach might not help identify new risks or threats that member agencies had not already identified. The Office of Financial Research (OFR) has made some progress in developing data tools to support FSOC since the 2012 report, but GAO's observations of two of these tools suggest that one tool does not focus on risks to the financial system, while another remains in a prototype phase.

FSOC has taken steps to improve its communication with the public but could do more to improve transparency and accountability. In May 2014, FSOC approved a revised transparency policy, and FSOC staff said they had attempted to provide more information in the minutes of meetings. But FSOC staff said that they did not intend to keep detailed minutes because of the confidential information discussed. Also, FSOC staff also said that the impact of designating nonbanks for enhanced supervision would be assessed as part of a mandated January 2016 study. However, FSOC has not begun to prepare for this study. GAO has reported on the importance of advance planning for retrospective studies so that needed data are collected.

FSOC has taken steps to improve collaboration and coordination among member agencies but does not plan to act on some of GAO's recommendations on coordination. In May 2014, FSOC approved one formal mechanism that supported coordination—bylaws for the Deputies Committee of senior officials from member agencies that describe its role in coordinating FSOC activities. FSOC staff said they did not plan to clarify the roles and responsibilities of FSOC, OFR, and member agencies because the overlapping responsibilities for monitoring systemic risk had not been problematic. Officials also said that FSOC would not adopt practices to coordinate rulemaking across member agencies, as it does not have the authority to direct independent agencies. GAO maintains that action is needed as its past work has shown that the lack of clear roles and coordination can lead to duplication, confusion, and regulatory gaps.

Chairman McHenry, Ranking Member Green, and Members of the Subcommittee:

Thank you for the opportunity to be here today to discuss the Financial Stability Oversight Council (FSOC). As you know, the 2007-2009 financial crisis focused attention on weaknesses in the U.S. regulatory structure, including the lack of an agency or mechanism responsible for monitoring and addressing risks across the financial system and a shortage of timely information to facilitate that oversight. In response to the crisis, in 2010 Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), which provided for a broad range of regulatory reforms.[1] Among other things, the act established FSOC to monitor the stability of the U.S. financial system and take actions to mitigate risks that might destabilize the system.[2] The Dodd-Frank Act also created the Office of Financial Research (OFR), in part, to support FSOC by providing financial research and data.[3] Congress gave FSOC a number of significant authorities to help it execute its broad mission, including designating nonbank financial companies for heightened supervision by the Board of Governors of the Federal Reserve System (Federal Reserve).

My remarks are based on our September 2012 report on FSOC and OFR and updates conducted from June through September 2014.[4] Specifically, in our 2012 report we reviewed FSOC's challenges in achieving its mission, efforts to establish management mechanisms, activities for supporting collaboration among their members and external stakeholders, and its processes for issuing reports and rules and made nine recommendations to FSOC for improving its ability to identify systemic risk and emerging threats, its transparency and accountability, and

[1]Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[2]The provisions of the Dodd-Frank Act dealing with FSOC are contained primarily in subtitle A of title I, §§ 111-123, codified at 12 U.S.C. §§ 5321-5333, and title VIII, codified at 12 U.S.C. §§ 5461-5472.

[3]The provisions dealing with OFR are contained primarily in subtitle B of title I, §§ 151-156, codified at 12 U.S.C. §§ 5341-5346.

[4]GAO, *Financial Stability: New Council and Research Office Should Strengthen the Accountability and Transparency of Their Decisions*, GAO-12-886 (Washington D.C.: Sept. 11, 2012).

collaboration and coordination across members and member agencies.[5] In my comments today, I will discuss FSOC's progress in addressing these recommendations.

For our September 2012 report, we reviewed our earlier reports on financial reform and the 2007-2009 financial crisis, statements by government officials and academic experts, and agency documents, including information on budgeting, staffing, and planning. We evaluated FSOC's management mechanisms using criteria from *Standards for Internal Control in the Federal Government* and our past work on establishing federal entities.[6] We analyzed FSOC policies, procedures, and products to determine whether and how their collaboration practices compared with key elements of effective collaboration that we had previously identified and to identify FSOC's processes for issuing products.[7] We also interviewed FSOC and OFR staff; officials from FSOC's member agencies; and external stakeholders, including foreign officials, industry trade groups, and academics. More details on our scope and methodology are included in the September 2012 report. We previously testified on our 2012 report in March 2013.[8] To obtain updates on the progress FSOC had made in implementing our recommendations, we interviewed FSOC staff and reviewed relevant documents, such as the 2014 annual report. The work on which this statement is based was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for

[5]In addition to these nine recommendations, we also recommended that OFR build on its strategic framework by further developing its strategic planning and performance management system to link its activities to goals and use publicly available performance measures to measure progress.

[6]GAO, *Internal Control: Standards for Internal Control in the Federal Government,* GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999); and *Internal Control Standards: Internal Control Management and Evaluation Tool,* GAO-01-1008G (Washington, D.C.: August 2001) and GAO, *Millennium Challenge Corporation: Progress Made on Key Challenges in First Year of Operations,* GAO-05-625T (Washington, D.C.: Apr. 27, 2005) and *Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency,* GAO-09-161 (Washington, D.C.: Dec. 2, 2008).

[7]GAO, *Results-Oriented Government: Practices That Can Help Enhance and Sustain Collaboration among Federal Agencies,* GAO-06-15 (Washington, D.C.: Oct. 21, 2005).

[8]GAO, *Financial Stability: Continued Actions Needed to Strengthen New Council and Research Office,* GAO-13-467T (Washington, D.C.: March 14, 2013).

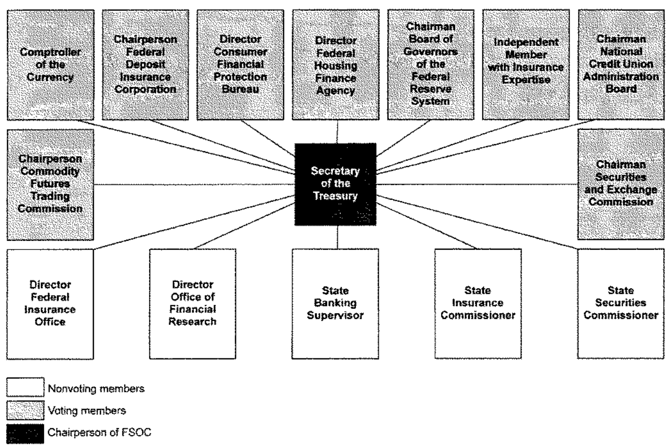
our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

FSOC has 10 voting and 5 nonvoting members (fig. 1). The 10 voting members include 9 federal regulators and an independent insurance expert. The five nonvoting members include representatives from state bank, securities, and insurance regulators and the directors of OFR and the Federal Insurance Office. As the chairperson of FSOC, the Secretary of the Treasury has certain powers and responsibilities related to FSOC's meetings, rulemakings, recommendations, and reports and testimony to Congress. The Secretary, in consultation with the other FSOC members, is also responsible for regular consultation with the financial regulatory entities and other appropriate organizations of foreign governments or international organizations. To help carry out the council's business, FSOC has established seven standing committees that are generally composed of staff of FSOC members and member agencies.[9]

[9]The committees are the Deputies Committee, Systemic Risk Committee, Designation of Nonbank Financial Companies Committee, Designation of Financial Market Utilities Committee, Heightened Prudential Standards Committee, Orderly Liquidation Committee, and Data Committee.

Figure 1: Financial Stability Oversight Council (FSOC) Membership



Source: GAO analysis of Dodd-Frank Act. | GAO-14-873T

The Dodd-Frank Act established OFR to serve FSOC and its member agencies by improving the quality, transparency, and accessibility of financial data and information; conducting and sponsoring research related to financial stability; and promoting best practices in risk management. The act requires OFR to

- collect and provide data to FSOC and member agencies;
- standardize the types and formats of data reported and collected;
- perform applied and essential long-term research;
- develop tools for risk measurement and monitoring; and
- make the results of its activities available to financial regulatory agencies.

To help achieve these goals, the OFR must set up a data center and a research and analysis center.

FSOC Has Made Some Progress in Responding to GAO's 2012 Recommendations

FSOC has taken steps to address some of our recommendations, such as those related to communication. However, it needs to take further action to fully address all of our recommendations.

Monitoring Systemic Risks and Identifying Emerging Threats

In September 2012, we made two recommendations to FSOC that were designed to improve its efforts to identify and report on sources of systemic risk and emerging threats to financial stability. First, we recommended that FSOC develop an approach that included systematic sharing of key financial risk indicators across FSOC members and member agencies to assist in identifying potential threats for further monitoring or analysis. We reported that FSOC had taken steps to meet its statutory responsibilities related to identifying risks and potential emerging threats to U.S. financial stability, including by setting up a Systemic Risk Committee—one of the seven standing FSOC committees—that is responsible for systemic risk monitoring and plays a key role in reviewing sources of systemic risk. The committee primarily relies on an approach that begins with suggestions from member agency staff of risks or threats that, in their view, may benefit from interagency coordination. As we noted in 2012 this approach may facilitate analysis of risks that could benefit from interagency discussions and responses, but may not help to identify new risks or threats that FSOC member agencies have not already identified on their own.

OFR participates in the Systemic Risk Committee and, since the publication of our 2012 report, has developed a tool known as the Markets Monitor, which provides an update on financial and economic developments, that OFR presents at each meeting of the committee. OFR also continues to develop a Financial Stability Monitor for assessing vulnerabilities in the financial system, which it first presented publicly in its 2013 Annual Report. However, the Markets Monitor does not appear to be focused on risks to the financial system, and the Financial Stability Monitor remains in a prototype phase—and neither yet reflect the systematic sharing of key financial risk indicators to assist in identifying potential threats to financial stability. OFR's continued work to develop indicator-driven tools to assess risks to the financial system is encouraging, but without a more systematic approach and comprehensive information, FSOC cannot be assured that it is fully informed about critical vulnerabilities in the financial system.

Second, in 2012 we recommended that FSOC develop more systematic, forward-looking approaches that would help in separating emerging threats to financial stability from more current risks and prioritizing them in its annual report. Since then, FSOC made some progress in addressing this recommendation but could do more. When we last reviewed the emerging threats identified in FSOC's annual report in 2012, FSOC had not developed a structure that supported having a systematic or comprehensive process for identifying and separating them from other risks. Further, FSOC had identified a large number of threats without explicitly prioritizing them. In contrast, other entities, such as the International Monetary Fund and European Central Bank, have issued reports that explicitly prioritized potentially significant threats.

Since our 2012 report, however, the ongoing work of the Systemic Risk Committee has become more tightly integrated into FSOC's annual reports according to FSOC officials. FSOC officials told us that the Systemic Risk Committee's efforts to identify and monitor threats to financial stability now served as a basis for the annual report. However, as noted previously, despite some new contributions from OFR, the work of the Systemic Risk Committee is not yet driven by a systematic and comprehensive approach. Instead, FSOC continues to rely on member agency staff to suggest various threats. Although FSOC staff distinguished between current known risks and potentially emerging threats to financial stability, the two are not clearly distinguished in the 2014 FSOC Annual Report. For example, the first threat identified in the 2014 Annual Report was the risk posed by financial institutions' reliance on short-term financing—a risk that had been identified for some time. Moreover, FSOC staff told us that they had not and did not plan to prioritize the threats they identified in the annual reports. FSOC staff said that prioritization could detract attention and resources from some of the identified threats. Until FSOC improves its processes for identifying and prioritizing potential emerging threats to financial stability in its annual reports, policymakers and market participants will not have the information they need to develop effective and timely responses to those threats.

Transparency and Accountability

Although FSOC had adopted communication methods to provide information on their activities to the public and taken steps to be transparent and accountable, we reported in 2012 that some of these efforts could be strengthened and made four recommendations. FSOC should

- develop a communication strategy to improve communications with the public;
- keep detailed records of closed door sessions of principals meetings and to the extent possible make them publicly available after an amount of time has passed;
- make recommendations in its annual report more specific by identifying which member agency or agencies, as appropriate, are recommended to monitor or implement such actions within specified time frames; and
- establish a collaborative and comprehensive framework for assessing the impact of decisions for designating financial market utilities (FMU) and nonbank financial companies on those entities and the wider economy.

Communication Strategy

In our 2012 report, we noted that FSOC had not taken full advantage of modern communication tools to provide information about its activities and its website did not provide a mechanism for the public to receive updates about the council's activities and decisions. In May 2014, FSOC updated its transparency policy. FSOC staff said that this effort was the result of a review of other entities' governance practices and that the policy reflected a commitment to improve communication with the public. For example, the council will now publicly announce its meetings at least seven days in advance of the meeting and will have a live web stream of its open meetings. In addition, FSOC staff said the decision to provide summaries of the meetings as soon as practicable afterwards was an effort to provide information in a timelier manner. Prior to the change to providing these summaries, the public would have to wait until the next FSOC meeting when the minutes were approved for the prior meeting. FSOC staff said that they have worked to make sure the website is updated more frequently, such as posting minutes soon after the council approves them. In addition, the website now offers the public the ability to sign up for email updates.

Detailed Record Keeping

In our 2012 report, we found that FSOC did not keep detailed records of deliberations or discussions at the council's meetings or at the committee level. FSOC has said it will provide more information in its minutes but has also argued that some of the information discussed is protected. No specific level of detail is required for FSOC minutes, but the limited documentation of their discussions has made it difficult to assess FSOC's performance. For instance, we reported in 2012 that the minutes typically described agenda items for the meetings and information on the presenters but lacked additional detail even if the information being discussed was not likely to be market sensitive or if disclosing it would not affect the deliberations. As a result, the minutes provided the public with little information about FSOC's activities and deliberations.

FSOC staff indicated that the council had been trying to include more detail in its minutes since October 2013. In July 2014, the Council of Inspectors General on Financial Oversight audited FSOC's compliance with its transparency policy and recommended that the council continue its efforts to provide greater detail in the meeting minutes for closed sessions.[10] For example, it specifically noted that FSOC could have provided more information than it did about a presentation on housing finance rules from its December 2013 meeting because the rules were final. In 2012, we reported that similar bodies, such as the Federal Open Market Committee, publish minutes that provide greater detail and voluntarily release transcriptions of their meetings 5 years after a meeting occurs. FSOC staff recognized the need for transparency but also noted that certain information was protected from disclosure under various statutes and could not be released. They noted more recently that discussions often touched on confidential information, some of which would remain sensitive for long periods of time. However, even if FSOC determines that some information should not be made public, its current practices do not provide detailed records even for policymakers, including members of FSOC, to assess decisions.

Accountability in Annual Report Recommendations

FSOC's annual reports serve as a key accountability document. FSOC staff noted that FSOC's annual reports provided Congress and the public with a description of FSOC's activities, its views on potential emerging threats to U.S. financial stability, and recommendations to enhance the integrity, efficiency, competitiveness, and stability of U.S. financial markets. However, in 2012 we found that the annual reports did not consistently designate an FSOC member or members to monitor or implement the recommendations or establish time frames for certain actions, such as reporting to the council on the status of recommendations. Without such detail, we noted, it is difficult to hold FSOC or the responsible member agency accountable for progress in implementing the prescribed recommendation(s).

[10] Council of Inspectors General on Financial Oversight, *Audit of the Financial Stability Oversight Council's Compliance with Its Transparency Policy*, CIGFO-14-001, July 2014.

In March 2013, Treasury officials told us that FSOC had begun to develop a process for the 2013 annual report and that our recommendations were provided to the team assigned to pull together the annual report for consideration. In June 2014, they told us that they had identified responsible agencies or others for certain recommendations in its most recent reports, as appropriate. In September 2014, FSOC staff explained that staff supporting the Systemic Risk Committee were monitoring progress and actions related to the annual report recommendations and providing updates on previous recommendations in the following year's annual report. We found that the 2014 annual report reflected progress in identifying member agencies that would address certain recommendations compared to the 2012 report. However, several recommendations continue to include specific actions without identifying an agency or agencies responsible for them. For example, the council recommends developing a plan to implement a smooth transition to any new interest rate benchmarks—rates such as the London Interbank Offered Rate (LIBOR), which are the basis for hundreds of trillions of dollars in financial contracts—but does not identify any specific member agencies or others who would develop the plan.[11] We continue to believe that FSOC should hold responsible parties accountable for its recommendations and identify them in its annual report as appropriate.

Framework for Assessing Designation Decisions

The Dodd-Frank Act gave FSOC the authority to designate FMUs as systemically important if FSOC determined that the failure of an FMU or a disruption in its functioning could threaten U.S. financial stability. Similarly, the Dodd-Frank Act provided FSOC with the authority to designate nonbank financial companies for supervision by the Federal Reserve under its enhanced prudential standards.[12] The act stipulates that FSOC may designate these companies if material financial distress at that company, or the nature, scope, size, scale, concentration,

[11]The international regulatory community moved to reform LIBOR after systematic manipulation of interest rate surveys. FSOC identified threats related to continued reliance on LIBOR, including that reference rates are not anchored to observable transactions and that LIBOR might be discontinued.

[12]The Dodd-Frank Act also subjects large bank holding companies with total consolidated assets of $50 billion or more to enhanced supervision and prudential standards. No FSOC designation is required for these bank holding companies to be subjected to enhanced supervision and standards. In addition, some potential nonbank holding companies that may be designated are already subject to some Federal Reserve oversight because they are thrift holding companies. The Dodd-Frank Act transferred the oversight of these companies from the Office of Thrift Supervision to the Federal Reserve.

interconnectedness, or mix of the company's activities could pose a threat to U.S. financial stability. In our September 2012 report, we recommended that FSOC develop a comprehensive framework for assessing the impact of its designation decisions. While FSOC has done some limited reviews, it has not planned for a comprehensive review that would provide a broad picture of the impact of designating these firms.

To date, FSOC has designated eight FMUs and three nonbank financial companies. On September 4, 2014, it announced that it proposed to designate another nonbank financial company. The designations were intended to address certain risks that these entities posed to financial stability and have the potential to confer other benefits and costs on the wider economy (as well as on the designees). We noted in our March 2013 testimony that FSOC had some limited processes in place to review its designations of nonbank financial companies, including an annual review and a review of the stage one thresholds stated in dollar terms at least every 5 years.[13] FSOC reported that at its July 31, 2014, meeting, it held a discussion that included an annual review of two nonbank financial companies designated in July 2013: American International Group, Inc. and General Electric Capital Corporation. The council did not rescind either company's designation. However, we also had noted in our 2013 testimony that FSOC had not set up processes to conduct a comprehensive assessment of the overall impact of the designations and to determine whether they were achieving the intended result.

We recognize that doing a comprehensive analysis to assess whether designations are having their intended impact of providing greater financial stability and the extent of any other impacts will be challenging. For example, establishing a baseline from which to evaluate the overall impact of the designations will likely be complex because the impact will depend on the application of a number of rules being written by multiple independent regulatory agencies—the Commodity Futures Trading Commission, Federal Deposit Insurance Corporation, the Federal Reserve, and Securities and Exchange Commission—and issued over a

[13]The process for designating nonbank financial companies for enhanced supervision generally includes three stages. The guidance for determining whether a company should pass from the first stage to the second stage, uses six uniform quantitative thresholds that measure size, debt, leverage, and derivative liabilities. If a company meets the size threshold of having total consolidated assets of at least $50 billion and one of the other thresholds, it would move from stage one to stage two.

span of time.[14] However, FSOC is uniquely positioned to address challenges associated with such an analysis. FSOC is responsible for designating FMUs and nonbank financial companies, and its member agencies are responsible for writing the rules that will impact these designated entities. Moreover, FSOC with OFR's help has already collected information on both designated and other companies that could help in creating a baseline. FSOC could also continue to rely on OFR for some further data collection and analysis. But without a comprehensive assessment, decision makers may not have the information they need to determine whether designating new entities for enhanced supervision and other requirements and restrictions is addressing a perceived gap in the regulatory system and improving the financial system's stability or whether policy changes should be considered.

According to FSOC staff, the recurring study required under Section 123 of the Dodd-Frank Act (next required no later than January 2016) is the appropriate mechanism for evaluating the overall impact of the designations process. Section 123 requires FSOC's Chairperson to carry out a study of the economic impact of possible financial services regulatory limitations on financial institutions that are intended to reduce systemic risk. According to the act, such a study should estimate the benefits and costs on the efficiency of capital markets, on the financial sector, and on national economic growth of limitations on the activities or structures of financial institutions that may be useful to limit systemic risk, such as limits on the organizational complexity and diversification of large financial institutions. FSOC staff said that they had not begun planning for a study and did not know when planning for it would begin. We noted in our 2012 report that such an evaluation would require collaboration among several members of FSOC and emphasized the importance of advance planning for retrospective studies so that needed data are collected. We have ongoing work examining FSOC's designation process, including the data collection, analyses, and criteria used in making determinations. We plan to issue this report later this fall.

[14]In GAO-12-151 we note the importance of setting up baselines early to support later retrospective reviews of individual rules. In addition, we reported that in light of its various statutory requirements, FSOC plans to assess the future impact of significant Dodd-Frank rules. Given these plans, we previously recommended that FSOC direct OFR to begin collecting the necessary data to carry out these analyses.

Collaboration and Coordination

In our September 2012 report, we also made three recommendations to improve FSOC's collaboration and coordination. Title I of the Dodd-Frank Act directs FSOC to facilitate information sharing and coordination among its member agencies and other federal and state agencies regarding domestic financial services policy development, rulemaking, examinations, reporting requirements, and enforcement actions.[15] The Dodd-Frank Act encourages collaboration between FSOC and external stakeholders, especially state regulators and international entities.

However, we found FSOC could do more to promote collaboration and coordination. We recommended that it establish formal collaboration and coordination policies that clarify issues such as when collaboration or coordination should occur and FSOC's role in facilitating that coordination. In October 2010, FSOC issued an integrated implementation road map for the Dodd-Frank Act that included a list of the rules regulators were required to promulgate, provided a time line for those rulemakings, and identified the agencies responsible for each one. FSOC has also developed a consultation framework for the agencies involved in rulemakings. In a November 2011 report, we noted that although FSOC's road map and consultation framework were a positive development in facilitating coordination, they had limited usefulness.[16] For example, the consultation framework does not provide any specifics about staff responsibilities or processes to facilitate coordination, and according to FSOC staff, it is not intended to provide such information. It also does not describe when interagency coordination is required or what happens when rules conflict with or duplicate each other.

Since our 2012 report, FSOC has made some changes that are responsive to this recommendation. It has undertaken a review of its governance structure, and one of the outcomes of that review was the development of bylaws for its Deputies Committee of senior officials from member agencies, which were adopted in May 2014. These bylaws formally state that the Deputies Committee is responsible for coordinating and overseeing the work of FSOC committees, coordinating the council's agenda, and coordinating with OFR. A key purpose of the bylaws is to provide guidance on how the Deputies Committee will function when the council delegates to it any authorities or actions. FSOC staff recently told

[15] 12 U.S.C. § 5322(a)(2)(E).

[16] GAO-12-151.

us that FSOC has an ongoing effort to develop charters for the other committees that serve the council. The Deputies Committee's bylaws and the ongoing effort to review FSOC's governance structures are positive developments in providing additional clarification on the roles and responsibilities of FSOC committees. We will continue to monitor these efforts and the extent to which they clarify coordination and collaboration across member agencies.

Similarly, in our September 2012 report, we recommended that FSOC more fully incorporate key practices for successful collaboration that we have previously identified, which could include working jointly with agencies to coordinate schedules for rulemakings, conduct collaborative systemwide stress tests, or create external advisory committees.[17] FSOC staff told us that the statute did not give FSOC the authority to direct actions of individual members including requiring members to coordinate rulemakings. While we understand the sensitivity to respecting members' independence, we maintain that additional collaboration practices can be adopted without impinging on the regulators' independence. Further, although the Dodd-Frank Act gave FSOC a certain statutory exemption to encourage the development of external advisory committees that could include industry representatives, academics, and state regulators, it has not formed any such committees. However, over the last year, FSOC has reached out to external stakeholders in some other ways. In May 2014, FSOC held a public conference on the asset management industry and its activities, at which they solicited input from the industry and other stakeholders, including academics and public interest groups. FSOC staff at Treasury also told us in June 2014 that a banker had briefed FSOC principals on cybersecurity issues.

Finally, we recommended in our September 2012 report that FSOC and OFR clarify responsibility for implementing requirements to monitor threats to financial stability across FSOC and OFR, including among FSOC members and member agencies. As noted earlier, FSOC is tasked with monitoring the financial services marketplace to identify potential

[17]This recommendation complements a previous recommendation we made in our 2011 report on financial regulations (GAO-12-151). Specifically, in that report we recommended that FSOC enhance interagency coordination on regulations issued pursuant to the Dodd-Frank Act by working with federal financial regulators to develop formal coordination policies that would clarify issues such as the timing of coordination, the process for soliciting and addressing comments, and FSOC's role in facilitating coordination.

threats to U.S. financial stability, and OFR's Research and Analysis Center must develop and maintain metrics and reporting systems for risks to U.S. financial stability as well as monitor, investigate, and report on changes in systemwide risk levels. The Dodd-Frank Act defines certain responsibilities for FSOC and OFR, but the lack of clear responsibility for implementation can lead to duplication, confusion, and gaps in their efforts. This risk is further compounded by the fact that many FSOC member agencies have risk analysis and data collection functions associated with their supervisory responsibilities. Some of these functions are explicitly focused on risks to financial stability, and some member agencies have created their own programs to examine them. To the extent that these programs provide unique information to FSOC, they will be contributing to the overall effort. However, if not properly coordinated, these separate efforts could be less effective and duplicative, resulting in wasted time and resources.

FSOC staff told us that FSOC and OFR work well together and that there was no need to make formal distinctions when both entities were statutorily required to monitor risks to financial stability. They also stated that though some overlap existed in the roles of the council and member agencies in terms of overseeing threats to financial stability, the council provided a forum for sharing and working together on these issues. We maintain that actions to address these recommendations are needed. Our past work has shown that the lack of clear roles and coordination can lead to duplication, confusion, and regulatory gaps. We have ongoing work reviewing duplication, overlap, and fragmentation in the financial regulatory structure and as part of that work will be reviewing the various roles and responsibilities of federal agencies that oversee risks to financial stability.

In conclusion, FSOC has worked to establish accountability and transparency mechanisms and promote collaboration among FSOC members and with external stakeholders. However, further efforts continue to be needed, including fully implementing our September 2012 recommendations. Fully addressing our recommendations will help shed more light on FSOC's decision making and activities and allow Congress to hold the council accountable for results. Addressing our recommendations can also help FSOC enhance collaboration among its members and with external stakeholders that are critical to their ability to achieve their missions. We will continue to monitor FSOC's progress in implementing our recommendations and stand ready to assist Congress as it continues its oversight of these entities.

Chairman McHenry, Ranking Member Green, and Members of the Subcommittee, this completes my prepared statement. I would be pleased to respond to any questions that you may have at this time.

GAO Contact and Staff Acknowledgements

For questions regarding this testimony, please contact A. Nicole Clowers at (202) 512-8678 or clowersa@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. Other individuals who made key contributions to this testimony statement include Kay Kuhlman (Assistant Director), Nancy Barry, Emily Chalmers, and Michael Hoffman.

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Written Statement of Patrick Pinschmidt
Deputy Assistant Secretary, Financial Stability Oversight Council
U.S. Department of the Treasury
House Financial Services Subcommittee on Oversight and Investigations
September 17, 2014

Chairman McHenry, Ranking Member Green, and members of the Committee, thank you for the opportunity to testify today regarding the Financial Stability Oversight Council (Council).

Next month will mark the fourth anniversary of the first meeting of the Council. The Council was created as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), a set of reforms designed to address flaws in our financial regulatory system that were made apparent by the financial crisis. Before the Council, no single authority was accountable for identifying, monitoring, and addressing risks to financial stability. Regulators focused on the institutions, functions, or markets within their jurisdictions, allowing some risks to fall through the cracks of the regulatory system.

With the establishment of the Council, federal and state regulators from across the system now meet regularly to coordinate and work together to respond to potential threats to financial stability. The Council has convened over 40 times since its first meeting in October 2010, providing a forum for close collaboration among its members. Over just the last year, the Council has considered issues including market volatility, the debt ceiling impasse, interest rate risk, developments in Europe and emerging economies, housing finance reform proposals, operational incidents in the equity markets, and risks to financial stability arising from cybersecurity threats.

Much of the benefit of the Council also comes from ongoing engagement among the staffs of its members on a near-daily basis. Independent regulatory agencies continue to be responsible for regulating the markets and institutions they oversee. But they are now also part of a process that enables them to look across the entire financial system to address risks that may not be confined to any single agency's jurisdiction. By bringing regulators together in this manner, the Council fulfills its statutory purposes of identifying risks to U.S. financial stability, promoting market discipline, and responding to emerging threats to the stability of the U.S. financial system.

Congress provided the Council with a number of tools to address risks to financial stability. If the Council identifies a risk that requires action, the Council carefully considers the appropriate response. In its annual reports to Congress, it can highlight potential emerging threats and make recommendations to address those threats. The Council can issue recommendations to existing primary financial regulatory agencies to apply new or heightened standards and safeguards for financial activities or practices that create or increase the risk of liquidity, credit, or other problems spreading among financial markets. The Council can also collect and facilitate improved sharing of information to assess risks to the U.S. financial system. To address company-specific risks, the Council can designate nonbank financial companies and financial market utilities for heightened supervision and enhanced prudential standards.

The Council has used a number of these authorities to address potential risks. It has designated three nonbank financial companies for Federal Reserve supervision and enhanced prudential standards; designated eight financial market utilities for enhanced risk-management standards; issued for public comment proposed recommendations regarding money market mutual fund reform; and made specific recommendations in its annual reports regarding reforms to address vulnerabilities in the tri-party repo market and other areas.

In June of this year, the Secretary of the Treasury, in his capacity as the Chairperson of the Council, testified before the full Financial Services Committee to present the Council's 2014 annual report, which focused on nine areas that warrant continued attention and possibly further action from the Council's members:[1]

- First, regulatory agencies and market participants should continue to take action to reduce vulnerabilities in wholesale funding markets, including tri-party repo and money market mutual funds, that can lead to destabilizing fire sales.
- Second, regulators should continue to work with policymakers to implement the significant structural reforms that are needed to reduce the taxpayers' exposure to risk in the housing market.
- Third, cybersecurity threats, infrastructure vulnerabilities, and other operational risks remain a top priority for the Council, and regulators should continue to take steps to prevent operational failures and improve resiliency.
- Fourth, as the financial system evolves in response to technological, competitive, and regulatory changes, regulators should remain attentive to financial innovations and the migration of certain activities outside of traditional financial intermediaries in a manner that could create financial stability risks.
- Fifth, U.S. regulators should continue to cooperate with foreign counterparts to address concerns about benchmark reference rates such as LIBOR.
- Sixth, regulators and institutions should remain vigilant in monitoring and assessing risks related to interest rate volatility, particularly as investors seek higher yields in a low interest rate environment.
- Seventh, Council member agencies should continue to work with the Office of Financial Research (OFR) to fill financial data gaps and address related issues of data quality and comprehensiveness.
- Eighth, regulators should continue implementation of Dodd-Frank Act reforms to reduce risk-taking incentives of large, complex, interconnected financial institutions.

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[1]The Council's annual reports are available at http://www.treasury.gov/initiatives/fsoc/studies-reports/Pages/2014-Annual-Report.aspx.

- And finally, there is a need for continued monitoring of adverse financial developments abroad and their potential impact on the U.S. financial system.

Since its creation four years ago, the Council has continued to mature as an organization and make progress in fulfilling its statutory responsibilities. The Council has built an organizational framework that supports openness and collaboration throughout every aspect of its work. In particular, I would like to highlight several areas in which the Council has made substantial progress.

The Council has fulfilled its statutory responsibilities through staff committees dedicated to supporting the Council's work. These committees, which draw upon the collective policy and supervisory expertise of each of the Council members and member agencies, institutionalize opportunities for open discussion, collaboration, and coordination. The Council's Deputies Committee, which meets bi-weekly, coordinates the activities of the Council and oversees the work of the other staff-level committees. Among other things, the Deputies Committee engages in consultations regarding Dodd-Frank Act rulemakings by member agencies. In May, the Council adopted bylaws for the Deputies Committee that provide the public with an understanding of the structure and role of the committee.

The Council has published four annual reports to Congress, and six additional studies or reports. The Council's annual report stands as a public testament to how the Council is executing its statutory duty to identify and respond to threats to financial stability. Each annual report is the product of a highly collaborative analysis and reflects the collective judgment of the Council members regarding potential emerging threats to financial stability. The annual report is an important example of the Council's commitment to sharing information about its work with Congress and the public in a clear and transparent manner. Each annual report documents for Congress and the public the Council's identification of risks in all corners of the markets, its assessment of how those risks might be transmitted to the broader financial system, and its recommendations for specific actions to mitigate those risks. As I noted earlier, the Council's 2014 annual report highlighted, among other areas, vulnerabilities in wholesale funding markets, the need for structural reforms to reduce taxpayers' exposure to risk in the housing market, cybersecurity threats and infrastructure vulnerabilities, and risks related to interest rate volatility.

The Council established a rigorous and fair process for evaluating nonbank financial companies for potential designation. The Council's designations authority addresses a key weakness brought to light by the financial crisis: the regulatory structure in place at the time allowed large, complex nonbank financial firms to pose risks to financial stability that were not subject to adequate supervision. Based on lessons learned from the crisis, the Dodd-Frank Act provides the Council with the authority to designate a nonbank financial company for supervision by the Federal Reserve and enhanced prudential standards, if the company could pose a threat to U.S. financial stability. Although a rulemaking was not required in this context, the Council developed a rule and guidance regarding this authority and provided the public with three separate opportunities to comment on the proposed approach and process. The Council's thorough and careful analyses of individual firms include extensive interactions between the companies under consideration and staff of the Council members and member agencies. Together, for the three nonbank financial companies that have been designated by the Council, the firms submitted thousands of pages of information for the Council's consideration, met with the Council or staff dozens of times, and each received a lengthy written explanation of the Council's analysis before a designation was made.

The Council adopted a transparency policy, and further expanded it this year. At its first meeting in 2010, the Council voluntarily adopted a transparency policy that committed the Council to conducting its meetings in public whenever possible and to releasing minutes for all its meetings. Though no statute required the Council to do so, the Council is committed to conducting its business in an open and transparent manner and these steps have helped provide the public with insight into the Council's work.[2] In May of this year, the Council enhanced its transparency policy after a months-long review. The improvements include public statements both before and immediately after Council meetings that provide additional information about the Council's discussions. Much of the Council's work—particularly with regard to companies under consideration for potential designation—relies on sensitive company-specific information that would not be shared by firms or regulators without an expectation of confidentiality. Further, protection of this information is necessary to prevent destabilizing market speculation. Within this context, the Council is committed to conducting its business in an open and transparent manner.

The Council developed a website and notifications to keep the public informed. In December 2012, the Council redesigned its website to improve transparency, usability, and access to documents and reports. For example, as part of the Council's recent enhancements to its transparency policy, we now post a statement to the website immediately following each Council meeting regarding the Council's discussion, to provide more timely information in advance of the public release of minutes. The website also allows users to receive updates when new information is posted, and we notify over 5,000 current subscribers every time we update any web page.

The Council has worked closely with the Government Accountability Office (GAO) and Council of Inspectors General on Financial Oversight (CIGFO). Since its creation four years ago, the Council has participated in more than a dozen performance audits by the GAO and the CIGFO reviewing almost every aspect of the Council's work, with four audits ongoing today. In July, the CIGFO completed a review of the Council's transparency policy and found that the Council complied fully with its existing policy and that the recent revisions largely addressed the improvements they otherwise would have recommended.[3] We have also engaged extensively

[2]Minutes for each Council meeting and webcasts of the Council's public meetings are available at http://www.treasury.gov/initiatives/fsoc/council-meetings/Pages/default.aspx.
[3]The CIGFO audit is available at http://www.treasury.gov/about/organizational-structure/ig/Documents/CIGFO%20Audit%20July%202014.pdf

with Congress through correspondence and member and staff briefings. Today is the tenth hearing for which Treasury has testified specifically regarding the Council.

The Council has actively sought and considered input from external parties. The Council has a track record of soliciting input from the public and stakeholders. For example, in May, the Council's Deputies Committee hosted a public conference on asset management to hear directly from industry representatives, academics, and other stakeholders on topics related to asset management. In December 2013, a bank chairman and CEO who leads industry efforts to address cybersecurity issues joined a public meeting of the Council to discuss strengthening the partnership between the private and public sectors in that area.[4] Furthermore, the Council has requested public comment on its proposed processes for nonbank financial company designations, financial market utility designations, and the process for hearings conducted by the Council. And in the context of nonbank financial company designations, staff representing Council members frequently engage with firms and state regulators. In recent months, the Council has received a number of suggestions regarding its process for evaluating nonbank financial companies for potential designation, including some from members of this Committee. The Council is always interested in ways to improve its processes, and I expect that the Council will consider any potential changes in the coming months.

Conclusion

In summary, the Council plays a critical role in our financial regulatory system by bringing together federal and state financial regulators from across the financial system to identify and respond to risks to financial stability. The Council by its very existence fosters better communication and a more proactive response to emerging threats to financial stability.

The actions of the Council and its member agencies have made the financial system more stable and less vulnerable to economic or financial stress. I look forward to working with this Committee and Congress to continue to make progress in creating a more resilient and stable financial system.

[4]A recording of the webcast of this meeting is available at http://treas.yorkcast.com/webcast/Play/d223201575c0439fa9511bb2ebcb1caa1d.

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July 29, 2014

The Honorable Jacob Lew
Chairman
Financial Stability Oversight Council
1500 Pennsylvania Avenue NW
Washington, DC 20220

Dear Chairman Lew:

I am writing with regard to the Financial Stability Oversight Council's (the "Council") process for identifying and designating non-bank financial companies as systemically important.

I strongly support the Council, and I believe that its mission of identifying, monitoring, and mitigating risks to financial stability is critical to preventing another financial crisis. While Congress provided the Council with a number of tools to address systemic risks, the most significant tool at the Council's disposal is its authority to designate particular non-bank financial companies as systemically important; once so designated, the financial company is subject to Federal Reserve supervision, as well as enhanced prudential standards.

Because designating a financial company as systemically important is so consequential for the company, it is critical that the designation *process* be as robust and transparent as possible. In designing the designation process, the Council — to its credit — went through a lengthy rulemaking process that included three separate public comment periods. This public rulemaking was entirely voluntary, and I applaud the Council for its decision to actively engage with the public in creating its designation process. As a result, the final rule and interpretive guidance governing the Council's designation process for non-bank financial companies creates a clear, three-stage process that is designed to balance the industry's desire for transparency and predictability with the Council's need to maintain flexibility in identifying and mitigating systemic risks.

While well-intentioned, I am concerned that the Council's designation process has, in practice, created needless uncertainty for companies that are under consideration for designation as systemically important. To that end, I believe there are four improvements that the Council should make to ensure that the designation process is as robust, fair, and transparent to the companies under consideration as possible.

First, I believe that the Council should provide notice to companies that they are in Stage 2, either affirmatively or upon request. While most companies will be able to apply the simple quantitative thresholds described in the final rule to determine if they have automatically advanced to Stage 2, this will not be the case for all companies — the Council expressly reserved the right in the final rule to advance a company to Stage 2 even if it does *not* meet the automatic quantitative thresholds. This reservation of authority necessarily creates uncertainty for companies that don't meet the automatic quantitative thresholds, because unlike companies that *do* meet the automatic quantitative thresholds, they have no way of knowing whether they have advanced to Stage 2.

Second, the Council should begin its engagement with a company that is under consideration once the company has advanced to Stage 2, rather than waiting until Stage 3. Even though the Council is only analyzing existing public information about the company in Stage 2, important misconceptions can form if the Council's analysis of this public information is inaccurate or incomplete. The easiest way to avoid these misconceptions is to engage with companies in Stage 2. Further, because the Stage 2 analysis is based on public information, the Council could also share its analysis, as well as the public documents reviewed, with the company when it votes to advance the company to Stage 3. This should not raise significant confidentiality concerns, if the analysis is based on existing public and regulatory information, and is only shared with the company.

Third, when the Council provides a company with notice that it has advanced to Stage 3, the Council should, to the extent feasible, identify the particular issues that the Council believes merit further review in order to determine whether the company is systemically important. Some companies operate in many different markets, and perform many different roles in these markets. Without some indication of the areas that are of interest to the Council, these companies will have no way of knowing which of their diverse business lines the Council is examining — and thus will not know what kind of information to submit to the Council to aid its analysis.

Finally, once the Council votes on a proposed designation for a particular company, I believe that the Council should adopt a policy of automatically granting an oral hearing to the company upon request. Despite requests for such a policy from commenters, the Council's final Hearing Procedures did not incorporate this right to an oral hearing upon request, citing the statutory language that grants the Council discretion to grant or deny an oral hearing after a proposed designation. While I recognize that the Council technically has the authority to deny an oral hearing under the statute, I believe that the Council would be better served by adopting a formal policy of granting an oral hearing to any company that requests one. Such a formal policy would demonstrate the Council's commitment to fairness in the designation process, and would protect the Council from charges of favoritism by removing the opportunity for disparate treatment of companies under consideration for designation.

I am strongly supportive of the Council's efforts to create a fair, thorough, and transparent designation process for non-bank financial companies. I understand that creating such a process requires the Council to strike a careful balance between transparency and flexibility, and that certain aspects of the designation process must, by necessity, remain confidential in order to protect the integrity of the Council's work.

As the Council considers ways to improve the designation process for non-bank financial companies, I respectfully urge the Council to consider the changes outlined in this letter. I believe that these modest changes would improve the designation process without undermining the Council's ability to identify, monitor, and mitigate systemic risks.

Sincerely,

Carolyn B. Maloney
Ranking Member
Subcommittee on Capital Markets and
Government Sponsored Enterprises

Questions for the Record for Deputy Assistant Secretary Patrick Pinschmidt
Hearing entitled "Oversight of the Financial Stability Oversight Council"
Subcommittee on Oversight and Investigations
House Financial Services Committee
Hearing Held September 17, 2014

Rep. Andy Barr Submission of Questions for the Record

1. **Question directed to Deputy Assistant Secretary Pinschmidt: I have heard concerns from individuals involved in asset management regarding the Form PF, which must be submitted to the SEC, the CFTC, and FSOC for systemic risk assessments. These individuals tell me that the forms are onerous and require the consolidation and submittal of volumes of data. However, there has never been any clear description of how these forms are used by federal agencies, or any guidance on how they may be used in assessing systemic risk.**

    a. **How many firms are required to file a Form PF with FSOC or one of its member agencies?**

    b. **If there are a large number of these firms, how do FSOC and its member agencies analyze and assess the volumes of data filed? Do officials review them as they come in or are they simply used for automated data collection and catalogued for later use?**

    c. **Does the FSOC use these filings used in rulemakings or SIFI designations?**

    d. **There is a significant cost for the financial sector associated with submitting these forms – is there any real benefit? Can FSOC associate these forms with any successful reductions of systemic risk?**

Answer:

Sections 404 and 406 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act) directed the Securities and Exchange Commission (SEC) to establish reporting and recordkeeping requirements for investment advisers to private funds and required a joint rulemaking of the SEC and Commodity Futures Trading Commission (CFTC) for investment advisers that are registered with both the SEC and CFTC. The Dodd-Frank Act specifies that such records must include certain information about each private fund advised by the investment adviser, including the amount of assets under management, use of leverage, counterparty credit risk exposure, types of assets held, and trading practices. In 2011, the SEC and the CFTC adopted final rules implementing these provisions. The SEC's rule generally requires registered investment advisers that advise one or more private funds and have at least $150 million in private fund assets under management to file Form PF with the SEC.

The Dodd-Frank Act requires the SEC annually to report to Congress on how the SEC has used the data collected regarding private funds for the protection of investors and the integrity of the markets. According to the SEC's 2014 report, as of May 7, 2014, there were 2,661 investment advisers and 21,542 funds in the Form PF filing population.[1]

As the FSOC noted in its most recent annual report, it has already begun to use certain Form PF data provided by the SEC to evaluate potential risks to financial stability. Form PF data has also contributed to the FSOC's analysis of the asset management industry to determine if there are products or activities that could pose risks to U.S. financial stability. In addition, the Office of Financial Research (OFR) published preliminary results from analysis of Form PF data in its 2013 annual report, including an analysis of leverage and value at risk for private funds. The FSOC's 2014 annual report also notes that the SEC has identified a number of uses of the information, including incorporating Form PF data into SEC analytical tools, using Form PF information to monitor the risk-taking activities of investment advisers to private funds, conducting pre-examination due diligence and in risk identification, and providing certain aggregated Form PF data to the International Organization of Securities Commissions regarding large hedge funds to offer a more complete overview of the global hedge fund market. The availability of this information closes certain regulatory data gaps that existed before and during the financial crisis. The 2014 SEC report cited above provides additional information about how the SEC is using the data.

[1]U.S. Securities and Exchange Commission, "Annual Staff Report Relating to the Use of Data Collected from Private Fund Systemic Risk Reports," August 15, 2014, available at http://www.sec.gov/reportspubs/special-studies/im-private-fund-annual-report-081514.pdf