THE ANNUAL REPORT OF THE FINANCIAL STABILITY OVERSIGHT COUNCIL

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTEENTH CONGRESS

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THE ANNUAL REPORT OF THE FINANCIAL STABILITY OVERSIGHT COUNCIL

Wednesday, June 17, 2015

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:07 a.m., in room 2128, Rayburn House Office Building, Hon. Jeb Hensarling [chairman of the committee] presiding.

Members present: Representatives Hensarling, Royce, Lucas, Garrett, Neugebauer, Pearce, Posey, Fitzpatrick, Westmoreland, Luetkemeyer, Huizenga, Duffy, Hurt, Stivers, Fincher, Stutzman, Mulvaney, Hultgren, Ross, Pittenger, Wagner, Barr, Rothfus, Messer, Schweikert, Guinta, Tipton, Williams, Poliquin, Love, Hill, Emmer; Waters, Maloney, Velazquez, Meeks, Capuano, Lynch, Scott, Green, Cleaver, Moore, Ellison, Perlmutter, Himes, Carney, Sewell, Foster, Kildee, Murphy, Delaney, Beatty, Heck, and Vargas.

Chairman HENSARLING. The Financial Services Committee will come to order.

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

This hearing is for the purpose of receiving the annual testimony of the Chair of the Financial Stability Oversight Council (FSOC).

I now recognize myself for 5 minutes to give an opening statement.

When Democrats first passed the Dodd-Frank Act, they claimed that the Financial Stability Oversight Council (FSOC) was one of its crown jewels. FSOC, whose agency heads largely failed in the last crisis, would now be able to clearly identify risks to financial stability and take action before these emerging threats metastasized into another crisis.

But a fatal flaw in this pipe dream was always the failure, perhaps the deliberate refusal, of Dodd-Frank's supporters to recognize that among the greatest threats to financial stability are Washington policies themselves, including policies of the very agency heads who sit on the Council. FSOC simply refuses to look in the mirror.

In its report, it conspicuously omits any references to specific government policies or agencies that are helping to cause the systemic risk it identifies: "Greater risk-taking across the financial system is encouraged by the historically low-yield environment," the Council reports. Yet, the Council refuses to identify the obvious source of this apparent risk, one of its own members, the Federal Reserve, and the Fed's unprecedented loose monetary policy.

The Council warns of reduced liquidity in the capital bond markets, yet never acknowledges that Dodd-Frank's Volcker Rule and other regulations have drastically reduced liquidity.

The Council lists "risk-taking of large, complex, interconnected financial institutions" as a threat. Yet, again, it fails to mention that Dodd-Frank amplifies the threat by empowering the Council to designate certain firms as too-big-to-fail, thus enshrining the concept into law.

These designations will only make worse the profound threat ignored by the Council but recently identified by the Federal Reserve Bank of Richmond in their "Bailout Barometer," that threat being that hardworking taxpayers, implicitly or explicitly, are now on the hook for a staggering 60 percent of the liabilities of the entire U.S. financial system.

The Council turns a blind eye to other serious threats. Fannie Mae and Freddie Mac, at the epicenter of the last crisis, barely receive a mention.

And it gets worse. Our unsustainable national debt, $18 trillion and counting, as all can see, perhaps one of the greatest existential threats that we face, with more debt incurred under this Administration than in our Nation's first 200 years, is totally ignored. This is beyond negligent. It is beyond egregious. It is dangerous and, frankly, it is offensive.

Another glaring omission from the report is any meaningful reference to economic growth or, rather, the lack of it. Along with Obamacare, Dodd-Frank is at the center of the Administration's economic policies. As we approach Dodd-Frank's fifth anniversary, we see the slowest, weakest recovery in the post-war era.

We see an economic recovery that has created 12.1 million fewer jobs and has provided $6,175 less income for every citizen compared to the average post-war recovery. Again, compared to the average, we see an economic recovery that has left 1.6 million of our fellow citizens mired in poverty, and working middle-income families losing over $11,000 in annual income that rightfully should have been theirs.

I find it stunning that in its report FSOC can find a link between weak economic growth in Greece and stability in the eurozone but apparently can find no link between economic growth and stability on this side of the Atlantic.

Also nowhere to be found in the Council's report is the threat posed to our stability, growth, and personal freedoms by the erosion of the rule of law under this Administration. We know that our President seemingly never tires of admonishing us that he has a pen and a phone ready to enact whatever policy he sees fit. Regrettably, he never seems to have handy a copy of the Constitution.

As Americans become less governed by the rule of law and more governed by the whims of Washington, fear, doubt, uncertainty, and pessimism are sown. It is not lost on the American people that increasingly, Washington decides what credit cards can go in their wallets, what kind of home mortgages they can receive, and whether, if they like their bank account, they can keep it.

Truly, never before in my lifetime has more unchecked, unbridled discretionary power been given to the unaccountable and unelected. This includes the Financial Stability Oversight Council, which operates largely out of public view, yet its decisions have the potential to profoundly alter the lives and livelihoods of every American. FSOC typifies not only the shadow regulatory system but also the unfair Washington system that Americans have come to loathe—powerful government administrators, secretive government meeting, arbitrary rules, and unchecked power to punish or reward.

Mr. Secretary, your Council and the rest of Washington need to awaken to the obvious truth, and that is, when it comes to systemic risk, Washington is a large part of the problem.

I now recognize the ranking member for 5 minutes.

Ms. WATERS. Thank you, Mr. Chairman.

And welcome back, Secretary Lew.

Today, we receive the annual report of the Financial Stability Oversight Council, as required by law.

As we all know, this year marks the fifth anniversary of the enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act. It is hard to believe it was just 5 years ago that we were coming to grips with the magnitude of the financial crisis, which caused the greatest loss of wealth in a generation. All told, the financial crisis cost our Nation more than $13 trillion in economic growth and $16 trillion in household wealth, not to mention the devastation of an unemployment rate topping 10 percent in many States.

In the lead-up to the crisis, nobody in the private sector or in government was looking at the stability of our financial system as a whole. Nobody was looking at the big picture. And nobody had the responsibility to deal with emerging threats before they caused damage to our economy.

That is why we created the Financial Stability Oversight Council as part of Dodd-Frank. FSOC filled that void, looking at every aspect of our financial system for possible weaknesses. And it serves as an advance warning system to identify and address systemic risk posed by large, complex companies, products, and activities before they threaten the economy.

The Council has ensured for the first time that our financial regulators are working collaboratively to identify and respond to emerging threats to financial stability. And with their February announcement outlining enhanced engagement and opportunities for public input, they have doubled their efforts to engage with the industry and Congress in a transparent manner.

In its 2015 annual report, the FSOC noted substantial progress to protect Americans from another crisis. And, indeed, we have taken important steps to prevent another economic disaster from happening, including making our large banks more resilient through stronger capital, leverage, and liquidity standards; covering oversight gaps in our financial system by designating complex, interconnected nonbanks for consolidated supervision; and reforming key markets like asset-backed securities and money market mutual funds.

However, 5 years after Dodd-Frank became law, my Republican colleagues remain fighting the battles of the past. They continue to believe that if only we rolled back all of the rules of the road, the financial system would magically unlock growth and the market would suddenly police itself.

And they continue to ignore the lessons of the last crisis by doing all they can to undermine FSOC under the guise of oversight. By focusing merely on dismantling Dodd-Frank, my colleagues on the other side of the aisle impede Congress' ability to focus on the new emerging threats to financial stability identified in FSOC's 2015 annual report.

Like the Consumer Financial Protection Bureau (CFPB), destroying FSOC has become a leading component of the Republican deregulatory agenda. And while they waste countless hours working to undermine it, engines of job growth and American competitiveness like the Export-Import Bank face a possible shutdown in just 5 legislative days. Rather than renew a proven job creator like the Ex-Im Bank, Republicans are spending their time bogging the FSOC down in countless document requests and inquiries—an obvious effort to undercut its ability to protect homeowners, consumers, and the American economy.

So welcome, Secretary Lew, and thank you for your resilience in the face of efforts to stop the Council from its important work. I look forward to your insight on areas of systemic risk the Council has identified and hope to learn more about what FSOC is currently doing to monitor for such risk and promote financial stability.

As we hear additional details from you, I will be interested to hear whether Republicans believe FSOC should take any action to address systemic risk or simply wait for another crisis.

So I thank you, and I yield back the balance of my time.

Chairman HENSARLING. The gentlelady yields back.

Today, we welcome the testimony of the Honorable Jacob J. Lew, Secretary of the Treasury. Secretary Lew has testified before our committee on previous occasions, so I feel he needs no further introduction.

Welcome, Mr. Secretary. We are happy to have you back.

Without objection, your written statement will be made a part of the record.

Mr. Secretary, you are now recognized for 5 minutes to give an oral presentation of your testimony.

STATEMENT OF THE HONORABLE JACOB J. LEW, SECRETARY, U.S. DEPARTMENT OF THE TREASURY

Secretary LEW. Chairman Hensarling, Ranking Member Waters, and members of the committee, thank you for having me today and for this opportunity to testify on the Financial Stability Oversight Council's 2015 annual report.

I would like to begin by recognizing that we are a few short weeks away from the 5-year anniversary of the enactment of Wall Street reform and the creation of the Council. As we approach this milestone, it is clear that these reforms have made the financial system safer and more resilient while supporting long-term economic growth.

Wall Street reform has put important consumer, investor, and taxpayer protections in place, supporting companies that play by the rules and serve their customers, small businesses that need access to credit to grow and create jobs, and working men and women trying to save for their children's education, a downpayment on a home, or their own retirement. Wall Street reform has worked.

Five years ago, the Council was created to be a forum for the entire financial regulatory community to come together to look across the U.S. financial system to identify and respond to potential threats to financial stability. Today, the Council is doing exactly what Congress designed it to do, from asking the tough questions that will make our financial system safer to shining a light on emerging threats before they can evolve into the next financial crisis.

Moreover, the Council's member agencies work collaboratively to leverage the expertise that each regulatory agency brings to the table. And the Council has also established a track record of conducting its work in an open-minded and deliberative manner, incorporating constructive suggestions from stakeholders, including members of this committee, who have made the Council more effective. The Council asks hard questions and only makes judgments based on facts and detailed analysis.

Before discussing this year's report, I want to emphasize why each annual report is important. The annual report provides transparency about the Council's work. Each report covers a range of issues based on extensive data-driven analysis, and it contains in one place the collective views of the financial regulatory community about current risks and emerging threats to financial stability, along with recommendations for specific actions to mitigate those risks.

The findings and recommendations set down a marker for action, providing clarity regarding the Council's priorities and a roadmap to the year ahead. This provides Congress and the public with a way to hold the Council accountable for making progress.

The report highlights the Council's recent work and demonstrates its continued commitment to openness and good governance. For example, this year's report highlights a series of important Council initiatives over the past year, including enhancements to the Council's transparency policy, stronger internal governance, supplemental guidance to our nonbank designations process, and ongoing engagement with the public regarding potential risks from asset management products and activities.

Last month, at our 51st meeting, the Council released its fifth annual report. This year's report focuses on 11 key areas, many of which have been discussed by the Council in prior annual reports as well as at its meetings over the past year. These include the potential incentives for greater risk-taking in a low-yield environment, the need for continued progress to reform benchmark rates such as LIBOR, and the continued reliance on short-term wholesale funding. For each of these areas, the report highlights where progress has been made and where more still needs to be done.

Cybersecurity remains a key area of focus for the Council. The financial sector has been a leader of other industries adopting cybersecurity measures, but still we have seen cyber incidents affect the largest financial institutions and the community banks that form the bedrock of the financial system.

That is why this Administration and the Council are focusing on how to continue working with the private sector to strengthen best practices, information-sharing, and incident response. I commend the committee for focusing on the topic in recent hearings, and we look forward to working with Congress on this critical issue.

This year's report also identifies several new potential risks coming into focus which the Council and its member agencies will monitor over the coming year. For example, the Council will pay heightened attention to ongoing regulatory efforts to bolster the resiliency of central counterparties, or CCPs. The Council also highlighted the ongoing evolution of market structure across various asset classes and the need for constant monitoring to ensure that markets function efficiently.

The Council recommends continued vigilance to the confluence of factors driving changes in market structure and the extent of their impact on market functioning and the provision of liquidity.

Promoting financial stability and protecting the American public from the next financial crisis should be a common objective that we all support. Yet, opponents of reform continue to advocate rolling back these protections, including the ability of the Council and its member agencies to respond to future threats to financial stability. As the Council's annual report demonstrates, threats to financial stability are real and will evolve with the marketplace. We simply cannot let our guard down.

I want to thank the other members of the Council and all of the staff involved with the 2015 annual report for their hard work and commitment.

As we approach the 5-year anniversary of Wall Street reform, we will continue to work with this committee to continue addressing these threats and promoting the strength and stability of the U.S. financial system.

Thank you very much, and I look forward to answering any questions that you have.

[The prepared statement of Secretary Lew can be found on page 66 of the appendix.]

Chairman HENSARLING. Thank you, Mr. Secretary.

The Chair now yields himself 5 minutes for questions.

Mr. Secretary, I alluded to it in my opening statement, but by chance are you familiar with the "Bailout Barometer" report of the Richmond Fed? Are you familiar with this report?

Secretary LEW. I have seen it in the past. I am not sure which one you are holding.

Chairman HENSARLING. I'm sorry?

Secretary LEW. I have seen it in the past, but I am not familiar with what you are holding.

Chairman HENSARLING. Okay. So you have reviewed the document. You are familiar with—

Secretary LEW. I am familiar with the—

Chairman HENSARLING. Okay. So you are familiar with the fact that it indicates that there has been a 61-percent increase in the explicit Federal guarantees in our financial system since the crisis. Is that correct?

Secretary LEW. I understand that is the analysis which is in that piece of paper. I haven't read the piece of paper.

Chairman HENSARLING. Okay. Do you have any reason to challenge that analysis? Has FSOC come up with a contrary analysis?

Secretary LEW. Look, I think if you look at the experience we have had since the financial crisis, since financial reform, we have seen—

Chairman HENSARLING. No, I am just asking, Mr. Secretary, has the Council—

Secretary LEW. I haven't looked at that piece of analysis, so—

Chairman HENSARLING. Okay. That is—

Secretary LEW. —I can give you my response to the idea, but that is what I was—

Chairman HENSARLING. Okay. Well, let me quote from the report. There is $26 trillion, according to the Richmond Fed, in explicit and implicit Federal backstop today. One of the final conclusions of the report is that, "It is essential to restoring market discipline and achieving financial stability to shrink this Federal safety net."

Do you agree or disagree with their conclusion?

Secretary LEW. I don't want to comment on a report I haven't read. I am happy to address the issue, Mr. Chairman—

Chairman HENSARLING. How about their conclusion? Do you believe, independent of their report, that it is important to achieving financial stability to shrink the size of the government Federal safety net?

Secretary LEW. Congressman, I—

Chairman HENSARLING. In our financial markets, is it important or not important?

Secretary LEW. I think if you look at the financial stability situation today versus before the Dodd-Frank Act and Wall Street reform, we have a much—

Chairman HENSARLING. Mr. Secretary, I would be happy to let you have some context, but I would like for the question to be answered. It is a fairly simple—

Secretary LEW. Congressman, I am happy to—

Chairman HENSARLING. —question. Do you believe that for the sake of financial stability, the extent of the Federal safety net in our financial markets should be shrunk?

Secretary LEW. I think if you look at an issue that we have talked about before, I very much believe that it would be a good thing to enact reform in the area of GSEs. There was progress on that on a bipartisan basis in the Senate last year. It is something that didn't proceed to the Floor—

Chairman HENSARLING. So can I take your answer as "yes?"

Secretary LEW. Mr. Chairman, I am happy to look at that report. I am happy to offer my views on this issue, but—

Chairman HENSARLING. You don't have it to look at the report, Mr. Secretary. I am just asking you about a conclusion.

Secretary LEW. Yes. I—

Chairman HENSARLING. I don't sense I am going to get an answer. Let me move on, Mr. Secretary.

Secretary LEW. I would be delighted to answer the question if you give me the time.

Chairman HENSARLING. I think you have had plenty of time to answer the question, Mr. Secretary—

Secretary LEW. Yes, I don't think I have gotten—

Chairman HENSARLING. —and you haven't.

Under Dodd-Frank, FSOC is comprised of agency heads as opposed to the agencies themselves, correct? We can both agree on that?

Secretary LEW. Yes.

Chairman HENSARLING. Okay. And we can also agree that of the 10 voting members of FSOC, each was appointed by President Obama, correct?

Secretary LEW. Yes, I believe that is correct.

Chairman HENSARLING. Okay. I alluded to it again in my opening statement. I have read excerpts of this report. I have not read the entirety of the 150-page report. Have you read the entire report?

Secretary LEW. I have.

Chairman HENSARLING. Good. My staff read the entirety of the report; I have read many excerpts. So, in identifying emerging threats to financial stability, can you point to any page in the report where FSOC identifies a current Federal policy or rule as a contributing factor to an emerging threat? Because we can't find it.

Secretary LEW. Mr. Chairman, we identified the threats that we see as real. Many of those have a connection to Federal policy. And I am happy to answer specific—

Chairman HENSARLING. Okay. But under Dodd-Frank, you also have the mandate to actually make recommendations. So how do you make a recommendation if you can't cite a source?

Secretary LEW. It is not my view that Federal regulation is a significant risk to financial stability. So I don't agree with—

Chairman HENSARLING. The last time you were here, Mr. Secretary, there was increasing evidence that we are suffering great illiquidity in our corporate bond market. You admitted that. This report cites it. We know that when mid-market companies hoard cash, they can't promote jobs and economic growth. Many economists believe this will be the source of the next financial crisis.

Somehow, the FINRA head can connect this bond illiquidity to the Volcker Rule. SEC Commissioner Dan Gallagher has said that the Volcker Rule has set the stage for a potentially dire liquidity crisis. There has been similar testimony from CFTC Commissioner Giancarlo. Even former Secretary of the Treasury Larry Summers has said, "There is a danger in their enthusiasm for keeping each individual institution safe that regulatory authorities will lose sight of keeping markets open and liquid, and I think that is a legitimate concern."

So, in your last testimony, you found no evidence that the Volcker Rule contributed to the bond illiquidity. We have incredible evidence that it has contributed. Do you still stand by your previous testimony that there is no connection to bond illiquidity in the Volcker Rule?

Secretary LEW. Mr. Chairman, I think that the question of market liquidity is a very complicated one, and trying to reduce it to one factor is never going to—

Chairman HENSARLING. I said a contributing factor, Mr. Secretary. Is it a contributing factor?

Secretary LEW. If you would allow me to answer your question, this is a complicated issue. It is a very important issue. It is an issue that I spend a lot of time thinking about. It is not a 10-second answer. I will give you a—

Chairman HENSARLING. Starting out with, is it a contributing factor? Or is it not a contributing factor?

Secretary LEW. Yes. I think that it is not possible to say what is the single cause. I do not believe that Federal regulation is a significant factor—

Chairman HENSARLING. I understand that, Mr. Secretary.

My time has expired. I now—

Secretary LEW. May I just ask to address this issue? Because I think it is actually a very important issue.

Ms. WATERS. Mr. Chairman? I will yield time to the gentleman.

Chairman HENSARLING. I would be happy to have the Secretary answer the question.

Please. The Secretary is recognized.

Secretary LEW. Mr. Chairman, I think if you look at the question of liquidity, there are a lot of people trying to reach a simple explanation to a complicated question.

We are at a point in the business cycle where we are seeing naturally a lot of volatility as we move out of the deepest recession since the Great Depression. We are seeing an expectation of some movement in interest rates. That is a significant factor.

We are seeing market structure changing rapidly. We are seeing the introduction of a high level of electronic trading, including high-frequency trading, that is changing the structure of markets.

We have also seen a tremendous increase in the volume of issuance of bonds. That is having a big effect on market structure—

Chairman HENSARLING. I understand all that, Mr. Secretary.

Secretary LEW. I think anyone who tries to point to a single thing, like a rule, is not going to—

Chairman HENSARLING. Mr. Secretary, I did not say it was a single thing. I asked you the question, was the Volcker Rule a contributing factor, and several minutes later you have still refused to answer the question.

Secretary LEW. Well—

Chairman HENSARLING. My only takeaway is that you don't see it as a contributing factor, and so many other market—

Secretary LEW. I think that part of the issue—there was a desire in financial reform for certain things that are high-risk, highly leveraged investments to be less liquid. I don't that is necessarily a bad thing.

That doesn't mean it is a good thing for there to be a loss of market liquidity. I do not see a major impact—

Chairman HENSARLING. Thank you.

Secretary LEW. —in terms of broad liquidity, but we are constantly looking at this question of liquidity. And we are open to asking the question as to what the impact of Federal policy is. I just think it is a mistake to start there.

Chairman HENSARLING. You could have fooled me, Mr. Secretary.

I now recognize the ranking member for 5 minutes.

Ms. WATERS. Thank you very much, Mr. Chairman.

Mr. Secretary, I would like to offer you the courtesy of continuing your explanation, if you would like to have it.

Secretary LEW. Thank you very much, Congresswoman Waters.

I guess the thing I would add is that there has been a lot of focus on this issue since October 15th, and there has been a lot of telling of the story of what happened on October 15th that is just not based on the analysis or the facts.

There was no breakdown in Treasury markets on October 15th. That is not something that is supported. There was no liquidity crisis. There was a moment, there was a blip, there were a lot of things going on, but we don't see any evidence that regulation contributed to that event.

There was a moment in time when there was a lot of off-risk sentiment because of events going on in the world. There was a huge amount of electronic trading going on. And there was a blip in the market that, obviously, is very much worthy of our attention. But people took from that, I think incorrectly, the notion that somehow that was an event that was caused by a rule. It wasn't.

And we are doing a lot of work on it and look forward to issuing an analysis very shortly.

Ms. WATERS. Thank you, Mr. Secretary.

One of the largest and most frequent criticisms my Republican colleagues have lodged against the Financial Stability Oversight Council is what they deem to be a lack of transparency with respect to nonbank systemically important financial institution, or SIFI, designations.

And while I think many of their criticisms are merely attempts to hamstring the Council under the guise of oversight, I do appreciate that you and your staff have redoubled your efforts to engage with Congress and with nonbank institutions and to open up your deliberations for additional public scrutiny.

Mr. Secretary, would you describe precisely what changes to both the annual and to the 5-year designation processes FSOC made in its February 2015 supplemental procedures announcement? And please also describe how FSOC balances the need for transparency against the need to protect sensitive market and supervisory information.

Secretary LEW. Congresswoman, thank you.

We made a number of changes that were designed to respond to concerns raised both by this committee, members of the committee, and by stakeholders, which give a great deal earlier notice and transparency to the process to parties that are under review.

I want to just underscore that there was a lot of back and forth even before. So this is not as radical a change as it may sound like, but it is more formal. And I think it is something that has led to a good deal of, kind of, recognition that the system is more transparent, which is our goal.

The review process, by necessity, involves reviewing highly confidential business documents that are commercially sensitive under law where we have to protect the documents and the information. We try our best, in the context of that constraint, which is a reasonable constraint, and it is a constraint shared by supervisors of these institutions as well, to be transparent with the public and the committee at the same time.

I think that the changes that we have made have helped, but FSOC is a young organization, and we always remain open to suggestions on how to improve the process.

Ms. WATERS. Last month, the chairman of the full committee and five chairmen of each subcommittee sent a lengthy and onerous request for documents regarding the FSOC designation process, which contained at least 13 different subparts. It is my understanding that more than a week ago you responded to that document request with an offer for an in-camera review of 1,400 pages of confidential business and bank supervisory information.

Since you responded, my staff has begun a review of those materials. To your knowledge, has the Majority availed themselves of that opportunity?

And would you consider the production of such sensitive and voluminous documents to be consistent with the Council's desire to be transparent with the Congress?

Secretary LEW. Congresswoman, we did make that offer. We appreciate that your staff has begun reviewing it. Unless it has happened in the last day, I am not aware that the Majority has reviewed it, but it could have happened in the last 24 hours.

That is the right way for us to make clear the commitment to transparency while protecting very sensitive confidential information.

Ms. WATERS. Thank you very much.

And, Members on this side of the aisle, would you please allow the Secretary to answer questions and give him the courtesy of not badgering him. This is complicated subject matter that we are dealing with, and he deserves the right to be able to respond in the time that it takes.

I yield back the balance of my time.

Chairman HENSARLING. The time of the gentlelady has expired.

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

Mr. GARRETT. I thank the Chair.

So, Mr. Chairman, you said at the outset, "I would be delighted to answer your questions if you would just give me the time."

Mr. Secretary, we gave you the time to answer some questions that were submitted to you after the last hearing, which was back in March, and, lo and behold, it took your appearance here today before we got the answers to them. In other words, at 11:18 last night, we got the answers.

That is March, April, May, and now halfway through June. So we do give you a lot of time. But it is just a pattern, I guess, of this Administration of ducking the questions and evading the answers. And it is certainly a pattern of yours of obfuscation in all these things and not giving a clear answer. You have such disdain for the American public that we have to bring you before this committee before you would simply answer the American public's question?

Mr. Chairman, you asked a question, is it a factor, the Volcker Rule, and the Secretary couldn't answer it.

And yet, Mr. Secretary, you were able to come up with a litany of other factors. You said it was a factor with regard to, the time that it was happening, high-frequency trading was a factor, volume was a factor. So you ran off all those—correct?—that those were all factors.

But then did you say that regulation and Volcker is not a factor? Is that the final answer?

Secretary LEW. Congressman, what I said is complicated, and we are open—

Mr. GARRETT. It is complicated. I understand. And you listed the other four factors.

All we want is a simple question. You did say that in the blip, there was no evidence of regulation being a factor in that blip. Correct?

Secretary LEW. That is certainly my understanding.

Mr. GARRETT. Okay. So is it your understanding, further, going forward, that Volcker, therefore, is not a factor in any of this?

Secretary LEW. Congressman, I think the Volcker Rule is a very important protection against—

Mr. GARRETT. Is it a factor?

Secretary LEW. —risk-taking. I can't give you—

Mr. GARRETT. You listed four other factors. Is this one of the factors?

Secretary LEW. Congressman, I listed the factors that I know are very much real—

Mr. GARRETT. Do you know whether this one is a factor?

Secretary LEW. I am not able to say that I know the Volcker Rule—

Mr. GARRETT. So you knew the other factors, and you don't know this factor. That is—

Secretary LEW. I—

Mr. GARRETT. —the end of those questions.

Secretary LEW. I am trying to demonstrate an open-mindedness that you are not giving me a chance to express.

Mr. GARRETT. No. You are just—

Secretary LEW. I haven't ruled out—

Mr. GARRETT. You were given the chance to answer the question, Mr. Secretary.

Reclaiming my time, with regard to the FSOC and the FSB, I appreciate that the FSOC has announced that it has a process with regard to the listing of the potential risk associated in going forward in the designations.

Is there such a process with FSB, as far as a due process system in place there, that we are trying to get to with FSOC?

Secretary LEW. Congressman, the FSB is a very different process than—

Mr. GARRETT. I understand that.

Secretary LEW. —FSOC. There is no consequence to the designation in terms of—

Mr. GARRETT. I understand that.

Secretary LEW. So it doesn't have the powers that FSOC—

Mr. GARRETT. I understand that.

Secretary LEW. Only FSOC has the power to impose—

Mr. GARRETT. I understand that.

Secretary LEW. —a regulatory burden on—

Mr. GARRETT. So is there a process, nonetheless, of due process for the companies—

Secretary LEW. There is an open process where stakeholders share their views and, certainly, governmental entities share their views with the FSB, but it is a different kind of a process. So I don't think the same kinds of due process issues apply when you are not designating a firm with the consequence—

Mr. GARRETT. So it is not a due process, it is a different process, is what you are saying?

Secretary LEW. I am saying you are comparing apples and oranges. FSB and FSOC are very different. So there is an appropriate set of due process concerns—

Mr. GARRETT. Within that process right now, the FSOC is asserting its authority with regard to new roles with their disclosures to asset managers and the like, and I am sure you are familiar with that.

Secretary LEW. Yes.

Mr. GARRETT. And I know the FSOC had previously been looking at that issue.

Until the SEC finalizes that, will you go to the FSB and suggest that they make no final determination with the asset managers?

Secretary LEW. Congressman, I think there is a more basic issue, which is that we are—

Mr. GARRETT. I am not asking about the basic issue. I am asking one question.

Secretary LEW. I don't think the FSB's process and our process are at all identical.

Mr. GARRETT. I understand that.

Secretary LEW. We have our own responsibility—

Mr. GARRETT. You just said that. So what I am asking you is, as a member of FSB, where you have told us repeatedly it is done on a consensus basis, I am asking, when you go back and try to get a consensus, will you say as your position is until your regulator, the SEC, which is working on this, you would ask FSB to stand down for now until this decision is made over here.

Secretary LEW. What we are doing at the FSB is trying to make sure that it is a thorough, complete review. They—

Mr. GARRETT. I gotcha.

Secretary LEW. —are proceeding in a similar manner—

Mr. GARRETT. I gotcha. I understand all that. You are being thorough, diplomatic, and all the rest.

Simple question: Until the SEC finishes their process, will you use your capacity to say the FSB should stand down in this area? That is a simple yes-or-no question too.

Secretary LEW. I don't know the precise schedule at the FSB, so I—

Mr. GARRETT. I didn't think that you did. I am just asking you, would you—

Secretary LEW. I don't think that the FSB can time all of its actions around—

Mr. GARRETT. I doubt that they can. But can you assert your authority in that regard to try to do so?

Secretary LEW. Look, this consensus process, let's understand what it is about. It is about trying to drive the world—

Mr. GARRETT. No, I am not asking about a consensus process. I am trying to ask you whether you will use your authority as the American Secretary—

Secretary LEW. I don't know. I would have to—

Mr. GARRETT. —of the Treasury to represent the American companies on their behalf?

Secretary LEW. I would have to look at where we were and where they were and make a judgment at the time.

Mr. GARRETT. Yes. Well—

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentlelady from New York, Ms. Velazquez.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Mr. Secretary, we have held a number of cybersecurity hearings this year both in this committee and in the Small Business Committee to examine the toll of cyber attacks on consumers and businesses. Many of the witnesses stated that a clear, uniform set of rules was needed to address this problem.

Can you elaborate on FSOC's proposal for a national plan to respond to cyber threats that you mentioned in your testimony?

Secretary LEW. Thank you, Congresswoman. This is a hugely important issue in every sector of our economy and our country because, truly, there are exposures to cyber risk everywhere.

The financial sector, I think, has been a leader in taking it seriously. And the largest firms are putting enormous resources into trying to put systems in place that are effective.

One of the things that we have done as a government that I think is very important is our National Institute of Standards (NIST) has put out best practices. We have encouraged the private sector to use best practices. I have certainly encouraged other financial regulators to have the same view.

I think that we are at kind of a moment where it is not just a question of what does a firm do itself, but you have to ask what are the policies a firm has with regards to who it will do business with. A lot of the exposures come not directly at the firm but when a third party connects to the firm.

Ms. VELAZQUEZ. Right.

Secretary LEW. So those firms do not just have to worry about what are they doing, but do they have good standards as to who they will do business with. And our goal ought to be to bring all of those parties to the highest standard.

I think it is premature to talk about having a single national standard that is mandatory. We have put it out as a voluntary standard. I think many are going and using that standard. And I think it is something we have to continue to look at.

Ms. VELAZQUEZ. The cost is an issue, especially for small businesses. Do you have any type of interagency working relationship on this matter like the Small Business Administration (SBA)?

Secretary LEW. We do work across agencies in many areas. In particular, there are connections between, say, the utility sector and the financial sector, because if your power goes out, you are obviously going to face a risk.

I am not familiar with what the SBA's program on this is. In the financial area, one of the things that we have focused on is the need for smaller financial institutions to be able to work together or through organizations so that they can pursue best practices together, because the burden for any individual firm would be too high. That is one of the reasons it is so important to have legislation in this area, to make the collaboration between firms easier and less risky for them.

We have been very much supporting the enactment of cyber legislation, but even pending the enactment, we have put out Executive Orders to try and pave a way for firms to work together.

Ms. VELAZQUEZ. Thank you.

As you mentioned, lending standards have decreased as financial institutions try to find profitability in the current low-interest-rate environment. While the loosening of credit markets since the recession is beneficial for small businesses, too much risk-taking could again lead to problems.

If interest rates were to rise, what impact will this have on the markets overall and specifically on access to capital for small businesses?

Secretary LEW. Congresswoman, I think that there is at some point a tradeoff between access to credit and risk-taking. We have raised concerns over the last couple of years that in some cases there may by an overadjustment, where—if you look at the FICO scores for home mortgages, the averages have gotten very high. There are a lot of not very risky potential borrowers who are having access-to-credit issues.

Some of that requires a clarification of some of the policies put in place. It is why some of the agencies have been addressing the issues like put-back risk.

Now, why am I answering a question about small-business lending with housing issues? I think we all know, for a lot of small businesses, the pathway to credit, in part, is through their personal home equity, their home mortgages.

Ms. VELAZQUEZ. Sure.

Secretary LEW. So the two are related.

We have done a lot through our programs to reach out, both through the SBA and through programs we at Treasury run, to make credit available to small businesses. We work with the community banks and local lenders to encourage that lending. I think it is an important question.

I do think, as we come out of the—through the financial crisis into a period of calmer macroeconomic circumstances, that is an important time for more lending activity to be appropriate.

The question isn't, do financial institutions have no risk, but do they take reasonable risks, and are they not overly leveraged?

Ms. VELAZQUEZ. Thank you.

Chairman HENSARLING. The time of the gentlelady has expired.

The Chair now recognizes the gentleman from Missouri, Mr. Luetkemeyer, for 5 minutes.

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

And good morning, Mr. Lew.

Secretary LEW. Good morning.

Mr. LUETKEMEYER. I was kind of taken aback by your report. This morning in the Washington Times, there is a report that CBO put out, I think yesterday. I don't know if you have seen the article yet with regards to—

Secretary LEW. I haven't seen the article. I know the report.

Mr. LUETKEMEYER. Okay. Thank you.

And they make the comment here that—the headline is, "CBO Warns of Financial Death Spiral from Debt." The first line says, "Rising Federal debt threatens to choke off economic growth in a decade, beginning a death spiral that will sap revenue from government programs even as demand grows, forcing the government to borrow even more."

And one of the things—in your testimony here, your second paragraph, the first line says, "The Council was created to identify and respond to vulnerabilities in the U.S. financial system and provide a mechanism for agencies to talk to each other and take collective responsibility for addressing potential threats to financial stability."

And yet, in your report, I don't see anything about debt. Am I missing something?

Secretary LEW. Congressman, I think if you look at the risks to our economy from Federal spending and debt, we are in a much better position now than we were 6½ years ago. We have reduced the deficit as a percentage of GDP and in dollars at a historically quick rate. And that very report makes clear that over the next 10 years, we are in a pretty stable place.

I think the thing in that report that people are concerned about is the long term. And, obviously, there are still—

Mr. LUETKEMEYER. That is not what it says, Mr. Secretary. That is not what it says here. It says the long-term outlook for the Federal budget has worsened dramatically—

Secretary LEW. No, I said over the next 10 years. That report goes out far longer than 10 years. And I think that the issue of—

Mr. LUETKEMEYER. So we have just a little blip in the screen here—

Secretary LEW. No.

Mr. LUETKEMEYER. —and then we go back a little lower part of the curve, and then we go back up again?

Secretary LEW. I think if you look at where we were in 2008–2009, we were careening towards a very treacherous place. We have stabilized it, and it is improving. We still have long-term challenges, and—

Mr. LUETKEMEYER. Mr. Secretary, if you just quote the President and use his analogy of a car in a ditch, we are not out of the ditch yet, we are still trying to struggle to get out of there. We are bumping along here with an annual growth rate of what? Less than 2 percent, 1 percent, something like that, of our GDP?

And here CBO says—and the point I am trying to make is, CBO points out the debt is a problem for our economy, and yet your report does nothing, says nothing about it. And you are supposed to be an agency that points out these problems.

My question is, why did you not point out that debt is a problem for our economy?

Secretary LEW. Our report appropriately looks at the threats to financial stability, and—

Mr. LUETKEMEYER. So you don't consider it a threat?

Secretary LEW. I think that if you look at where we are today versus 6 years ago, the Federal deficit has been brought under control for the next decade.

Mr. LUETKEMEYER. Yes, but part of—

Secretary LEW. We are in a period where we need to get the economy growing; I totally agree with you. Our conversation should be about what can we do to grow the economy.

And we know there are things we could do. We could have an infrastructure program in place. We could have immigration reform. There are lots of things we could do to grow our economy.

I don't think, right now, the debt 20, 30 years from now is the thing that is holding our economy back.

Mr. LUETKEMEYER. I think you have missed the boat, quite frankly. CBO points it out. There is nothing in here. I think we are missing the boat. We have dropped the ball on this.

Next question. One of the concerns I have, as the chairman of the Housing and Insurance Subcommittee is that we have a situation where we have designated some insurance companies as SIFIs. And one of the things is, that is fine if you feel there is that much risk there. We have asked before, quite frankly, to give us the criteria on which you based your analysis, and we have never gotten it. We had an Under Secretary who was here not too long ago who actually did a very good job of getting me the analysis on this.

But I think part of your job, also, is to figure out how to de-risk things. You pointed out there is a problem. Okay, how do we get the problem solved? And I think that is also what is in your report. In your first line here, it talks about addressing potential risks to find ways to get back to financial stability.

So how do we de-risk your—do we have criteria in place yet to de-risk a SIFI, an insurance SIFI?

Secretary LEW. The analysis that led to firms being designated is laid out clearly in the record that is quite public. And I think each of the firms understands why they were designated.

The question of how they—you are really asking how could they exit, because de-risking would mean they would no longer be.

Mr. LUETKEMEYER. Right.

Secretary LEW. We have made clear that we are going to review regularly, annually, the status of the firms. We have done that with the firms that have been designated. And—

Mr. LUETKEMEYER. Okay.

Secretary LEW. —if a firm changes its business model and has less risk, it would no longer be designated.

Mr. LUETKEMEYER. I see my time is up. I will yield back. Thank you, Mr. Chairman.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from New York, Mr. Meeks.

Mr. MEEKS. Thank you, Mr. Chairman.

Mr. Secretary, I want to go somewhere else, but I just have to say, I think, from what you were talking about, how we are better off than we were 6 years ago—and I wish my colleagues had talked about the person, and when they had the opportunity to stop the person who drove the car into the ditch in the first place, that caused us to have this debt and all this problem. So then when someone else comes along and says, okay, I am going to help you get out of this ditch that I didn't drive you in—but I am going to get you out of the ditch now. And you start pushing them to get them out of the ditch. Now, you might not be going 100 miles an hour yet. You are going maybe 50 miles an hour. But now you are no longer in that ditch. You are out the ditch, and you are moving in the right direction.

But yet you want to blame the person who is getting you out of the ditch instead of the one who put you in the ditch in the first place. And that is where we are today. We were in a ditch in 2008, and now we are driving ourselves out of the ditch. That is where we are today.

Let me go to where I really want to go to, Mr. Secretary, dealing with asset management. That is what I have been looking at, dealing with FSOC and the work-around, the asset management and that industry. And I know they don't assume all of the risk as banks, that we look at them differently.

But I did see in one of the reports, however—and I am concerned about herding. I think that was in an FSOC report, or OFR, et cetera. And we have a lot of investments there. Should we be concerned about this process of herding?

Secretary LEW. Congressman, I think that, obviously, asset management has grown as a sector, and there are a lot of individual and institutional assets there. We have been looking carefully at this question for some time. The risks are not necessarily just firm-specific. That is one of the reasons that we are looking across the industry at activities to ask, are there activities that are particularly risky?

We have not reached a conclusion. I am reluctant to give a view until we have reached a conclusion. Because, frankly, we have entered the process, as have regulators around the world, trying to understand and learn about a growing and somewhat new industry. We have identified that as a question. I can't prejudge what the answer is.

What I can tell you is that it is important that we complete the process and that it be driven by facts and by analysis. And if there is action that needs to be taken, the appropriate regulatory body should do so.

I think the notion that you cut these questions off because you think you might not like the answer or because you think you know the answer is exactly what got us into trouble in 2007 and 2008. We have to be willing to ask the questions and, even if the answers end up being hard, follow them to a logical analytic conclusion. I think that is what FSOC is doing, and I look forward to that process being completed.

Mr. MEEKS. So let me ask—and I know on some municipal levels and State levels where we have multibillion-dollar pension plans that have tried to benefit from a greater diversification of asset management by using more emerging and diverse asset managers, which are generally smaller asset managers. And some are minorities and women who have selective investment strategies. However, I am finding that these small managers face real barriers that prevent them from gaining more market shares.

Has the Treasury or FSOC looked into how we can get more diversification of managers in this industry?

Secretary LEW. I don't know that FSOC has looked at it. As Treasury Secretary, I have looked at it. And I think that if you look at the performance of the smaller and minority-owned managers, there is not a huge difference. Some are successful, some are not. The same is true with the large managers. Some are successful, some are not. Some have good years, some have bad years.

I think one of the problems is that there is a tendency to bulk things up because it easier to deal with a few rather than a lot of managers, and we need to push back on that. We need to make it clear that the door has to be open to new participants in this space.

And we have tried through a number of things we have done to have that be the approach, both in terms of how we have managed some things within Treasury and through other intergovernmental efforts we have had. I think we are making progress, but there is more progress that needs to be made.

Mr. MEEKS. Okay. Because as these asset managers get bigger and bigger, they play more and more of an important role in the sourcing of capital to businesses that create jobs in various communities. And so, that is one of the reasons why with banks we had to go to the Community Reinvestment Act in the 1970s.

So don't you think we should be looking into some policy that can ensure that we have more inclusion in the asset management industry so that we can also make sure that they are investing or reinvesting in some of our other communities?

Secretary LEW. I think it is important for there to be broad participation and for the process to be open. I don't know that I would think you should have, kind of, mandatory targets. But I would be happy to follow up with you. And it is a matter I have a great deal of interest in and would like—

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Michigan, Mr. Huizenga, chairman of our Monetary Policy and Trade Subcommittee.

Mr. HUIZENGA. Right over here, Secretary Lew.

Secretary LEW. Everybody has moved around. I don't know where to look.

Mr. HUIZENGA. Sorry about that.

So, unfortunately, I have 5 minutes, not 15 minutes, so I am going to try and quickly and respectfully move through a number of things.

I, too, received the email at 11:18 last night and the answer to my questions on a few things from 3 months ago.

Congratulations. You were actually very clear on one of my questions regarding financial services trade negotiations. I asked for you to explain why Treasury continues to oppose including financial regulatory matters in TTIP. This is the most clear answer that I think I am aware of and I think the committee has seen. You say TTIP is not, however, an appropriate or necessary vehicle for addressing financial regulatory cooperation. You claim that it is already happening at the Financial Stability Board, international standards-setting bodies, and a number of others.

I disagree with the answer. I think it should be included. But I appreciate your clarity. However, it does lead me to another question, which has to do with local storage data requirements that many in Europe are starting to push.

And it is my understanding that the Administration has highlighted the free flow of information across the digital world as sort of a centerpiece of the negotiations for both TPP and TTIP, which is, again, a provision I fully support. I am confused as to what that difference without a distinction might be, as to why you are going to be doing that, since it is—it makes a tremendous amount of sense to have us negotiate with our partners in this if it is bad for American business. But, again, you exclude financial services.

And I am curious, is it the Administration's position that we are seeking to prohibit local storage requirements for everything except for financial services?

Secretary LEW. No. We have been very firm on the issue of putting nontariff barriers in place where you have a local storage requirement for electronic data.

I think the distinction is easy to make, and I have tried to be clear in this committee before. We view prudential regulation as something that ought not to be brought under trade negotiation or a trade process. And that is the difference. It is not prudential regulation to say that there shouldn't be a nontariff barrier—

Mr. HUIZENGA. So you are willing to have the financial services sector treated differently than any other sector of the U.S economy in the trade negotiation?

Secretary LEW. In general, trade agreements do not bring prudential matters or—

Mr. HUIZENGA. We have the Europeans—

Secretary LEW. We said "no" to the Europeans on this.

Mr. HUIZENGA. Yes, the Europeans would like to do it. And it seems very odd and, I think, a huge mistake.

Secondly, I do want to quickly move on to the IMF and Greece. Would you agree or acknowledge that the decision to bend the rules, shall we say, if not ignore the rules regarding Greece on the exceptional access framework, which was done with Treasury's concurrence, was a mistake?

Secretary LEW. I think that the actions taken in 2010, 2012 to avoid an economic crisis in Greece were the right thing for the IMF and the right thing—

Mr. HUIZENGA. So it was not a mistake?

Secretary LEW. —for the United States.

Mr. HUIZENGA. Okay. But just so I am clear, it wasn't a mistake?

Secretary LEW. At the time, Greece said—

Mr. HUIZENGA. Okay. So now, looking back, do you think it was a mistake?

Secretary LEW. No. And if I could just take—

Mr. HUIZENGA. I will take "no" as your answer. That is fine. Because there is a discussion of putting those rules back in place at the IMF. That is something that the IMF board is interested in. And I am curious why the Administration, from my understanding, is opposed to that. Why?

Secretary LEW. So, look, I think that there are occasions when it would be important for the IMF to have flexibility—

Mr. HUIZENGA. So the rest of the IMF board, excluding us, wants to put those rules back in place because they believe that what happened with Greece was a mistake . But you—

Secretary LEW. I think that is not exactly where the conversation in the IMF is. There is a serious conversation—

Mr. HUIZENGA. I have had a number of conversations with folks from the IMF and involved with the IMF, and I am not sure that is an accurate portrayal—

Secretary LEW. Congressman, there is a range of issues, and I think it is important to distinguish them. There is the exceptional access issue itself, and there is a question of how to proceed into a new world of debt reprofiling. We have tried to—

Mr. HUIZENGA. We also have the temporary new arrangements to borrow. And I know that the Administration has been trying to use that as a reason to not necessarily go into IMF quota reform. But it seems to me, if we are not going to address this exceptional access framework—

Secretary LEW. Congressman, if I could just take—I know you are running out of time, but if I could take half a minute to respond—

Mr. HUIZENGA. I am happy to take a private meeting later about this, but—

Secretary LEW. I would be delighted to—

Mr. HUIZENGA. —we can only get you up here twice a year, so—

Secretary LEW. This is a hugely important issue. Obviously, quota reform is critical to the U.S. place in the world, and we are working very hard to get quota reform enacted.

I think exceptional access has serious questions. I have never pushed back on the kinds of questions you are asking, and I am open to a serious conversation about it. I think, looking forward, finding a way for the IMF to avoid having to use tools like that is in all of our interests, and I would be happy to have a conversation.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Massachusetts, Mr. Capuano.

Mr. CAPUANO. Thank you, Mr. Chairman.

Hello, Mr. Secretary. How are you doing?

Secretary LEW. I am fine.

Mr. CAPUANO. Are you familiar with Major League Baseball?

Secretary LEW. I have heard of it.

Mr. CAPUANO. Are you familiar with the team called the Boston Red Sox?

Secretary LEW. I have.

Mr. CAPUANO. So you purport to be an expert in baseball. Mr. Secretary, can you tell me what is wrong with the Red Sox right now?

Secretary LEW. That is a long—

Mr. CAPUANO. No. Then you refuse to answer that question. I need to know, is it the pitching? Is it the fielding? Is it the hitting? Come on, Mr. Secretary, answer the question.

Secretary LEW. I am—

Mr. CAPUANO. I can't believe you refuse.

If you won't answer that question, can you answer me why the Republican baseball team can't seem to beat the Democrats? Come on, Mr. Secretary, answer the question. You have plenty of time.

Oh, well, okay, if you refuse to answer the question, I guess I will have to move on to some other areas. Because I just wanted to show that I guess badgering is not the exclusive realm of some of my colleagues. We can badger, too. But it doesn't produce much. So—

Secretary LEW. As a Mets fan, I am showing great self-control, though.

Mr. CAPUANO. Mr. Secretary, for everybody's sake, in your next FSOC report, can you put a chapter in there on debt? You have a great story to tell. I think my colleagues actually raise a good point. Debt, in theory, could be a risk to the economy, and you have a good story to tell. It would satisfy everyone, including me.

Secretary LEW. I understand. And, look, we could discuss it and say why we don't think it is a risk. The report focuses on the things that we think are risks.

Mr. CAPUANO. But I—

Secretary LEW. It is a fair point.

Mr. CAPUANO. Yes. Just, if you do it the next time, at least you take one of their arguing points away and you make some good points.

Secretary LEW. Yes.

Mr. CAPUANO. And I think it is a fair thing to discuss.

With that, I am going to move on to a couple of things that are not directly related to FSOC but indirectly related to it.

First of all, I would like to talk about Fannie and Freddie. Have Fannie and Freddie paid back every penny of the money that they borrowed from the American taxpayers?

Secretary LEW. They have, I believe, just—

Mr. CAPUANO. The answer is "yes."

Secretary LEW. I believe the answer is "yes," but—

Mr. CAPUANO. I know it is. I am asking a question I know the answer to.

And, by the way, haven't they also paid back billions upon billions of dollars above what they borrowed?

Secretary LEW. Yes. I think I understand where you are going, Congressman.

Mr. CAPUANO. I hope so.

Secretary LEW. And I think what they have not done is they have not removed from the Federal Government, the Federal taxpayer, the risk that goes with those institutions having the backing of a Federal backstop.

Mr. CAPUANO. I understand that. But the money that they are paying now above and beyond the money they borrowed, where does that money go?

Secretary LEW. It goes to the Treasury.

Chairman HENSARLING. It goes to the general Treasury. So, basically, homeowners who have a mortgage—

Secretary LEW. And so does the risk—the support that goes behind the risk—

Mr. CAPUANO. I supported all that. I am not—I totally agree with everything that was done up until they paid back their loans.

Secretary LEW. Yes.

Mr. CAPUANO. My problem is they paid it back, they are stable, they are heading in the right direction, and it is time to get back to more business as usual. Because, like everybody else, I want to keep homeowners keeping their own money, to the best of our ability. Yes, there are interest rates, and, yes, there is some risk. But their dollar-for-dollar risk—right now they are simply contributing to the Federal Reserve—to the general Treasury account, and that doesn't seem fair to me.

It strikes me that if we are going to have a general Treasury account, either we should tell people we are charging you extra because you have a service or we are increasing your taxes—neither one of which, it seems to me, is fair. But, in this case, you are charging them through their mortgage for something that is unnecessary at this point in time.

Secretary LEW. Yes. That is not the way I look at it. I see—the GSEs are still in conservatorship, which means the Federal taxpayer is directly standing behind them if they fail in the future.

Mr. CAPUANO. They have done that from day one, and you weren't—

Secretary LEW. Well, no. From day one, there was an actual denial that there was a backstop. It is now clear there is a backstop.

Mr. CAPUANO. Who denied that?

Secretary LEW. It was in law.

Mr. CAPUANO. I would respectfully and strongly disagree, and I think facts pointed out that I was right.

Secretary LEW. No. I think that we have seen over the last several years the estimates of the potential risk of a problem in the GSEs is still quite large. So—

Mr. CAPUANO. I understand. But if the money were going to a separate account to sit there and build up some kind of capital reserve, I think you would have a fair argument.

Secretary LEW. But the liability is borne generally.

Mr. CAPUANO. But the money going into the general Treasury doesn't bear up, in my estimation.

Secretary LEW. The liability is borne generally, yes.

Mr. CAPUANO. Number one, they deserve their money back now that they are stable. Number two, homeowners deserve lower interest rates unless they are being told what the money is used for. And right now some of their money is being used to support something other than Fannie and Freddie. So I guess we will have to disagree on that.

And I guess with the last few seconds, I wanted to follow up with something that I brought up with Mr. McRaith, who I think is also doing a great job. However, it strikes me that FIO and possibly FSOC is pursuing a backdoor way to take over regulation of U.S. insurance companies via international agreement.

Now, that may be a little overstatement, and I am not a "black helicopter" guy, I kind of overstated it to make the point. But it certainly strikes me that some of the agreements we are about to make with some our international friends may be pushing a little too far.

With that, I will have to yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Wisconsin, Mr. Duffy, chairman of our Oversight and Investigations Subcommittee.

Mr. DUFFY. Thank you, Mr. Chairman.

Welcome, Mr. Lew. Obviously, you are the Treasury Secretary, not the coach of the Red Sox, and therefore we are not going to ask you questions about their failings. We would note that they are doing better than the Brewers, which says a lot about the Brewers.

But if you were the coach, we would expect you to answer the questions that we have about baseball. And when we asked questions, we would hope that you wouldn't give us answers about the history of baseball and how it came to be and you could talk about the history of Fenway. But you would actually answer the question of what is wrong with the Red Sox.

You had a lot of questions today about the liquidity in the bond market. And I think the chairman brought out, is this related to Volcker or other rules and regulations that have caused banks and traditional market makers to leave the space.

And I want to give you a chance to answer that question. Is this something that you are looking at? Do you think the rules and regulations that have come since the crisis have had any part in the lack of liquidity in the bond market?

Secretary LEW. Congressman, I think that to answer the question fully would take quite a long time, because it is a very complicated issue.

Mr. DUFFY. The Red Sox are complicated too.

Secretary LEW. And I had tried to indicate that we are open to looking at any of the possible costs.

Mr. DUFFY. This is not a "gotcha" game at all. You identify risk in the markets, right? That is your job. And you do come in, and you talked about cyber, and you talked about other things that are very complicated, that we can't wrap our heads around, but you tell us where you see those risks.

And so it is a very simple question, because a lot of the commentators will say: Listen, it is complicated. There are a lot of reasons why there is a lack of liquidity in the bond market. But they will unanimously point out that one of the causes could be the new regulatory regime and its impact.

The commentators can talk about this, but you are not willing to answer that question today?

Secretary LEW. In fairness, Congressman, I am offering a much more detailed answer than the commentators. Most of the commentators that I have heard, with some self-interest, have jumped to one explanation.

Mr. DUFFY. You do this really well. So I ask you about liquidity in the bond market, and I mention commentators, then you will start to talk to me about commentators and the history of commentating and the articles that are written.

Listen, are you unwilling to answer this question because the dogooders who are looking for risk are actually the ones who are potentially creating the risk in the market? And so, if you tell us, yes, this could be a cause of the lack of liquidity in the bond market, you have to look at yourself. You have to look at the regulatory regime that has taken place since the financial crisis, and you don't want to admit that today.

That is not badgering. I think that is a fair question. And to say that it is too complicated to answer, I don't understand that, Mr. Lew. Give us a straight-up shot. What is it? Yes or no?

Secretary LEW. I think that if you look at the many factors that are at work right now that are having an impact on liquidity, it is not my view that financial regulation is the principal thing that requires our attention. I have not said we shouldn't look at it, and I think these other factors are very clear.

Mr. DUFFY. I don't know whether you were a tap dancer when you were young. I didn't ask if it was the principal. This goes back to what the chairman was saying. You are playing with words. Is it a contributing factor, which goes back to the point the chairman made, is it a contributing factor, the rules and regulations? Are you looking at that? Is it a contributing factor? Not the main factor, not the only factor, but a contributing factor? Yes or no?

Secretary LEW. If you look at liquidity, you have to look at different parts of the market.

Mr. DUFFY. I know. I know.

Secretary LEW. And if you are looking at Treasuries, it is different than if you are looking at high-risk bonds.

Mr. DUFFY. I am going to ask you a yes-or-no question. Are you looking at FSOC, yes or no, at whether the rules and regulations are having some impact on the lack of liquidity in the bond market?

Secretary LEW. We are looking at all of the factors that could contribute.

Mr. DUFFY. So you are looking at that?

Secretary LEW. We are looking at all of the factors that could contribute.

Mr. DUFFY. So this is one?

Secretary LEW. I am saying that as Secretary of the Treasury, it is something that many of the members of FSOC in their own agencies are looking at as well.

Mr. DUFFY. Mr. Lew, this isn't complicated stuff. We ask you simple questions and I think we are entitled to get straight answers from you. And I think if you think, listen, the rules and regulations that come have no impact, the commentators are wrong, banks and market makers have left the space, but that has no direct correlation with the lack of liquidity, tell us that.

Secretary LEW. Congressman, I think that the financial reform has made our system safer and sounder than it was. We have a stronger economy because of it. Liquidity is still deep.

Mr. DUFFY. Is it creating a risk too?

Secretary LEW. And I think that when we look at the issues related to liquidity, we should look at all potential factors. I identified the things that I am aware of.

Mr. DUFFY. One quick question: Do you support TPA like the President?

Secretary LEW. I do, very strongly.

Mr. DUFFY. Duly noted.

I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentlelady from New York, Mrs. Maloney.

Mrs. MALONEY. Thank you so much, Mr. Chairman.

And I am very pleased to welcome one of the favorite sons of the great City of New York. It is very good to see you.

Secretary LEW. Thank you.

Mrs. MALONEY. And I regret I had to chair another meeting and I just got here. But I want to follow up with something that was raised by Ranking Member Waters earlier. And while my good friends on the other side of the aisle have criticized FSOC for not being responsive to their document request, I would like to point out that FSOC did make 1,400 pages of confidential documents available to this committee. And my staff and I believe the staffs of many other Members on this side of the aisle have been over there to Treasury and reviewed these documents.

And these were confidential documents laying out the detailed reasoning behind the FSOC's decision to designate individual companies as systemically important, which was exactly what the Majority asked for. So I think supplying 1,400 documents for review is being responsive, and I just want to make that very clear.

Now, I would like to ask you, Mr. Secretary, you said earlier that the issue of bond market liquidity is a legitimate one, but we should be very careful about assessing the causes of the lack of liquidity. And I agree with you. I don't think we have any definitive answers yet, but I think it is an incredibly important issue.

I think it is also important to focus on potential problems in the Treasury market rather than other markets, because the Treasury market is a $12 trillion market that determines the borrowing costs in so many other key markets as well.

You mentioned the huge swing in the Treasury market on October 15th of last year and said there was no evidence of a breakdown in the market that day. And I agree with you. On October 15th, trading was continuous and trading volume was heavy. So was it really a lack of liquidity driving the wild price swings or was it something else?

Can you give us some more context for what the FSOC has found so far as it has looked into this issue?

Secretary LEW. Thank you, Congresswoman.

We have worked at Treasury, together with other agencies that look at the market carefully, and tried to follow the transactions that day to understand what actually happened. And there was a huge amount of volume, and there was this 15-minute period when there was a price spike. But there was not a breakdown in the market. It is something we have to ask what happened then and what do we learn from it going forward.

There was a huge amount of electronic trading going on. Market structure has evolved, and one of the things with technology is you never go back. So we have to deal with the reality. And there are many positive things about electronic trading, so I don't say that critical of the development of electronic trading. But that changes the structure of a market.

We are looking at that. I can't sit here today and say I have a clear answer. We are hoping over the course of the next few weeks to complete our analysis so that we can offer a more definitive view.

But what I was trying to say before is that there was a desire to jump to a conclusion that somehow financial reform caused October 15th. We see no link between financial reform and what happened on October 15th. Maybe others will find it. But it is why we have to be so careful when we ask these questions about liquidity to treat a very complicated issue the way it should be treated.

I have not ruled out looking at any of the contributory possibilities from any policy area or market condition. But we also ought not to jump to a conclusion, which many did very quickly in a way that I can understand why they did, but it doesn't mean it is right.

And the Treasury market remains the deepest and most liquid in the world. There are other areas of the market where there are some questions about liquidity that are quite legitimate, where they are not electronically traded, so that is different, where the huge volume of corporate bond issuances raises some questions about would there be a good liquid market if there were a very stressed day. We are looking at all those questions. We take them very seriously.

One of the things, you have to separate the different kinds of liquidity, because if it is a question of institutions keeping high-risk proprietary investments on their balance sheet or not, that is not something we should go back to. We have a system that is safer and sounder because we have moved away from that.

Mrs. MALONEY. Thank you. I look forward to your report, and I hope you will personally brief Members of Congress.

Secretary LEW. I would look forward to it.

Mrs. MALONEY. I think it is critically important.

And my time has expired. Thank you very much.

Chairman HENSARLING. The time of the gentlelady has expired.

The Chair now recognizes the gentleman from Pennsylvania, Mr. Fitzpatrick, chairman of our Task Force to Investigate Terrorism Financing.

Mr. FITZPATRICK. Thank you, Mr. Chairman.

And thank you, Mr. Secretary, for your time here.

We have had a couple of hearings of the Task Force to Investigate Terrorism Financing. And I have a series of questions here, which I would like to sort of make part of the record rather than go through them today and ask that the Secretary give us a timely response.

Secretary LEW. Sure. I would be happy to respond.

Mr. FITZPATRICK. I will submit them to the Chair.

I actually wanted to follow up on some questions and your quick responses from my friend, Mr. Capuano of Massachusetts, with respect to the national debt.

It was being referred to as the national debt, which is not in the FSOC report, it is not even identified, that, number one, the national debt is a good story, it is a good story to tell about the national debt, and, number two, it is not a threat to our economy. And I think that you answered both in the affirmative. Do you agree with that?

Secretary LEW. Again, it is a complicated question. I was OMB Director 3 years with a surplus. I believe in having a fiscal policy that lasts for the long, long term. I think if you look at what we inherited, the stability that we now have is a world of improvement, and there is still work to do 30, 40 years from now.

Mr. FITZPATRICK. But, Mr. Secretary, the question is the debt itself, which in 2008 President Obama referred to as a $10 trillion national debt is unpatriotic and immoral. Today, there is a debt clock, it is right above us at the hearing, $18 trillion, $159 billion—it is going up a million dollars a minute.

Secretary LEW. It has come down.

Mr. FITZPATRICK. Is it a good story?

Secretary LEW. It is a good story. The deficit has come down as a percentage of GDP faster than at any other point.

Mr. FITZPATRICK. That deficit started coming down, there was a new Administration, a new Speaker who took office in January of 2011, and because of fiscal restraint, restraint of Federal spending and growth of the economy, the annual operating deficit is coming down. But it is not zero yet and the national debt continues to rise. Is that a good story?

Secretary LEW. I don't think it would be good for our economy if we were to have a balanced budget today. Right now, we have an economy which many of you have said isn't growing fast enough. We need to continue to look at keeping the economy growing and keeping an eye on the long term. Having a stable fiscal posture for 10 years is huge progress.

Mr. FITZPATRICK. Mr. Secretary, a couple of years ago the then-Chairman of the Joint Chiefs of Staff described the national debt as the greatest threat to our national security. Is an $18 trillion debt a threat to our national economy?

Secretary LEW. At the time, our deficit was in double digits. It is now coming below 3 percent of GDP.

Mr. FITZPATRICK. I am not asking about the annual operating deficit. I am asking about the national debt.

Secretary LEW. The debt as a percentage of GDP has stabilized for this period of time. We have made enormous progress. It was climbing and it is has stabilized.

Mr. FITZPATRICK. Mr. Secretary, last month you referred to a proposed amendment to combat currency manipulation in the Trans-Pacific Partnership as a poison pill. But also last month, the President said he was opening new efforts to combat currency manipulation abroad.

Can you describe what efforts or what ideas the Administration might have, what the role of the Treasury would be, and whether you think they could be effective?

Secretary LEW. Sure. The President and I personally take this extremely seriously. We put in enormous effort through our multilateral and bilateral engagements to use the tools we have. And we have had considerable success. We have helped push China into a different policy and Japan into a different policy. So I think we are using the tools, and we are using the tools well.

In the trade legislation that is moving through Congress, there are additional tools. One is that there is a negotiating instruction that says in TPP currency issues are a high priority. And we are working with our TPP negotiating partners to arrive at agreements that will give us more visibility and more ability to use the consultative process and the public disclosure to get them to do the right thing.

Mr. FITZPATRICK. But can you identify the ideas the Administration was referring to last month?

Secretary LEW. And then I was going to say there is an amendment that we support that Senator Hatch and Senator Bennet put in, in the Senate, which puts new tools in place, which requires that we do an evaluation based on objective criteria as to whether or not countries are violating what we would consider fair currency practices. If they are in violation, it puts us in a position where there are several new tools, including not being able to be in trade negotiations with countries that are violating. So I think we have important new tools in the trade law.

Mr. FITZPATRICK. I want to get a question on Treasury's budget. The President identifies the budget as a compilation of our Nation's priorities. FinCEN and the Office of Terrorism and Financial Intelligence (OTFI) have been relatively flat-funded. Congress has met, probably even exceeded the President's request, specifically on FinCEN. I want to say that the organizations within the Department of the Treasury do an outstanding job with the resources that they have.

Secretary LEW. Thank you.

Mr. FITZPATRICK. But we see terror growing, the challenges globally every single day, new organizations coming to light every single month. What can you tell us about—

Secretary LEW. Congressman, I couldn't be prouder of our offices that work on threats.

Mr. FITZPATRICK. Do they have sufficient resources?

Secretary LEW. They do have sufficient resources, and they punch way above their weight. But if we thought we needed more resources to do the job, we would ask for them.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Massachusetts, Mr. Lynch.

Mr. LYNCH. Thank you, Mr. Chairman.

First of all, I think you are doing a great job, Mr. Secretary. And I know we had a disagreement last week on TPA, but never in my time knowing you have I ever heard you address Congress or the American people with disdain. That is something not in your makeup or character.

Secretary LEW. Reverence would be more like it.

Mr. LYNCH. That is right. And a desire to serve. So I appreciate that. You are a good man. We don't always agree, but I honestly believe you have the best interests of the American people at heart, and the Administration is lucky to have you.

I want to focus on a situation here. When a bank is convicted of a felony or a bank pleads guilty to a felony, we have laws in place. Congress has put forth some laws that say, when they are guilty of these crimes, we remove some privileges that they have.

One of those privileges that they have is that of a well-known seasoned issuer (WKSI). And so we had a recent bout of guilty pleas by big banks, both in connection with LIBOR and also with the FX manipulation of dollar-euro exchange rates.

Normally those banks should be penalized by removing that WKSI designation, which allows them off-the-shelf registration and other privileges. But what has happened is that—I believe Labor Secretary Perez is the one who grants these waivers—I will give you a for-instance. In the latest round of SEC waivers, Barclays just received their third WKSI waiver since 2007. Citigroup has triggered a disqualification 5 times in the last 9 years, and every single time we give them a waiver. We don't penalize them. So there is no difference in how they operate, because we give them a waiver after they plead guilty.

UBS just received a seventh WKSI waiver since 2008. So they broke the law, criminal conviction, all pled guilty. JPMorgan Chase received its sixth WKSI waiver since 2008. And the Royal Bank of Scotland received its third WKSI waiver since 2013.

And UBS, going back to UBS, their last WKSI waiver occurred while they were still under a nonprosecution agreement from LIBOR. So they immediately failed.

So the penalties that Congress has put in place don't happen because the SEC has given them waivers. And I am just wondering if giving these waivers continually and not punishing these banks is a moral hazard, is causing them to behave just as they always have been, because it seems that way to me.

Secretary LEW. Congressman, let me start by saying I think we have made clear as an Administration that no individual and no firm is above the law, and we will prosecute and we will enforce regardless of who has broken the law.

Secondly, the violations of law that are behind these actions are very serious. They get to the heart of the integrity of our system, things like tax fraud, things like terrorist financing facilitation.

I think that if you look at the prosecutions, if you look at the settlements, the numbers have been very large, and there is no question but that firms are being held accountable.

Mr. LYNCH. But the penalty falls on the shareholders. The penalty doesn't go to any of the individuals who were involved here, and these banks continue to operate. Yes, you are right, there was $2.5 billion in fines, but they just keep on doing what they have been doing. And I have people in my district who are convicted of far smaller crimes, and they do serious time.

Is there another set of penalties that we could put in there that you would actually agree to enforce?

Secretary LEW. If I could answer your first question, then I will come back and answer that last question.

I think if you look at the approach the prosecutors have taken, they have wanted to make sure they could hold accountable financial institutions and the individuals in them and not have unintended consequences that they can't control.

Mr. LYNCH. But these are intended consequences. That is my point. We intended them to be penalized, and they are not.

Secretary LEW. And I would leave it to the regulators to decide the right way to respond. But prosecutors need to know that they are not going to create an unintended consequence.

Mr. LYNCH. No, that is not the point here.

Secretary LEW. I think on your last question, there are a lot of things we could look at in terms of what the practices within the industry are and how you hold individuals accountable that are worthy of consideration.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Texas, Mr. Neugebauer, chairman of our Financial Institutions Subcommittee.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

Secretary Lew, it is good to have you back. I want to refresh your memory a little bit. Back in March, you and I had a conversation a little bit about U.S. regional banks and whether or not they were a systemic risk. And you and I also discussed a little bit, the OFR report in February where they used, I think, five of the Basel standards to analyze a number of banks.

And if you recall, that analysis showed that $50 billion banks were not a systemic risk. In fact, it went pretty far up the asset chain before it reached a point where they felt like those financial institutions were a systemic risk. Yet, Dodd-Frank says that the trigger is $50 billion.

And so I guess my question to you is, as the Chairman of FSOC, is the framework of Basel in conflict with Dodd-Frank?

Secretary LEW. I don't think it is a question of in conflict. The question is, do banks of all size pose the same risk and require the same exact treatment? The answer is no. And we have been very careful in designing rules to try and distinguish different levels of treatment for different firms of different size.

That doesn't mean we have it perfect. There certainly is an openness to looking at issues there. But I have to say that the debate recently has taken on a kind of odd character. There has been discussion of exempting banks of $500 billion or less.

Do you know how many banks there are that are between $500 billion and the biggest banks? There are six banks, the largest financial institutions in the country and the world. So we have to be careful not to ask questions as if a $2 billion bank is it like a $50 billion bank, or a $50 billion is it like a $500 billion bank.

I would be happy to have this conversation. We are open to ideas of how to tier the treatment appropriately.

Mr. NEUGEBAUER. And I guess that kind of leads me into the other discussion that you and I had, and that was about Section 115. I think one of the things is that when Dodd-Frank was passed, it was passed in a pretty hurried manner and not in a very transparent manner, but somebody just picked $50 billion. But then in Section 115 they said, you know what, you all can establish—it gives you the latitude to establish a different trigger or trigger mechanism if you choose to.

And I think, if I go back and look at our conversation, you said that you all had not formally looked into it. You mentioned that you had informally looked into it. But there is, in fact, a process where there can be a formal process where Treasury could go through that process and recommend to FSOC to change that. And I am a little confused.

Secretary LEW. There could be a formal process. But I think if you look, there are a number of regulators taking a look at this issue to see what they can do with their regulatory flexibility. And I think it is a question of when you raise it to the level of a formal review.

I will give you an example of the kind of issue that we have looked at, the frequency of the examination cycle. There is a reasonable case that the frequency should be different for a small institution and a very large institution. So there are ideas here that could be pursued.

The fact that it is not a formal Section 115 review doesn't mean that people aren't asking these questions. If you look within the regulatory bodies, they are looking at them, and we are obviously looking across the landscape.

Mr. NEUGEBAUER. Mr. Secretary, I think it is important to get their input, but the truth of the matter is that under Section 115, those other regulators do not have that authority. Section 115 authority resides in the Secretary of the Treasury, and last I checked, that is you.

I think it is kind of a little confusing here, that we have one entity, OFR, using these Basel standards, saying this is what the world looks like from a systemic risk standpoint, and then we have Dodd-Frank. I think from a banking perspective, it is a little confusing as to what standards should be in place. And I think it is really kind of time for you to take on that leadership role and exercise Section 115 and bring some certainty to the marketplace.

Secretary LEW. I would be happy to continue this conversation with you, Congressman. To be clear, OFR expresses independent views. It doesn't express the views of the Treasury or of FSOC. I am expressing my own views. And they won't always be identical. You wouldn't want them to be identical with OFR, because OFR was put in place to be an independent institution expressing its own analytic view.

Mr. NEUGEBAUER. I see my time has expired, Mr. Chairman.

Chairman HENSARLING. The gentleman yields back.

The Chair now recognizes the gentleman from Georgia, Mr. Scott.

Mr. SCOTT. Thank you, Mr. Chairman.

Secretary Lew, it is good to have you here. You are doing a great job.

Secretary LEW. Thank you.

Mr. SCOTT. I want to keep the conversation for a moment on liquidity. It is a very serious issue. I am very concerned about it. A number of experts are registering great warnings about it. Liquidity, to me, is the key to protecting our financial system. It is also the key to being able to ascertain potential risks to our system. It sort of like provides us with a way to be able to not just look down the road for problems, but see them before they turn that corner.

So I also realize, and I think you would agree, you too are concerned about liquidity, correct?

Secretary LEW. I have said so, yes.

Mr. SCOTT. Yes. And so the issue becomes, will this liquidity worsen as the economy worsens? And specifically, tell me what if there were another crisis? We don't want another crisis. After they finished the Depression, they said they didn't want another crisis. But as surely as we have a free enterprise system, it is free to go up, sideways, down, whatever.

So if we had another crisis, would the financial system, in your opinion, have the liquidity to be able to come to the assistance of our financial system the way it did in 2008 when healthier institutions, it helped us a lot, they had the liquidity, they were able to buy up institutions at IndyMac, Washington Mutual, Countrywide, and Lehman Brothers, rather than the government having to wind them down?

Secretary LEW. Congressman, I think when we talk about liquidity in the markets we are not talking about institutions that merge or don't by other institutions or not. I think what we are talking about is, is there a market for buying and selling bonds in a quick way with stable prices?

So obviously the capital and the depth of the balance sheet of institutions will affect, potentially, both questions. But I think they are severable.

Let me make a couple of comments. One, I think that as we came out of the financial crisis, there is undoubtedly going to be some more volatility. When I started testifying as Treasury Secretary everyone was concerned there was no volatility in the market. Now there is a concern that there is volatility in the market. It shouldn't be a surprise that as we see a return to a more normal economy, there is more volatility.

I think that the institutions themselves are stronger than they were going into the crisis. They have more of a capacity to come through a period of economic stress in a healthy way, and that is a good thing.

And I think in our FSOC report, we look at the risks that we see to the broad financial system, and we do include liquidity on the list, but it is not the single factor that we are looking at. And I think it is also going to separate the different parts of the market, because Treasuries are very different from high-risk bonds.

Mr. SCOTT. Let me ask you this other question. I don't have much time. But do you believe that there is any link between our anemic United States growth rate and the fact that our financial institutions have to hold so much capital in reserve rather than putting that capital back into the economic system to good use?

Secretary LEW. Congressman, I think that there is a lot of money that is on the balance sheet of businesses they don't even need to borrow to get access to. And yet, there is a more fundamental question, why are they not investing more? I think it has to do with a sense of confidence that they are looking for that the continued economic growth will be strong.

Mr. SCOTT. But do you see a link? Is there a causal—

Secretary LEW. Yes. I don't think there is a lack of access right now to capital that is the problem. I focused earlier on things like housing and small business, because I think that is where the questions are real as to whether individuals or small businesses are having trouble accessing capital. Large firms right now are not having trouble accessing capital.

Mr. SCOTT. Do you feel that these companies should have to hold as much capital in reserve as they are, and is that helping or damaging?

Secretary LEW. I think that the fact that our banks now have the ability to see themselves through a difficult period makes our system safer and sounder. They did not have the capital, they had too much leverage, and we saw in the financial crisis what the result was. We can't go back there.

Mr. SCOTT. All right. Thank you, sir.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentlelady from Missouri, Mrs. Wagner.

Mrs. WAGNER. Thank you, Mr. Chairman.

There seems to be so much interest in this issue of liquidity, so I just can't help myself. And perhaps I will ask a question that will help put this to rest for all of us.

In going back to your March 2015 testimony, Secretary Lew, on the issue of liquidity you said, and I quote: "So I think that this is something that requires a lot of analysis. We are doing it. And I would be happy to share with you a more complete analysis when we complete it."

Now, this was March of 2015. I didn't get anything at 11:18 last night. What is the plan here?

Secretary LEW. As I have indicated earlier, our hope is that in the next few weeks, that analysis of October 15th will be completed, and we look forward to sharing it with the committee. It has been a complicated analysis. It has required a number of agencies working with very different bodies of data, and I am very anxious to get it completed.

Mrs. WAGNER. So within the next 3 weeks, we will receive—

Secretary LEW. I can't say 3 weeks; over the summer is the schedule we are working on. I have been pressing people very hard to finish it as soon as possible, and as soon as it is finished, we will share it.

Mrs. WAGNER. And you believe that will come this summer then?

Secretary LEW. That is the schedule we are working on, yes.

Mrs. WAGNER. And that should answer all our questions about the importance of liquidity or lack thereof?

Secretary LEW. No, I wouldn't say that any single analysis will answer all the questions. It will help us understand October 15th much better. And in the FSOC report, we noted that there is a broad range of factors.

I must say that I have taken a lot of questions today which want me to comment on regulation. In the FSOC report we added regulation to the list of things that we need to look at. So we are open to looking at all the causes. I identified the things that I am confident are things that we need to be looking at.

Mrs. WAGNER. I have several more questions here. We look forward to your report this summer.

To date, FSOC has designated four nonbank financial companies as systemically important financial institutions, or SIFI, essentially signaling to market participants that the government considers them too-big-to-fail. As a result, Richmond Fed President Jeffrey Lacker stated that shareholders and creditors of those firms can't expect the government to shield them from losses during periods of distress, ultimately putting the taxpayer on the hook for a future potential bailout.

For that reason, I am interested—and I think others on this committee also have mentioned this today—in how these companies can ultimately de-risk and shed their designation status from

FSOC and remove the implicit government support that such a designation carries with it, knowing that the primary goal for FSOC is to reduce risk in the financial system. I think that you also would share that sentiment.

I know that Senator Mark Warner has told you before that there was never any intention of creating a "Hotel California," I believe were his words, with the designation process where you were able to check out any time you like but never leave.

Secretary Lew, in the absence of any practical guidance from FSOC on how to exit SIFI designation, is it really possible for designated firms to know what they are supposed to do to reduce systemic risk?

Secretary LEW. Yes, Congresswoman. I think that the process is clear, that we review the designations annually. If the business of the designated company has changed and it no longer presents risk, they know what the risks are, we have identified the risks very clearly. And right now, it has been in the news that GE Capital has changed its business plans for reasons that have nothing, I believe, to do with the SIFI designation, but that will cause there to be a review, and we will have to see whether that changes their character.

So we are open to, if firms change their structure, if they change their business—

Mrs. WAGNER. They specifically, though, know how they can reduce risk, have you have given them guidance on this, how to change their business model, their structure?

Secretary LEW. They know what it is about their business that created the designation in the first place. They know what the transmission mechanisms are.

Mrs. WAGNER. Do they know from you specifically?

Secretary LEW. There is a very long analysis that goes to the companies when they are designated that identifies for them the basis of determining the risk. If the basis, then, changes—

Mrs. WAGNER. So you have a list—because I have limited time here—of specific information on what firms can do to remove this designation?

Secretary LEW. It is not a question of take steps A, B, and C. It is a question of what are the risk factors, and if they no longer present those risk factors.

Mrs. WAGNER. So you don't have a list of how these—

Secretary LEW. The risk factors are quite clear.

Mrs. WAGNER. The risk factors are quite clear to whom?

Secretary LEW. To the firms that are designated. They understand what it is.

Mrs. WAGNER. Have you provided them with those risk factors?

Secretary LEW. Yes. It is in the analysis that is available to the public.

Mrs. WAGNER. I have run out of time, Mr. Chairman.

Chairman HENSARLING. The time of the gentlelady has expired.

The Chair now recognizes the gentleman from California, Mr. Sherman.

Mr. SHERMAN. Mr. Chairman, thank you for holding these hearings. I hope that we get the other members of FSOC to also testify. "Chairman" is a lofty position, but if you were to interview the chairman of this committee, I am not sure you would get the views that would reflect every member. And I am glad that Secretary Lew is here, but I look forward to hearing from the others.

You have litigation on whether, I guess, it is MetLife, perhaps Prudential, is a SIFI. You have filed your reasons to dismiss their lawsuit under seal. You are the client. This is a document filed on your behalf. Could you just put it on your website, because it is of public policy interest, of course redacting any proprietary information about the individual company? Why would the reasons for arguing the dismissal of the lawsuit be under seal?

Secretary LEW. Congressman, obviously it is a matter under litigation. I am not going to comment on the substance or the process of pending litigation. We have tried in all of the designations to be as transparent as we can be while protecting legitimate commercial information that we need to protect.

Mr. SHERMAN. I would hope that you would make that document available for members of this committee since it is a public policy document as much as anything.

Lehman Brothers didn't go under because it had too many assets. It went under because it had too many liabilities, particularly contingent liabilities. And I am confused as to how there is discussion of mutual funds being listed as SIFIs.

Now, obviously if the markets dropped by thousands of points, that is terrible for the economy. It is terrible for me, because I have my individual accounts. It would be just as terrible if that same money was in a mutual fund.

Why would an unleveraged mutual fund be classified with a SIFI knowing that it has no liabilities?

Secretary LEW. Congressman, in a review of asset managers we have made the judgment that the area that we need to spend considerable time on is looking at activities that asset managers engage in and whether or not there is risk associated with those activities. We haven't completed the review yet, so I am not in a position to—

Mr. SHERMAN. Are you looking at whether the asset management company would go bankrupt, whether the mutual fund would go bankrupt, or whether the economy would suffer not because the SIFI wasn't able to pay its liabilities, but rather because a big company was doing this or that in the stock market?

Secretary LEW. Ultimately, the questions of looking at financial stability involve looking at what the losses would be to creditors and associated businesses, not so much of an issue here, what the run risk would mean in terms of the potential spread to the economy and markets, whether or not it locks up access to one or another kind of essential services.

We are looking not just at firms. We are looking at activities to see whether—

Mr. SHERMAN. So an entity could be designated as SIFI not because their inability to pay their liabilities would cause a problem, but just because their activities cause a problem?

Secretary LEW. No. The question is, are there activities within asset managers that if there were, under a stressed situation, a series of bad events. These things don't happen in good situations. They usually happen when there are a lot of bad things going on.

Mr. SHERMAN. Okay. I want to go on.

Secretary LEW. And we have to understand, are there activities in those asset management firms that present the kinds of risks we need to be concerned about. I don't know the answer to it. We have asked this question—

Mr. SHERMAN. I need to move on to another issue.

Secretary LEW. We have asked the question knowing that the answer could be yes or no. So I don't sit here today with a firm view.

Mr. SHERMAN. We are of course faced with this trade deal. We are told that there are enforceable standards, but they are usually enforceable only if the Executive Branch of our government is willing to take action. With regard to China currency manipulation, we passed a law requiring the Executive Branch to do things. You explained to this committee last time I asked you about it that, well, the law is really bad policy and so will not be followed.

If the Executive Branch won't enforce U.S. laws because our trading partners would find that offensive, it is difficult to see how any provision of any trade agreement would be enforceable if that enforcement required the Executive—

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Oklahoma, Mr. Lucas.

Mr. LUCAS. Thank you, Mr. Chairman.

Mr. Secretary, it is good to see you again. In the working order with which we work through members on this side, we have worked through the subcommittee chairmen, we have worked through the underclassmen who didn't have a chance to ask you questions the last time, that is appropriate, and now you are back to the old guys on the back row.

I share some of the concerns of my colleagues on both sides of the aisle that there is a real problem with this liquidity issue on the Financial Services Committee. And I find it seems very hard to argue that this reduction of liquidity has nothing to do with the cumulative impact of new rules and regulations and the capital requirements.

And while we of course continue to work to improve the safety and soundness in the system, it is just as important that we don't lose sight of that big picture of course, that aggregate impact of all these factors, and be ever mindful of unintendedly creating risk and harming the ability of end users to drive this economy and create growth.

I have a particular issue that I would like to focus on for this moment, though, and that is on the leverage ratio rule as it applies to the treatment of segregated margin. This is an issue that increases costs for end users and impacts their ability to hedge risks. And as you know, Congress required that margin received from customers for clear derivatives belongs to the customers and should remain segregated from the banks' affiliated members' accounts.

However, under the leverage ratio rule, this client margin is treated as something the bank can leverage and treated punitively by requiring higher capital requirements for clearing. If end users don't have the ability to hedge their risk, more risk is introduced into the system, customers pay more, and economic growth is harmed. And I think this is an example of the leverage ratio rule and higher capital requirements when applied, I believe, inappropriately, in my opinion, where it actually harms liquidity and increases risk.

As a prudential regulator, can you tell me, why does the rule treat customer margin as something the bank can hedge?

Secretary LEW. Congressman, the leverage rules apply to all assets. It even applies to Treasuries and cash. So it is a very inclusive rule. And I think it is reasonable to ask questions as to whether or not there are unintended consequences. And certainly you distinguish it, say, from the Volcker Rule. The Volcker Rule exempted Treasuries. A lot of the questions I got earlier were trying to tie liquidity to the Volcker Rule. The Volcker Rule obviously doesn't affect Treasury holdings.

I would have to look at the specific issues related to the margins.

Mr. LUCAS. But I hope you agree it would seem to have the effect, by requiring extra capital to cover these margin accounts that are segregated, it would have the net effect of increasing the costs to the end users. I hope you see where I am coming from on that.

Secretary LEW. Yes. Look, as I say, I haven't focused on the margin issue. I have focused on the Treasury and the cash issue. And I think if you go back to the purpose of the leverage rule, it is a very solid objective, which is to make sure institutions don't get overextended. And I think that what the percentage is makes a big difference in terms of whether or not it is the binding constraint or not.

Mr. LUCAS. Segregating the money makes very good sense, and I think we did the right thing there, but the net effect.

Let me ask you this then. Regulators have been focused on removing risk from the banking system through the capital requirements and the additional regulations such as the Volcker Rule. Risk is going to exist somewhere within the system. If we remove it from the banking system, Mr. Secretary, where does it pop up next? If the banks can't play this role of playing a market, somebody will. Will it be more of a danger to the overall economy than, for instance, the banks?

Secretary LEW. I think it is an overstatement to say the banks aren't playing that role. Banks are still doing their core business. And even under the Volcker Rule, they are not prohibited from market making and holding inventory for market making.

You are asking a question that I am asking as well, with the evolution of the markets, are there questions of financial stability that we need to ask that are different? So you look at some of the newer players in the market, where the volume of trading is, I think it does raise questions, both about the kind of plumbing of the system, but also about implications on liquidity.

Mr. LUCAS. Historically, the banks in making these markets, it would seem to me, historically have had a perspective of evening things out, consistency, stability being boring. But the entities who are winding up taking their place have historically made their money off of volatility. If we take it away from the people who like to take the wave out, yet give it to people who have made and make more the more intense the waves, it just doesn't seem logical.

Secretary LEW. I think one can overstate the tradition of banks doing things that weren't in their economic interest to maintain markets. But clearly having inventory has been real.

I also think that if you look at what the definition of liquidity is, it may not be reasonable to think that there should be no price fluctuation even if there are dramatic things going on.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Missouri, Mr. Cleaver, ranking member of our Housing and Insurance Subcommittee.

Mr. CLEAVER. Thank you, Mr. Chairman.

Mr. Secretary, thank you for being here.

We are moving toward the fifth anniversary of the passage of Dodd-Frank. Many of us were here during those turbulent and troublesome days, and we know that great care was taken in dealing with the creation of this Act. And we think that we made significant progress. And I think you, apparently, agree with us as well, that we have made tremendous progress. And regulators have moved toward implementation. Some of the rulemaking I agree with, some of it I, along with my colleagues, have challenged. But overall, we have made great progress.

But when you think about Dodd-Frank as a whole, what do you think is the most significant thing left undone? What would you want to see right now completed so that we would have the full strength of Dodd-Frank at work preventing another collapse?

Secretary LEW. That is a very good question. Obviously there are pieces that need to be completed, and that is not really what you are asking. You are asking, what is the kind of area that we haven't addressed?

Mr. CLEAVER. Yes.

Secretary LEW. I would have to say GSE reform is the area we haven't addressed. And it would be a good thing if we would. I am not sitting here today optimistic that is going to happen legislatively. But it is why we engaged so much in the Senate in the bipartisan discussion to try and work through an approach to GSE reform.

Mr. CLEAVER. Mel Watt, who was a member of this committee—you mentioned the GSE reform and Mel Watt, of course, is now over at FHFA and doing a great job. Some of the work he is doing is going to help in some of the housing needs we have with money put into the Housing Trust Fund. But one of the things that you might be able to help me with is what do we do to enable private money to move back into the market?

Secretary LEW. To back mortgages, you mean?

Mr. CLEAVER. Yes.

Secretary LEW. I think there have been some small steps taken, but there needs to be an active effort to look at what can we do to have a more active private securitization industry. The notion that most mortgages are backed by either FHA or a GSE that is backed by the Federal Government is not a great place for the industry and that part of the market to be, which is why I said GSE reform, which is a path towards an active private marketplace.

The experiments that I think have been useful have been things like putting first-loss protection in place apart from the GSE. It has been small. But we have seen that there are ideas there that you can insulate the public from the first risk and start to bring private money back into place. That can be through mortgage insurance. It can be through capital market products. I think more thought has to be put into that area to develop it further.

Mr. CLEAVER. But you do believe that there is a need for a secondary market?

Secretary LEW. I'm sorry?

Mr. CLEAVER. You do believe that we do need a secondary—

Secretary LEW. Yes. I think it would be good if there were more private, nongovernmentally backed.

Mr. CLEAVER. So the GSEs would be a hybrid?

Secretary LEW. Yes. Or they would have competitors.

Mr. CLEAVER. I think in this committee there is some suggestion from time to time that the GSEs are not even needed.

And one of the things that I am wondering about, when some prefer that it be completely private, is whether you believe the private market has an appetite to fully either take over or, what I would prefer, reenter the market.

Secretary LEW. Look, I think right now the structure of our mortgage industry makes the continued operation of Fannie and Freddie necessary. The idea behind GSE reform was to be able to chart a path where there would be a different kind of marketplace in the future. So we live in the present, we live in a world with FHA and Fannie and Freddie, and we have to try to make that world better absent legislation.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from California, Mr. Royce, chairman of the House Foreign Affairs Committee.

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

And for the record, Mr. Secretary, one of my colleagues earlier asked if the GSEs have repaid the money that they have borrowed from the American taxpayer. The simple answer that my colleague tried to elicit, I think, was that the payments they have made to the government now exceed the rescue funds they received.

Mr. Secretary, I think you agree here this is not the real answer nor the real question. The real question is, have they repaid their debt to the American taxpayers?

And for that answer, I think we can go to the Federal Reserve Bank of New York that was asked that question. And they put it this way. They said, "Should these figures be interpreted to mean that the Treasury, and therefore the taxpayers, have been 'repaid' by Fannie Mae and Freddie Mac, and that the two firms should now pay dividends to their regular shareholders again? The answer to that is no."

The New York Fed said that taxpayers are entitled to a substantial risk premium, government support has lowered funding costs and boosted profits, and the government has never collected the commitment fee that the government is owed from Fannie and Freddie.

So the false scenario that is perpetuated is that taxpayers have been repaid, it is time to end conservatorship and return the GSEs to control of the shareholders. From your comment earlier, I assume you disagree with this narrative and agree with the conclusion of the New York Fed that failing to work to wind down the GSEs and give space for private capital to come in would be a colossal missed opportunity to put the U.S. residential mortgage finance market on a more stable long-term footing?

Secretary LEW. Congressman, I totally agree, and I was trying to indicate in my response earlier that the risk is being borne by taxpayers on an ongoing basis and the conservatorship is not over.

I would only add one additional thing to what I said earlier, which is that the damage done to our economy by the housing crisis was far more than the simple amount of money that was put into the GSEs. And I think Americans are still healing from the pain of that financial crisis.

So I think that the right thing is to do GSE reform and to get on to a new restructured system, but it is not the right time to be talking about ending the conservatorship or paying dividends.

Mr. ROYCE. And I think we can move forward together on that GSE reform concept. I have publicly endorsed reforms that would increase private sector participation in the secondary housing market, that would decrease taxpayer exposure to future losses, and that would limit disruption to the housing market.

But I think, if you look at the particulars, more risk sharing is something that can be done to create a lot of space here. A common securitization platform is something that works for the GSEs and then brings in private capital to use that platform. A common residential mortgage-backed security would be a good start for Congress, I think, to pass this year. If I could have your thoughts on that?

Secretary LEW. Look, I think the items that you just mentioned are the kinds of things we have been talking about and thinking about. Obviously, there is a common security platform being built. It is something that could be expanded beyond the GSEs and be available more broadly. I think the more we are able to lay a foundation that a private securitization market can be built on, the better off we would be.

Mr. ROYCE. If I have a minute here, I am going to quickly push— Last week, the Treasury Department announced its deliverables for the upcoming Strategic and Economic Dialogue with China. One of the issues a few years back was that ownership caps were raised there from 33 to 49 percent. But this is largely symbolic because it doesn't really provide further benefit to firms operating in China. When Chinese institutions invest in the United States, they face no ownership cap or activity restrictions. And this is just one of many impediments that our financial services firms face when operating there.

I did want to raise that issue with you. And also, I raised with you earlier that on this technology restriction, we have China agreeing to delay implementing a certain restriction on its draft antiterror laws that would require foreign companies to hand over their encryption keys. Clearly, our banks and our financial services firms, technology firms, cannot operate under those conditions in China.

Recently, we were in Shanghai, and they were pushing that. It is still on the third reading. The peoples' Congress has adjourned until next year, but that still hangs out there. And so, we need to have greater pushback.

Secretary LEW. Congressman, I agree with you totally. I have pushed back with China's most senior leaders on this issue and have made it clear to them that it is a very significant issue here and it is something that in the context of both the S&ED and the leaders meeting we need to see movement on.

Mr. ROYCE. Thank you, Mr. Chairman.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentlelady from Wisconsin, Ms. Moore, ranking member of our Monetary Policy and Trade Subcommittee.

Ms. MOORE. Thank you so much for joining us today, Secretary Lew.

I can't resist asking some questions about liquidity as well, since that has come up several times, but I want to take a different approach, as opposed to the required capital standards. In your testimony you mentioned that it has been a year now since we have floated the NAV for institutional investors, and at least your executive summary was not very descriptive of how that has been working.

I am wondering if we have seen less use or about the same of assets which are typically a little bit more liquid than other investments in the money market mutual fund space?

Secretary LEW. Congresswoman, first, I don't believe the rules are effective yet. They were put in financial form with a future effective date.

I think we have seen a continued reduction in the reliance on short-term wholesale funding, which is a good thing, but we still have very large amounts of investment in money market funds. And we saw in the financial crisis that there was run risk there, and the reason that the rules were put in place by the SEC was to create a safer path forward.

I certainly will keep an eye on that as it is implemented to make sure it works as designed. But we have made clear that we have to keep attentive to whether or not they are sufficient or whether there is a need for additional policy.

Ms. MOORE. But it would not be a good thing if we were to close down or essentially shut down the money market mutual fund—

Secretary LEW. No.

Ms. MOORE. —or stagnate it in some way, prevent those institutional investors from having that liquidity. That would be something you would be watching out for?

Secretary LEW. Right. The problem is the connection between the money market funds and the rest of the financial system. What we saw during the financial crisis was that the risk of money market investors, institutional investors, leaving, selling their position, was creating the risk that the overnight funding that the largest financial institutions relied on would evaporate. And that could have caused the entire implosion of major financial institutions.

We are in a much better place because there is less reliance on wholesale funding, and we now have rules in place to try and make it safer.

Ms. MOORE. Thank you, Mr. Secretary.

You mentioned also that the threat of migration of servicing from banks from nonbanks, such as the recently announced algorithmic lending that Goldman Sachs, for example, wants to do, really demonstrates there is a change in market structure, that there is more risk-taking incentive.

I am wondering, in that context, how nonbank SIFIs—do you think it is more important to focus on a few industries, fewer institutions? Or what do you see? Do you see an expanded role for the FSOC given the change in the market structure?

Secretary LEW. Look, I think that we have tried to be very careful and analytic in the approach and not to overreach and go into spaces that we don't need to be in or belong in. The institutions that have been identified are market utilities that have cross-cutting exposures, and the largest kinds of firms that are nonbank firms, where the determination was made that the risk is there.

So it is not that we are looking to regulate more firms for the sake of regulating more firms. We are going to continue to go through the criteria, and we are obviously getting to smaller firms as we get down the list.

Ms. MOORE. Thank you, Secretary Lew.

I was stunned at some of your comments to Mr. Cleaver about GSE reform, and also your declaration in your testimony that negative equity has declined. That hasn't been my experience at all. And I think homeowners are in a lurch after this recession, a lot of housing in my district is deteriorating because you can't lend for needed improvements in the home, I mean, basic things like roofs, plumbing, and so on. I think we need some sort of product.

I only have 10 seconds. I guess I just want to get your insight about help for the homeowner in this environment.

Secretary LEW. I would be happy to follow up. I don't have the time now. But I have tried in a few instances to express the concern that creditworthy borrowers should have access to the market, and there are a number of things that we are looking at in that regard.

Chairman HENSARLING.The time of the gentlelady has expired.

The Chair now recognizes the gentleman from Florida, Mr. Posey.

Mr. POSEY. Thank you, Mr. Chairman.

Mr. Secretary, in October of 2013, the online publication RepealFATCA.com submitted a Freedom of Information Act (FOIA) request for documents concerning the intergovernmental agreements with the United Kingdom, Switzerland, and Canada. The Department promptly acknowledged the request, and on October 24, 2013, stated that, "Expedited treatment has been approved." It is a letter from your agency. However, since then there has been no response from the Department despite repeated follow-up inquiries from the requester.

On January 27th of this year, 15 months after the initial request, I sent you a letter asking for prompt action on the request and to keep me informed on the response that would be forthcoming. Despite additional inquiries, the only answer I have received so far is, "We are working on it."

It has now been 20 months, almost 2 years since their simple initial request under the Freedom of Information Act, and 5 months since my letter inquiring about the status of that request. Is this the Treasury standard for expedited treatment?

Secretary LEW. Congressman, in general our performance on FOIA is better than that. I am not familiar with this specific matter. I am happy to look into it.

Mr. POSEY. It is just hard to believe that there is some reason that the Department is stonewalling that one.

Secretary LEW. I will have to look into the matter and get back to you.

Mr. POSEY. On another matter, I would like to bring to your attention that the Fiscal Year 2012 Financial Services appropriations bill included report language directing the Secretary of the Treasury to submit a report to Congress regarding the potential risks to the U.S. financial markets and economy posed by financial terrorism and economic warfare.

I subsequently met with Treasury Assistant Secretary Fitzpayne in August of 2012 and was told that the Treasury would work on that. The report language also included in Fiscal Year 2013 and 2014 appropriations bills.

In July of 2013, my staff sent nearly a half-dozen emails to the appropriate Treasury staffer for a status update, but those emails went unanswered. Finally, in the Fiscal Year 2015 CR/Omnibus bill that became public law, the actual bill language was included to the same effect.

"The Secretary of the Treasury, in consultation with the appropriate agencies, departments, bureaus, and commissions that have expertise in terrorism and complex financial institutions, shall provide a report to the Committees on Appropriations of the House of Representatives and the Senate, the Committee on Financial Services of the House of Representatives, and the Committee on Banking, Housing, and Urban Affairs of the Senate not later than 90 days after the date of enactment of this act on economic warfare and financial terrorism."

Obviously, Congress felt the issue was important enough that it has included language in an appropriations bill dating back as far as Fiscal Year 2012. However, it is apparent the Department isn't giving this matter the same attention. I was hoping you could provide us with some information about your progress on the report.

As the Secretary provided his report to the relevant committees in Congress, given the Department has had knowledge of this issue for over 3 years, I would have thought the Department would have prepared to meet that 90-day threshold set by Congress. And so ultimately the question is, when can we expect the report?

Secretary LEW. Congressman, I will have to check on the report.

But in the area of economic warfare and terrorism, there is no agency in any government in the world that does a more effective job than Treasury, and I am happy to defend the record that we have here. We really are the global leaders in making progress in this area. And I think it is an area of great bipartisan consensus and we looking forward to working together.

Mr. POSEY. Just doing the report as the law requires would be a great way to kind of boast or toast what you are doing.

Secretary LEW. I will check on the report. I am quite familiar with what we are doing. It takes a great deal of my attention and the world's attention. The report I will have to check on.

Mr. POSEY. So, will you have someone get moving in the next week on these two issues about the FOIA request so we don't have to wait another 2 years for that one?

Secretary LEW. We will get back to you.

Mr. POSEY. And let me know the status of this report within the next week, would that be asking too much?

Secretary LEW. We will get back to you.

Mr. POSEY. I heard you say "yes" a little while ago to somebody on the other side. I was just hoping we could maybe get the word "yes" twice in one meeting in the 3 hours. But can we expect that maybe in a week?

Secretary LEW. I don't know what the status of the issues are. We will get back to you promptly.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Texas, Mr. Green, ranking member of our Oversight and Investigations Subcommittee.

Mr. GREEN. Thank you, Mr. Chairman. And I thank the ranking member. Of course, I also thank the witness for appearing today.

Mr. Secretary, in your annual report you cite some concerns about cybersecurity. Ironically, yesterday the Subcommittee on Oversight and Investigations held a hearing on cybersecurity styled, "A Global Perspective on Cyber Threats." One of the things that I took away from this hearing is that there appears to be clear and convincing evidence that cyber threats and attacks pose a clear and present danger to our financial system.

And I am pleased to see that you have addressed this, and you need additional assistance pursuant to what I am reading. You indicate that you would like for Congress to provide the financial regulators with the authority to oversee third-party vendors. And I believe I have some sense of why, but I think that the record should reflect your thoughts on why this is so important.

Secretary LEW. Congressman, this issue of cybersecurity is obviously a relatively new issue, but it has gone right to the top of the worry list and priority list that we have, and as I talk to CEOs, it is the top issue that many of them have. The challenges are many. It is hard to protect a system, it is hard to have individuals in the system operate in a way that makes it as safe as possible.

I think the financial sector is actually at the lead and we have a lot of work to do in the financial sector. There are many other areas where the exposure is even greater and some of them overlap. I mentioned earlier the connection between utilities and financial up here. Power and phones are not there, it is very hard to run a modern financial institution.

I think that it is very much in the mind of both the regulators and the industry, and the more tools we have to work together, the more tools there are for them to work collaboratively and to share information and best practices, the more likely we are to be successful. A threat that shows up in one place, if you know about it, you can then look for it as opposed to being blindsided by it.

And we are making progress. There is much better sharing of information than there was. But I wouldn't suggest that we are ultimately where we need to go. And I think the passage of legislation to enable the greater sharing of information would be very helpful.

Mr. GREEN. I want to concur with you. The witnesses who appeared yesterday all indicated, I believe, that you are at the top of the game as it were, that you are doing better than most.

Secretary LEW. I don't take much comfort in that, though.

Mr. GREEN. They didn't say that we have absolute security and I understand this. My concerns have to do with the need for authority. What would you have us do immediately to give you this authority? I know that it is in broad terms here. Are there some specifics that you can call to our attention?

Secretary LEW. The cybersecurity legislation that is pending would take down some of the barriers for sharing of information and collaboration in the private sector. I think getting that in place would be quite helpful.

We are doing things now on a voluntary basis where there are risks that firms have to balance which would be very much eased if the legislation were to pass. We have Executive Orders that go as far as Executive Orders can.

I would be happy to follow up with you on more specific issues in the financial space that could be helpful.

Mr. GREEN. Thank you.

And finally this: You have indicated that you believe that you should be allowed to coordinate a national plan, as it were, to deal with these responses to cyber threats, and you would like to coordinate this with law enforcement, Homeland Security, as well as regulators. How far along are we with this concept of your having this opportunity to coordinate a national plan?

Secretary LEW. Obviously, within the Federal Government, we collaborate quite a lot, and DHS plays the lead on cybersecurity. But I will tell you, in the financial space we have a regular meeting amongst the agencies that work most closely together and we are looking at what we can do to be more prepared. And obviously, that gives us the ability to reach out more effectively and develop a plan.

Mr. GREEN. Thank you for your service.

And I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from South Carolina, Mr. Mulvaney.

Mr. MULVANEY. I thank the chairman.

Mr. Lew, in October 2013, you went to the Senate Finance Committee and had a hearing concerning prioritization of payments. And you told them at the time that, and I am quoting: "The systems are automated to pay because for 224 years the policy of Congress and every President has been to pay our bills." You went on to say it wouldn't be easy to pay some things and not others, they weren't designed that way, et cetera.

And then in May of 2014, you gave this chairman a letter saying something slightly different. You said, "If the debt limit were not raised and assuming Treasury had sufficient cash on hand, the New York Fed systems would be technologically capable of continuing to make principal and interest payments while the Treasury was not making other kinds of payments."

I will ask you, Mr. Lew, when did you come to learn the New York Fed was technologically capable of making the payments you set forth in your letter to the chairman of May 2014?

Secretary LEW. Congressman, I don't remember the exact date, but I can tell you the statement I made at the Senate in October 2013 and the statement to this committee are entirely consistent. What I said in October 2013 is that we make tens of millions of payments and we don't have the capacity to pick and choose amongst all of them.

I didn't address specifically the question of, is there the technical capacity to pay principal and interest. I did indicate to this committee that we do have the technical capacity, but it would be a terrible thing to do because if you chose to pay principal and interest, you would be defaulting on something else. You would be defaulting on a Medicare payment or on a veteran's payment or on something else.

The only solution is to raise the debt limit and to not put any President in the position where they have to make the decision, do they pay one thing but not another?

Mr. MULVANEY. Mr. Lew, that was a really good answer the first three times I have asked it. I asked you that same question, sir, in May of 2014, and you told me you would have to check. When you came back before us in March of 2015, you told me you had checked but you had forgotten it and you didn't remember it on that day, but you would look into it again. I sent you a set of written questions and asked you the exact same question. I got two pages with no answer in them.

So I am not going to ask you any more questions, Mr. Lew. I feel like I have given you enough chances to answer that question. My question was very straightforward, when did you know? It is an answer you should know. And if you don't know it, you are right, you should go back and be able to look it up. In fact, you told me one time you did go back and look it up and you knew it at one point but you had forgotten it before you got here.

Mr. Lynch asked you a question, sir, earlier today about whether or not you felt like your answers to this committee were disdainful, and you said that, no, you thought that they were reverent. And I kept waiting for the laughter after that, Mr. Lew.

I have asked you some really serious questions. We have asked you some really serious questions. By the way, the other questions I asked you, not the first time, go deeper. This not an empty question, Mr. Lew, this is not a question that was designed to just "gotcha," to try and make you look bad so we would get on television. That is not the point. We are interested in answering the questions because of the market turmoil that always raises its head as we come up against the debt ceiling.

So in addition to the question I asked you about when you knew, I also asked you, "In the event we reach the debt limit and exhaust extraordinary measures and Congress does not raise the debt limit, can the Treasury Department continue to make principal and interest payments on the debt, yes or no?" You didn't answer that. You have had, by the way, 6 months to answer these questions.

I also went on and asked you, “Will you commit that in the event we reach the debt limit and exhaust extraordinary measures and Congress does not raise the debt limit, the Treasury will continue to make principal and interest payments on the debt?” You didn’t answer that either.

What are we to infer from your refusal to answer now for a year-and-a-half these types of questions, that the answers—no, you had your chance. I did what very few people here did today; I let you go until you stopped. In fact, I was going to even go until I had a minute-and-a-half left. You had your chance. It is my turn.

We are interested in asking these questions because we are concerned about what happens in the markets. We would hope that the Secretary of the Treasury of the United States would be just as concerned. Your name is on the money, Mr. Lew. We have given you the chance to calm the markets. You have refused to do so. We have given you the chance to give this committee information. You have refused to do so.

One implication is that you don’t want us to know the information we ask for because it is harmful to you or the Administration. And the other implication that we are completely within our rights to make is that the answers regarding payments are not being given to us because you want the chaos, because you think it is preferable to you and your Administration, this Administration, to have the chaos, that it will help you achieve politically what you want to achieve.

So I am done asking, Mr. Lew. All I will say is that when the chaos comes, it will not be on the shoulders of the people on this committee on either side of the aisle, it will be on you, because you have had the chance to calm the markets and refused to do so.

Secretary LEW. Mr. Chairman—

Mr. MULVANEY. No, sir. Not on my time.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Minnesota, Mr. Ellison.

Mr. ELLISON. I would like to thank the Chair and the ranking member for the time.

And I would actually like to thank you, Mr. Secretary, for answering some of the written questions that I gave you. I know it is not easy to do that, you are busy doing a lot of things, but you did give us some answers, and they were answers that we can use. So I extend my thanks and appreciation for that.

As you know, Mr. Secretary, you are probably going to get a question from me about Somalia. I know you are shocked. And what I would like to just ask you is if you have any information on the bill that we passed last year into law.

There was a bill that we passed last year that was called the Money Remittances Improvement Act and the goal of the bill was to improve oversight of State-licensed nondepository financial institutions. Now that the law is in place, all well-supervised entities like the money services business should have their license status recognized and respected.

And I just want to know what you know. And if you don’t know anything, I understand, because I didn’t tell you I was going to ask you that. But if you do know, I would be happy to get a report.

Secretary LEW. Congressman, thank you. As we have discussed many times, this issue of remittances is a very important one, and we are very concerned about the problems that families are having in making payments.

We are working on the implementation of the legislation. And I am happy to get back to you with a more detailed response on the status of the implementation.

But we are more broadly working on this issue of how to deal with remittances in Somalia.

Mr. ELLISON. Right.

Secretary LEW. As I think you know, we are very involved with the World Bank to develop solutions to the problem, and that really means building up some capacity in the Somali financial system.

Mr. ELLISON. I agree.

Secretary LEW. Because right now there is not a real financial system to engage with. We have had meetings at a very senior level in Somalia, at the political level, at the central bank level. And I know that our Under Secretary will be traveling to your district to have some meetings on this issue.

Mr. ELLISON. I appreciate that. And I just want to say again that I am foursquare with the Administration's effort to stop terrorist financing. I am on a task force to help achieve that.

But on the other hand, we can get so successful at that effort that we close off all the money, and that, I think, would be unfortunate because it would actually serve the interests of Al Shabaab and terrorists over there to see the collapsing of the Somali economy which depends upon remittances to the degree about 40 percent.

So I would like to talk with you more about the implementation of that program. I know that you all are doing some technical assistance to Somalia. I talk with political leaders there and try to give them my best perspective on how they can improve their system.

Could you talk a little bit about the work that you all are doing in the technical assistance area and what sort of message that you would like them to receive in order to develop that solid banking system that I think they are going to need?

Secretary LEW. Right. There is not an easy answer to that question. It is hard to exaggerate how little they are starting with in terms of building a functioning financial system. And the tragedy is that there are legitimate transactions, like family remittances, that should be able to go forward, but it is very hard to know that the money isn't going to go into hands that will do real harm.

And trying to figure out how to build that system is why we are working with the World Bank. We can't go into Somalia the way we go into some countries, because of the security conditions. So we have people come out of Somalia into other countries for training. It is not the most efficient way to do it. Our OTA people are great when they can go in and work with people side by side. We just can't do that in Somalia. But we are trying to do it offsite to help them build the skills.

It is a process. It is not something you can just kind of hand over and have a functioning system. They are trying, we are going to work with them, and we have to be creative in finding the ways to start that building process.

Mr. ELLISON. I just want to urge you on behalf of the people who live in the Fifth Congressional District of Minnesota and many other parts of this country.

We actually, me and Mr. Emmer, are going to start a Somali caucus because we have constituents who live in both districts and definitely want to see that country get stable and strong and not be a haven or an attractive nuisance for bad people. So we try do our good part, and we hope you will continue to push with that technical assistance.

Secretary LEW. We will do so and we will continue to work with you and try to find a solution to this.

Mr. ELLISON. Thank you.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentlemen from Tennessee, Mr. Fincher.

Mr. FINCHER. Thank you, Mr. Chairman.

And thank you, Mr. Secretary, for being here today.

I am going to go back to an issue you and I talked about a few months ago, liquidity. I know it has been a pretty hot subject today. In recent comments from Larry Summers, former Treasury Secretary under President Clinton, who later served as adviser in the White House during the creation of Dodd-Frank, he warned, "Regulatory authorities have made a mistake when they looked at each institution and they said, 'You will be safer if you withdraw from the markets a bit,' and then forgot that if all institutions withdraw from the markets a bit, the markets will be less liquid, the markets themselves will be less safe, and that will in the end hurt all of the institutions. I think there is a real issue there. Frankly, a lot of the effort that is going into macro prudential should be into making sure we have liquidity."

What is your reaction to his comments about the role of the regulations, not just Dodd-Frank, but layered capital and liquidity mandates are having on fixed-income markets?

Secretary LEW. Congressman, as I have said in response to several questions today, I think this liquidity issue requires our very serious attention. I think there are a number of factors that have been at work. It ranges from the point we are at in the economic cycle and the volatility that is natural at that point, to the emergence of new market mechanisms that are different and present different risks, to the volume of corporate bond issuance.

I have also said that we have our eye on whether or not there are regulatory issues, it is in the FSOC report, that it is one of the things we need to look at. So I am not approaching this from the point of view that we know exactly what it is. Frankly, I don't think anyone knows exactly what the answer is.

Mr. FINCHER. But you think it could be a possibility that it could be overregulation?

Secretary LEW. But I think the factors that I described I know are at work. I think that the question of regulation is much more speculative. And I think people have jumped prematurely to a conclusion about regulation which I think would take our eye off of where the real risks lie.

Mr. FINCHER. Would you say that we need more regulation?

Secretary LEW. Look, I think that we have come a long way since the financial crisis. Our system is safer and sounder. We have the ability for our institutions to withstand a bump in the road that they didn't have before. That doesn't mean that we should ever stop. We have to keep looking forward.

Mr. FINCHER. So you think more is needed?

Secretary LEW. I didn't say more or less. You can't take 50 years between looking at these questions, that didn't turn out so well. We need to keep our eye on the future, and we have to be open to the possibility that there are multiple different factors that are at the core of an issue.

And on something like liquidity, it is of fundamental importance that we have a deep and liquid market here. You still have to separate out Treasury markets from corporate markets to high-risk markets. They are not all the same. Liquidity issues aren't all the same.

Mr. FINCHER. Let me follow up. Secretary Summers' comments have been echoed by everyone from the Bank for International Settlements, Mr. Ketchum at FINRA, SEC Chair White, CFTC Commissioners Bowen and Giancarlo, and many overseas regulators, such as Mark Carney at the Bank of England. We talked about you issuing a data-driven analysis, and I think you have said there is going to be a White Paper coming out.

Secretary LEW. Hopefully. Our goal is to get it this summer and we will share it as soon as it is completed.

Mr. FINCHER. Okay. It seems like every time we have a hearing, we talk about the problems that we face and more regulation. I know I am just going to differ with you, and I know you haven't said.

Secretary LEW. I didn't say anything—

Mr. FINCHER. I know. But it sounds like that you are inclined to be for more regulation.

Secretary LEW. We have to be open to less also. I didn't say more.

Mr. FINCHER. There are you go, and that is good.

Secretary LEW. We have to be open to more or less.

Mr. FINCHER. What seems to be happening is the more liquid that is tied up in the markets, it is not the bigger institutions that pay the price here, it is the small guys. It is the guys back in States like Tennessee and Arkansas, Mr. Hill, that end up paying, the folks at the bottom. And we need to make sure that when something does happen, there is enough liquidity available to take care of these issues.

So thank you, Mr. Lew.

And with that, I yield back, Mr. Chairman, which is rare, the balance of my time.

Chairman HENSARLING. The gentleman yields back.

The Chair recognizes the gentleman from Colorado, Mr. Perlmutter.

Mr. PERLMUTTER. Thanks, Mr. Chairman.

And thank you, Mr. Secretary, for staying cool under the withering cross-examination of my Republican colleagues.

So I just really have a different view than the chairman and than Mr. Duffy, as to what is going on in the economy. We might as well start with all the records being set by Dow Jones, it is up from 6,500 at the end of George Bush to 18,000. The S&P from about 700 to 2,100. The NASDAQ is 3 times what it was. Foreclosures are down very low. There has been a tremendous improvement across pretty much all sectors, from manufacturing, to hotels, to whatever.

So when they are talking about calming the markets and you are causing them to roil, I want to thank you for rebuilding the markets from the recession that we were in at the end of George Bush. I don't know if you have your report in front of you, but there are some very important graphs that I would like you to take a look at, if you have your report in front of you.

So let's take a look, just at easy ones, starting with 4.1.4. Under the Obama Administration, we see oil imports drop and oil production increased like we haven't seen in decades. Do you see that one?

Secretary LEW. I do.

Mr. PERLMUTTER. How about 4.1.6, civilian unemployment rate dropping like a rock—this is on page 20 of the report—after the 2007–2008 recession. Do you see that? All right.

But now let's talk about FSOC. So if you would turn forward in your report to pages 62 and 63. I want to look at graphs 5.3.16 and 5.3.19. Do you see those?

Secretary LEW. Yes.

Mr. PERLMUTTER. So can you tell us what graph 5.3.16 is?

Secretary LEW. I have read the words. I am looking at some of these graphs for the first time.

Mr. PERLMUTTER. All right. So let me tell you what it is and then you can expand on it if you like.

As the recession took place starting in 2008, 2007–2008, we saw loan loss reserves fall so that banks couldn't withstand one more loss. But since FSOC was created in 2010, what do you see in terms of the loan loss reserves? They have almost tripled.

Secretary LEW. Yes. And we are seeing performing loans doing better and we are seeing the foreclosure issue settle down.

Mr. PERLMUTTER. Okay. Now let's look at the one that is really quite telling, and that is 5.3.19, FDIC-insured failed institutions. Do you see that?

Secretary LEW. Yes.

Mr. PERLMUTTER. And my friend the chairman was talking about this recovery and why isn't it bigger, other than the fact we have 13 million new jobs. We see pensions at an all-time high. But under Republican Administrations, and I think between 1980 and 1990 we had the Reagan Administration and the first George Bush Administration, look at the number of failed institutions. Do you see that?

Secretary LEW. I do.

Mr. PERLMUTTER. Okay. Then it falls off to virtually zero under the Clinton Administration. There were almost no bank failures. Do you see that?

Secretary LEW. Yes, sir.

Mr. PERLMUTTER. Then under the second George Bush we see a tremendous spike in failed institutions. Do you see that? So now, it has fallen off precipitously.

We are here to talk about the FSOC and about Dodd-Frank and putting some structure back into the market so that we don't have a failed banking system. Would you like to comment on that?

Secretary LEW. Congressman, I think that you have talked about the improvement in the economy in a very compelling way. Obviously, the graphs illustrate it, but so does the number of people working every day.

I think that there is no doubt but that the steps we have taken through Wall Street reform and FSOC have made our system safer. We also have an economic recovery underway, which is why everything is also getting better.

What I don't think we can do is kind of rest comfortably that there is no problem out there to worry about, because what will happen is we will get to the down point of a business cycle, there will be stress on the system, and we owe it to the American people to make sure we are in a position when times get tough that we don't go back to the 2007–2008 kind of situation. That is exactly what we are doing in FSOC.

Mr. PERLMUTTER. I completely agree with you, and that is why you need the loan loss reserves, so that you can withstand a downturn. That is why we take into consideration these precautions.

Secretary LEW. It is why you need capital.

Mr. PERLMUTTER. If I were my Republican friends, I would be grasping at this liquidity straw too, given the overall recovery of the economy. But I want to thank you and I want to thank the President for putting this economy back on track.

And I yield back.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from Florida, Mr. Ross.

Mr. ROSS. Thank you, Mr. Chairman.

Mr. Secretary, it is a pleasure to have you here again.

I want to talk about the ultimate goal of FSOC. FSOC's goal is to reduce risk in the market, is it not?

Secretary LEW. Yes, it is to reduce. It is to make sure that we have financial stability always on our minds and we reduce the risk of a financial crisis.

Mr. ROSS. And financial stability could be accomplished with the elimination of risk too, which I don't think that is the ultimate goal, because without risk you have no return of course.

Secretary LEW. No, no. It is why I focused on stability.

Mr. ROSS. Thank you. And let's talk about stability, because in gaining stability we need to make sure that our institutions have a proper road map. And right now we have a designation of a SIFI that leads to an institution now trying to find out how they get out. And I give you credit for what happened in February with some of the transparency rules that you promulgated and an opportunity every 5 years to try to get a decertification, if you will, of being a SIFI.

My concern is, why don't we have in place a road map, a precautionary measure to prevent them from ever being designated as a SIFI?

Secretary LEW. The process is not one where we assume that everyone could be a SIFI. It is to go through the firms that present themselves because of their size, complexity, and structure.

Mr. ROSS. True. True. But are we not focusing on more of a treatment for the cure instead of giving the prevention of the problem.

Secretary LEW. I think the reality is that no two firms present themselves in an identical place. And the way we go through the analysis looks at each firm and the risk that it presents through a—

Mr. ROSS. And it should be done—

Secretary LEW. —consistent set of questions.

Mr. ROSS. It should be done that way. But, again, in a proactive way, if these firms being looked at were given some guidance to prevent them from ever going over the cliff, we wouldn't have to have—

Secretary LEW. Right.

Mr. ROSS. —the designation.

Let me move into something really quickly here on asset managers, because I think asset managers are pretty important, and I have some concerns about them being declared SIFIs.

For example, in Dodd-Frank, it says that some of the criteria to include are leverage, the extent and nature of the off-balance-sheet exposure of the companies, the amount and types of liabilities of the company, including the degree of reliance on short-term funding.

Let's talk about leverage. What is a leverage ratio that you would consider to be worrisome? 30 to 1?

Secretary LEW. Yes, I don't want to give you a single number. Obviously, the larger it is, the—

Mr. ROSS. So smaller would be better.

Secretary LEW. Yes.

Mr. ROSS. And knowing that, 5 to 1 may even be a little bit of a concern.

Secretary LEW. And it depends on what the investments are in.

Mr. ROSS. Correct.

Secretary LEW. It is a combination of leverage and risk.

Mr. ROSS. When asset managers will not—they won't have a greater than 1½-to-1 risk—in fact, I think Vanguard has 1.04-to-1 risk, which is about almost minuscule—it would seem to me that should be a consideration that would prevent them from even being considered a SIFI. Would you agree?

Secretary LEW. It is certainly a factor that you would have to consider. And we have made our focus for this last period of time looking at the activities that contain the most risk, because we don't—

Mr. ROSS. But they don't really contain risk. Asset managers don't contain risk. They are basically—they don't even have any collateral as such to have risk.

Secretary LEW. First, asset managers have different business models. Some of them are leveraged; some of them are not leveraged.

Mr. ROSS. But the leverage is very minuscule.

Let me just go into this, if I can. Once you are a SIFI, then you become jointly and severally liable for all SIFIs, do you not? If one fails, then everybody that is a SIFI bears the brunt of that?

Secretary LEW. I am not sure what you mean by joint and several. It—

Mr. ROSS. The SIFIs themselves will bail out the SIFIs.

Secretary LEW. I am just—I am not sure what you are referring to.

Mr. ROSS. Okay.

Let me move on, then, to what the impact is if an asset manager were to be deemed a SIFI. You, of course, realize the cost of compliance, but, most importantly, asset managers deal in mutual funds, they deal in 401(k)s, they deal in investments that deal with people's retirements and pensions.

And there is a study out there by the American Action Forum that indicated that the capital requirements necessary if an asset manager was deemed a SIFI could raise the cost as much as 25 percent, that over the life of that program for the retiree could be over $100,000.

Will that not be taken into consideration when trying to determine whether or not they are a SIFI?

Secretary LEW. Obviously, those same retirees have an interest in making sure that they have access to their savings when they need them and that they—

Mr. ROSS. But it is having a significant impact—

Secretary LEW. Yes. So—

Mr. ROSS. —on the mom-and-pop—

Secretary LEW. —I don't start out with the presumption that firms should be or shouldn't be designated. I think we have to complete the analysis and come to a conclusion of what risk factors we are looking at and if those risk factors warrant any kind of action. So—

Mr. ROSS. I agree with you. I just think it would be a good preventive measure to do it in conjunction with the institution so that they can prevent that risk from ever being taken—

Secretary LEW. Yes.

Mr. ROSS. —and ultimately continue in a very stable financial environment.

Secretary LEW. My sense is that the asset management industry is very much offering its views as we go through this process.

Mr. ROSS. Very strongly. Yes, sir.

I see my time is up. I will yield back.

Chairman HENSARLING. The Chair now recognizes the gentleman from Maryland, Mr. Delaney.

Mr. DELANEY. Thank you, Mr. Chairman.

And thank you, Mr. Secretary, for being here.

I want to associate myself with the comments that Congressman Ross just made, because I have a similar view on asset managers, but I don't want to take up my time to talk about that.

When I walked in, I thought I heard my colleague asking you about the prioritization of our debts, but I might not have heard that. And I know you weren't able to answer it, so I do want to make a comment on that.

It seems to me that is a really misguided idea, because the best credits in the world, which, obviously, we should view the United States as certainly one of them, never prioritize their debts. Right? Berkshire Hathaway, ExxonMobil, all these terrific credits, all their debts are treated the same, and they have great flexibility as a result, whereas weak credits are forced by the market to prioritize their debt so that people know exactly what they have and when they get it paid.

So it strikes me it would be a really misguided idea to force the United States Government into a position where it was somehow signaling to the world that we are weak credit. I don't know if you agree with that. Very quickly, if you don't mind.

Secretary LEW. I couldn't agree more.

I think that the reality is the technical question of could you pay principle and interest misses the point, which is that, if you pick and choose what you pay, you are going to default on something.

Mr. DELANEY. Right. And you are going to present very differently than the way we want the United States—

Secretary LEW. Even if you reach the conclusion that you had to do that because it would be disastrous not to, it is a terrible place to be because you are still in default.

Mr. DELANEY. Right.

Secretary LEW. So the only thing that solves the issue is to raise the debt limit.

Mr. DELANEY. So the second question is about the liquidity crisis, and I know you have talked about this a lot.

And it is interesting, when you think about the role of banks, which have been very important to our economy for a long period of time, which is why the government has supported them, which is why we also try to regulate them in ways that make sense, right now banks are not all that important when markets are good. There are a lot of other alternatives for liquidity. But they are really, really important when markets are bad because there is no incentive for market-based participants to really participate in markets when they are bad, other then if they are kind of vulture investors and trying to get really good deals.

And I do worry that what has happened with liquidity has put these banks in a position that, if there were some kind of a crisis, they wouldn't be able to respond as well. And I know there are a lot of reasons why this liquidity data is emerging, but it seems to me—and this is coming from someone who is supportive of the regulatory response that we have had, supportive of Dodd-Frank. I think all the things we did we obviously had to do.

But it seems to me the notion of having very high minimum liquidity standards for banks, coupled with not looking at risk-weighted assets from a capital test and having this kind of overlay where you still risk-weight assets but you need a minimum amount of capital, which inevitably puts a lot of capital against really low-risk-weight assets like Treasuries, it seems to me those create very big incentives for banks not to be liquidity providers in a crisis.

Do you agree with that assessment?

Secretary LEW. I think that the liquidity rules, the theory behind them was you look at the overall exposure of the firm, and they didn't make distinctions between different kinds of assets.

I obviously think that Treasuries and cash have a degree of safety that is different—

Mr. DELANEY. Right.

Secretary LEW. —than almost any other asset in the world. But that is a different approach than saying everything is treated the same.

Mr. DELANEY. Right.

Would you support changes to the regulatory framework that actually eliminated disincentives for institutions to hold Treasuries and cash so that they are actually in a position to do their job in a crisis?

Secretary LEW. I don't think we have any evidence that they are not in a position to do their job. The Treasury markets remain deep and liquid. And as I have said a couple of times today, I don't think that what people looked at on October 15th, in terms of the movement on Treasuries, had to do with a lack of—it wasn't the effect of any kind of regulatory environment.

Mr. DELANEY. But the people running these institutions seem to think they have a disincentive to hold liquidity in cash.

Secretary LEW. Yes.

Mr. DELANEY. So sometimes perception becomes reality.

Secretary LEW. I will give you an example. I have heard a lot of them say as if it affects the Treasury market, that Volcker is the reason, but Volcker—

Mr. DELANEY. That has nothing to do with it.

Secretary LEW. —Volcker doesn't cover Treasuries.

Mr. DELANEY. I agree. I am talking about Treasuries.

Secretary LEW. Yes. So, in Treasuries, I think you asked the right question, is it something in the leverage rules, because the other rules didn't—

Mr. DELANEY. Because it used to be, no matter how many Treasuries you had, you didn't have to have, really, capital against them.

Secretary LEW. Right.

Mr. DELANEY. Now you kind of do. So, in my mind, if I was running an institution, that would make me have less of them.

Secretary LEW. Right. I think that it is very important for us to maintain the deep and liquid Treasury markets. It is something that is part of what makes our dollar the world's reserve currency. It is part of our economic backbone. I don't see a weakness in the Treasury market right now, but I can assure you that—

Mr. DELANEY. You are looking at it.

Secretary LEW. —a day doesn't go by when I don't ask questions about it.

Mr. DELANEY. Right. Sure.

Last question, Ex-Im Bank. I have talked about ideas where institutions like Ex-Im are required to sell off some of their portfolio on a regular basis so there is better transparency as to how their assets are priced. Do you support approaches like that?

Secretary LEW. I am not familiar with that proposal. I would be happy to look it.

I think the Ex-Im Bank does enormously important work in leveling the playing field for U.S. exporters. It throws off a—

Mr. DELANEY. Right. And I agree with that position. I just think additional transparency around how they price their assets is useful—

Secretary LEW. I just haven't looked at that. I would be happy to look at it.

Mr. DELANEY. Yes.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair wishes to alert Members that in order to accommodate the Secretary's schedule, we anticipate clearing three more Members in the queue. Presently, that would be Mr. Stivers, Mr. Pittenger, and Mr. Barr, depending on whether or not somebody else walks in on the Democratic side.

The gentleman from Ohio, Mr. Stivers, is now recognized.

Mr. STIVERS. Thank you, Mr. Chairman.

Right here, Mr. Secretary. How are you?

Secretary LEW. I am well. How are you?

Mr. STIVERS. Good.

So you have already answered questions from Mr. Duffy and Mr. Ross and Mr. Fincher about liquidity. I want to ask a couple of things about that.

You have said you don't think there is a problem, and, to you, the world is rainbows and unicorns and everything is good with liquidity.

Secretary LEW. I don't think that is what I said.

Mr. STIVERS. You said there wasn't a problem with liquidity, didn't you?

Secretary LEW. No. I said I think the Treasury market—we haven't seen problems in the Treasury market. I think there are issues about liquidity that require a lot of attention, and I went through at some length the kinds of issues that I think we need to pay attention to.

Mr. STIVERS. Great. Okay. Well, then, let's talk a little bit about that.

So you do believe that we need to give it a little attention. In your role of Chair of the FSOC, have you directed the Office of Financial Research (OFR) to study this problem and how the policies that are completed and proposed might come together to cause a problem? Or have you asked them anything at all?

Because some of us would love to see them do a study. I wrote them a letter asking them to do a study. And I am just curious if you have asked them to do a study on it, on liquidity and—

Secretary LEW. They are doing work in this area. And they have obviously issued some analysis, and I know they have other work that is ongoing.

And I think it is not just an OFR question. It is a question that we have to ask in domestic finance in Treasury, securities and banking regulators have to ask. So I think that there is a serious conversation in this area.

What I have tried to make clear is that it would be a mistake to jump to conclusions about what the relationship between the safer, sounder world after financial reform and liquidity is. We have to be open to it but not assume that is the whole explanation.

Mr. STIVERS. I don't disagree with you, which is why I ask you if you would ask the OFR to do a study.

And so you just indicated there is some work going on. When can we expect to see a study from OFR around—

Secretary LEW. I would have to get back to you on the workstream.

Mr. STIVERS. Please do. Because that is their job. Their job is—it is called the Office of Financial Research. So it seems to me that they are the most logical place to look at it.

Secretary LEW. They have been doing a lot of analysis on October 15th, for example, to understand what happened on that day. And they are very much in the space of helping to make it possible to look between the data that different regulators have and do the analysis.

Mr. STIVERS. Which is their job. And I am just asking you—

Secretary LEW. Yes.

Mr. STIVERS. —to have them do their job and make that available to us. Because, as policymakers, we would love to see that, and it may impact some of the policies we decide to make. And as somebody who enforces those policies that are made by Congress, obviously you have some ability to change the way you do your job too.

But we would love to see that information. And the sooner we can see it, the sooner we can make an informed decision, as opposed to either one of us, maybe me assuming that it is a problem and you assuming it is not. Let's look at—

Secretary LEW. I couldn't agree more that we have to understand things before we act.

Mr. STIVERS. So please ask them do a study that is detailed with regard to this. Because I think, when you see what is going on between the Volcker Rule and what is going on with the Department of Labor and what is going on in the private sector separately from regulation, where a lot of people are simplifying their business model, getting out of some risky businesses, those three come together in a way that could really cause a liquidity crisis in the future. And I just want to make sure we look toward it and try to anticipate it and head it off. So, please, I would urge you to do that.

The other question I have, really quickly, is with regard to designating systemically important institutions. Has anybody talked to you about that? Because I didn't hear whether anybody had talked much to you about that.

Secretary LEW. There were quite a number of questions earlier.

Mr. STIVERS. So—

Secretary LEW. I am not sure what question—

Mr. STIVERS. Okay. Well, do you think the $50 billion—let's talk about banks for a second. The $50 billion level—many folks, including folks at the Federal Reserve, have said that is an inadequate and artificial number. How do you feel with that number in the law?

Secretary LEW. I think that it is important that we use the flexibility we have to treat institutions of different size differently. And we have tried to do that, and we need to continue to ask, is it being done as well as we can do it.

I think it is a mistake, though, to think that a $2 billion institution is the same as a $50 billion institution or a $100 billion or a

$500 billion institution. So I think some of the suggestions that I have heard about drawing the line, say, at $500 billion are very bad policy. That would take the next six largest institutions out of the heightened supervision.

Mr. STIVERS. Let me suggest an alternative approach. Have you looked at nonbank assets, the assets that are not under the covered institution—I would ask you to look at that, because that is where the systemic risk is created.

I know my time is gone, but please look at that. I will follow up in writing.

Chairman HENSARLING. The time of the gentleman has expired.

The Chair now recognizes the gentleman from North Carolina, Mr. Pittenger.

Mr. PITTENGER. Secretary Lew, there has been some discussion today, a considerable amount, regarding the debt. From what I understood, you seemed to be somewhat dismissive of this concern and of the threat. Do you see it as a threat?

Secretary LEW. I—

Mr. PITTENGER. Do you see it as an economic—

Secretary LEW. I have spent most of my professional life trying to control our spending and have revenue to cover our expenses, so I don't dismiss it at all.

Mr. PITTENGER. Okay. But do you see it—

Secretary LEW. I think we have made enormous progress—

Mr. PITTENGER. Do you see it as a level of concern as much as Iran—

Secretary LEW. I don't think—

Mr. PITTENGER. —in terms of national security and economic security?

Secretary LEW. I think—

Mr. PITTENGER. How would you place it?

Secretary LEW. —if we had stayed on the course we were on in 2008—

Mr. PITTENGER. No.

Secretary LEW. —I would say that—

Mr. PITTENGER. Sir—

Secretary LEW. —we have made progress since then. I don't—

Mr. PITTENGER. —with all due respect, let me ask you—this is the question I am asking. How do you view the threat? Do you view it as important as the concern we have with Iran and the security threat there?

Secretary LEW. I—

Mr. PITTENGER. The economic threat that we have with the debt—

Secretary LEW. Look, I—

Mr. PITTENGER. —do you sense that? Is that as compelling to you?

Secretary LEW. I think they are, obviously, very different kinds of—

Mr. PITTENGER. They are.

Secretary LEW. —threats. We have made a lot more progress on our fiscal position than we have in terms of moving Iran.

Mr. PITTENGER. I understand that.

You heard the statement from Admiral Mullen earlier, and you hear it from Peter Orszag still today, the former budget writer for Mr. Obama, still talking about the trajectory of spending and the concerns over the debt.

I was with Erskine Bowles over the weekend. I have known Erskine for 25 years. He made a statement publicly this last fall regarding the spending levels and the debt and where that is headed.

There are a lot of people who give a clear focus on the debt and see it as a major priority and a concern. And what I am asking you, do you see the same level of concern—when you put your head on a pillow at night, does that keep you awake as much as Al Qaeda?

Secretary LEW. Congressman, we have made enormous progress—

Mr. PITTENGER. No, no, no. That is not the question, with all due respect.

Secretary LEW. But it is the reason why my answer is what my answer is. If you had asked me this question in 2009, I would have given you a different answer than I am giving you now because—

Mr. PITTENGER. I am asking you today.

Secretary LEW. —we are not in the same place.

Mr. PITTENGER. Is it a vital concern to you today?

Secretary LEW. I don't think it is the most pressing concern today, because we have controlled the rate of growth—

Mr. PITTENGER. So $18 trillion, that is not a concern to you?

Secretary LEW. As a percentage of GDP, we have stabilized the deficit and the growth of the debt.

Mr. PITTENGER. And the trajectory of spending is going up—

Secretary LEW. I think—

Mr. PITTENGER. —not leveling off.

Secretary LEW. —for the next 10 years, we have a stable debt and deficit situation.

Mr. PITTENGER. Here is Erskine Bowles—

Secretary LEW. It does not mean—

Mr. PITTENGER. Excuse me. Here is Erskine Bowles, October 2014: "The deficit is projected to return to an upward path over the rest of the decade and beyond."

Sir, a lot of smart people disagree with you. A lot of smart people are concerned about the trajectory of spending and the imploding debt and the fiscal crisis that is going to put us in. And what I am asking you is, do you not share that concern?

Secretary LEW. Congressman, I am telling you I do have a concern about our fiscal policy. We have to maintain a responsible fiscal policy. We also have to maintain growth, and we have to—

Mr. PITTENGER. Do you think it is enough to talk about, to bring it to the American people?

Secretary LEW. We have done more than talk, Congressman. We have reduced the debt—

Mr. PITTENGER. Sir, in all due respect, the man that you work for, that you report to, has he ever brought it up in an inauguration? Has he ever brought it up at the State of the Union address? He came here to the Capitol this week to talk about TPA. Has he ever come to talk to the Members of Congress about the debt and the—

Secretary LEW. Congressman, when he took office—

Mr. PITTENGER. The man that you advise, do you advise him to address this debt concern?

Secretary LEW. Congressman, we have reduced the deficit as a percentage of GDP from 10 percent—

Mr. PITTENGER. That is—

Secretary LEW. —to under 3 percent.

Mr. PITTENGER. I am talking about the future.

Secretary LEW. That speaks to what we are doing and what we have done.

Mr. PITTENGER. There are a lot of smart people who proceeded you in your job who have serious concerns about it.

Let me go on to another issue, and that deals with FATF. There are 34 countries, as you know, committed to the 40 recommendations of FATF in going after terrorism, terrorism financing. What capabilities do we have of going after those countries that are not in compliance?

We have Turkey, we have Qatar. Clearly, they are complicit with terrorism financing. What role can you play as enforcer, in that FATF is not an enforcer? They merely have the standards. And yet, clearly, we see the infractions by those who, in some measure, like Turkey, is a member of NATO.

Secretary LEW. FATF has been a very important process to bring the world community together behind high standards to control bad practices and bad activity.

We are very much engaged on a bilateral basis with any country that we see doing things or not doing things that they need to do to control—

Mr. PITTENGER. Have you called out Turkey on the matter?

Secretary LEW. I have talked with our counterparts in Turkey about what they need do in their banking system, and—

Mr. PITTENGER. Have you called out Qatar?

Secretary LEW. I have talked to people in most of the world about this issue. And when we talk, they actually respond and they move.

So it is not an easy process where you can just kind of turn a switch and have everybody doing everything they need to do, but we are engaged very deeply at a very high level around the world.

Mr. PITTENGER. Thank you for your service.

I yield back.

Chairman HENSARLING. The gentleman yields back.

Our last questioner will be the gentleman from Kentucky, Mr. Barr. He is now recognized.

Mr. BARR. Thank you, Mr. Chairman.

Mr. Secretary, thank you for your patience and for staying with us here.

Since we have talked a lot today about market liquidity, let me bookend our discussion here today with that subject.

The Center for Financial Stability has found that market liquidity has declined 46 percent since its peak in March of 2008. And a recent article in the Wall Street Journal provides this analysis: "Talk to almost any banker, investor, or hedge fund manager today, and one topic is likely to dominate the conversation. It is the lack of liquidity in the markets and what this might mean for the world economy and their businesses. Market veterans say that they have never experienced conditions like it. Banks have become so reluctant to make markets that it has become hard to execute large trades, even in the vast foreign exchange and government bond markets, without moving prices."

So I want to address my question to your skepticism that regulation has played a part in this liquidity issue.

Have you heard from bankers, many of your former colleagues on Wall Street, and bankers that I have heard from as well, that they are less likely today to engage in market-making activities as a result of Volcker and other regulatory pressures?

Secretary LEW. Look, I have heard people say things, some of which are supported by facts and some of which are not. So—

Mr. BARR. But, clearly, as Secretary of the Treasury, you have—

Secretary LEW. I talk to people all the time.

Mr. BARR. Yes, and they have given you that feedback. But what is it that leads you to doubt their sincerity, or do you not—

Secretary LEW. I am not doubting anyone's sincerity. I think people see the world the way they see it. Sometimes it is right, and sometimes it is wrong.

I think that—you just cited at the end of the piece that you read that people are saying they are having trouble moving blocks of bonds in any size they want without any movement in price. I think that has something to do with market structure. You have different players in the market now. It may mean that to maintain liquidity you have to do multiple transactions.

Mr. BARR. I understand, but—

Secretary LEW. That is different from not being able to transact.

Mr. BARR. Yes. I understand. But would you acknowledge that when banks become reluctant to engage in market-making that impacts liquidity?

Secretary LEW. I think there are different kinds of market-making going on. There is a lot of market-making going on, and you can't roll back the clock. The fact that you have the emergence of, say, electronic trading and high-frequency trading, there is a lot of activity taking place in that space that isn't the traditional broker-dealer model.

Mr. BARR. Let me take one example, and that is the collateralized loan obligation marketplace: $350 billion of senior secured commercial and industrial loans that provide financing for very dynamic job-producing companies, many of which are actually in my own district.

Would you acknowledge that the Volcker Rule has forced banks to take pretty significant losses in AAA and AA CLO paper?

Secretary LEW. Obviously, the Volcker Rule is still taking effect. It hasn't—

Mr. BARR. There are already banks being forced to divest AAA and AA CLO paper.

Secretary LEW. Banks are going to have to not have proprietary investments that they had in the past.

Mr. BARR. Right, but let me ask you—

Secretary LEW. That means that they are going to have to sell some assets.

Mr. BARR. Sir, do you know how many AAA or AA tranches of CLO notes defaulted over the last 20 years? The answer is zero.

The Volcker Rule is forcing banks to divest in very safe investments. And you have to acknowledge that has a destabilizing impact on the financial stability of these institutions.

Secretary LEW. But I think you also have to acknowledge that the exposure to risk on proprietary investments was a significant—

Mr. BARR. What risk is there with AAA or AA CLO notes that have never defaulted over 20 years and performed well during the financial crisis?

Secretary LEW. The objective of the Volcker Rule was to reduce the level of risk exposure of firms by getting them out of proprietary investments. I think that we will be better off when that is implemented. And I think the markets will adapt—

Mr. BARR. You don't dispute the fact that Volcker forces banks, which haven't defaulted in 20 years, to divest of AAA paper?

Secretary LEW. With the exception of Treasuries, it is a pretty tight rule in terms of—

Mr. BARR. Let me conclude just really quickly with one other point, and that is community banks.

Community banks in my district, the bankers tell me that Dodd-Frank and the avalanche of compliance costs and red tape has really impacted their bottom line. And the numbers bear this out. The number of community banks $10 billion or below has shrunk from 7,700 in the second quarter of 2010 to only 6,300.

Meanwhile, there is consolidation in the industry. So the big banks, the SIFI banks, are larger. And too-big-to-fail is a bigger problem now because we don't have diversity and we don't have as much competition in the system.

Can you respond to that financial stability issue?

Secretary LEW. Look, I think the consolidation was going on before Wall Street reform was enacted, and I am not sure that consolidation is leading to the SIFIs taking over. It is mostly smaller banks combining. And it is an issue that—we have a real shared interest in making sure communities have access to community banks—

Mr. BARR. And I would encourage FSOC to look at consolidation, industry consolidation, as a problem, because it is exacerbating too-big-to-fail.

Thank you. I yield back.

Chairman HENSARLING. Although there are other Members in the queue, they will not be recognized today.

I would like to thank Secretary Lew for his testimony.

The Chair notes that some Members may have additional questions for this witness, 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 this witness and to place his 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.

Mr. Secretary, we would ask that your office respond as promptly as you are able. And I mean this most respectfully and sincerely: We would ask that Treasury cease the response dump at midnight before your appearances. That is a sincere request to you, sir.

With that, this hearing stands adjourned.

[Whereupon, at 1:13 p.m., the hearing was adjourned.]

A P P E N D I X

June 17, 2015

EMBARGOED FOR DELIVERY

The Honorable Jacob J. Lew
U.S. Department of the Treasury
Hearing on the Financial Stability Oversight Council Annual Report to Congress
House Committee on Financial Services
June 17, 2015

As prepared for delivery.

Chairman Hensarling, Ranking Member Waters, and members of the Committee, thank you for the opportunity to testify today regarding the 2015 annual report of the Financial Stability Oversight Council.[1]

The Council was created to identify and respond to vulnerabilities in the U.S. financial system and provide a mechanism for agencies to talk to each other and take collective responsibility for addressing potential threats to financial stability. At its 51st meeting last month, the Council released its fifth annual report, which highlighted many of the topics the Council has discussed over the last year, including cybersecurity, interest-rate risk, benchmark rate reform, potential fire sale risks in short-term wholesale funding markets, threats from market instability in Europe and emerging markets, and a host of other risks. Those discussions laid the groundwork for many of the recommendations in this year's annual report, and these issues will continue to be areas of focus in the coming year.

The Council's annual report serves as an important mechanism for public accountability and transparency regarding the Council's work. Each report is the product of extensive, data-driven analysis conducted by the Council and its member agencies that documents the Council's views of current risks and emerging threats to financial stability, along with recommendations for specific actions to mitigate those risks. The findings and recommendations set down a marker for action, providing transparency regarding the Council's upcoming priorities as well as a roadmap for the year ahead. Importantly, the annual report also contains an affirmation by each of the Council's voting members that the actions outlined in the report are the reasonable steps that should be taken to promote financial stability. This creates clear accountability for making progress.

Areas of Focus of the Council's 2015 Annual Report

The Council's 2015 annual report focuses on 11 themes that warrant continued attention and, in many cases, further action from the Council's members and member agencies.

Cybersecurity

Over the past year, financial sector organizations and other U.S. businesses experienced numerous cyber incidents, including large-scale data breaches that compromised financial information. Malicious cyber activity is likely to continue, and financial sector organizations

[1] The Council's 2015 annual report is publicly available at http://www.treasury.gov/initiatives/fsoc/studies-reports/Pages/2015-Annual-Report.aspx.

should be prepared to mitigate the threat posed by cyber attacks that have the potential to destroy critical data and systems and impair operations. Treasury and U.S. regulators have taken steps to prompt financial institutions to mitigate risks to the financial system posed by malicious cyber activities, including developing new tools for financial institutions to evaluate their readiness to identify, mitigate, and respond to cyber threats, and by focusing on technology service providers' cybersecurity preparedness. As cyber threats continue to evolve, critical areas of focus must include strong collaboration and information sharing among financial service companies and government agencies, improvements in technology infrastructure;, and comprehensive plans for responding to and recovering from cyber incidents. The annual report contains specific recommendations about cybersecurity information sharing between the private sector and government, continued implementation of best practices, and the maintenance of robust plans for responding to a significant incident. Specifically, the Council encourages the establishment of a national plan for cyber incident response for the sector, coordinated by Treasury, which includes identifying and articulating the role of law enforcement, the Department of Homeland Security, and financial regulators. The Council also continues to support comprehensive cybersecurity legislation, including proposals to enhance cybersecurity information sharing and data breach notifications.

Increased Risk-Taking in a Low-Yield Environment

The historically low-yield environment continues to encourage greater risk-taking across the financial system. Investors may seek incremental gains in yield for disproportionate amounts of risk. Banks, credit unions, and broker-dealers have lower net interest margins, leading some firms to increase risk by holding longer-duration assets, easing lending standards, or engaging in other forms of increased risk-taking. In its annual report, the Council recommends that supervisors, regulators, and firm management continue to closely monitor and assess the heightened risks resulting from continued search-for-yield behaviors as well as the risks from potential severe interest rate shocks. The Council's report also recommends that the Federal Insurance Office and state insurance regulators continue to closely monitor and assess the growing risks that insurers have taken by extending the duration of their portfolios and by investing in lower-quality or less-liquid assets.

Changes in Financial Market Structure and Implications for Financial Stability

Financial market structure has evolved substantially over the years, owing to a confluence of factors including technology, regulation, and competition. Electronic trading platforms and algorithmic trading firms now play an increasing role in facilitating market liquidity. In addition, the business models and risk appetite of traditional broker-dealers have changed, with some broker-dealers reducing their securities inventories and, in some cases, exiting certain markets. New trading venues and platforms have also developed or expanded in certain markets, including new regulated exchanges, interdealer platforms, and dark pools among others. Cyclical factors in the current environment may further magnify the impact of these developments on market liquidity. As this evolution of market structure plays out across a broader collection of asset classes and markets, market participants and regulators should continue to monitor how it affects the provision of liquidity and market functioning, including operational risks.

The Council recommends that its members and member agencies continue to remain vigilant to the confluence of factors driving changes in market structure, the extent of their impact on market functioning and the provision of liquidity, and potential implications for financial stability. Regulators should assess the extent to which potential actions in certain markets might be applicable to other markets as well. Regulators should also work to better understand the linkages between and across markets, both regulated and unregulated, by improving data collection efforts and data-sharing arrangements across the member agencies. The Council also recommends that regulators continue to enhance their understanding of firms that may act like intermediaries and that may be outside the regulatory perimeter, work to develop enhanced tools, and, as warranted, make recommendations to Congress to close such regulatory gaps.

Central Counterparties

Following the crisis, U.S. and foreign regulators have encouraged or required more derivatives and other financial transactions to be cleared through central counterparties (CCPs). CCPs require robust frameworks for risk management if they are to enhance financial stability and increase market resiliency. Regulators have taken significant steps in recent years to promote strong risk management at systemically important CCPs and remain focused on identifying and mitigating any potential threats to financial stability that could arise from CCPs. In particular, it is important to evaluate whether existing rules and standards are sufficiently robust to mitigate the risk that CCPs could transmit credit and liquidity problems among financial institutions and markets during periods of market stress.

In its report, the Council recommends that the Federal Reserve, Commodity Futures Trading Commission (CFTC), and Securities and Exchange Commission continue to coordinate closely in the supervision of all CCPs that are designated as systemically important financial market utilities under Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Wall Street Reform), and recommends that the agencies continue to actively evaluate whether recently enhanced rules and standards are sufficiently robust to mitigate potential threats to financial stability. Further, the Council's report recommends that the agencies continue to evaluate whether certain CCP-related risk areas are being addressed adequately. In addition, member agencies should continue working with respective international official sector bodies to identify and address areas of common concern as additional derivatives clearing requirements are implemented in other jurisdictions.

Global Economic and Financial Risks

In today's globally integrated financial markets, foreign shocks have the potential to disrupt financial stability in the United States. In 2014, concerns about stability in the euro area resurfaced amid weak economic growth and political uncertainty in Greece. Although there has been some progress during Greece's ongoing discussions with Europe and the IMF, the negotiations and the path to securing agreement are challenging and complex. We continue to urge a timely resolution so that Greece is able to continue to meet its obligations. We continue to monitor financial vulnerabilities in emerging market countries — including property market excesses and rapid growth in dollar credit — which could cause disruptions in economic and financial markets. Finally, fiscal policy tools and structural reforms are needed in a number of advanced economies to help support monetary policy and lead to a more balanced and sustainable growth path.

Financial Innovation and Migration of Activities

Technology, competition, and regulatory changes are continuously reshaping the financial system and bringing about innovations in products, services, and business practices, which benefit investors and consumers. Since the recent financial crisis, the changing financial system landscape has fostered many innovations. One challenge for regulators is the need to monitor new products or services in light of existing standards and regulations. Another challenge is the migration of activities to less regulated or unregulated institutions. In its report, the Council recommends that its members and member agencies remain vigilant to the potential financial stability risks that may arise from financial innovation, business practices, and migration of activities in the financial system. In particular, the Council recommends that state regulators continue to monitor concerns raised in its 2014 annual report about nonbank mortgage servicers and collaborate with the Consumer Financial Protection Bureau and Federal Housing Finance Agency (FHFA), as appropriate, on further developing and implementing prudential and corporate governance standards to strengthen these companies.

Short-Term Wholesale Funding

Domestic banking firms' reliance on short-term wholesale funding has decreased since the recent financial crisis. The decline partly reflects the large increase in retail deposits and adjustments some banks are making to their funding and balance sheet structures in response to enhanced liquidity standards, such as the liquidity coverage ratio, and capital requirements, including the supplementary leverage ratio. Similarly, total borrowing by primary dealers across all segments of the repurchase agreements (repo) market was essentially flat in 2014.

Previous annual reports have highlighted structural vulnerabilities in the tri-party repo market. Significant progress has been made in this market in recent years, in particular reducing the reliance of market participants on intraday credit from clearing banks. The risk of fire sales of collateral deployed in repo transactions remains an important financial stability concern. The industry is still working to bring the settlement of general collateral finance (GCF) repo transactions in line with the reforms effected for tri-party repo generally. In its report, the Council recommends that market participants continue to make progress toward extending improvements in the tri-party repo settlement process to GCF repo settlement. The Council also urges continued coordination between market participants and financial regulators to address the risk of post-default fire sales of assets by repo investors.

Risk-Taking Incentives of Large, Complex, Interconnected Financial Institutions

Wall Street Reform enhanced the safety and soundness of the largest financial institutions and instituted limits on the support that can be provided in the event of future financial crises. Specifically, Wall Street Reform requires the Federal Reserve to adopt enhanced prudential standards for the largest bank holding companies (BHCs) and designated nonbank financial companies. It also requires that certain companies develop and submit to the Federal Reserve and the Federal Deposit Insurance Corporation their own plans for rapid and orderly resolution, and limits the ability of the Federal Reserve to provide extraordinary support to individual institutions.

Although the largest BHCs have become even larger, some market-based measures indicate they have become less interconnected and less complex since the passage of Wall Street Reform. Additionally, some credit rating agencies have lowered their assessments of the likelihood of government support for the largest banks in times of stress. However, these rating agencies still factor into their ratings that there is some chance that the government will provide support to the largest banks if they become financially distressed. The Council recommended continued efforts by regulators to promote full implementation of Orderly Liquidation Authority and phasing in enhanced prudential standards in the coming years, which should help reduce remaining perceptions of government support for large, complex, interconnected financial institutions.

Reforms of Reference Rates

Investigations of manipulation of the widely used London Interbank Offered Rate (LIBOR) that surfaced in 2012 highlighted concerns about the integrity of interest rate and other financial benchmarks. Incidents of manipulation reduce public confidence in the financial system and risk financial instability, in part owing to the significant disruptions associated with changing the reference rates for financial contracts. Since the Council's 2014 annual report, administrators of LIBOR, the Euro Interbank Offered Rate, and the Tokyo Interbank Offered Rate have made substantial progress toward enhancing oversight, governance, transparency, and accountability of these benchmark rates. Official sector efforts have focused on developing multiple reference rates, which would allow the rate used in a financial transaction to be more closely tied to the underlying economic purpose, reduce the incentive to manipulate, and enhance stability by having more ready alternatives. Concerns have also been raised about other financial benchmarks, including swap rates and foreign exchange rates, which are used for valuing numerous contracts and portfolios of assets. The Council recommended that U.S. regulators continue to cooperate with foreign regulators and official sector bodies in their assessments of market practices for these benchmarks.

Housing Finance Reform

The housing market recovery continued in 2014, despite some signs of softness early in the year. As house prices continued to rise, the number of households with negative equity declined while the performance of outstanding loans improved. Congress has debated several housing finance reform proposals, including separate pieces of legislation that advanced out of the House Financial Services Committee in July 2013 and the Senate Banking Committee in May 2014. The Council recommended that comprehensive legislation address the conservatorship of Fannie Mae and Freddie Mac — the government-sponsored enterprises (GSEs) — and clarify the future role of the federal and state governments in mortgage markets. In the absence of housing finance reform, FHFA, primarily through its conservatorship and oversight of the GSEs, continued to make meaningful efforts to improve housing finance infrastructure and reduce the amount of taxpayer risk. However, core challenges persist. The GSEs remain in conservatorship, subject to FHFA supervision, with the vast majority of newly originated mortgages carrying a federal government backing either through the GSEs, the Federal Housing Administration, or other government-backed programs. The Council's report includes a number of recommendations to reduce the GSE's exposure to mortgage credit risk.

Data Quality, Collection, and Sharing

Data limitations can hamper the ability of market participants and regulators to fully comprehend the scope and size of risks throughout the financial system. Regulators took several steps in 2014 to improve the scope, comparability, and transparency of existing data collections. Promoting transparency in the over-the-counter derivatives markets is a major priority for the Council and international regulators, given the market's role in the financial crisis, its decentralized nature, and evolving infrastructure. The global Legal Entity Identifier (LEI) project progressed in 2014. In the United States, more regulatory reporting forms are requiring the use of the LEI. Also, in 2014, the CFTC and Office of Financial Research entered into a cooperative effort to enhance the quality, types, and formats of data collected from CFTC-registered swap data repositories. Although regulators now collect significantly more data on financial markets and institutions, critical gaps remain in the scope and quality of available data. For example, regulators and market participants lack comprehensive data on repo and securities lending markets. The Council's report recommends that regulators and market participants continue to work together to improve the quality, access and comprehensiveness of financial data in the United States and across global markets. The Council's report also recommends that its member agencies support the adoption and use of data standards, including the LEI and the unique loan identifier for mortgage data. Finally, the Council's report recommends that the member agencies continue to explore best practices for data sharing and for improving reporting efficiency.

The annual report goes into detail on each of these important issues. These 11 areas of focus also demonstrate the need for continued vigilance of the financial system and for the Council and its member agencies to draw attention to these risks.

Additional Work of the Council

The report also provides the public with a comprehensive summary of the progress regarding the Council's other work. For example, since our last annual report, the Council has continued to identify nonbank financial companies whose material financial distress could pose a threat to U.S. financial stability and conducted its first annual reevaluations of the three nonbank financial companies that were designated in 2013. The Council has also considered potential risks within the asset management industry, by focusing its efforts on industry-wide products and activities that could require additional attention. This work incorporated extensive engagement with stakeholders, including a formal solicitation of public comment.

The Council's annual report also highlights a number of Council initiatives over the past year that demonstrate its continued commitment to transparency and good governance, including the adoption of supplemental procedures related to its nonbank designations process, which addressed a number of suggestions made by stakeholders.

As the forum for the entire financial regulatory community to work collaboratively to identify and respond to potential threats to financial stability, the Council has done what Congress designed it to do, including asking the tough questions that will make our financial system safer. Our mandate has allowed us to shine a light on emerging threats before they can evolve into another financial crisis. As part of this responsibility, the Council has been responsive and has worked closely with a broad array of stakeholders as it conducts its work, including adapting its policies and procedures when good ideas are raised. Despite the Council's record, unfortunately, opponents of financial reform continue to back attempts to undermine the Council, its member agencies, and its ability to respond to potential threats to financial stability.

As we approach the five-year anniversary of the enactment of Wall Street Reform and the creation of the Council, we know that these reforms have made the financial system safer, more resilient, and supportive of long-term economic growth. Wall Street reform has put into place important consumer, investor, and taxpayer protections that support companies that play by the rules and serve their customers, small businesses that need access to credit to grow and create jobs, and working men and women trying to save for their children's education, a down payment on a home, and their own retirement. It would be a mistake to roll back the clock on these protections or to constrain the ability of the Council or its member agencies to address new risks or emerging threats to financial stability. I look forward to working with this Committee, and with Congress as a whole, to continue addressing these threats and promoting the strength and stability of the U.S. financial system.

ACLI
Financial Security...for Life.

Statement for the Record
House Committee on Financial Services

Hearing titled "The Annual Report of the Financial Stability Oversight Council"

June 17, 2015

The American Council of Life Insurers (ACLI) is pleased to submit this statement for the hearing record expressing the views of the life insurance industry regarding the procedures governing the designation of nonbank financial companies by the Financial Stability Oversight Council (FSOC).

The American Council of Life Insurers (ACLI) is a Washington, D.C.-based trade association with approximately 300 member companies operating in the United States and abroad. ACLI advocates in federal, state, and international forums for public policy that supports the industry marketplace and the 75 million American families that rely on life insurers' products for financial and retirement security. ACLI members offer life insurance, annuities, retirement plans, long-term care and disability income insurance, and reinsurance, representing more than 90 percent of industry assets and premiums.

ACLI has a particular interest in the subject matter of this hearing; three of the four nonbank financial companies that have been designated by FSOC for supervision by the Federal Reserve Board are insurance companies, and all of those companies, Prudential, MetLife, and AIG, are members of ACLI. Many ACLI member companies also are actively engaged in asset management, which is a business under active review by FSOC.

Last year, ACLI along with several other national trade associations submitted a petition to FSOC recommending changes to the procedures for designating nonbank financial companies as being subject to supervision by the Federal Reserve Board. In response, FSOC made some needed improvements to the process. Nonetheless, additional reforms to the procedures and standards applied by FSOC in its designations are necessary to promote transparency and ensure a fair process.

This statement addresses five key points: (1) the additional procedural safeguards that should be adopted by FSOC in connection with designations; (2) FSOC's flawed application of the "material financial distress" standard for designations; (3) FSOC's failure to give sufficient weight to the views of state insurance authorities in connection with designations; (4) FSOC's failure to give consideration to the consequences of designation; and (5) FSOC's failure to consider an "activities-based" approach for insurance.

1. The designation and de-designation processes lack sufficient procedural safeguards and the public explanations accompanying designations give the public and other nonbank financial companies insufficient insight into why particular companies have been designated.

FSOC has established a three-stage process for determining whether a nonbank financial company should be subject to supervision by the Federal Reserve Board. In response to concerns raised by ACLI and other

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national trade associations, FSOC has made some improvements to the process. Nonetheless, additional reforms are needed.

A company should have access to the entire record.

A company that advances to the third and final stage of review still has no way of knowing all the materials FSOC believes are relevant, whether and in what form the materials it submits are provided to voting members of FSOC, or what materials, in addition to those submitted by the company, FSOC staff and voting members reviewed and relied upon. In other words, a company is not provided with the evidentiary record upon which the voting members will make a proposed or final determination. A company should have access to the entire record that is the basis for an FSOC determination.

FSOC should have separate staff assigned to enforcement and adjudicative functions.

Council staff who identify and analyze a company's suitability for designation and author the notice of proposed determination and final determination should not also advise Council members in deciding whether to adopt the notice of proposed determination and final determination. Dividing Council staff between enforcement and adjudicative functions would protect the independence of both functions. Separation of powers principles and basic fairness require no less. In addition, communications between Council members and enforcement staff should be memorialized as part of the agency record and provided to companies under consideration for designation.

Special weight should be given to the views of the Council member with insurance expertise and to the primary financial regulatory agency for a company.

FSOC must vote, by two-thirds of the voting members then serving including the affirmative vote of the Chairperson, to issue a final determination. The requirement for a supermajority vote is intended to ensure that designation is reserved for companies that pose the most obvious risk to the financial stability of the United States. Yet, the members of FSOC vote as individuals rather than as representatives of their agencies. Thus, the vote is based upon their own assessment of risks in the financial system rather than the assessment of their respective agencies. Moreover, the voting process gives equal weight to views of all members, regardless of a member's experience in regulating the type of company being considered for designation. In the case of an insurance company, special weight should be given to the views of the Council member with insurance experience, and to the state insurance regulator for the company.

The explanation of a designation should provide greater insight into the basis for designation, and a designation should be based upon evidence and data.

When FSOC votes to designate a company, it provides the company with an explanation of the basis for the determination and releases a public version of that document. These documents provide little insight into the basis for a designation, typically offering only conclusory statements unsupported by data or other concrete evidence and analysis. For example, in the documents released by FSOC in connection with the Prudential and MetLife determinations, FSOC concluded that material financial distress at Prudential and MetLife would be transmitted to other financial firms and harm the financial system. In drawing this conclusion, FSOC relied on extensive speculation about the behavior of policyholders and the reactions of competing insurers and assumed that state regulatory responses would be inadequate, even though history and empirical evidence were to the contrary. When the only explanation for a designation disregards historical experience, empirical research, and fundamental and proven principles of economic behavior and risk analysis, the industry can at best only speculate about the kind of evidence that would satisfy FSOC that designation is neither necessary nor appropriate. While there may be legitimate reasons why the public version of the designation decision omits certain sensitive information, the company should receive a full explanation of the basis for the decision.

A company should have more than 30 days to seek judicial review of a final decision in a federal court, and during judicial review, the company should not be subject to supervision by the Federal Reserve Board.

Upon receipt of a final designation, a company may seek judicial review before a federal court. Even this safeguard, however, is subject to limitations. A company has only 30 days in which to file a complaint, and loses the right to do so beyond that date. Moreover, filing the complaint carries no automatic stay of supervision by the Federal Reserve Board. Thus, while a company is challenging the legitimacy of a designation, it simultaneously must establish a comprehensive infrastructure (e.g., systems, procedures, and controls) to comply with Board supervision.

Companies should be able to petition for a review of a designation based upon a change in operations or regulations, and a company should be provided with an analysis of the factors that would permit it to be de-designated.

FSOC is required to review the designation of a company on an annual basis. A company also should have the opportunity to obtain a review based upon a change in its operations, such as the divestiture of certain business lines, or a change in regulation. Moreover, during a review, FSOC should be required to provide a company with an analysis of the factors that would lead FSOC to de-designate a company. This would lead a company to know precisely what changes in its operations or activities are needed to eliminate any potential for the company to pose a threat to the financial stability of the United States. In addition, it makes little sense that it takes a supermajority to de-designate a company. If a simple majority of the Council no longer believes that a company deserves designation, the designation should be rescinded.

FSOC's determinations should be independent of international regulatory actions.

Finally, the lack of transparency in FSOC's designation process and the thinly-reasoned explanations in its designation decisions support the concern voiced by some that FSOC's designations have been preordained by actions of an international regulatory entity, the Financial Stability Board (FSB). The member of FSOC with insurance expertise, Roy Woodall, expressed this concern in his dissent to the Prudential designation. The U.S. Department of Treasury and the Federal Reserve Board are both important participants in the FSB, which in 2013 issued an initial list of insurance companies that the organization considered to be "global systemically important insurers." AIG, Prudential, and MetLife were all on the FSB's list. Those companies' designations as SIFIs should have been based on the statutory requirements of the Dodd-Frank Act, which differ meaningfully from the standards FSB has said it applies.

Yet, there is ground for concern that leading participants in FSOC were committed to designating as systemic under Dodd-Frank those companies that they had already agreed to designate as systemic through the FSB process. FSOC should not be outsourcing to foreign regulators important decisions about which U.S. companies are to be subject to heightened regulation.

2. FSOC's flawed application of the material financial distress standard for designation distorts the purpose of designations by failing to account for the vulnerability of prospective designees and departs from the requirements of the Dodd-Frank Act and its own regulatory guidance.

The Dodd-Frank Act authorizes FSOC to designate a nonbank financial company for supervision by the Federal Reserve Board if either (1) material financial distress at the company, or (2) the nature, scope, size, scale, concentration, interconnectedness, or mix of activities of the company could threaten the financial stability of the United States. Each of the designations made by FSOC has been based on the first standard, the material financial distress standard. Moreover, in each case, FSOC assumed the existence of material financial distress at the company, and then concluded that such distress could be transmitted to the broader financial system.

This interpretation of the material financial distress standard departs from the authorizing statute and FSOC's own regulatory guidance, and distorts the purpose of designation. The Dodd-Frank Act expressly directs FSOC, when considering a company for designation, to consider 11 factors, a number of which implicate the company's vulnerability to material financial distress. And FSOC's own interpretive guidance recognizes that a company's vulnerability to financial distress is a critical part of the designation inquiry.[1] The statute, FSOC's guidance, and well-established principles of reasoned regulation make clear that FSOC should not evaluate a company's systemic effects by assuming that the designated company is failing, but instead should separately assess the company's vulnerability to material financial distress. Making this a part of the designation process also provides guidance and the right incentives for companies that may be considered for designation in the future, because it incentivizes them to change aspects of their business that FSOC regards as vulnerabilities.

Roy Woodall addressed FSOC's flawed application of the material financial distress standard in his dissents in both the Prudential and MetLife cases. In the Prudential case, he noted that:

"...the Notice's analysis under the [material financial distress standard] is dependent upon its misplaced assumption of the simultaneous failure of all of Prudential's insurance subsidiaries and a massive and unprecedented, lightning, bank-style run by a significant number of its cash value policyholders and separate account holders, which apparently is the only circumstance in which the Basis concludes that Prudential could pose a threat to financial stability. I believe that, absent a catastrophic mortality event (which would affect the entire sector and also the whole economy), such a corporate cataclysm could not and would not occur."

Similarly, in his dissent in the MetLife case, Mr. Woodall highlighted the lack of evidence to support one of FSOC's principal bases for assuming "material financial distress" at MetLife:

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[1] See *Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies*, 77 Fed. Reg. 21,637 (Apr. 11, 2012)

"I do not, however, agree with the analysis under the Asset Liquidation Transmission Channel of the Notice of Final Determination, which is one of the principal bases for the finding under the [material financial distress standard]. I do not believe that the analysis' conclusions are supported by substantial evidence in the record, or by logical inferences from the record. The analysis relies on implausible, contrived scenarios as well as failures to appreciate fundamental aspects of insurance and annuity products, and, importantly, State insurance regulation and the framework of the McCarran-Ferguson Act."

One consequence of FSOC's interpretation of the material financial distress standard is that FSOC focuses too narrowly on a company's size. When it passed the designation provisions in the Dodd-Frank Act, Congress never intended a unilateral focus on size. Rather, size is just one of 11 factors that Congress directed FSOC to consider when it designates a company.

Another consequence of FSOC's reliance on the material financial distress standard is that it is difficult for a company, or the public, to understand the basis for a designation. The documents accompanying designations address how the company's failure might impact financial stability, but do not address what hypothetically caused the company to fail in the first place. Thus, a designated company has little, if any, insight into what activities are, in FSOC's view, associated with systemic risk.

Under a material financial distress standard that actually meets the statutory requirements of the Dodd-Frank Act, FSOC would need to employ the 11 statutory factors to first determine whether the company is vulnerable to material financial distress based upon its company-specific risk profile and, if it is, then determine whether the company's failure could threaten the financial stability of the United States. In other words, FSOC should not be able to designate a company on an assumption that it is failing, but instead should only designate a company when a company's specific risk profile – including its leverage, liquidity, risk and maturity alignment, and existing regulatory scrutiny – reasonably support the expectations that the company is vulnerable to financial distress, and then that its distress could threaten the financial stability of the United States. The purpose of designations should be to regulate nonbanking firms that are engaged in risky activities that realistically "could" cause the failure of the firm, not to regulate firms that are not likely to fail.

3. FSOC does not give sufficient weight to the views of primary financial regulatory agencies.

In drafting the Dodd-Frank Act, Congress recognized that many nonbank financial companies are subject to supervision and regulation by other financial regulators. Insurance companies, for example, are subject to comprehensive regulation and supervision by state insurance authorities. Thus, Congress directed FSOC to consult with other primary regulators when making a designation determination, and required FSOC to consider "the degree" to which a company is already regulated by another financial regulator. Congress also gave the Federal Reserve Board authority to exempt certain classes or categories of nonbank financial companies from supervision by the Board, and directed the Board to take actions that avoid imposing "duplicative" regulatory requirements on designated nonbank companies.

FSOC's designation of insurance companies shows little deference to these requirements. In the case of MetLife, for example, FSOC discounted state insurance regulation even after the Superintendent of the

New York State Department of Financial Services (NYDFS), Benjamin Lawsky, told FSOC that: (1) MetLife does not engage in non-traditional non-insurance activities that create any appreciable systemic risk; (2) MetLife is already closely and carefully regulated by NYDFS and other regulators; and (3) in the event that MetLife or one or more of its insurance subsidiaries were to fail, NYDFS and other regulators would be able to ensure an orderly resolution.[2] Similarly, in his dissent in the Prudential case, the Council member with insurance experience noted that the scenarios used in the analysis of Prudential were "antithetical" to the insurance regulatory environment and the state insurance company resolution and guaranty fund systems.

This lack of deference to an insurer's primary financial regulator is particularly troubling given the fact that insurance, unlike every other segment of the financial service industry, does not have any of its primary regulators as voting members of FSOC. Moreover, none of the primary regulators of the three insurers that have been designated were "at the table" when FSOC designation decisions were made.

4. FSOC has failed to consider the consequences of designation.

FSOC has an obligation to consider the consequences of its actions. Administrative law requires that an agency consider the effects of its actions, and the failure to do so can cause a court to void the action. SEC Chair Mary Jo White acknowledged publicly in June that a principle of good policymaking is to know "...what is on the other side if I make that decision " and to understand what a decision " actually accomplish[es] in terms of the issue you're trying to solve for."[3] In its determinations to date, however, FSOC has failed to consider the consequences of its designations.

This failure is particularly relevant to designations involving insurance companies. The insurance industry is highly competitive, and the additional regulation imposed upon a designated company can place that company at a significant competitive disadvantage relative to its non-designated competitors. Capital standards are the most obvious example. Congress recently clarified that the Board has the ability to base capital standards for designated insurance companies on insurance risk, rather than banking risk. We appreciate very much this Committee's role in effecting that important clarification. At this point, we are waiting on a proposal from the Federal Reserve Board that makes use of this revised statutory provision. Should the Federal Reserve Board impose capital requirements on designated insurers that are materially different from those imposed by the states, designated insurers may find it difficult to compete against non-designated competitors.

Additionally, FSOC's failure to consider the consequences of designations on insurance companies is at odds with FSOC's "duty" under the Dodd-Frank Act to monitor regulatory developments, including "insurance issues," and to make recommendations that would enhance the "integrity, efficiency, competitiveness, and stability" of U.S. financial markets.[4]

5. FSOC has failed to consider an "activities-based" approach to insurance.

[2] Letter to Honorable Jacob Lew, Secretary of the Treasury, from Benjamin M. Lawsky, Superintendent, New York State Department of Financial Services, July 30, 2014.
[3] "SEC Chair: Asset Managers Not Overreacting to FSOC." *Politico Pro*. June 22, 2014.
https://www.politicopro.com/financialservices/whiteboard/?wbid=33914
[4] §112(a)(2)(D) of the Dodd-Frank Act.

The Dodd-Frank Act gives FSOC two principal powers to address systemic risk. One power is the authority to designate nonbank financial companies for supervision by the Federal Reserve Board. The other power is an "activities-based" authority to recommend more stringent regulation of specific financial activities and practices that could pose systemic risks. FSOC has not been consistent in its exercise of these powers. In the case of the insurance industry, FSOC has actively used its power to designate. In the case of the asset management industry, FSOC has undertaken an analysis of the industry so it can consider the application of more stringent regulation for certain activities or practices of asset managers, and it has not designated any asset management firm to date.

FSOC held a public conference on the asset management industry in order to hear directly from the asset management industry and other stakeholders, including academics and public interest groups, on the industry and its activities. Furthermore, following its meeting on July 31, 2014, FSOC issued a "readout" stating that FSOC had directed its staff "to undertake a more focused analysis of industry-wide products and activities to assess potential risks associated with the asset management industry."

In contrast, FSOC has not held any public forum at which stakeholders could discuss the insurance industry and its activities. Instead, FSOC has used its power to designate three insurance companies for supervision by the Federal Reserve Board.

ACLI supports the more reasoned approach that FSOC has taken in connection with the asset management industry and believes that FSOC should be required to use its power to recommend regulation of the specific activities of a potential designee before making a designation decision with respect to that company.

FSOC's power to recommend more stringent regulation of specific activities and practices has distinctive public policy advantages over its power to designate individual companies for supervision by the Federal Reserve Board. FSOC's power to recommend brings real focus to the specific activities that may involve potential systemic risk and avoids the competitive harm that an individual company may face following designation. As noted above, in certain markets, such as insurance, designated companies can be placed at a competitive disadvantage to non-designated companies because of different regulatory requirements. Finally, the power to recommend avoids the "too-big-to-fail" stigma that some have associated with designations.

FSOC's recommendations for more stringent regulation of certain activities and practices must be made to "primary financial regulatory agencies." These agencies are defined in the Dodd-Frank Act to include the SEC for securities firms, the CFTC for commodity firms, and state insurance commissioners for insurance companies. A recommendation made by FSOC is not binding on such agencies, but the Dodd-Frank Act includes a "name and shame" provision that encourages the adoption of a recommendation. That provision requires an agency to notify FSOC within 90 days if it does not intend to follow the recommendation, and FSOC is required to report to Congress on the status of each recommendation.

Recommended Reforms

To address the concerns highlighted in this statement, ACLI recommends the following reforms:

Institute additional procedural safeguards during the designation process.

We recommend the following changes to the designation process: (1) companies that receive a notice of proposed determination should be given access to the entire record upon which FSOC makes the determination to issue the notice; (2) the same FSOC staff should not serve as factfinder, prosecutor and adjudicator; (3) in the case of an insurance company, the views of the Council member with insurance expertise and the primary financial regulatory agency for the company should be given greater weight; (4) a company should be given more than 30 days to initiate judicial review of a final determination; and (5) supervision of the company by the Federal Reserve Board should be stayed during judicial review.

Establish additional procedures for de-designation.

In addition to the mandatory annual review of a determination, FSOC should be required to conduct a review upon the request of a designated company if there has been a change in the operations of the company or a change in regulation affecting the company. In connection with such a review, FSOC should also provide a company with an analysis of the factors that would lead FSOC to de-designate the company. This would permit a company to know precisely what changes in its risk profile are needed to eliminate any potential for the company to pose a risk to the financial stability of the United States. During the de-designation review, the views of the Council member with insurance expertise and the primary financial regulatory agency for the company should be given special weight. Finally, de-designation should not require a two-thirds supermajority.

Require FSOC to pursue an "activities-based" approach before using its power to designate a company for supervision by the Federal Reserve Board.

FSOC should use its authority under the Dodd-Frank Act to recommend specific activities and practices for more stringent regulation before designating individual nonbank financial companies within an industry for supervision by the Federal Reserve Board. More stringent regulation of the activities or practices of an entire class or category of financial firms can have a greater impact on financial stability than the designation of an individual firm.

Require FSOC to consider "vulnerability" in its designation decisions.

The statute, FSOC's own regulatory guidance, and common sense dictate that a company should not be designated systemic without an evaluation of whether the company, as currently structured and operated, is indeed vulnerable to material financial distress. Steps should be taken to ensure that FSOC makes this factor an element of its decision making process in the future.

Promulgate the regulations required by Section 170 of the Dodd-Frank Act.

Section 170 of Dodd-Frank directs the Federal Reserve Board, in consultation with FSOC, to issue regulations exempting certain classes or categories of companies from supervision by the Federal Reserve Board.[5] However, to date no such regulations have been issued pursuant to this authority. This requirement represents yet another tool Congress created to delineate between those entities that pose

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[5] §170 of the Dodd-Frank Act.

systemic risk and those that do not. How such regulations might affect insurance companies, if at all, is unknown. But presumably the regulations will shed additional light on what metrics, standards or criteria operate to categorize a company as non-systemic. The primary goal here should be to clearly inform companies of how to conduct their business and structure their operations in such a way as to be non-systemic. Only if that primary goal cannot be met should the focus turn to regulating systemic enterprises.

Conclusion

ACLI believes the best interests of the U.S. financial system and the stated objectives of the Dodd-Frank Act can be realized most effectively by an FSOC designation process that operates in a more transparent and fair manner. The overarching purpose of the Dodd-Frank Act is to minimize systemic risk in the U.S. financial markets. Providing companies with the choice and the ability to work constructively with FSOC to structure their activities in such a way as to avoid being designated as systemic in the first instance advances that purpose and reflects sound regulatory policy – as would affording companies a viable opportunity for de-designation. The reforms we are recommending are intended to achieve these objectives, and we pledge to work with this Committee and others in Congress toward that end.

Thank you for convening this important hearing and for your consideration of the views of ACLI and its member companies.

U.S. House of Representatives Committee on Financial Services
"The Annual Report of the Financial Stability Oversight Council"
Questions for the Record for
The Honorable Jacob J. Lew, Secretary, U.S. Department of the Treasury
Hearing held June 17, 2015

Questions of Congressman Sean Duffy (WI-07):

1. **Would you support a more transparent process by Treasury to provide a more USTR-like process for consultations with Congress and interested stakeholders before Treasury advocates major policy positions at the International Association of Insurance Supervisors?**

Answer:

At the International Association of Insurance Supervisors (IAIS), the United States is represented by the Treasury's Federal Insurance Office (FIO), the Board of Governors of the Federal Reserve System (Federal Reserve), state insurance regulators, and staff of the National Association of Insurance Commissioners (NAIC). FIO welcomes the opportunity to meet and confer with Congress and has met regularly with members of Congress and staff throughout its work at the IAIS.

In addition, FIO successfully executes an ambitious and transparent process for engagement with stakeholders. For example, FIO regularly hosts meetings for all stakeholders with the U.S. representatives to the IAIS, and these meetings include as many as 80 individual participants including consumer advocates, trade associations and insurers. FIO hosts frequent telephone calls with U.S. stakeholders involved with the IAIS development of capital standards, and regularly engages with stakeholders in a direct and bi-lateral manner.

Notably, the IAIS itself adopted an enhanced approach to stakeholder engagement that began in 2015. For example, stakeholders were previously required to pay an annual fee to obtain "observer" status that entitled that select group of stakeholders to attend select meetings and receive select content. Beginning in 2015, the IAIS eliminated the annual fee for observers and, now, *all* stakeholders, not just those that pay a fee, are able to participate in and receive access to information in personal stakeholder sessions or through the IAIS web site. Further, whereas the IAIS hosted approximately 15 hours of in-person sessions for observers in 2014, in 2015 the IAIS hosted approximately 140 hours of stakeholder sessions.

Finally, USTR negotiates agreements that would, by the terms of the agreements, bind the United States. This is distinct from the work at the IAIS, a global standard-setting organization, which through consensus, develops global standards that are not self-executing, i.e. do not have the force of law in the United States unless implemented by the Federal Reserve or the state insurance regulators following processes that facilitate direct and public stakeholder engagement.

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Questions of Congressman Scott Garrett (NJ-05)

Question 1:

Recently, the Bank of England requested comment on a proposed rule that would require UK banks to engage in financial contracts only with companies that have agreed to waive certain rights in the event of the bank's solvency, including termination rights and venue. (See Consultation Paper 19/15 issued by the Bank of England Regulation Authority in May of 2015)

The proposed rule from BoE seems to be largely based on an ISDA protocol that was signed by 18 banks last fall.

- **Are U.S. banking regulators planning to propose a similar rule in the United States with respect to banks and their counterparties?**
- **Is it your understanding that these agreements – such as the one proposed in the UK – would require a counterparty to a SIFI to submit to the resolution regime of that SIFI's home country? For example, a U.S. company doing business with a U.K. bank would have to agree to waive into whatever resolution regime exists in the U.K.?**
- **Has a U.S. regulator ever required that U.S. citizens give up their rights under U.S. law and submit themselves to the law of a foreign jurisdiction?**

Answer:

The global financial crisis demonstrated a need to improve resolution regimes across jurisdictions so that authorities would have the legal powers and tools necessary to, if needed, resolve global systemically important banks (G-SIBs) in an orderly manner. An important element of this resolution toolkit is the 'resolution stay' for financial contracts.

The resolution stay is intended to prevent mass unwinds of financial contracts, which can be triggered through "early termination rights" upon entry of a firm into resolution or in connection with the use of resolution powers. In the case of a G-SIB entering resolution, the termination of large volumes of financial contracts could result in disorderly resolution and transmission of contagion, further destabilizing markets. The stay is a temporary suspension (e.g., 48 hours to allow the resolution authority to use its transfer powers). Counterparties will be stayed temporarily from terminating and closing out a contract solely based on the firm's entry into resolution or the exercise of resolution powers, but will retain rights related to the firm's ability to meet any margin, collateral, or settlement obligations.

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The International Swaps and Derivatives Association (ISDA), an industry group, led an initiative to amend terms for bilateral over-the-counter (OTC) derivatives contracts that incorporated the stay cross-border recognition provisions – the ISDA 2014 Resolution Stay Protocol. This Protocol was adhered to by the world's 18 largest dealer banks on January 1, 2015. 17 of the 18 firms that adhered to the ISDA 2014 Resolution Stay Protocol, and several additional G-SIBs, adhered to the ISDA 2015 Universal Resolution Stay Protocol, adding stays for securities financing and repo transactions. The ISDA Stay Protocol amounts to a private contractual agreement, which now specifies in advance how the contracts will be handled in the event of resolution, helping to provide predictability to market participants, something that is particularly valuable in the event of a G-SIB resolution.

Question 2:

The Dodd-Frank Act required that certain standardized over-the-counter derivatives be cleared via central counterparties (CCPs). Notably, the FSOC annual report states that "the increasing importance of CCPs has heightened public and regulatory focus on risk management practices at CCPs and the potential threat to financial stability in the event of a CCP failure." Obviously, there is a clear connection between the Dodd-Frank requirement to clear such derivatives via CCPs and the potential for such CCPs to create systemic risk.

- **When FSOC identifies certain risks that have been directly created because of actions by Congress, do you view it as your role as the Chair of FSOC to advocate for repeal or amendment to such laws? Will you be advocating for repeal or amendment to the Dodd-Frank provisions that mandated central counterparty clearing?**

Answer:

It is widely agreed that CCPs are critical to the infrastructure of the financial system and have made derivatives markets more transparent and resilient. Using CCPs can concentrate risks if not managed appropriately, and the Dodd-Frank Act recognized this in establishing an enhanced regulatory and supervisory regime for CCPs. FSOC's annual reports describe potential emerging threats to U.S. financial stability that FSOC has identified as well as recommendations.

Question 3:

At the June 17th hearing, you stated in response to my questions that there are "no consequences" of a Financial Stability Board (FSB) designation of a financial institution as a global systemically important financial institution (G-SIFI) or a global systemically important insurer (G-SII).

- **Is it therefore your position that the FSB designation of three U.S. insurers in 2013 did not influence the decision of FSOC to later designate these same insurers as**

systemically important financial institutions (SIFIs) and subject them to enhanced prudential regulation by the Federal Reserve?

Answer:

FSOC's process for designating nonbank financial companies pursuant to the Dodd-Frank Act is distinct from the international processes of the FSB with respect to identifying global systemically important financial institutions. In the FSB process, the relevant standard-setting body develops a methodology to identify companies for consideration by the FSB for identification as globally systemically important.

The identification of a particular firm by the FSB as globally systemically important does not create a legal obligation on the part of the FSOC or its members to designate the firm or even consider it for designation. FSB identification also does not indicate that the FSOC will arrive at the same conclusion if the FSOC chooses to consider the firm. The FSOC has not relied on identifications by the FSB in conducting its own assessments of nonbank financial companies. The FSOC's evaluation of nonbank financial companies for potential designation is governed by the standards that Congress set forth in Section 113 of the Dodd-Frank Act and the process articulated in the FSOC's rule and interpretive guidance on nonbank financial company designations. The Government Accountability Office has stated that, based on a review of documentation supporting FSOC's designation decisions, it did not find references to FSB's evaluations or identifications of global systemically important financial companies in FSOC's evaluation considerations.

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Questions of Congressman Frank Guinta (NH-01)

Question 1:

FSOC's 2015 report says that Treasury is working towards a covered agreement on reinsurance collateral. The state insurance regulators have already begun adopting reinsurance collateral reforms and have suggested a covered agreement is unnecessary. What analysis has Treasury done to demonstrate that additional federal action is necessary and what changes from the state model do you believe would better protect U.S. consumers and our marketplace?

Answer:

Treasury and the office of the United States Trade Representative (USTR) will not enter into a covered agreement with the European Union (EU) unless the terms of that agreement are beneficial to the United States. Treasury and USTR notified the Committee on November 20, 2015, of the negotiating objectives for a covered agreement with the EU. These negotiations remain in the early stages and it is too early to predict the final substance of any potential final covered agreement.

Additionally, Treasury and USTR, in recognition of the important role of state insurance regulators, have engaged extensively with representatives of the state insurance regulators during the covered agreement process.

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Questions of Congressman French Hill (AR-02)

Question 1:

On page 2 of your written testimony, you state that "some broker-dealers [are] reducing their securities inventories and, in some cases, exiting certain markets." You seem to suggest that a "confluence of factors including technology, regulation, and competition" have contributed to this. What regulations or regulatory factors do you believe are causing broker-dealers to reduce inventory or exit markets?

Answer:

During the financial crisis, broker-dealers and banks realized significant losses on their securities inventories, which were loaded with subprime-related mortgage securities and other securities with elevated levels of market and credit risk and often financed with leverage or short-term funding. In the wake of the crisis, firms have reduced risk appetites for such investments and the amounts of leverage used to finance such positions. Around this same time, new regulations have increased risk-based capital requirements on the types of risky investments that were central to the recent financial crisis, reduced the amounts of leverage firms could use, and encouraged greater reliance on more stable sources of funding.

Question 2:

Will the Treasury Department submit a draft legislative proposal to reform the government-sponsored enterprises (GSEs)? If no, why not? If yes, when can the Financial Services Committee expect to see such proposal?

Answer:

After more than seven years, Fannie Mae and Freddie Mac are still in conservatorship, leaving taxpayers at risk. The best way to address the conservatorship of the GSEs is through legislation that ensures broad access to safe, responsible financing, like the 30-year fixed rate mortgage. We continue to believe that such a system must protect taxpayers from the risk of another housing downturn while ensuring a level playing field for financial institutions of all sizes. To achieve this important but unfinished piece of financial reform, the Administration has continually expressed its willingness to work with Congress on bipartisan legislation that meets the President's principles for reform, and remains ready to support these efforts going forward.

Question 3:

On page 42 of the 2015 Annual Report of the Financial Stability Oversight Counsel (FSOC), there is a chart (5.1.17) regarding "covenant-lite" debt. Please provide more detail on the definition of covenant-lite as well as the sources for the information.

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Answer:

The source of the data is S&P LCD, which defines covenant-lite loans as loans with bond-like incurrence covenants, rather than maintenance tests. Covenant-lite loans are less restrictive than typical maintenance covenants, which require an issuer to meet certain financial tests every quarter whether or not it takes an action such as paying a dividend, making an acquisition, or issuing more debt. The data in the annual report are a percentage of total loans, which includes both institutional and pro rata loans.

Question 4:

In past Annual Reports, the FSOC has flagged as a potential systemic risk the migration of mortgage servicing assets from regulated financial institutions to less heavily regulated non-bank mortgage services, which it says "have purchased large amounts of mortgage servicing rights from banks and thrifts" and "grown to account for a material portion of the mortgage servicing market."

- **Why do you think large depository institutions are abandoning mortgage servicing activity?**
- **Could this be a result of new capital requirements agreed to as part of the Basel III process, and is the FSOC examining the effect of the Basel rules for these assets on the ability and willingness of regulated financial institutions to hold mortgage servicing assets?**

Answer:

There are a number of factors that have likely led large depository institutions to reduce their exposure to mortgage servicing in recent years. Firms have had to re-evaluate the economics of mortgage servicing based on the sharply increased responsibilities and costs of mortgage servicing experienced during the recent financial crisis. Significantly elevated levels of homeowner default and loss mitigation have led to sharply higher administrative costs for servicing. Similarly, litigation, liability or settlement expenses related to past servicing practices have also risen sharply. These elevated responsibilities and costs for servicing were much higher than during more stable periods in the housing and mortgage markets.

Alongside these changes in the mortgage servicing business, the independent banking agencies also determined it was necessary and appropriate to require institutions to meet higher Basel III capital requirements, including increased capital requirements for mortgage servicing assets. These higher capital requirements enhance the ability of banks to withstand losses, including from volatile mortgage servicing assets, in order to better support the real economy during times of severe financial stress.

FSOC has been monitoring developments in the mortgage servicing business, including the rise in participation by nonbanks servicers. FSOC has recommended that the responsible agencies continue to work together to monitor and appropriately regulate the nonbank participants in the mortgage servicing business.

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Questions of Ruben E. Hinojosa (TX-15)

Question 1:

Since the Financial Crisis, it appears that our largest banks are not only getting bigger in size, but grabbing up a larger share of the economy. The top four institutions (JP Morgan, Bank of America, Wells Fargo, & CitiBank) now account for about 51% of all U.S. bank assets. In 1983, the six biggest American banks had assets equal to 14% of the nation's GDP. Today, their assets equal a staggering 61% of GDP, a massive increase.

Given the sheer size of these banks and their interconnectedness into the economy and the financial system, will our financial system be able to survive a failure similar to what we saw in 2008 of one or more of the mega banks? Is the Orderly Liquidation Authority a sufficient tool to keep our financial system stable in case one or more of these banks fail? Should we be considering other options?

Answer:

The Dodd-Frank Act gave authorities much needed additional tools in order to help ensure that a large firm can fail in an orderly manner. The orderly liquidation authority provides regulators with an alternative to the U.S. Bankruptcy Code, which was the only option in the event of a failure of a large financial holding company during the crisis. Authorities have been working hard to ensure that this process will be successful. For example, the FDIC has discussed its use of a Single Point of Entry strategy, in which only the holding company would be put into resolution, thus keeping the subsidiary business functioning. The Federal Reserve Board recently proposed a rule requiring sufficient amounts of Total Loss Absorbing Capacity that will aid in the implementation of this resolution strategy.

In addition to the work that has been done to ensure a successful liquidation under Title II, regulators continue to use the living will process to increase the resolvability of the largest banks. The largest banks are required to submit living wills to the Federal Reserve and the FDIC detailing how the firm would be wound down using the U.S. Bankruptcy Code. If these plans are deemed deficient or not credible by the regulators, then additional steps may be taken to further ensure that a bank becomes resolvable. In April 2016, the regulators provided feedback to the eight largest U.S. financial firms based on a review of their 2015 living wills. Five firms received a joint determination of non-credibility. Two firms passed with one regulator but failed with the other. One firm passed with both regulators. Regulators will continue to work with firms to ensure progress on their next round of submissions. The next submission deadline applicable to all eight firms is July 1, 2017..

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Question 2:

Given all the recent cyber-attacks on the federal government, retailers, financial institutions and so on, does the FSOC or the Treasury Department have a response plan in the case of a catastrophic cyber-attack that incapacitates particular financial institutions, markets, or whole portions, if not all of our financial system? Can you please elaborate on said plan with respect to what agency and/or person would lead the response effort, and what the response plan entails in terms of government action?

Is the FSOC or the Treasury Department working with DHS in its National Cyber Incident Response Plan with respect to cyber-attacks affecting the financial industry?

Do we have a clear line of authority as to what government department/agency/head would be in charge of responding to an attack on our financial system? Does Congress need to take action and create a more formalized structure?

Answer:

Treasury works closely with financial regulators, law enforcement, the intelligence community, the Department of Homeland Security (DHS), and private industry to prevent and prepare to respond to significant cybersecurity incidents impacting the financial services sector. This work primarily involves supporting cybersecurity information sharing, promoting baseline cybersecurity protections and best practices among industry, and assisting with cybersecurity incident response and recovery efforts.

Effectively promoting financial services sector cybersecurity requires specialized skills and Treasury maintains staff within its Office of Critical Infrastructure Protection and Compliance Policy (OCIP) who are dedicated specifically to carrying out Treasury's financial services sector cybersecurity mission. Recognizing that effectively engaging with the private sector to address the risks associated with malicious cybersecurity activity means leveraging the unique authorities and capabilities of various government agencies, OCIP coordinates closely with interagency partners, including by stationing staff at the Federal Bureau of Investigation-led National Cyber Investigative Joint Task Force and the DHS' National Cybersecurity and Communications Integration Center. Financial regulators also play a critical role in financial services sector cybersecurity, and Treasury coordinates closely with these agencies through the Financial and Banking Information Infrastructure Committee (FBIIC) which includes representatives from seventeen federal and state financial regulators who are designated by their agencies to focus on security and resiliency issues. Recognizing the potential for a significant cybersecurity incident to have economic stability implications, the FBIIC works closely with FSOC member agencies to discuss emerging cybersecurity risks and to discuss plans for responding to "worst-case" scenarios.

In the event of a significant cybersecurity incident targeting the financial services sector, Treasury will play a key role in coordinating response efforts among interagency partners and the private sector. Being prepared to carry out this work effectively calls for a strong planning framework. This framework has been established and will continue to evolve to keep pace with the growing cyber threat. Specifically, Treasury has supported industry in developing a sector-specific incident response plan which identifies key coordination mechanisms for quickly sharing information and coordinating response efforts among industry, as well as key government touch points. In addition, Treasury is assisting with efforts to develop a policy for national cyber incident coordination and an accompanying severity methodology for evaluating cyber incidents so that government agencies and the private sector can communicate effectively and provide an appropriate and consistent level of response. DHS' National Cybersecurity Incident Response Plan is expected to align to this policy and Treasury is in close coordination with DHS and other agencies on that effort.

Question 3:

Although some of my Republican colleagues were rude and did not give the Secretary an opportunity to fully address their questions and concerns, I do feel that they brought up some interesting points about FSOC's annual report. Specifically, with respect to identifying risks to the financial system, the Annual Report does not discuss government action and or polices to much extent. In addition to looking at the wealth of other factors, players, institutions and the like, has the FSOC and the OFR taken a good faith effort to review government policies and or government actions to judge whether they pose a threat to the financial system as a whole? Why or why not? And if so, which policies and/or actions of the government did the FSOC consider in its analysis?

Answer:

FSOC regularly monitors regulatory and market developments to identify areas where regulators or market participants should take steps to address potential risks. The FSOC annual report expresses the collective judgment of the FSOC about potential emerging threats to financial stability and how they should be addressed. As financial regulation leads to changes in the risks that manifest in the financial system, FSOC closely monitors the evolving nature of potential threats to financial stability.

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Questions of Congressman Robert Hurt (VA-05)

Question 1:

Did Treasury agree at the Financial Stability Board (FSB) to designate three U.S. companies as global systemically important insurers?

a. **Both of FSOC's insurance experts strongly criticized the decisions to designate two of the U.S. insurers. FSOC insurance expert Woodall dissented that despite assertions by some FSOC members that the designations of systemically important companies by the FSB and the FSOC are separate and distinct, they are in fact interconnected and FSB's determinations have overtaken FSOC's process.**

   What sort of transparency, accountability and due process did Treasury provide before committing to an international designation that essentially prejudged the FSOC determinations?

   Answer:

   The efforts by the Financial Stability Board (FSB) and the International Association of Insurance Supervisors (IAIS) to identify internationally active insurers that could pose a threat to the global financial stability is a process that is governed by unique methodology established by the IAIS, and approved by the FSB. The work of the FSB, which Treasury supports, is not a factor in any determination by the Financial Stability Oversight Council (FSOC) to designate a nonbank financial company for Federal Reserve supervision and enhanced prudential standards. The process used by FSOC in considering nonbank financial companies for potential designation is separate from the international process and is governed by the Dodd-Frank Act.

b. **Did Treasury first consult with the insurers' primary functional supervisors – the state insurance regulators – on alternatives to agreeing to global systemically important insurer designations?**

   And how specifically did you incorporate the input of the insurance regulators into your decision to support a designation of the three American insurers?

   Answer:

   The FSB identification of globally systemically important insurers (GSIIs) is based on the work and recommendation of the International Association of Insurance Supervisors (IAIS). At the IAIS, the United States is represented by the Treasury's Federal Insurance Office (FIO), the Federal Reserve, state insurance regulators, and staff of the National

Association of Insurance Commissioners (NAIC). All 56 states, territories and the District of Columbia have a vote at the IAIS.

c. In the Dodd-Frank Act, Congress left insurance regulation to the states, is that correct?

- **Has Treasury previously recommended mandatory federal regulation of insurance?**

  It appears that this is being partially accomplished for the largest insurers by FSOC implementation of the international deal to designate insurers as systemic.

- **Are the primary functional insurance regulators in the U.S. represented at the FSB where the first systemic designations were made that ultimately led to increasing federal insurance regulation, or is there a regulatory conflict of interest for Treasury?**

Answer:

The Dodd-Frank Act established the Federal Reserve as the consolidated supervisor for nonbank financial companies designated by the FSOC for Federal Reserve supervision and enhanced prudential standards and for savings and loan or bank holding companies, including those that have insurance subsidiaries. The Dodd-Frank Act also established FIO within Treasury and, among other things, authorized FIO to serve as a non-voting member of the FSOC and to represent the United States in the IAIS. Except for the roles established for FIO and the Federal Reserve, the Dodd-Frank Act did not alter the role of the states as the primary regulators for the business of insurance.

In 2008, Treasury recommended the development of an optional federal charter for the U.S. insurance sector. However, beginning in 2009, Treasury has supported the U.S. integrated state-federal system in which states remain the primary regulators of the business of insurance. In fact, in a 2013 report by FIO entitled *How To Modernize And Improve the System of Insurance Regulation In The United States*, Treasury expressed continued support for the U.S. system of integrated state-federal insurance oversight. Treasury supports the U.S. state regulatory system and its integration with the separate but complementary roles of FIO and the Federal Reserve.

The FSB identifies GSIIs based on a recommendation from the IAIS. At the IAIS, the United States is represented by the FIO, the Federal Reserve, state insurance regulators, and staff of the NAIC. All 50 states, 5 territories, and the District of Columbia have a vote at the IAIS. The work of the FSB to identify large internationally active insurers that could pose a threat to global financial stability is not self-executing.

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Questions of Congressman Stephen Lynch (MA-08)

Offshore Swaps:

Question 1:

On the issue of offshore swaps, FSOC meeting minutes have indicated that Chair Massad of the CFTC has raised the issue of offshore swaps with the Council on numerous occasions. These are closed door meetings, though, so we don't know the contents of what was said.

Recently, Chair Massad discussed reports that some U.S. swap dealers were removing or no longer providing guarantees of swap transactions entered into by their offshore affiliates, a practice termed "de-guaranteeing." Additionally, Chair Massad indicated that the CFTC is going to move forward with a plan to address this issue.

- **Secretary Lew, do you agree with Chair Massad that the "de-guaranteeing" of the foreign operations of US banks could result in unregulated swaps risk being imported to the US?**
    - **If so, do you think that this is an issue that should be a concern to the FSOC?**

Answer:

Chairman Massad has spoken publicly about the '"de-guaranteeing" issue on numerous occasions. In June 2015, the CFTC issued for public comment a proposed rule regarding margin for uncleared cross-border swaps. Part of this proposed rulemaking sought to address the potential for risk to be transmitted to a U.S. entity from a foreign affiliate even if there is no explicit guarantee. The CFTC continues to engage with the Council and its member agencies regarding this issue to consider whether there are potential risks to financial stability. It should be noted that the firms in question, including their overseas activities, continue to be subject to the requirements of their U.S. regulators. I expect the Council to continue to monitor developments in this area, consistent with the Council's duty to monitor the financial services marketplace and to provide a forum for discussion of market and regulatory developments.

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Questions of Congressman Randy Neugebauer (TX-19)

Question 1:

"De-risking" refers to the phenomenon of financial institutions terminating or restricting business relationships with clients or categories of clients to avoid risk. What is Treasury's plan to solve this problem in relation to money transfer companies? What is the timetable for a solution? Will you commit to updating this committee on a quarterly basis on your work to find a solution?

Answer:

Treasury remains actively engaged on preserving access to financial services in the United States for money services businesses (MSB) and clarifying the expectations for financial institutions with respect to their MSB customers. Banks that have terminated relationships or limited specific types of banking services in recent years have articulated a number of drivers, including profitability concerns and macroeconomic factors, challenges in meeting heightened prudential requirements, as well as challenges with anti-money laundering/countering the financing of terrorism (AML/CFT) compliance, including poor implementation of AML/CFT standards in some foreign jurisdictions. Often, decisions are based on a combination of these factors. Treasury is working across a number of fronts to address those factors that we can affect.

Treasury continues to engage with multilateral bodies, such as the Financial Action Task Force (FATF), to shape international AML/CFT standards and help address issues related to the loss of correspondent account relationships by MSBs. For example, Treasury played an instrumental role in the FATF drafting new guidance in February 2016 highlighting that financial institutions should identify, assess, and manage the money laundering and terrorist financing risks associated with individual MSBs, rather than avoid this category of customers entirely.

In addition to Treasury's multilateral engagement and provision of technical assistance to strengthen foreign jurisdictions' AML/CFT, Treasury believes it can work towards addressing one of the drivers of de-risking by seeking to ensure that U.S. AML/CFT regulations are appropriately balanced and clearly understood. Treasury develops these regulations to address valid security and law enforcement concerns and does so in a manner that allows key stakeholders, including the private sector, to provide feedback and improve the effectiveness of the AML/CFT regulations.

Treasury has also worked with the private sector and our federal and state regulatory partners over the last year to determine how to identify the information and guidance banks and other depository institutions would find useful in working with MSB customers. As part of that effort, the Financial Crimes Enforcement Network (FinCEN), a bureau of the Treasury Department, issued guidance in March reiterating the AML program obligations that MSB principals have in supervising their agents, and providing clarity so that MSB principals and their agents can more easily understand how to comply with AML requirements. This guidance may also help inform financial institutions' understanding of what to expect in MSB AML programs and better enable them to assess the risk of doing business with MSBs.

Lastly, FinCEN continues to utilize authorities granted under the Money Remittances Improvement Act of 2014 to rely on examinations conducted by state supervisory agencies, thereby improving oversight of nonbank financial institutions, such as MSBs, that otherwise lack a federal regulator. By allowing federal regulators to utilize state exams, regulators are able to more efficiently ensure compliance with laws and regulations while also reducing costs for money services businesses themselves.

Should you have questions about Treasury's ongoing work on this important matter, please contact me or have your staff contact Treasury's Office of Legislative Affairs at (202) 622-1900.

Question 2:

Section 115(b) of the Dodd-Frank Act provides the FSOC with a mechanism to recommend to the Federal Reserve Board that it exercise authority under Section 165 of Dodd-Frank to raise the threshold for application of enhanced prudential standards. In your testimony, you stated there has been no formal recommendation by FSOC utilizing Section 115. Please provide any and all memorandum, staff analysis, reports, or legal opinions prepared by FSOC, or the Office of Financial Research, which has been relied upon by you, or any member of the FSOC in making a determination to not exercise Section 115 authority.

Answer:

I am not aware of any written memorandum, analysis, report, or legal opinion that FSOC has relied on in not exercising its authority under section 115 of the Dodd-Frank Act.

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Questions of Congressman Dennis A. Ross (FL-15)

Question 1:

I write today as a follow up to the Financial Services Full Committee Hearing dated June 16, 2015. At this hearing, I asked you whether systemically important financial institution (SIFI) are jointly and severally liable for a failing SIFI. For example, if one designated SIFI were to fail, would all other designated SIFIs potentially be responsible to bailout the failed SIFI? I would like clarification on your answer. During the hearing, both you and your staff denied that this was the case.

Under Title 2 and the Orderly Liquidation provisions of the Dodd-Frank Act, the FDIC has authority to put risk-based assessments on Bank Holding Companies with assets of $50 billion or more or any nonbank financial institution subject to oversight by the Financial Stability Oversight Council (FSOC). Is that correct?

Further, if a regulated fund or asset manager was designated a SIFI by FSOC, would they potentially be on the hook to bail out another failed SIFI?

Answer:

Under the Dodd-Frank Act, a failing firm should be responsible for paying back its own emergency liquidity funding; recently implemented standards for loss absorbing capacity are designed to ensure that a firm in resolution could do just that. However, in exigent circumstances, the financial system at large should be required to pay their share of any unpaid remainder – thus saving taxpayers from once again bailing out a failed firm.

By law, the full amount of the disbursed funds must be repaid. If the receiving firm is not able to repay the entirety of the balance, then the financial sector would be responsible for ultimate repayment. In order to accomplish this, the statute gives the FDIC the authority to impose a risk-based assessment on eligible firms – bank holding companies with greater than $50 billion in assets, and nonbank financial companies supervised by the Federal Reserve. If the firm in resolution could not repay the loans on its own and the assessment power were to be invoked, assessments would be risk-based – larger and more risky firms would be required to make a larger payment than smaller and less risky firms. While a riskier firm may be charged larger assessments, all firms in the eligible category would still be assessed; therefore, joint and several liability is not an accurate representation of the responsibility that financial sector firms may be subject to.

Title II of the Dodd Frank Act provides a mechanism, called the Orderly Liquidation Fund that would provide emergency liquidity funding for a firm in a Title II orderly liquidation, if necessary. Funding acquired from the Orderly Liquidation Fund by the firm in resolution are akin to loans, and not bailout funds, and therefore must be repaid by the receiving firm.

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Questions of Congressman Keith Rothfus (PA-12)

Question 1:

What is the status of discussions at the International Association of Insurance Supervisors (IAIS) for an international capital standard and what are the timetable and expected results? Shouldn't the IAIS wait for developments in the U.S., including the Federal Reserve's development of a capital standard under Dodd-Frank for insurance holding companies that include banks, before deciding whether a global capital standard is needed or what its specifics should be?

Answer:

The development of an international capital standard (ICS) by the International Association of Insurance Supervisors (IAIS) is in its very early stages. In this work, the United States is represented by the Treasury's Federal Insurance Office, the Board of Governors of the Federal Reserve System, state insurance regulators, and staff of the National Association of Insurance Commissioners (NAIC).

The first iteration of the ICS will be completed in 2017; however, it is important to note that the ICS, as with all global insurance supervisory standards, is not self-executing and will only become effective in the United States if the Federal Reserve and the state insurance regulators determine to move forward with such implementation.

Question 2:

The Governor of the Bank of England Mark Carney sent you a letter last October about the Financial Stability Board's potential designation of Berkshire Hathaway as a G-SII and your objection to that designation. Would you share that letter with the Committee and any other FSOC documents containing or relating to communications between the FSB and FSOC, and each body's members or staff, concerning the designation of nonbank financial companies as either systemically important financial institutions or as global systemically important financial institutions?

Answer:

FSOC's process for designating nonbank financial companies pursuant to the Dodd-Frank Act is distinct from the international processes of the FSB with respect to identifying global systemically important financial institutions. The FSOC does not rely on designations by the FSB in conducting its own assessments of nonbank financial companies. The FSOC's evaluation of nonbank financial companies for potential designation is governed by the standards that Congress set forth in section 113 of the Dodd-Frank Act and the process articulated in the FSOC's rule and interpretive guidance regarding nonbank financial company designations. The

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Government Accountability Office has stated that, based on a review of documentation supporting FSOC's determination decisions, it did not find references to FSB's evaluations or identifications of global systemically important financial companies in FSOC's evaluation considerations.

Question 3:

In testimony before the Senate Banking Committee you said that "the work that we're doing in the FSB is bringing international standards closer to our own." But if that is the case, why wouldn't you want the U.S. to act first on SIFI designations, before the FSB acts, so that we can try to align the FSB's actions with ours, and not the other way around?

Answer:

The processes used by the FSOC and the FSB are separate and distinct. Decisions reached at the FSB do not dictate decisions made domestically. While the development of international standards is important, no standards, recommended or developed, by the international bodies are binding in the United States. Rather, the United States would need to separately determine whether and how to adopt any standards in accordance with U.S. law.

The FSB identification of globally systemically important insurers (G-SIIs) is based on the work and recommendation of the International Association of Insurance Supervisors (IAIS). At the IAIS, the United States is represented by the Treasury's Federal Insurance Office, the Federal Reserve, state insurance regulators, and staff of the National Association of Insurance Commissioners (NAIC). All 50 states, 5 territories, and the District of Columbia have a vote at the IAIS.

Question 4:

How does the methodology the Financial Stability Board uses to designate global systemically important companies differ from FSOC's methodology?

Answer:

FSOC's process for designating nonbank financial companies pursuant to the Dodd-Frank Act is distinct from the international processes of the FSB with respect to identifying global systemically important financial institutions. In the FSB process, the relevant standard-setting body develops a methodology to identify companies for consideration by the FSB for identification as globally systemically important.

The FSOC's evaluation of nonbank financial companies for potential designation is governed by section 113 of the Dodd-Frank Act and the FSOC's rule and interpretive guidance regarding nonbank financial company designations. Section 113 sets forth both the standards for designation and also 10 specific considerations, such as leverage, interconnectedness, and existing regulatory scrutiny, which the FSOC must take into account in making any designation.

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"The Annual Report of the Financial Stability Oversight Council"
Questions for the Record for
The Honorable Jacob J. Lew, Secretary, U.S. Department of the Treasury
Hearing held June 17, 2015

Questions of Congressman Steve Stivers (OH-15)

Question 1:

In international insurance regulatory discussions, Treasury frequently advocates positions different from the state insurance regulators that actually protect our consumers. For example, when the International Association of Insurance Supervisors proposed to reduce transparency and accountability by kicking out the public from their working group meetings, including U.S. consumer groups who did not pay to play, the state insurance regulators voted to maintain transparency while Treasury voted for less transparency. When Treasury goes against the state insurance regulators, does that undermine our U.S. voice?

Answer:

At the International Association of Insurance Supervisors (IAIS), the United States is represented by the Treasury's Federal Insurance Office (FIO), the Board of Governors of the Federal Reserve System (Federal Reserve), state insurance regulators, and staff of the National Association of Insurance Commissioners (NAIC). Treasury, through FIO, prioritizes collaboration and coordination among the U.S. participants at the IAIS and spends countless hours facilitating such coordination. Many positive developments at the IAIS can be attributed to the teamwork between the U.S. participants.

In October 2014, the IAIS adopted enhanced approach to transparency and stakeholder engagement that began in 2015. Prior to the IAIS taking this action, stakeholders were required to pay an annual fee (approximately $20,000) to obtain "observer" status that entitled that select group of stakeholders to attend select meetings and receive select content. Under the new approach adopted by the IAIS, beginning in 2015, the IAIS eliminated the annual fee for observers and, now, *all* stakeholders, not only those that pay a fee, are able to participate in and receive access to information in personal stakeholder sessions or through the IAIS web site free of charge. Further, whereas the IAIS hosted only approximately 15 hours of in-person sessions for fee-paying observers in 2014, in 2015 the IAIS hosted approximately 140 hours of stakeholder sessions that were open to all stakeholders. The IAIS web site now contains more publicly available information than ever before, including minutes of meetings that were not previously available, and a monthly newsletter that summarizes events of the past month and upcoming highlights. Now, following the adoption of the enhanced transparency regime, the IAIS hosts stakeholder meetings and calls when consultation materials are released in order to explain the documents and their objectives, and then the IAIS also provides written replies to all written comments received from stakeholders.

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Questions of Congresswoman Ann Wagner (MO-02)

Question 1:

On March 3, 2015 at a House Financial Services Committee hearing on the "Semi-Annual Report of the Bureau of Consumer Financial Protection," I asked Director Richard Cordray which individual at the CFPB ultimately made the decision to renovate the building at 1700 G Street, NW in Washington, DC. He responded with:

> ***"There were different people in the position of setting up the Bureau at different times. ... What I am saying, for the first year, the Bureau did not exist, it was part of Treasury. So exactly whether – whether there are people in Treasury who contributed to that decision because they actually were in charge. ...It was Treasury who was in charge of all Bureau operations."***

To follow up on Director Cordray's inability to identify the responsible individuals within the Treasury Department as part of my questioning, Chairman Hensarling submitted a letter to you dated on June 9, 2015 requesting the following information:

a. **The identity of the individual who made the decision to renovate the building located at 1700 G Street, NW in Washington, DC; and**
b. **Unredacted copies of all final decision memoranda approving the renovation of the building.**

On June 16, 2015, the Acting Assistant Secretary for Legislative Affairs at Treasury submitted a response letter to the Chairman that did not provide adequate information on either of those requests. However, the letter stated that "Treasury is committed to ensuring a transparent dialogue with Congress and the Committee on matters related to managing the U.S. Government's finances. We look forward working with you to address the questions raised in your letter."

In light of a lack of adequate responses to our requests for information regarding the CFPB building renovations, I would like to ask the following:

- **Who was principally responsible for standing up the CFPB prior to its doors formally opening up on July 21, 2011?**
- **Which individuals led the CFPB implementation team at Treasury?**
- **Prior to Richard Cordray's recess appointment on January 4, 2012, which CFPB individuals were in charge of the day-to-day operations?**

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- **Which individuals were ultimately responsible for approving the renovations at 1700 G Street, NW in Washington, DC?**
- **Considering that there were no final decision memoranda included in Treasury's response to Chairman Hensarling, shall we treat this as an indication that no such documents exist?**
- **Is it possible that a decision allocating funds to be used for such expenses as property leasing and building renovations could be made without producing a final decision memorandum?**
- **What is standard operating procedure at Treasury in regards to making final approval decisions for the release of funds to be used for building renovations and property leasing?**

Answer:

As stated in Treasury's letter to Chairman Hensarling dated August 25, 2015, the Department conducted a search for decision memoranda approving renovation of the building at 1700 G Street, NW. It located a building evaluation prepared in 2010 by Gensler, an architectural consultant, on behalf of the Office of Thrift Supervision – the prior occupant of the building. This evaluation assessed the condition of the facility, concluded that most of the building systems had reached the end of their serviceable lives, and recommended three possible scenarios for renovation. This is consistent with a press release that Treasury issued in February 2011, which indicated that major renovations would be needed before CFPB could move into the building.

As also stated in Treasury's August 25, 2015 letter, the Department located the July 2011 lease agreement between the CFPB and OCC, as well as the January 2011 Letter of Intent leading to that agreement. Copies of these and the other above-referenced documents were provided with Treasury's August 25, 2015 letter.

Treasury did not locate any decision memoranda approving renovation of the building. While Treasury recognized that renovations would be needed, substantive decisions to move forward on renovation were not made by Treasury. As reflected in the 2015 report by the Inspector General for the Federal Reserve Board (IG) entitled "CFPB Headquarters Construction Costs Appear Reasonable and Controls are Designed Appropriately," the work authorizations related to the renovation were finalized after the CFPB Director was appointed. The IG determined that CFPB awarded a contract for architecture and engineering (A/E) design services in September 2012 and signed reimbursable work authorizations with GSA in September 2013. It found that GSA awarded contracts for construction management and construction in July and December 2014.

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Importantly, the IG concluded in its report that the costs associated with this renovation appeared reasonable and that the project was to-date under budget. Specifically, the IG found that "(1) the CFPB followed required processes in evaluating the price reasonableness of A/E costs, (2) construction costs appear reasonable based on comparisons to an independent cost estimate and the costs of two comparable building renovations, and (3) potential renovation costs are below the amount previously budgeted and obligated for the renovation."

Question 2:

Following up on questions I asked at the hearing on June 17, 2015 regarding liquidity in the fixed-income market, I would like to ask some further questions on the pending analysis regarding volatility on October 15.

- **When exactly will this analysis be made available, as we have heard "in the next few weeks" as well as "over the summer?"**
- **Which FSOC member agencies are contributing to this analysis? The FSOC annual report notes that "[c]ertain member agencies" will be publishing an interagency white paper. Which FSOC member agencies were excluded from working on the paper? Why?**
- **Were these agencies instructed to consider the impact that regulation has had on liquidity in the fixed-income market?**

Answer:

On July 13, 2015, staff from the Department of Treasury, the Board of Governors of the Federal Reserve System, the Federal Reserve Bank of New York, the Securities and Exchange Commission, and the Commodity Futures Trading Commission (the Joint Staff) issued a joint report analyzing the significant volatility in the U.S. Treasury markets on October 15, 2014. Using nonpublic data from the Treasury cash and futures markets, the joint report provided detailed analysis of the market conditions and record trading volumes that day, including an unusually rapid round trip in prices and deterioration in liquidity during a narrow window.

The joint report made clear that a number of developments help explain the conditions that likely contributed to the volatility. Specifically, the report found that in addition to other factors, changes in global risk sentiment and investor positions, a decline in order book depth, and changes in order flow and liquidity provision together provide important insight into the developments that day. The report also underscored the changing structure of the U.S. Treasury market, the deepest and most liquid government securities market in the world.

Finally, the report also offers several next steps to further enhance the public and private sectors' understanding of changes to the structure of the U.S. Treasury market and their implications. The report recommended continued analysis of U.S. Treasury market structure and functioning, focusing on trading and risk management practices, the availability of public data, and continued efforts to strengthen monitoring and inter-agency coordination related to trading across the U.S. Treasury cash and futures markets.

Following up on this effort, on October 20-21, 2015, the Joint Staff sponsored a conference, held at the Federal Reserve Bank of New York, on the "Evolving Structure of the U.S. Treasury Market." The conference consisted of a variety of panels on subjects ranging from automated and algorithmic trading, market making, liquidity, end investor perspectives on market structure, operational risks, repo markets, academic and practitioner perspectives on potential improvements to market structure, and regulatory requirements applicable to the government securities market. The conference included prominent industry and academic experts and featured remarks by several authorities in the official sector.

In addition, on January 22, 2016, the Department of Treasury published in the Federal Register a request for information on the Evolution of the Treasury Market Structure. The RFI seeks public comment on several specific questions that will inform the ongoing work related to the next steps identified in the joint staff report. The RFI is intended, in part, to seek information and viewpoints from a diverse group of stakeholders, including the general public, buy and sell-side market participants, academics, and industry groups regarding these and other structural changes in the Treasury market, and their implications for the depth, liquidity, and functioning of the market. The RFI is also intended to develop a holistic view of trading and risk management practices across U.S. Treasury cash and futures markets—including the various trading venues and modes of execution present in the cash market—and it seeks input on potential improvements in Treasury market policies, practices, and conduct.

The comment period for the RFI ended on April 22, 2016. The Department of Treasury intends to publish a white paper summarizing the comments that were received. Following this, Treasury intends to communicate a policy proposal for next steps, to address the issues raised in the joint report, particularly with regards to the collection of trade data by the public sector.

Finally, it should be made clear that the Joint Staff has collaborated on issues related to the functioning of government securities market in the past and pre-dates the FSOC. For example, as directed by the Government Securities Act Amendments of 1993, the Department of Treasury, the Securities and Exchange Commission and the Board of Governors of the Federal Reserve System conducted a study on the regulatory system for government securities, including an evaluation of the effectiveness of surveillance and enforcement. As required, the report on the study was provided to Congress in March 1998. The most recent joint staff report included the Commodity Futures Trading Commission due to its regulatory authority over the Treasury futures market and the Federal Reserve Bank of New York for its market expertise.

Question 3:

I would also like to follow up on questions I asked at the June 17, 2015 hearing regarding SIFI de-designations.

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- **Other than information that FSOC provides companies during initial designation, is FSOC doing anything to communicate risks and ways to decrease those risks towards the ultimate goal of removing a SIFI designation?**
- **Is there any way that FSOC can make the process of rescinding a SIFI designation any more clear and structured other than an annual review?**
- **What is the reason that FSOC has not made any recommendations for the appropriation regulation of SIFIs?**
- **Could such recommendations prove helpful to a firm's ability to achieve a de-designation?**

Answer:

FSOC provides each designated company with a lengthy and detailed explanation of the basis for its designation. These explanations provide a company-specific analysis that identifies specific potential risks arising from factors such as counterparty exposures and asset liquidations. This information allows each company to make informed decisions regarding potential changes it could make to mitigate the risks FSOC has identified. Following a designation, a company's management is in the best position to take information provided by FSOC and make decisions about how to move forward.

The FSOC reevaluates each of its designations annually based on a process set forth in the Dodd-Frank Act and in guidance FSOC has issued publicly. FSOC has also made clear that it may consider a request from a company for a reevaluation before the next annual reevaluation in the case of an extraordinary change that materially decreases the threat the nonbank financial company could pose to U.S. financial stability. As part of each reevaluation, the company is provided an opportunity to meet with FSOC staff to discuss the scope and process for the review and to present information regarding any change that may be relevant to the threat the company could pose to financial stability, including a company restructuring, regulatory developments, market changes, or other factors. If a company contests its designation during FSOC's annual reevaluation and FSOC does not rescind the designation, FSOC provides the company with a detailed explanation of the primary basis for any decision not to rescind the designation. The notice addresses the material factors raised by the company in its submissions to FSOC contesting the designation during the annual reevaluation. In addition, FSOC provides each company subject to a designation an opportunity for an oral hearing before FSOC once every five years at which the company can contest the designation.

The Dodd-Frank Act assigns responsibility to the Federal Reserve for establishing the regulations that designated firms will be subject to. I expect that the Council will monitor and consult on the Federal Reserve's enhanced prudential standards for designated nonbank financial companies.

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Questions of Congressman Roger Williams (TX-25)

Question 1:

FSOC's 2015 annual report states that Treasury and the Fed are working on insurance capital standards for international companies. And yet our U.S. insurance regulators have suggested that there has been no need established to replace our current U.S. protections with global requirements, and that shifting from legal entity oversight to bank-like holding company regulation will cost consumers more and shift focus away from consumer protection. Since the state insurance regulators would have to adopt any new global requirements for a majority of U.S. firms, shouldn't Treasury be working to support our U.S. system and the states internationally?

Answer:

At the International Association of Insurance Supervisors (IAIS), the United States is represented by the Treasury's Federal Insurance Office (FIO), the Board of Governors of the Federal Reserve System (Federal Reserve), state insurance regulators, and staff of the National Association of Insurance Commissioners (NAIC). Treasury, through FIO, prioritizes collaboration and coordination among the U.S. participants at the IAIS, and spends countless hours facilitating such coordination. Many positive developments at the IAIS can be attributed to the teamwork between the U.S. participants.

Treasury has repeatedly affirmed its support for the U.S. integrated state-federal approach to insurance sector oversight and the continued role of the states as the primary regulators of the business of insurance. For any IAIS standard to become effective in the United States, either the Federal Reserve or the states would implement that standard through processes that include direct public stakeholder engagement.

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