

TESTIMONY OF
THOMAS J. CURRY
COMPTROLLER OF THE CURRENCY

before the

COMMITTEE ON FINANCIAL SERVICES
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The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

I. Introduction

Chairman Hensarling, Ranking Member Waters, and members of the Committee, thank you for the opportunity to testify today. I am pleased to provide the views of the Office of the Comptroller of the Currency (OCC) on the functions and operations of the Financial Stability Oversight Council (FSOC or Council).

The OCC charters, regulates, and supervises national banks and federal savings associations (collectively, banks). These banks range from small community banks to multi-trillion dollar institutions that are among the world's largest financial companies. The OCC's mission is to ensure that these banks operate in a safe and sound manner, provide fair access to financial services, treat customers fairly, and comply with applicable laws and regulations. As the only federal financial regulator with prudential regulation as its primary focus, the OCC has specialized knowledge about the safe and sound operations of banks.

As one of the FSOC's ten voting members, the OCC brings considerable expertise to the Council. Many of the areas of financial risk on which the OCC focuses as part of its bank supervision – for example, credit, liquidity, interest rate, and operational risk – are the same risks that the FSOC evaluates with respect to nonbank financial companies. Furthermore, the OCC has staff experts with in-depth knowledge in areas such as asset management who support the OCC's FSOC work.¹

Congress established the Council to identify, monitor, and respond to systemic risk. The FSOC brings together its member agencies to fulfill this critical mission. Through its committees and staff, the FSOC provides a formal, structured process for communicating, coordinating, and

¹ Approximately 44% of national banks and 27% of federal savings associations, including a number of limited purpose trust institutions, are engaged in asset management activities. To supervise these institutions, the OCC has over 170 examiners specializing in asset management activities and risks.

responding to emerging market, industry, and regulatory developments, as well as to unforeseen events.² In addition, the FSOC identifies and designates nonbank financial companies and financial market utilities (FMUs) for heightened supervision.

My testimony will provide a brief summary of specific mandates Congress has given to the FSOC and a discussion of recent, important actions of the Council.

II. The FSOC's Statutory Mandates

The FSOC's Purposes

In section 112 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act or Act), Congress described the purposes of the FSOC as follows: (1) to identify risks to the financial stability of the United States that could arise from the material financial distress or failure, or from ongoing activities, of large, interconnected bank holding companies or nonbank financial companies, or that could arise outside the financial services marketplace; (2) to promote market discipline by eliminating expectations on the part of shareholders, creditors, and counterparties of such companies that the U.S. government will shield them from losses in the event of failure; and (3) to respond to emerging threats to the stability of the U.S. financial system. As described below, Congress provided the FSOC with tools to carry out these purposes.

Nonbank Financial Company Designations

In section 113 of the Act, Congress gave the FSOC the authority to designate, on a case-by-case basis, certain nonbank financial companies for supervision by the Board of Governors of the Federal Reserve System (Board) and to be subject to heightened prudential standards, if the Council determines that material financial distress at any such company would pose a threat to

² Current committees include: the Deputies Committee; Data Committee; Financial Market Utilities and Payment, Clearing, and Settlement Activities Committee; Nonbank Financial Companies Designations Committee; Regulation and Resolution Committee; and Systemic Risk Committee.

the financial stability of the United States. A number of additional provisions apply to nonbank financial companies that are designated for supervision by the Board. For example, designated companies become subject to the Board's examination authority, enforcement actions under 12 U.S.C. § 1818, and assessments by the Board and the Office of Financial Research. To date, the FSOC has used this authority to designate four nonbank financial companies.³

The FSOC uses a three-stage process to identify, evaluate, and engage with nonbank financial companies under review. In stage one of the process, the FSOC applies six quantitative thresholds to a broad group of nonbank financial companies to identify companies that merit further evaluation. In stage two, the FSOC notifies a company when it comes under active review and considers existing public and regulatory information, as well as information submitted by the company. If the Council decides to evaluate the company further, it notifies the company and begins stage three. In this stage, the Council conducts a detailed, in-depth analysis of the company, including a review of confidential information provided by the company. Throughout the stage two and stage three processes, the Council engages extensively with the company, and in stage three, prior to a designation, the company has the opportunity to make a presentation before the FSOC principals. Following this robust process, the FSOC may designate the company pursuant to a supermajority vote.

By contrast, in accordance with section 165 of the Act, bank holding companies with total consolidated assets equal to or greater than \$50 billion are automatically subject to the Board's heightened prudential standards. While the Act permits the Board to tailor these standards, including by considering a company's capital structure, riskiness, complexity,

³ These companies are: American International Group, Inc.; General Electric Capital Corporation, Inc.; Prudential Financial, Inc.; and MetLife, Inc.

financial activities, size, and any other risk factors the Board deems appropriate, the Act does not provide these companies with the opportunity to contest the application of these standards.

Financial Market Utility Designations

Title VIII of the Act charges the FSOC with the responsibility for identifying and designating systemically important FMUs. The Act subjects designated FMUs to heightened supervision by one of three agencies: (1) the Securities and Exchange Commission (SEC) in the case of clearing agencies; (2) the Commodity Futures Trading Commission (CFTC) in the case of derivatives clearing organizations; and (3) the Board for all other FMUs (on either a direct or back-up basis). The FSOC determines whether to designate an FMU as systemically important on a case-by-case basis, after assessing the FMU's market activities and the effect its failure or disruption would have on critical markets, financial institutions, or the broader financial system. Once designated, an FMU is subject to periodic examination by the SEC, CFTC, or Board, as appropriate. Designated FMUs also are subject to operating rules issued by these agencies and must give advance notice to their supervising agency of any material changes to their operations. Designated FMUs are subject to enforcement proceedings by their supervising agency for breach of these requirements, unsafe or unsound practices, or other violations of law, in accordance with 12 U.S.C. § 1818(b). Pursuant to a final rule and interpretive guidance issued by the FSOC in 2011, the FSOC designated eight entities as systemically important FMUs in 2012.⁴ The FSOC monitors the financial markets and periodically determines whether designation status should remain in place for each FMU and whether it should designate additional FMUs.

⁴ These entities are: The Clearing House Payments Company, L.L.C., on the basis of its role as operator of The Clearing House Interbank Payments System; CLS Bank International; Chicago Mercantile Exchange, Inc.; Depository Trust Company; Fixed Income Clearing Corporation; ICE Clear Credit LLC; National Securities Clearing Corporation; and Options Clearing Corporation.

Other Authority of the FSOC

In addition to the authority to designate nonbank financial companies and FMUs as systemically important, Congress gave the FSOC other tools to address systemic risk. For example, under section 120 of the Act, the FSOC has the authority to issue recommendations to the primary financial regulatory agencies to apply new or heightened standards and safeguards for a financial activity or practice conducted by the firms under the agencies' respective jurisdictions. The FSOC may issue such recommendations if it determines that the conduct of such activity or practice could create or increase the risk of significant liquidity, credit, or other problems spreading among such firms, the U.S. financial markets, or low-income, minority, or underserved communities. Pursuant to section 120, in 2012, the FSOC published for public comment proposed recommendations with respect to money market mutual funds.

III. Recent Actions

The Council has demonstrated a sustained commitment to working collaboratively to fulfill its statutory mission in a transparent and accountable manner. Council members and their staffs have developed strong working relationships, and the Council, its committees, and working groups provide a forum to have candid conversations; share confidential, market-sensitive information; and ask tough questions that help make the U.S. financial system safer.

The Council convenes regularly to monitor market developments, consider a wide range of potential risks to financial stability, and, when necessary, take action to protect the United States against potential threats to the financial system. As part of this work, the Council regularly examines significant market developments and structural issues within the financial system. Examples of such issues include short-term wholesale funding, cybersecurity, volatility in fixed income markets, equity market structure, high frequency and automated trading

activities, leveraged lending, reference rate reform, and interest rate risk at a variety of financial institutions.

Nonbank Financial Company Designation Supplemental Procedures. In February of this year, the FSOC adopted supplemental procedures to the nonbank financial company designation process to address stakeholder concerns and to formalize a number of existing Council practices regarding engagement with companies. For example, the Council now will notify a nonbank financial company within 30 days of forming an analytical team to commence an active review of the company in stage two. As a result, companies will know their status earlier in the process, which in turn will provide them with more opportunities to engage with and provide input to the Council. Additionally, under the supplemental procedures, the Council is providing companies with a clearer and more robust annual review process and an opportunity for an oral hearing every five years to contest a designation.

The supplemental procedures also provide greater transparency while still allowing the Council to protect sensitive, nonpublic information. For example, the Council will continue its recent practice of including more information in its public bases for designations in an effort to provide a deeper understanding of the Council's analysis. In addition, the Council has started to publish more information in its annual reports about its designation work. Together, these procedural changes to the FSOC's nonbank designations process make it a more interactive and transparent process that permits the Council to continue its important work while also addressing concerns of stakeholders.

Asset Management Analysis. The Council has conducted extensive analysis and public outreach regarding potential risks to U.S. financial stability posed by asset management products and activities. In May 2014, the Council's Deputies Committee hosted a conference on the asset

management industry and its activities during which practitioners, academics, and other stakeholders discussed a variety of topics related to the industry. In July 2014, the Council directed staff to undertake a more focused analysis of industry-wide products and activities to assess risks associated with this industry. In order to inform that analysis, in December 2014, the Council voted unanimously to release a notice seeking public comment on aspects of the asset management industry. In particular, the Council sought input from the public about risks to the U.S. financial system associated with liquidity and redemptions, leverage, operational functions, and resolution in the asset management industry. The notice provided another important mechanism to solicit input from the public and build upon the Council's prior public engagement in this area. The public comment period closed in March 2015. The FSOC is now evaluating, through a series of working groups, whether asset management products or activities pose a threat to the financial stability of the United States.

IV. Conclusion

The Dodd-Frank Act provided the FSOC with important duties and responsibilities to promote the stability of the U.S. financial system. The issues that the Council confronts in carrying out these duties are, by their nature, complex and far-reaching. Developing appropriate and measured responses to these issues requires thoughtful deliberation and debate among the Council's members. The OCC remains committed to helping the Council achieve its mission.