

Ben S Bernanke: Regulatory reform implementation

Testimony by Mr Ben S Bernanke, Chairman of the Board of Governors of the Federal Reserve System, before the Committee on Banking, Housing, and Urban Affairs, US Senate, Washington DC, 30 September 2010.

* * *

Chairman Dodd, Ranking Member Shelby, and other members of the Committee, thank you for the opportunity to testify about the Federal Reserve's implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act).

In the years leading up to the recent financial crisis, the global regulatory framework did not effectively keep pace with the profound changes in the financial system. The Dodd-Frank Act addresses critical gaps and weaknesses of the U.S. regulatory framework, many of which were revealed by the crisis. The Federal Reserve is committed to working with the other financial regulatory agencies to effectively implement and execute the act, while also developing complementary improvements to the financial regulatory framework.

The act gives the Federal Reserve several crucial new responsibilities. These responsibilities include being part of the new Financial Stability Oversight Council, supervision of nonbank financial firms that are designated as systemically important by the council, supervision of thrift holding companies, and the development of enhanced prudential standards for large bank holding companies and systemically important nonbank financial firms designated by the council (including capital, liquidity, stress test, and living will requirements). In addition, the Federal Reserve has or shares important rulemaking authority for implementing the so-called Volcker Rule restrictions on proprietary trading and private fund activities of banking firms, credit risk retention requirements for securitizations, and restrictions on interchange fees for debit cards, among other provisions.

All told, the act requires the Federal Reserve to complete more than 50 rulemakings and sets of formal guidelines, as well as a number of studies and reports, many within a relatively short period. We have also been assigned formal responsibilities to consult and collaborate with other agencies on a substantial number of additional rules, provisions, and studies. Overall, we have identified approximately 250 projects associated with implementing the act. To ensure that we meet our obligations in a timely manner, we are drawing on expertise and resources from across the Federal Reserve System in areas such as banking supervision, economic research, financial markets, consumer protection, payments, and legal analysis. We have created a senior staff position to coordinate our efforts and have developed project-reporting and tracking tools to facilitate management and oversight of all of our implementation responsibilities.

The Federal Reserve is committed to its long-standing practice of ensuring that all its rulemakings be conducted in a fair, open, and transparent manner. Accordingly, we are disclosing on our public website summaries of all communications with members of the public – including banks, trade associations, consumer groups, and academics – regarding matters subject to a proposed or potential future rulemaking under the act.

In addition to our own rulemakings and studies, we have been providing technical and policy advice to the Treasury Department as it works to establish the oversight council and the related Office of Financial Research. We are working with the Treasury to develop the council's organizational documents and structure. We are also assisting the council with the construction of its framework for identifying systemically important nonbank financial firms and financial market utilities, as well as with its required studies on the proprietary trading and private fund activities of banking firms and on financial-sector concentration limits.

Additionally, work is well under way to transfer the Federal Reserve's consumer protection responsibilities specified in the act to the new Bureau of Consumer Financial Protection. A

transition team at the Board, headed by Governor Duke, is working closely with Treasury staff responsible for setting up the new agency. We have established the operating accounts and initial funding for the bureau, and we have provided the Treasury detailed information about our programs and staffing in the areas of rulemaking, compliance examinations, policy analysis, complaint handling, and consumer education. We are also providing advice and information about supporting infrastructure that the Bureau will need to carry out its responsibilities, such as human resource systems and information technology.

Well before the enactment of the Dodd-Frank Act, the Federal Reserve was working with other regulatory agencies here and abroad to design and implement a stronger set of prudential requirements for internationally active banking firms. The governing body for the Basel Committee on Banking Supervision reached an agreement a few weeks ago on the major elements of a new financial regulatory architecture, commonly known as Basel III. By increasing the quantity and quality of capital that banking firms must hold and by strengthening liquidity requirements, Basel III aims to constrain bank risk-taking, reduce the incidence and severity of future financial crises, and produce a more resilient financial system. The key elements of this framework are due to be finalized by the end of this year.

In concordance with the letter and the spirit of the act, the Federal Reserve is also continuing its work to strengthen its supervision of the largest, most complex financial firms and to incorporate macroprudential considerations into supervision. As the act recognizes, the Federal Reserve and other financial regulatory agencies must supervise financial institutions and critical infrastructures with an eye toward not only the safety and soundness of each individual firm, but also overall financial stability. Indeed, the crisis demonstrated that a too narrow focus on the safety and soundness of individual firms can result in a failure to detect and thwart emerging threats to financial stability that cut across many firms.

A critical feature of a successful systemic or macroprudential approach to supervision is a multidisciplinary perspective. Our experience in 2009 with the Supervisory Capital Assessment Program (popularly known as the bank stress tests) demonstrated the feasibility and benefits of employing such a perspective.¹ The stress tests also showed how much the supervision of systemically important institutions can benefit from simultaneous horizontal evaluations of the practices and portfolios of a number of individual firms and from employment of robust quantitative assessment tools. Building on that experience, we have reoriented our supervision of the largest, most complex banking firms to include a quantitative surveillance mechanism and to make greater use of the broad range of skills of the Federal Reserve staff.

A final element of the Federal Reserve's efforts to implement the Dodd-Frank Act relates to the transparency of our balance sheet and liquidity programs. Well before enactment, we were providing a great deal of relevant information on our website, in statistical releases, and in regular reports to the Congress. Under a framework established by the act, the Federal Reserve will, by December 1, provide detailed information regarding individual transactions conducted across a range of credit and liquidity programs over the period from December 1, 2007, to July 20, 2010. This information will include the names of counterparties, the date and dollar value of individual transactions, the terms of repayment, and other relevant information. On an ongoing basis, subject to lags specified by the Congress to protect the efficacy of the programs, the Federal Reserve also will routinely provide information regarding the identities of counterparties, amounts financed or purchased and collateral

¹ See Ben S. Bernanke (2010), "The Supervisory Capital Assessment Program – One Year Later", speech delivered at the Federal Reserve Bank of Chicago 46th Annual Conference on Bank Structure and Competition, held in Chicago, Ill., May 6; and Daniel K. Tarullo (2010), "Lessons from the Crisis Stress Tests", speech delivered at the Federal Reserve Board International Research Forum on Monetary Policy, Washington, March 26.

pledged for transactions under the discount window, open market operations, and emergency lending facilities.

To conclude, the Dodd-Frank Act is an important step forward for financial regulation in the United States, and it is essential that the act be carried out expeditiously and effectively. The Federal Reserve will work closely with our fellow regulators, the Congress, and the Administration to ensure that the law is implemented in a manner that best protects the stability of our financial system and strengthens the U.S. economy.