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FINANCIAL STABILITY

Continued Actions Needed to Strengthen New Council and Research Office

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

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Highlights

Highlights of GAO-13-467T, a testimony before the Subcommittee on Oversight and Investigations, Committee on Financial Services, House of Representatives

Why GAO Did This Study

In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act created FSOC to identify and address threats to financial stability and OFR to support FSOC and Congress by providing financial research and data. This testimony primarily discusses findings from a September 2012 GAO report and addresses four topics (1) challenges FSOC and OFR face in carrying out their missions, (2) FSOC's and OFR's efforts to establish management mechanisms, (3) FSOC's and OFR's activities for supporting collaboration among their members and external stakeholders, and (4) FSOC's rules for designating nonbank financial firms that pose threats to financial stability.

For this testimony, GAO updated some information on the entities' response to the recommendations in its September 2012 report.

What GAO Recommends

In its September 2012 report, GAO made 10 recommendations to FSOC and OFR, which among other things, recommends ways to improve the transparency and accountability of their decisions. In response to GAO's report, Treasury said, as Chairperson, that the council and OFR had considered the recommendations. In March 2013 Treasury and OFR officials described steps that each entity was considering or taking to address some of them.

View GAO-13-467T. For more information, contact A. Nicole Clowers at (202) 512-8678 or clowersa@gao.gov

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Continued Actions Needed to Strengthen New Council and Research Office

What GAO Found

The Financial Stability Oversight Council (FSOC) and Office of Financial Research (OFR) face challenges in achieving their missions. For example, collaboration among FSOC members can be challenging, as almost all members represent independent agencies that retain existing authorities. Additionally, OFR faces the challenge of building a world-class research organization while meeting shorter-term responsibilities.

FSOC and OFR have developed some management structures to carry out their missions and taken steps to promote collaboration among their members and stakeholders. For example, FSOC established several standing committees composed of members' and member agencies' staffs to support the council in carrying out its business. FSOC also issued rules on the process for designating nonbank financial firms for additional oversight. However, GAO reported in September 2012 that these efforts could be strengthened to conform to key standards and practices and made 10 recommendations.

- FSOC should develop a systematic approach to help identify potential threats to financial stability that includes collecting and sharing key financial risk indicators. FSOC's Systemic Risk Committee, which is responsible for identifying risks to financial stability, has procedures to facilitate risk analysis but does not have a systematic approach or comprehensive information. FSOC member agencies on their own may not be well positioned to judge which potential threats will benefit from interagency discussions.
- FSOC should develop more systematic approaches that are forward looking and help prioritize threats to the financial system in its annual reports. To date, FSOC's annual reports have not reflected a forward-looking process for identifying emerging threats.
- To improve transparency, (1) FSOC should keep detailed records of closed-door sessions and (2) both FSOC and OFR should develop a communication strategy to improve communications with the public. Currently, public information on FSOC's and OFR's decision making and activities is limited.
- OFR needs to further develop its strategic planning and performance management system to include some leading practices. OFR issued a strategic framework in March 2012 that did not, among other things, link activities to strategic goals and performance measurement systems.
- FSOC should identify an agency or agencies to monitor or implement each recommendation from its annual reports within specified time frames. FSOC's annual reports have not consistently identified which entities should monitor or implement the identified recommendations.
- FSOC should (1) develop policies to clarify when formal collaboration or coordination should occur, (2) more fully incorporate key practices for successful collaboration, and (3) clarify with OFR responsibility for implementing requirements to monitor risks to the financial system.
- FSOC should develop a comprehensive framework for assessing the impact of its designation decisions. For example, FSOC has issued rules on processes for designating nonbank financial entities for additional oversight, but it has not developed plans to comprehensively evaluate whether the designations are having their intended impact.

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

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

My testimony today will address four topics: (1) the challenges FSOC and OFR face in fulfilling their missions; (2) FSOC's and OFR's efforts to establish management structures and mechanisms to carry out their missions and attain their goals; (3) FSOC's and OFR's activities supporting collaboration among members and external stakeholders, including international bodies and regulators; and (4) FSOC's rules for

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

[2]The provisions of the Dodd-Frank Act dealing with FSOC are contained primarily in subtitle A of title I, §§ 111-123, codified at 12 U.S.C. §§ 5321-5333, and title VIII, codified at 12 U.S.C. §§ 5461-5472. The following sections of this testimony describe FSOC's specific functions in detail.

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

designating nonbank financial companies that pose threats to financial stability.

My remarks are primarily based on our September 2012 report on FSOC and OFR.[4] For that report, we reviewed our prior reports on financial reform and the 2007-2009 financial crisis, statements by government officials and academic experts, and agency documents, including information on the entities' budgeting, staffing, and planning. In addition, we analyzed FSOC policies, procedures, and products to determine whether and how their collaboration practices compared with key elements of effective collaboration we have previously identified and to determine processes FSOC used to issue products.[5] We also interviewed FSOC and OFR staff; officials from FSOC's member agencies; and external stakeholders, including foreign officials, industry trade groups, and academics. In March 2013, we interviewed Treasury and OFR officials to obtain updates on the progress FSOC and OFR had made in implementing our recommendations. The work on which this statement is based was conducted from November 2011 through September 2012 and in March 2013 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

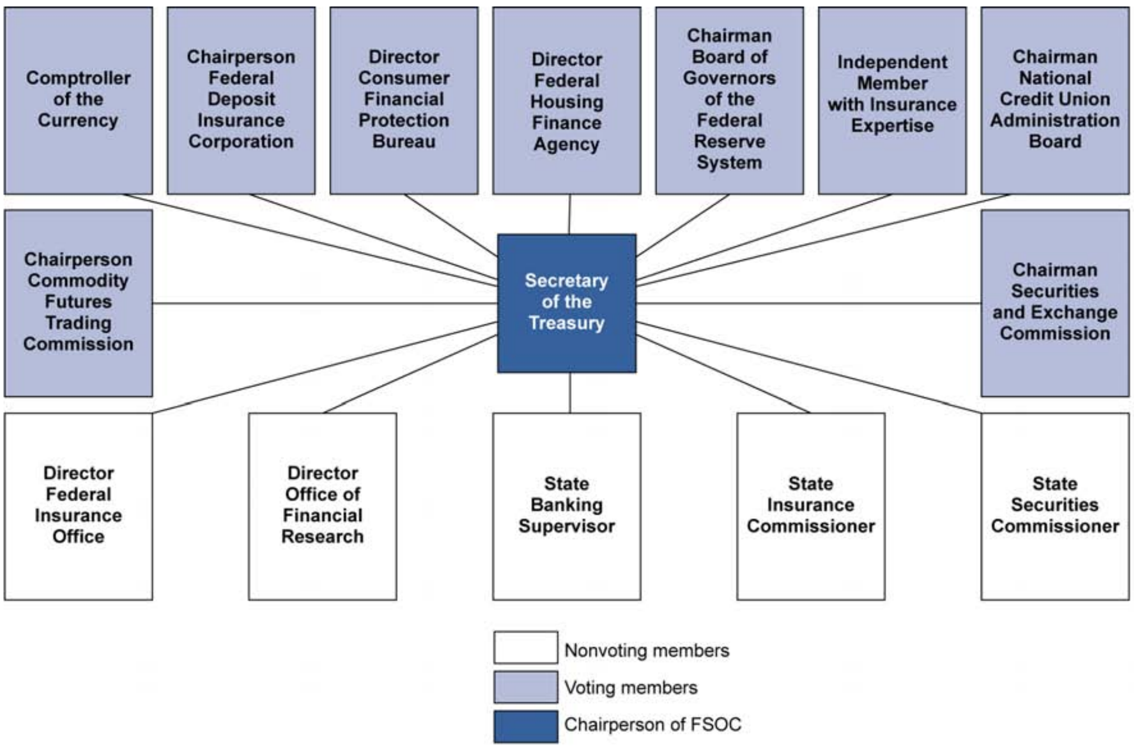
FSOC consists of 10 voting members and 5 nonvoting members (fig. 1). The 10 voting members include 9 federal regulators and an independent insurance expert. The 5 nonvoting members include state-level representatives from bank, securities, and insurance regulators and directors of OFR and the Federal Insurance Office. As the chairperson of FSOC, the Secretary of the Treasury has certain powers and responsibilities related to FSOC's meetings, rulemakings, recommendations, and reports and testimony to Congress. The

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

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

Secretary, in consultation with the other FSOC members, is also responsible for regular consultation with the financial regulatory entities and other appropriate organizations of foreign governments or international organizations. FSOC has established seven standing committees that are generally composed of staff of FSOC members and member agencies to help carry out the council's business.[6]

Figure 1: FSOC Membership



Source: GAO analysis of Dodd-Frank Act.

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

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

management. The act requires OFR to set up a data center and a research and analysis center to, among other things,

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

FSOC and OFR Face Challenges Achieving Their Missions

FSOC and OFR face several challenges as they work to carry out their responsibilities and achieve their missions. First, FSOC's missions—to identify risks to U.S. financial stability and respond to emerging threats to stability—are inherently challenging, for several reasons. Identifying risks to financial stability is challenging because (1) key indicators, such as market prices, often do not reflect threats to financial stability; (2) such threats do not develop in precisely the same way in successive crises; (3) financial innovations are not well understood; and (4) according to experts, effectively monitoring and mitigating systemic risk is both vast and procedurally complex. In addition, actions to preemptively mitigate emerging threats may appear unnecessary or too costly at the time they are proposed or taken.

Second, although the Dodd-Frank Act created FSOC to provide for a more comprehensive view of threats to U.S. financial stability, it left most of the fragmented and complex arrangement of independent federal and state regulators in place and generally preserved their statutory responsibilities. As a result, FSOC's effectiveness in providing for a more comprehensive view of threats to U.S. financial stability hinges to a large extent on collaboration among its many members, almost all of whom have their own independent regulatory responsibilities. In testifying on the coordination of Dodd-Frank rulemakings assigned to specific FSOC members before the U.S. House Financial Services Committee in October 2011, the chairperson of FSOC recognized this challenge. However, he also noted that certain agencies were working much more closely together than before FSOC's creation. The federal financial regulators have also emphasized the importance of maintaining their independence while serving as members of FSOC. For example, several member agencies noted in our prior work on Dodd-Frank rulemakings that any effort to coordinate rulemakings assigned to specific agencies through FSOC would need to be balanced against the statutory requirements of the independent agencies involved.[7] Regulators have also pointed to their differing statutory requirements to explain why they have differing views on policy issues. During the Basel II deliberations prior to the financial crisis, for instance, U.S. bank regulators—the Federal Deposit Insurance Corporation (FDIC), Federal Reserve, and the Office of the Comptroller of the Currency (OCC)—each had a different view of various aspects of those requirements.[8] The regulators traced their differences back to their specific statutory responsibilities.

Third, OFR faces the challenge of trying to build a world-class research organization from the ground up, including acquiring staff with the needed skills, while meeting its short-term responsibility to support FSOC. The researchers who supported the creation of OFR suggested that it would take many years for the new entity to provide the insights that would ultimately be expected of it. Though OFR now has a confirmed director, these researchers had also noted that the long absence of a director for the organization had slowed this process.

FSOC and OFR Could Strengthen Mechanisms to Fully Ensure Accountability and Transparency

FSOC and OFR have taken steps toward meeting the challenges they face. For example, they have taken steps to build mechanisms to identify potential threats to financial stability, provide information to the public about their activities and progress, and establish management and planning structures. However, additional actions could strengthen the accountability and transparency of these efforts. As we have reported in the past, agencies can manage or mitigate many of the challenges of

[7]GAO, *Dodd-Frank Act Regulations: Implementation Could Benefit from Additional Analyses and Coordination*, GAO-12-151 (Washington, D.C.: Nov. 10, 2011).

[8]Basel II is a risk-based capital framework for banks that is based on an international accord. For more information on Basel II adoption in the United States, see GAO, *Risk-Based Capital: Bank Regulators Need to Improve Transparency and Overcome Impediments to Finalizing the Proposed Basel II Framework,* GAO-07-253 (Washington, D.C.: Feb. 15, 2007) and *Risk-Based Capital: New Basel II Rules Reduced Certain Competitive Concerns, but Bank Regulators Should Address Remaining Uncertainties,* GAO-08-953 (Washington, D.C.: Sept. 12, 2008).

setting up new organizations by developing strong management structures and control mechanisms.[9]

Identifying Potential Risks and Emerging Threats to Financial Stability

FSOC has taken steps to meet its statutory responsibilities related to identifying risks and potential emerging threats to U.S. financial stability but has not yet developed comprehensive and systematic mechanisms to realize these goals. These steps include setting up the Systemic Risk Committee—one of the seven standing FSOC committees—that is responsible for systemic risk monitoring and plays a key role in reviewing sources of systemic risk. The committee is operating under draft procedures, with member agency staff suggesting risks or threats that, in their view, may benefit from interagency coordination.[10] According to FSOC policy staff, if there is agreement that an issue warrants further examination, an agency is assigned to develop it, including identifying vulnerabilities in the financial system. When the committee determines that the issue is sufficiently developed, it presents the issue to the Deputies Committee. According to the draft procedures, if issues are elevated beyond the Deputies Committee to FSOC members, agencies may respond with a variety of actions, including enhanced monitoring, additional analysis, the development of potential policy responses, or the implementation of a particular policy response. Potential threats to financial stability are also discussed at FSOC meetings; for example,

[9]GAO, *Millennium Challenge Corporation: Progress Made on Key Challenges in First Year of Operations,* GAO-05-625T (Washington, D.C.: Apr. 27, 2005) and *Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency,* GAO-09-161 (Washington, D.C.: Dec. 2, 2008). Such mechanisms include: GAO, *Internal Control: Standards for Internal Control in the Federal Government,* GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999); and *Internal Control Standards: Internal Control Management and Evaluation Tool*, GAO-01-1008G (Washington, D.C.: August 2001). For the importance of objectives and performance measures in determining accountability and efficiency, see, for example, GAO, *Results-Oriented Government: GPRA Has Established a Solid Foundation for Achieving Greater Results*, GAO-04-38 (Washington, D.C.: Mar. 10, 2004) and *Government Performance: GPRA Modernization Act Provides Opportunities to Help Address Fiscal, Performance, and Management Challenges,* GAO-11-466T (Washington, D.C.: Mar. 16, 2011).

[10]FSOC officials noted that the procedures were marked “draft” because the process was new and the committee expected to change the procedures based on its initial experience.

FSOC officials noted that a teleconference was convened to discuss MF Global's bankruptcy.[11]

OFR participates in the Systemic Risk Committee and is building capacity to monitor the financial system for threats to financial stability. OFR has developed the Financial Stability Monitor, a collection of metrics and indicators related to financial stability that is to be continuously updated, according to OFR and Treasury officials. According to these officials, OFR began sharing the Financial Stability Monitor with the Systemic Risk Committee and FSOC member agency staff in February 2012. OFR is also assessing options for analyzing risks to financial stability and produced a working paper in collaboration with outside researchers, published in January 2012 to survey existing approaches.[12] In addition, OFR and FSOC sponsored conferences in December 2011 and December 2012 to discuss a range of issues related to risks to financial stability.[13] OFR staff said that they were evaluating a range of metrics and methods for measuring and analyzing financial markets and systems and were in the early stages of developing network maps and other tools to assess financial stability. For example, OFR evaluated 11 measures against a series of crises over time and reported on some of these efforts in its 2012 Annual Report.[14]

However, FSOC and OFR have not developed a comprehensive, systemic approach to identifying and addressing threats to the financial system. Without a more systematic approach and comprehensive information, FSOC member agencies on their own may not be well

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[11]In October 2011, MF Global, the third largest independent broker dealer in the United States, filed for bankruptcy. MF Global Holdings Ltd. and MF Global Finance USA Inc. filed on a consolidated basis for relief under Chapter 11 bankruptcy protection. The jointly registered broker-dealer and futures commission merchant, operating as MF Global Inc., entered liquidation proceedings under the Securities Investor Protection Act. A series of events, including increased exposure to European sovereign debt securities, preceded the bankruptcy filing.

[12]Dimitrios Bisias, Mark Flood, Andrew W. Lo, and Stavros Valavanis, *A Survey of Systemic Risk Analytics,* Office of Financial Research Working Paper #0001 (Washington, D.C.: Jan. 15, 2012).

[13]The Macroprudential Toolkit: Measurement and Analysis. Conference held in Washington, DC, December 1-2, 2011, and Assessing Financial Intermediation: Measurement and Analysis. Conference held in Washington, DC, December 6, 2012.

[14]Office of Financial Research, *2012 Annual Report* (Washington, D.C.: July 2012).

positioned to judge which potential threats will benefit from interagency discussions. FSOC and OFR could improve their efforts to identify risks and threats by collecting and sharing a common set of financial indicators.[15] Systematic collection, analysis, and sharing of financial indicators of key risk factors such as leverage, liquidity, concentrations, underwriting standards, collateral quality, and delinquencies should provide insight into vulnerabilities affecting particular types of financial intermediaries or reveal patterns occurring across the financial system. OFR, through a mechanism such as the Financial Stability Monitor, could play a role in collecting, analyzing, and reporting on these indicators. To improve FSOC's approaches for monitoring threats to financial stability, we recommended that FSOC develop an approach that included systematic sharing of key financial risk indicators across FSOC members and member agencies to assist in identifying potential threats for further monitoring or analysis.

In addition, FSOC does not have sufficient processes for identifying or prioritizing potential emerging threats to U.S. financial stability for its annual reports. FSOC's annual reporting process is an ongoing responsibility which, in the absence of a strategic plan, functions as its major strategic planning document and method for communicating with Congress and the public, especially regarding potential emerging threats to U.S. financial stability. FSOC's 2011 and 2012 annual reports generally addressed the subjects mandated by the Dodd-Frank Act. These reports also provided extensive information about the current economy and complex issues, such as high-frequency trading and the MF Global bankruptcy. In addition, the reports contained extensive discussions of current known threats, such as those associated with money market funds and the European sovereign-debt crisis, and made some recommendations to address them. However, FSOC has not developed a structure that supports having a systematic or comprehensive process for identifying potential emerging threats. In particular, FSOC does not have processes for consistently identifying such threats, separating them from more current threats, or prioritizing them. For instance, certain potential threats related to U.S. debt are not in the 2011 Annual Report. However, the 2012 Annual Report identifies the U.S. debt as a potential threat but does not explain what has changed since the 2011 report. Similarly, the

[15] Such a data-sharing exercise is akin to what the International Monetary Fund proposes with its Financial Soundness Indicators. See International Monetary Fund, *Financial Soundness Indicators: Compilation Guide* (Washington, D.C.: March 2006).

2011 or 2012 annual reports identify risks, such as those associated with the European sovereign debt crisis or money market funds, which are ongoing or have previously been identified as potentially emerging. Further, FSOC identifies a large number of threats without explicitly prioritizing them. In contrast, other entities, such as the International Monetary Fund and European Central Bank, issue reports that explicitly prioritize potentially significant threats. Treasury and FSOC officials and staff noted that FSOC's annual reports have a different purpose and implicitly prioritize the threats in the recommendations sections of the reports. As a result of FSOC's limited processes for identifying and prioritizing potential emerging threats to financial stability in its annual reports, policymakers and market participants do not have the information they need to develop effective and timely responses to those threats. We recommended that FSOC develop more systematic approaches for identifying emerging threats to financial stability that are forward-looking and help prioritize such threats in annual reports.

Transparency

Although FSOC and OFR have adopted communication methods to provide information on their activities to the public and Congress, some of their methods could be strengthened. For example, both entities have web pages on Treasury's website. FSOC's web pages include minutes of the council's meetings, annual reports, frequently asked questions, and information on FSOC rulemakings. OFR has also posted key documents on its web pages, including its annual report, strategic framework, and updates on recent developments, such as the status of the legal entity identifier.

However, FSOC does not keep detailed records of deliberations or discussions that take place at the council's meetings or at the committee level. While no specific level of detail is required for FSOC minutes, the limited documentation of their discussions makes it difficult to assess FSOC's performance. For instance, the minutes typically describe agenda items for the meetings and information on the presenters for each agenda item but lack additional detail even when the information being discussed is not likely to be market sensitive or limit the quality of deliberations. As a result, the public receives little information about FSOC's activities and deliberations, limiting its understanding of these activities.

FSOC policy officials recognized the need for transparency but also noted that certain information was protected from disclosure under various statutes and could not be released. FSOC staff also noted the need to balance the desire for transparency with the need to provide an environment that allows for open discussion and deliberation of issues and policy options. However, similar bodies, such as the Federal Open Market Committee, publish minutes that provide greater detail, and the Federal Open Market Committee voluntarily releases transcriptions of its meetings 5 years after a meeting occurs. As we have previously reported, transparency is a key feature of accountability even when there is a need to safeguard certain sensitive information to protect the marketplace. We recommended that FSOC keep detailed records of closed door sessions of key meetings.[16] According to Treasury officials, the Deputies Committee has reviewed FSOC's existing transparency policy in light of this recommendation and may be positioned to make a recommendation to the Council on addressing our recommendation in the coming weeks.

In our September 2012 report, we also recommended that both entities develop a communication strategy to improve communications with the public, which could include more fully developing their websites. According to Treasury and OFR officials, both entities have taken steps to improve their websites. In November 2012, a Treasury official noted that OFR was actively engaged in redesigning its website but had still not posted some information that would show the progress the agency was making in standing up its operations. While the updated website includes a copy of OFR's organizational chart, that chart does not include the names of its top managers or indicate which positions are filled, as we noted in our report. In comparison, the Consumer Finance Protection Bureau, which was also created by the Dodd-Frank Act, has for some time had its own domain name, an easily identifiable website that includes a detailed organizational chart, and online services that provide regular updates to interested parties.

Management Structures and Strategic Planning

FSOC's management structures include a dedicated policy office within Treasury's Office of Domestic Finance and an executive director.[17] FSOC has also implemented bylaws, a transparency policy, and a consultation framework, and members have signed a memorandum of understanding

[16]See, GAO *Troubled Asset Relief Program: Continued Stewardship Needed as Treasury Develops Strategies for Monitoring and Divesting Financial Interests in Chrysler and GM*, GAO-10-151 (Washington, D.C.: Nov. 2, 2009).

[17]FSOC's policy office within Treasury's Office of Domestic Finance has been led by a Deputy Assistant Secretary. More recently, on December 13, 2012, the Council also approved the appointment of an executive director.

(MOU) on sharing confidential information to govern FSOC activities and promote accountability and transparency. OFR has also taken steps to set up needed management structures. It has developed an organizational structure that is built around a Data Center and a Research and Analysis Center—the two programmatic units established by the Dodd-Frank Act.

FSOC is subject to the Government Performance and Results Act of 1993 (GPRA), as amended, which requires agencies to periodically produce strategic plans, annual performance plans, and performance updates. FSOC has begun planning how it can satisfy these requirements but may request an exemption from some. Treasury's strategic plan for fiscal year 2012-2015 does not include information on FSOC's goals or describe how it will measure FSOC's progress in achieving them.

OFR, which is not independently subject to GPRA, received limited discussion in Treasury's 2012-2015 strategic plan and has begun its own strategic planning process. OFR issued a strategic framework in March 2012 to cover fiscal years 2012-2014 that lists five strategic goals, including:

- supporting FSOC through the secure provision of high-quality financial data and conducting the analyses needed to monitor threats to financial stability;
- developing and promoting data-related standards and best practices;
- establishing a center of excellence for research on financial stability and promoting best practices for financial risk management;
- providing the public with key data and analyses while protecting sensitive information; and
- establishing OFR as an efficient organization and world-class workplace.

OFR's framework also highlights a number of objectives under those goals and lays out implementation priorities for fiscal year 2012.[18] However, OFR acknowledges that it has not yet put other key elements of

[18] The framework also notes the importance of transparency and indicates that OFR is subject to oversight from the Treasury Office of the Inspector General (OIG) and GAO, which have both exercised that authority during OFR's first 2 years, and that the Dodd-Frank Act requires that the OFR Director testify before Congress annually on OFR's activities.

performance management in place, including linking programmatic, human resources, and budgetary decision making to its strategic goals and developing a performance measurement system. To support the growth of OFR into a viable and sustainable entity, we recommended that OFR build on its strategic framework by further developing its strategic planning and performance management system so that it linked its activities to its goals and used publicly available performance measures to measure its progress. OFR officials said that they had developed performance measures and planned to describe these in their fiscal year 2014 budget submission.[19]

In the absence of a strategic plan, FSOC's annual reports serve as a key accountability document. FSOC staff noted that its annual reports provided Congress and the public with a description of FSOC's activities, its views on potential emerging threats to U.S. financial stability, and recommendations to enhance the integrity, efficiency, competitiveness, and stability of U.S. financial markets. They added that the chairperson was required to testify annually before Congress on the report, an activity that served as another accountability mechanism.

When discussing accountability, FSOC members have noted the importance of the statement contained in the front of the reports (and signed by each member) that FSOC is taking reasonable steps to ensure financial stability and mitigate systemic risk. FSOC members have also acknowledged the need to follow up on the report's recommendations, and FSOC staff noted that recommendations would be monitored by FSOC as a whole. However, the annual reports do not specify how FSOC will conduct this monitoring. For example, they do not consistently designate an FSOC member or members to monitor or implement the recommendations or establish time frames for certain actions, such as reporting to the council on the status of recommendations. Treasury officials noted that the Dodd-Frank Act did not give the chairperson or council authority to require that independent regulators take action or impose time frames on member agencies. However, they noted that some recommendations in the 2012 Annual Report were made to specific agencies and put greater stress on more immediate action than others. For example, the 2012 report emphasized the importance of a

[19] OFR's budget submission will be included as part of the President's fiscal year 2014 budget submission.

recommendation to the Securities and Exchange Commission (SEC) to take action to address money market fund risks by noting that wholesale short-term funding markets were a critical component of a well-functioning financial system. FSOC continues to be focused on structural vulnerabilities in money market funds that could disrupt these markets and has proposed specific recommendations for addressing these. However, SEC has not taken further action, and FSOC does not have the authority to require that its proposals be implemented.

To improve FSOC's accountability, we recommended in September 2012 that FSOC should make recommendations in the annual report more specific by identifying which FSOC member agency or agencies, as appropriate, were recommended to monitor or implement such actions within specified time frames. In March 2013, Treasury officials told us that FSOC had begun the development process for the 2013 annual report and that our recommendations about the annual reports were provided to the team assigned to pull together this year's annual report for their consideration.

FSOC and OFR Have Taken Steps to Collaborate but Could Enhance Their Efforts

Title I of the Dodd-Frank Act directs FSOC to facilitate information sharing and coordination among its member agencies and other federal and state agencies regarding domestic financial services policy development, rulemaking, examinations, reporting requirements, and enforcement actions.[20] The Dodd-Frank Act encourages collaboration between FSOC and external stakeholders, especially state regulators and international entities. It also specifies a number of duties for OFR that require collaboration with FSOC members and others. In particular, OFR must collect data on behalf of FSOC, provide the data to FSOC and member agencies, and standardize data collection among the agencies.[21] These activities require collaboration not only with FSOC member agencies but also with commercial data providers, publicly available data sources, and the financial industry.

[20]12 U.S.C. § 5322(a)(2)(E).

[21]The Dodd-Frank Act provides that member agencies, in consultation with OFR, must implement regulations promulgated by OFR to standardize the types and formats of data reported and collected on behalf of FSOC. However, it also explicitly notes that this provision does not supersede or interfere with the independent authority of a member agency under other laws to collect data in the format that the agency requires.

FSOC and OFR have taken steps to enhance collaboration among FSOC members. Members' staffs told us that FSOC's organizational and committee structures helped support collaboration among FSOC members both on a formal and informal basis. In addition, FSOC is working to standardize data reporting systems among FSOC member agencies. OFR officials noted that the agency had begun a three-stage process to assemble an inventory of data collected by FSOC member agencies as a first step toward standardizing data, reducing duplication, and eventually lowering costs for industry and regulators.

FSOC and OFR have taken some actions to collaborate by leveraging the expertise of external stakeholders and coordinating U.S. activities internationally. In particular, FSOC and OFR held joint conferences in December 2011 and 2012 to discuss a range of issues related to risks to financial stability. OFR has also initiated a working paper series in which OFR researchers have collaborated with outside academics to catalog systemic risk monitoring systems and ways to improve risk management at financial institutions. In addition, OFR created the Financial Research Advisory Committee in November 2012 to solicit advice, recommendations, analysis, and information from academics, researchers, industry leaders, government officials, and experts in the fields of data and technology. Moreover, OFR is working with industry, foreign government entities, and international bodies to create a legal entity identifier, which OFR describes as an emerging global standard that will enable regulators and companies around the world to quickly and accurately identify parties to financial transactions.

However, FSOC could do more to promote collaboration and coordination and apply key practices for successful collaboration that we have previously identified, such as leveraging resources, agreeing on roles and responsibilities, and establishing mutually reinforcing or joint strategies. For example, FSOC has not taken advantage of opportunities to leverage resources through its authority to appoint technical and professional advisory committees. Industry representatives have commented on the benefits of having industry input through such committees, but to date FSOC has not established such committees. Moreover, while FSOC members from federal regulatory agencies are able to draw on staff from across their agencies, the independent insurance member and state representatives have limited support structures—a shortcoming that could be remedied by having other state regulators participate through advisory councils.

In addition, FSOC and OFR have not defined their roles and responsibilities for monitoring risks to the financial system. As noted earlier, FSOC is tasked with monitoring the financial services marketplace to identify potential threats to U.S. financial stability, and OFR must develop and maintain metrics and reporting systems for risks to U.S. financial stability as well as monitor, investigate, and report on changes in systemwide risk levels. These responsibilities overlap somewhat, but this overlap is not unexpected given OFR's primary mission of supporting FSOC. The Dodd-Frank Act defines certain responsibilities for FSOC and OFR, but the lack of clear responsibility for implementation can lead to duplication, confusion, and gaps in their efforts. This risk is further compounded by the fact that many FSOC member agencies have risk analysis and data collection functions associated with their supervisory responsibilities. Some of these functions are explicitly focused on risks to financial stability, and some member agencies have created their own programs to examine them. To the extent that these programs provide unique information to FSOC, they will be contributing to the overall effort. However, if not properly coordinated, these separate efforts could be duplicative, resulting in wasted time and resources. We recommended that FSOC and OFR clarify responsibility for implementing requirements to monitor threats to financial stability across FSOC and OFR, including among FSOC members and member agencies.

Further, although FSOC has taken action to better coordinate members' rulemakings, additional action is needed. In October 2010 it issued an integrated implementation road map for the Dodd-Frank Act that included a list of the rules regulators were required to promulgate, provided a time line for those rulemakings, and identified the agencies responsible for each one. FSOC has also developed a consultation framework for the agencies involved in rulemakings. In a November 2011 report, we noted that although FSOC's road map and consultation framework were a positive development in facilitating coordination, they had limited usefulness.[22] For example, the consultation framework does not provide, nor according to FSOC staff is it intended to provide, any specifics about staff responsibilities or processes to facilitate coordination. It also does not describe when interagency coordination is required or what happens when rules conflict with or duplicate each other. We recommended that FSOC work with federal financial regulators to (1) develop formal

[22]GAO-12-151.

coordination policies that would clarify issues such as the timing of coordination, the process for soliciting and addressing comments, and FSOC's role in facilitating coordination and (2) more fully incorporate the key practices for successful collaboration that we have previously identified.

FSOC Has Not Yet Designated Nonbank Financial Companies for Enhanced Supervision

The Dodd-Frank Act gave FSOC the authority to designate financial market utilities (FMUs) as systemically important if FSOC determines that the failure of an FMU or a disruption in its functioning could threaten U.S. financial stability. Similarly, the Dodd-Frank Act provided FSOC with the authority to designate nonbank financial companies for supervision by the Federal Reserve under its enhanced prudential standards.[23] The act stipulates that FSOC may designate these companies if material financial distress at that company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the company could pose a threat to U.S. financial stability. While individual designations are not made through rulemakings, in an effort to be more transparent FSOC has issued rulemakings for designating FMUs as systematically important and designating nonbank firms for Federal Reserve supervision. FSOC issued final rules, which explain the processes and criteria FSOC intends to use in making the individual designations, in July 2011 and April 2012, respectively.

Each rule, with any accompanying interpretive guidance, outlines a multistage process that FSOC intends to follow in designating these entities. For example, the interpretive guidance that accompanies the rule for designating nonbank financial companies for Federal Reserve supervision includes a number of thresholds that a firm must meet to move beyond the first stage of the process. Financial companies must meet a size threshold of $50 billion in assets and one of five other thresholds, including measures of leverage and debt. In its 2012 Annual Report, FSOC reported that it had designated eight FMUs as systemically important. However, FSOC is still engaged in its process for designating

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

nonbank financial companies, and therefore no company has yet been designated.

FSOC is subject to laws and executive orders that require certain regulatory analyses as part of its rulemaking processes, including the Paperwork Reduction Act and the Regulatory Flexibility Act, as well as Executive Orders 12866 and 13563.[24] However, FSOC was required to consider costs and benefits of its FMU and nonbank financial company rules only as they related to the Paperwork Reduction Act. FSOC did not conduct a benefit-cost analysis for the rules designating FMUs or nonbank financial companies because the Office of Management and Budget determined that these rules were not economically significant. Treasury officials noted that the rule did not impose substantive requirements on specific entities but only laid out the process by which they could become subject to other rules and regulations. In addition, FSOC member staff noted that the costs and benefits of the designation were not among the factors that the Dodd-Frank Act directed FSOC to consider when making a designation.

Nonetheless, the designations were intended to address certain risks to financial stability posed by these entities and have the potential to confer other benefits and costs on the wider economy as well as on the individual entities designated. For example, some research has shown that certain large, interconnected financial institutions considered too big to fail may have lower borrowing costs than would otherwise be warranted. But being designated would impose a significant regulatory burden on the designated companies according to some of those who commented on the nonbank financial company rule during the rulemaking process. FSOC has some limited processes in place to review its designations of nonbank financial companies, including an annual review of material changes for a designated company and a review of the stage one thresholds stated in dollar terms at least every 5 years. However, it has not set up processes to conduct a comprehensive assessment of the overall impact of the designations and to determine whether they are achieving the intended result.

[24]A regulatory action is determined to be “economically significant” if the Office of Management and Budget determines that it is likely to have an annual effect on the economy of $100 million or more or to adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or state, local, or tribal governments or communities.

Doing a comprehensive analysis to assess whether designations are having their intended impact of providing greater financial stability and the extent of any other impacts will be challenging, but FSOC is uniquely positioned to address that challenge. Establishing a baseline from which to evaluate the overall impact of various rules will likely be complex because the impact of being designated will depend on the application of a number of rules being written by multiple independent regulatory agencies—Commodity Futures Trading Commission (CFTC), FDIC, the Federal Reserve, and SEC—and issued over a span of time.[25] For example, the Federal Reserve has not issued final rules on the enhanced prudential standards that designated nonbank financial companies will be subject to, but other final rules that will apply to these entities have been issued. These rules include one on resolution plans or "living wills" that was jointly issued by the Federal Reserve and FDIC and that will require designated nonbank financial companies to prepare resolution plans. Treasury has also issued a rule that establishes an assessment schedule for the Financial Research Fund, which finances OFR and FSOC under the Dodd-Frank Act.[26] Moreover, not all of these agencies are required to conduct cost-benefit analyses that might be useful in establishing a baseline. Finally, while some regulatory agencies may conduct periodic retrospective reviews of their rules, these reviews tend to focus only on the rules issued by their agency.

Because FSOC is responsible for designating FMUs and nonbank financial companies and its member agencies are responsible for writing the rules that will impact these designated entities, it has certain advantages in conducting a comprehensive analysis. Moreover, FSOC can rely on OFR for some data collection and analysis. However, FSOC

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

[26]Other Dodd-Frank provisions impose additional requirements on large bank holding companies and nonbank financial companies designated by FSOC. These include a requirement that the Federal Reserve subject designated nonbank financial companies that engage in proprietary trading to additional capital requirements, the authority of CFTC to impose limitations on the ability of those companies to control derivative clearing organizations and exchanges, and the ability of FDIC to impose risk-based assessments on large bank holding companies and designated nonbank financial companies if necessary to repay any obligations issued by FDIC to Treasury under the orderly liquidation authority.

members would need to collaborate on such an assessment, because FSOC policy and OFR staff, who are Treasury employees, may not have access to all of the needed information. In addition, collaboration is needed because, according to Treasury officials, it would be inappropriate for FSOC staff to review rules drafted by independent agencies unless those agencies agreed to participate in the comprehensive assessment. Without such an assessment, decision makers may not have the information they will need to determine whether designating new entities for enhanced supervision and other requirements and restrictions is addressing a perceived gap in the regulatory system and improving the stability of the financial system or whether policy changes should be considered. To strengthen the accountability of FSOC's decisions, FSOC should establish a collaborative and comprehensive framework for assessing the impact of decisions for designating FMUs and nonbank financial companies on those entities and the wider economy.

Concluding Remarks

Over the past 2 ½ years, FSOC and OFR have made progress in establishing their operations and approaches for monitoring threats to financial stability. Both entities have also worked to establish accountability and transparency mechanisms and promote collaboration among FSOC members and with external stakeholders. However, as we reported in September 2012, continued efforts are needed. We made 10 recommendations to FSOC and OFR to strengthen the accountability and transparency of their decisions and activities as well as enhance collaboration among FSOC members and with external stakeholders.

In its November 2012 response to our report and recommendations, Treasury noted that FSOC and OFR had considered the recommendations. In March 2013, Treasury officials described steps that each entity was considering or taking to address some of the recommendations, such as reviewing FSOC's transparency policy and updating the websites. Although fully addressing the recommendations will likely take time, doing so will help FSOC and OFR shed more light on their decision making and activities and allow Congress to hold them accountable for results. Furthermore, addressing our recommendations can help FSOC and OFR enhance collaboration among FSOC's members and with external stakeholders, activities that are critical to their ability to achieve their missions. We will continue to monitor FSOC's and OFR's progress in implementing our recommendations and stand ready to assist Congress as it continues its oversight of these entities.

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

GAO Contact and Staff Acknowledgments

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

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