3/22/12 CQ-RollCall Pol. Transcriptions 17:55:00

Loaded Date: 03/22/2012

CQ-RollCall Political Transcriptions

March 22, 2012

SEN. TIM JOHNSON HOLDS A HEARING ON INTERNATIONAL HARMONIZATION OF WALL STREET REFORM

SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS HOLDS A HEARING ON INTERNATIONAL HARMONIZATION OF WALL STREET REFORM

MARCH 22, 2012

SPEAKERS: SEN. TIM JOHNSON, D-S.D. CHAIRMAN SEN. JACK REED, D-R.I. SEN. CHARLES E. SCHUMER, D-N.Y. SEN. ROBERT MENENDEZ, D-N.J. SEN. DANIEL K. AKAKA, D-HAWAII SEN. SHERROD BROWN, D-OHIO SEN. JON TESTER, D-MONT. SEN. MARK WARNER, D-VA. SEN. HERB KOHL, D-WIS. SEN. JEFF MERKLEY, D-ORE. SEN. MICHAEL BENNET, D-COLO. SEN. KAY HAGAN, D-N.C.

SEN. RICHARD C. SHELBY, R-ALA. RANKING MEMBER SEN. MICHAEL D. CRAPO, R-IDAHO SEN. BOB CORKER, R-TENN. SEN. MIKE JOHANNS, R-NEB. SEN. DAVID VITTER, R-LA. SEN. JIM DEMINT, R-S.C. SEN. PATRICK J. TOOMEY, R-PA. SEN. MARK STEVEN KIRK, R-ILL. SEN. JERRY MORAN, R-KAN. SEN. ROGER WICKER, R-MISS.

WITNESSES: LAEL BRAINARD, UNDERSECRETARY OF THE TREASURY FOR INTERNATIONAL AFFAIRS

ELISSE WALTER, SECURITIES AND EXCHANGE COMMISSION

MARTIN J. GRUENBERG, ACTING CHAIRMAN, BOARD OF DIRECTORS, FEDERAL DEPOSIT INSURANCE CORPORATION

ACTING COMPTROLLER OF THE CURRENCY JOHN G. WALSH

JACQUELINE H. MESA, DIRECTOR, OFFICE OF INTERNATIONAL AFFAIRS, U.S. COMMODITY AND FUTURES TRADING COMMISSION

DANIEL K. TARULLO, MEMBER, FEDERAL RESERVE SYSTEM BOARD OF GOVERNORS

[*] JOHNSON: I call this hearing to order. I thank the witnesses for joining us.

Today this committee continues its oversight of the implementation of the Wall Street Reform Act. Since our last Wall Street Reform hearing in December, there have been significant developments and implementation, including new proposed and (inaudible) rules and areas critical to strengthening market oversight instability.

Among the many lessons apparent from the recent financial crisis is that the financial system is truly global and that the risks and regulations in one country can have significant effects on institutions and markets worldwide.

Last month, we held a hearing to examine the European debt crisis and any potential spillover effects in the U.S.

Today's hearing will focus on the possible effects of our new financial rules on international markets and on international competitiveness for U.S. institutions.

Some of the most complex and critical rule makings of the Wall Street Reform Act are the ones with international implications that we will focus on today.

The FDIC's new orderly (inaudible) authority as well as the creation of living wills and (inaudible) designation will together help ensure that large multinational Internet connected financial institutions may be quickly wound down in times of stress without exposing tax payers to losses or threatening the financial system.

In order to fully implement these important rules, our agencies must work closely with their international partners to make cross- border resolutions early and are coordinated so that global firms will no longer be too big to fail.

I look forward to the agencies providing an update on efforts to harmonize regulations.

The (inaudible) also raises a number of complicated issues with potential international effects. It is important to carefully implement the rule's prohibitions on prop (ph) and fund investments in a manner that does not incur market making underwriting (inaudible) surfaces, hedging and other committed activities so important to our economy.

Market participants need greater clarity about the conformance period and what will be required of them starting this July.

I look forward to hearing the witnesses comments on these issues as well as their views on the rule's potential impact on capital markets, governments and institutions around the world.

Additionally, international coordination is key to being ensured of stability and transparency to the $700 trillion global (inaudible) market. Ideally, the rules, the CFCC, SEC and traditional regulators are working to finalize should have no (inaudible) degree of variance. They only differ for (inaudible) firms and transactions, the rules are being applied to.

JOHNSON: In addition, global harmonization and rules relating to margin capital and clearing will be essential to promoting financial stability, effective oversight and competitiveness of U.S. companies doing business abroad.

I welcome the regulators updates on these developments and then the next steps for strengthening the global financial system.

While our economy is starting to show signs of recovery from the financial crisis, we must remain vigilant and ensure that Wall Street reform is implemented thoughtfully and with full consideration of any initial implications. The Wall Street reform law gave our regulators the tools to address global threats to financial stability as well as oversight over new uncharted areas of the international financial markets.

We've already seen good progress in the recently announced stress test showing U.S. banks in a much stronger position than they were before the crisis. But until the new rules are fully implemented, our financial system remains vulnerable to threats both from within the U.S. and from abroad.

I believe our committee's robust oversight of Wall Street reform has reaffirmed the need for and improve the implementation of this important legislation.

As I have said before, I'm open to the idea of improving Wall Street reform than making technical corrections and fixing unintended consequences but in today's political environment, they will need to be broad bipartisan support to get anything approved.

Senator Shelby, your opening statement?

SHELBY: Thank you, thank you, Mr. Chairman. Welcome everyone.

Today our financial regulators will update us on their efforts to harmonize the requirements of the Dodd-

Frank Act with the financial regulations of other countries. I think this is an important issue due to the global nature of modern financial markets.

Today nearly all major U.S. financial institutions have operations overseas and most foreign -- major foreign financial institutions have operations, of course in the U.S.

The globalization of finance has generally been a positive development. It helps firms raise capital at a lower rate and more effectively manage their risk. This in turn helps financial institutions lend more cheaply to businesses and to consumers.

Yet the globalization of finance means that regulators need to be mindful of how their regulations interact with the regulations of other countries. Poorly conceived laws or ineffective coordination by regulators can easily undermine the efficiency of the international economic system.

And although such regulatory failures often go on largely unnoticed, they consequences can be significant. Their impacts show up in the form of higher interest rates and fees for consumers and higher operating costs for businesses. Ultimately, higher prices reduce economic growth and job creation.

We only need to recall how poor international economic coordination in the '30s stemming from the smooth Hawley Act and other laws worsen the Great Depression.

Accordingly, I believe it's critical that Congress and our financial regulators make sure that Dodd-Frank does not worsen our already troubled economy by unnecessarily impeding the international financial system.

I think it's worth noting that two years ago when Dodd-Frank was passed, the thought that Dodd-Frank would create any international coordination problems was not on the minds of the act's supporters. Rather we were told here that the rest of the world would follow our lead and adopt legislation similar to Dodd-Frank. Of course, this has not happened.

To the contrary, foreign regulators and governments have publicly expressed serious concerns about Dodd-Frank, Canada, Germany, Japan, the United Kingdom as well as the European Union, have all identified profound problems with the implementation of Dodd-Frank. These problems include reducing the liquidity of the government bond markets and the discriminatory treatment of foreign firms.

In addition, many market participants have expressed concerns about the extra territorial reach of Dodd-Frank. They justifiably fear that they will find themselves caught in a regulatory trap as many Dodd-Frank rules may conflict with theirs.

These concerns have been worsened by the fact that our financial regulators have already missed 70 percent of the Dodd-Frank rule making deadlines. And as a consequence, two years after the passage of Dodd-Frank, market participants are still unclear if and how Dodd- Frank rules will apply to their international banking operations.

The risk of having to comply with Dodd-Frank's costly regulations is causing many firms to consider doing -- reconsider doing business in the U.S. The U.S. should be the market of choice because it is the most sophisticated and modern. It should not be the market firms desperately seek to avoid due to its costly and heavy-handed regulatory approach.

But looking forward, it's my hope that our regulators will take the time to ensure that the Dodd-Frank rule makings have as few unintended consequences as possible.

I hope to hear today how our financial regulators are working with our foreign counterparts to address legitimate concerns about Dodd-Frank. In particular, I hope to hear how our regulators are working to address the major discrepancies that exist between the U.S. and international derivatives rules, especially with respect to margin and capital requirements.

I also hope to learn today what specific steps regulators have taken to ensure that the FDIC's new orderly liquidation authority can effectively wind down a large international firm.

As we say with the failure of Lehman and more recently MF Global, the collapse of an international financial firm can leave customer assets frozen in several countries, making resolution of a firm substantially more difficult.

Hopefully the next major -- the next time a major international financial institution fails, regulators will have a far more efficient and effective response than the CFD's response to MF Global.

Unfortunately, in the nearly two years since the passage of Dodd- Frank, regulators have done little to instill confidence that Dodd- Frank will do anything other than increase the cost of doing business in America.

Thank you, Mr. Chairman.

JOHNSON: Thank you, Senator Shelby.

Are there any other members who wish to make a brief opening statement?

Thank you all. I want to remind my colleagues that the record will be open for the next seven days for opening statements and any other material you'd like to submit.

Now I will briefly introduce our witness.

Lael Brainard is the Undersecretary for International Affairs at the U.S. Department of the Treasury.

Dan Tarullo is currently serving as a member of the Board of Governors of the Federal Reserve system.

Elisse Walter is currently serving as a commission on the U.S. Securities and Exchange Commission.

JOHNSON: Marty Gruenberg is the Acting Chairman of the Federal Deposit Corporation.

John Walsh is the Acting Comptroller of the Currency.

Jackie (ph) Mesa is Director of International Affairs at the U.S. Commodity Futures Trading Commission.

I thank you all again for being here today. I would like to ask the witnesses to please keep your remarks to five minutes. Your full written statements will be included in the hearing record.

Undersecretary Brainard, you may begin your testimony.

BRAINARD: Well, thank you, Chairman Johnson, Ranking Member Shelby and distinguished members of the committee.

There is an important debate over the merits of moving slow or fast, of moving first or last. As you know, partly due to the efforts of this committee we moved both fast and first to reform our financial system. And this strategy is already demonstrating its effectiveness both in terms of the strength of our institutions and their ability to weather shocks, and in bringing the world to our standards.

From 2009 through the end of 2011 Tier 1 common equity at large bank holding companies increased by more than $400 billion. Short- term wholesale funding at the largest bank holding companies decreased from 36 percent to 20 percent. And core deposits as a share of total liabilities at FDIC insured institutions increased from a low of 44 percent to 64 percent.

Far from disadvantaging U.S. institutions and harming credit, these early actions put U.S. banks in a stronger position as we entered the financial volatility at the end of last year, and indeed supported credit growth of 11 to 12 percent at annual rates in the third and fourth quarters. By contrast, as you know, Europe opted to move more slowly. As a result, many euro-area banks were less resilient in the face of shocks last year, contributing to financial stress in a negative spiral.

By moving first we've led from a position of strength in setting the international reform agenda and elevating the world's standards to our own. The alternatives, either following the reform standard set by other countries or subjecting our firms to a divergent set of standards across the board would have been unacceptable. It's also worth noting that not only the established financial centers and advanced economies, but also up and coming emerging market financial centers are signing up for the same set of standards. As you know going into the crisis too many financial institutions had too much leverage and too little liquidity.

We have now gotten across the international system new global capital liquidity and leverage standards. We've identified globally systemic important banks and agreed globally to subject them to enhanced prudential measures, including a capital surcharge. We are of course remaining vigilant as these rules are implemented, and we are pressing to ensure banks across the world measure risk weighted assets similarly.

Going into the crisis few understood the magnitude of aggregate derivatives exposures in the system. Now we have secured agreement on international standards for the OTC derivatives markets for the first time, requiring consistent reporting, moving trading onto exchanges and requiring central clearing.

Of course as these rules are implemented we have to guard against fragmentation or weaknesses in the globally payments infrastructure and avoid geographic mandates for clearing. We're also pressing for accelerated timetables. We are also pressing, with success, to finalize a global standard for posting margin on un-cleared derivatives transactions to reinforce the incentives for central clearing.

And finally, going into the crisis countries lacked tools to resolve systemically important financial institutions, effectively rendering them too big to fail. Going forward, all major financial jurisdictions have agreed to put in place the tools to resolve large cross-border firms.

Implementation is already underway. The U.K., Germany and Canada have already passed resolution legislation and the European Commission is developing a draft for the second quarter of this year. The FSB is working actively to ensure regulators and the major global banks developed cross-border living wills by the end of 2012, criteria to improve the resolvability of these institutions, and institution- specific resolution cooperation arrangements.

New laws and rules aimed at the home market of any major financial center will inevitably, as you recognize in writing the law, have cross-border implications. Regulators now have to sort out whose rules apply, how and where. Aligning the substance and the timing of reforms across jurisdiction is perhaps the first best insurance we have in that process; the greater the convergence around high quality standards, the greater the scope for deferring to jurisdictions that have similar regulatory regimes.

There are only one or two notable exceptions. As you know, the United States has moved ahead of others on the Volcker rule. But it's important to recognize other jurisdictions are grappling with the same issues pertaining to the structure of risk taking. In the U.K. the Vickers Commission proposed rules to ring-fence core financial intermediation activities. And in the E.U. Commissioner Barnier has set up a commission to look at this issue with particular interest in studying the implementation of the Volcker rule.

We cannot lose sight of the last crisis. Nor can we lose sight of the causes. That is why we think it's critical to complete the work we've begun. Thank you.

JOHNSON: Thank you.

Governor Tarullo, please proceed.

TARULLO: Thank you, Mr. Chairman, Senator Shelby and other members of the committee. So, let me just run down briefly for you at least my perspective on the significant international activities that are either quite directly or generally related to Dodd-Frank. The members of this committee won't be surprised that I put capital at the top of the list to regulatory imperatives both here in the United States and internationally.

Basel 2.5, which deals with market risk, and Basel III, which deals with both the amount and quality, the required capital, were already done or nearly done when Dodd-Frank was passed. But Dodd- Frank did add a new requirement that we have enhanced capital standards for large banking organizations.

We supported what turned out to be a successful international effort to agree on capital surcharges for banking organizations of global systemic importance. And the Federal Reserve intends to implement the Dodd-Frank requirement in a manner consistent with that international agreement.

So, we've had a lot of progress on capital internationally. And I would say that in this area the principal task in the near term will be to ensure that these various agreements are being implemented rigorously, both at national levels and within individual banking organizations. I'm pleased that the Basel Committee has now launched what is far and away its most significant effort ever to monitor implementation at both the national and firm level.

On liquidity standards, here too would like to make the Basel agreement consistent with our implementation of the Dodd-Frank requirements of enhanced liquidity standards for large institutions. Unlike the capital standards, though, the liquidity standards are in need of further study and revision, which is currently in progress internationally.

On resolution mechanisms, Title II of Dodd-Frank is fully consistent with the international standards that have been adopted. And other jurisdictions are gradually putting in place their own general comparable mechanisms. However, even if all major financial centers follow suit, not all cross-border resolution problems will be solved. So, we'll continue the work that we've begun along with the FDIC in addressing these continuing problems in both multilateral and bilateral fora.

On OTC derivatives, implementation of the G-20 commitments for reform is proceeding internationally, but I would characterize it as a somewhat uneven pace from jurisdiction to jurisdiction. Here I think our top international priority should be agreement on margin requirements for unclear derivatives.

And finally, I've noted in my prepared testimony a number of specific issue implicating international interests in parts of Dodd- Frank where there's less likely to be an international initiative. In these instances we don't have the realistic option of trying to conform an international agreement to domestic practice or vice versa for that matter. So, here we're going to have to be considering carefully all these concerns in our own rulemaking as we move forward.

Thank you, Mr. Chairman.

JOHNSON: Thank you.

Commissioner Walter, please proceed.

WALTER: Thank you, Chairman Johnson, Ranking Member Shelby and members of the committee for the opportunity to testify on behalf of the Securities and Exchange Commission about international cooperation in the realm of financial regulation.

The impact of regulation across borders has become ever more important as business has become increasingly global. And thus as part of our rulemaking efforts to implement the Dodd-Frank Act, the SEC has been actively engaged with our counterparts abroad to coordinate our regulatory reforms.

Our international efforts include both informal and formal bilateral discussions and arrangements and working through multilateral organizations. Due to the extensive international coordination efforts undertaken by the SEC and our colleagues at other U.S. financial regulatory agencies within international bodies, the recommendations in international standards being developed by these groups are broadly consistent with the Dodd-Frank Act and the G-20 objectives.

As the SEC's representative to the Financial Stability Board and the International Organization of Securities Commissions, I have detailed our international efforts in my written testimony. But I would like to highlight just a few areas this morning.

First, international coordination is particularly important in reform of the global over-the-counter derivatives market. Following the 2008 financial crisis, Congress recognized the need to bring transparencies to these markets. And the G-20 leaders shared this concern.

SEC and CFTC staff have been working with our international counterparts to coordinate the technical issues relating to regulation of derivatives transactions. In December global leaders and senior representatives of authorities responsible for regulation of OTC derivatives markets met to discuss significant cross-border issues related to the implementation of new legislation and rules.

Given the global nature of the market, the SEC intends to address the international implications of its Dodd-Frank derivatives rules in a single proposal in order to give interested parties including investors, market participants and foreign regulators an opportunity to consider as an integrated whole our approach to cross-border security based swap transactions.

A second area that requires robust international coordination and cooperation is the identification and mitigation of cross-border risks. The SEC has worked to enhance its capability to spot and address proactively emerging issues before they have the potential to cause serious harm to U.S. markets and the global financial system. We have open lines of communication and share data with our international counterparts to discuss emerging risks and to react promptly to new developments.

WALTER: A third area where international cooperation is important is the implementation of the Volcker rule. In the proposal we requested and received comment on several international issues. For example, the proposal, which closely tracks the statute, includes an exemption for proprietary trading in certain U.S. and municipal government obligations, but not for foreign government obligations.

Many commenters, including some foreign governments, have requested that such an exemption be adopted and have expressed concerns about the proposed rules potential impact on liquidity in foreign sovereign debt markets. However, some commenters have indicated that such an exemption would not be necessary or would not meet the statutory requirement that it promote and protect safety and soundness.

The Volcker Rule's general prohibition on covered fund activities includes certain non-U.S. funds in an effort to prevent circumvention by simply relocating activities off-shore. Some commenters have stated that this definition may be too broad, sweeping in foreign retail mutual funds or other types of regulated pooled investment vehicles.

Our commission staff is reviewing and considering the comments we have received including those on its -on the cross-border implications of Volcker.

A fourth area where we and our foreign counterparts have a common interest is market efficiency and integrity in light of the rapid development of new trading technologies and trading platforms.

Another key priority is assuring meaningful oversight of registrant firms wherever they are located. In an interconnected world, increased international supervisory cooperation is critical. Unfortunately, there currently are limitations on the ability of some U.S. regulators to achieve meaningful inspections in some foreign jurisdictions.

Finally, I'd like to mention our longstanding, bilateral and multilateral efforts in the enforcement arena. In conclusion, our ability to further shared objectives and strengthen cooperative relationships with our counterparts is an increasingly critical part of our mission. We simply must work together.

Thank you, again, for this opportunity to testify.

JOHNSON: Thank you. Chairman Gruenberg, please proceed.

GRUENBERG: Thank you, Mr. Chairman.

Chairman Johnson, Ranking Member Shelby and members of the committee, thank you for the opportunity to testify on international harmonization issues related to implementation of the Dodd-Frank Wall Street Reform Act.

While there are several issues addressed in my written testimony, I thought I would focus my oral remarks on progress we have made on cross-border cooperation on the resolution of systemically important financial institutions, the so-called SIFIs.

Section 2.10 of the Dodd-Frank Act requires the FDIC to coordinate, to the maximum extent possible, with appropriate foreign regulatory authorities in the event of a resolution of a SIFI with cross-border operations. The FDIC has been working on both a multilateral and bilateral basis with our foreign counterparts in supervision and resolution to address these important cross-border issues.

In October of last year, the Financial Stability Board of the G- 20 countries released the "Key Attributes of Effective Resolution Regimes for Financial Institutions." These key attributes set out the features of a legal and regulatory regime that would allow authorities to resolve financial institutions in an orderly manner without taxpayer exposure.

They address such critical issues as the scope and independence of the resolution authority and how jurisdictions can facilitate cross-border cooperation in resolutions of significant financial institutions.

The FDIC was deeply involved in the development of the key attributes and many of them parallel the provisions of the U.S. resolution regime under title II of the Dodd-Frank Act.

In November of last year, the G-20 endorsed these key attributes and, as a result, financial regulators from the G-20 member nations are required to move toward a resolution framework to resolve SIFIs in an orderly manner that protects global financial stability.

Now, in addition to the key attributes, the FDIC and its U.S. and foreign financial regulatory counterparts have formed what have been called crisis management groups under the auspices of the Financial Stability Board for each of the internationally active SIFIs. These are the so-called G-SIFIs or global SIFIs identified by the G-20 at the November meeting last year.

These crisis management groups consisting of both home and host country authorities are intended to enhance institution-specific planning for possible future resolution. The FDIC has participated in crisis management group meetings hosted by authorities in various foreign jurisdictions. In addition, the FDIC has hosted crisis management group meetings for the five largest U.S. G-SIFIs and met with specific foreign regulators to discuss the progress these firms have made on their recovery and resolution plans as well as other related cross-border issues.

These meetings assist the FDIC in developing and refining its own resolution strategies for these institutions and helps regulators in identifying and overcoming impediments to cross-border resolution.

Now, finally, the FDIC is also actively reaching out on a bilateral basis to the foreign supervisors and resolution authorities with jurisdiction over the foreign operations of key U.S. firms. The goal is to be prepared to address issues regarding cross-border regulatory requirements and to gain an in-depth understanding of the cross-border resolution regimes and the concerns that face our international counterparts.

It's worth noting that although U.S. SIFIs have foreign operations in dozens of countries around the world, these operations tend to be concentrated in a relatively small number of key foreign jurisdictions, particularly the United Kingdom.

While the challenges to cross-border resolution are formidable, they may be more amenable than is commonly thought to effective management through bilateral cooperation.

Our initial work with foreign authorities has been encouraging. In particular, the U.S. financial regulatory agencies have made substantial progress with authorities in the U.K. in understanding how our respective resolution regimes and resolution strategies would work.

To facilitate bilateral discussions and cooperation, the FDIC is negotiating memoranda of understanding pertaining to resolutions with regulators in various countries.

In conclusion, through multilateral and bilateral engagement, we believe we have made significant progress in developing a foundation for effective cross-border cooperation in the event of a future failure of an international - internationally systemically important financial institution.

Thank you.

JOHNSON: Thank you.

Comptroller Walsh, please proceed.

WALSH: Thank you. Chairman Johnson, Ranking Member Shelby and members of the committee, I appreciate this opportunity to provide my perspective on the international implications of the Dodd-Frank Act and on efforts currently underway to harmonize U.S. regulatory requirements with international standards.

My written testimony provides greater detail on the intersection of Dodd-Frank and international efforts in five key areas; capital standards, liquidity requirements, orderly resolution of large complex firms, derivatives activities and the Volcker Rule.

Since the financial crisis of 2008, much has been accomplished to improve the safety and soundness of financial systems and institutions. Internationally, the G-20 governments, the Financial Stability Board, the Basel Committee on Banking Supervision and other international bodies have developed and are introducing standards to increase capital and liquidity, create better mechanisms for resolving large financial institutions, centralized derivatives clearing and strengthen supervision in a number of other areas.

Implementation of this reform agenda is underway in all the G-20 countries. Within the United States, the Dodd-Frank Act encompasses many important parts of the international reform agenda. It enhances the resiliency of the U.S. financial system, requires higher capital and liquidity standards for large financial institutions and imposes steps to preclude future taxpayer bailouts.

The act also seeks to strengthen operations and safeguards pertaining to derivatives activities by enhancing transparency and reducing counterparty credit risks. Most of these efforts are still works in progress and I believe paths are available for international harmonization in many of these areas.

However, even where there is broad international consensus, there will be areas where policy makers in individual countries have chosen to tailor standards to their country's specific circumstances rather than adopt the totality of the international approach.

In the U.S., for example, the Dodd-Frank Act has added two requirements that will cause our implementation of international capital standards to differ from those of other countries.

For example, the Collins Amendment requires the same generally applicable minimum capital requirements to be applied to bank holding companies as to banks and places a floor under the capital requirement for large banks, applying Basel's advanced approaches capital framework.

This goal is to ensure that capital requirements for large banks do not decline below generally applicable minimum capital requirements, but it also means that U.S. banks pursuing saver loans or lower risk securities would not obtain a capital benefit for doing so.

Section 9.39a of Dodd-Frank requires all federal agencies to remove references to and reliance on credit ratings from their regulations and replace them with appropriate alternatives for evaluating credit-worthiness. Basel III, in contrast, continues to rely on credit ratings in many areas.

So implementation of those provisions of Basel III will differ from international standards and, generally, be more stringent in the U.S. - in that U.S. credit ratings are referenced in various places including in noncapital regulations. While we fully agree that blind reliance on credit ratings should be stopped, the cumulative impact of precluding any reference to credit ratings, even in conjunction with other factors, will be challenging, particularly for community banks.

The Dodd-Frank Act also contains certain provisions that have no foreign equivalent and, unlike capital and liquidity requirements, currently are not the subject of international harmonization efforts, most notably the Volcker Rule. This provision generally prohibits a bank from engaging in proprietary trading and for making investments in and having certain relationships with a hedge fund of private equity fund.

This is a policy aimed at the organization of activities within the U.S. banking system not part, presently, of a broader international policy consensus and, as such, the legislation reflects a determination that these policy objectives need to predominate overcompetitive considerations.

WALSH: The OCC is committed to consistent implementation of the Dodd-Frank Act and international financial regulatory agreements and, as we move forward with implementing Dodd-Frank, we must be mindful of the need to strike an appropriate balance between enhanced regulations, better supervision and market restrictions.

Achieving a level playing field for internationally active institutions is an important objective. But it is never fully achieved. And sometimes national policy choices place other important national objectives above competitive equity.

Thank you for the opportunity to discuss the international implications of Dodd-Frank, and to update the committee on efforts underway to harmonize U.S. regulatory requirements with international standards and frameworks. I'm happy to answer your questions.

JOHNSON: Thank you. Ms. Walter, please proceed.

WALTER: Good morning, Chairman Johnson, Ranking Member Shelby, and members of the committee. Thank you for the opportunity to testify today regarding international aspects of the Dodd-Frank Act.

The financial crisis has generated consensus on the need to strengthen financial regulation by improving transparency, mitigating systemic risk, and protecting against market abuse. In September 2009, the G20 leaders agreed that OTC derivatives contracts should be reported to trade repositories, standardized contracts should be cleared and traded on exchanges or platforms, and non-cleared contracts should be subject to higher capital requirements.

In 2010, less than one year following that G20 commitment, Congress broadened the CFTC's and FTC's jurisdiction to include oversight of the previously unregulated swaps and security-based swaps market. The CFTC is developing regulation to implement Dodd-Frank Act, and to establish a regulatory framework for swaps.

As CFTC rule-makings have progressed, one issue that has arisen is how Dodd-Frank requirements might apply to swap activities occurring on a cross-border basis. The CFTC recognizes that swaps business flows across national borders with agreements negotiated and executed between counterparties in different jurisdictions, and individual transactions often booked and risk-managed in other jurisdictions.

In addressing cross-border issues, the CFTC is charged with implementing Section 722(d) of the Dodd-Frank Act, which provides that Title VII provisions shall not apply to swaps activities outside the United States, unless those activities have a direct and significant U.S. connection, or contravene anti-evasion regulation.

The CFTC plans to provide guidance on the application of Title VII, and (inaudible) the commission's regulations to non-U.S. entities, and to swaps activities occurring on a cross-border basis. And we will seek public input on that guidance.

In line with the G20 commitments, efforts to regulate OTC derivatives are underway, not only in the United States, but also abroad. Japan has already passed reform legislation, and the E.U. is finalizing legislation that provides for mandatory clearing, reporting, and risk mitigation for OTC derivatives.

Other countries such as Canada, Hong Kong and Singapore, have published consultation documents on the regulation of OTC derivatives. The global and interconnected nature of the swaps market makes it imperative that the United States consult and coordinate with foreign regulators.

The fact that all major market jurisdictions are developing their OTC requirements, pursuant to the G20 directive, provides an opportunity to create a harmonized framework. Congress directed the CFTC and other U.S. regulators to consult and coordinate with foreign regulatory authorities on the establishment of consistent international standards.

The CFTC is fulfilling this statutory mandate through comprehensive and ongoing bilateral consultation and global coordination. The CFTC has considered international standards and principles in developing regulations, and staff has shared our role- making draft with international counterparts throughout this process.

The CFTC chairman and commissioners have met with foreign regulators to discuss financial reform. And Chairman Gensler and I have traveled to Brussels several times to discuss implementation of Title VII. Chairmen Gensler and Schapiro have met with Canadian, European and Asian regulators last December to discuss cross-border issues related to OTC derivatives, and an even broader group of regulators will meet again in May.

At a staff level, the CFTC and SEC are holding an unprecedented number of meetings to coordinate regulatory approaches, specifically with counterparts in Canada, the E.U., Hong Kong, Japan and Singapore. These discussions will continue, as other jurisdictions develop their own regulatory requirements for OTC derivatives.

In addition, CFTC staff is participating in this several standard-setting initiatives, and co-chairs the IOSCO Task Force on OTC derivatives. Throughout implementation of the Dodd-Frank Act, the CFTC is working with foreign regulators in an effective way to coordinate regulatory approaches and requirements to the greatest extent possible.

Thank you. And I'd be happy to answer any questions. JOHNSON: Thank you for your testimony. As we begin questions, I will ask the clerk to put five minutes on the clock for each member. Secretary Burton (ph), I believe the U.S. has led the way with a comprehensive package of Wall Street reforms, as to the financial crisis. Do you agree? And going forward, how will the U.S. continue to lead while walking toward a level playing field internationally?

BRAINARD: Mr. Chairman, I have participated in multiple international negotiations, both at the G20 and the FSB, where our goal has been to bring the world to convergence around the very strong protections put in place, under Dodd-Frank, in order to guard against a competitive disadvantage, and also to protect the safety and soundness of our system.

I would say that having participated in a lot of international negotiations over the years, and a whole number of subject areas, we have achieved remarkable success across the whole host of areas where convergence is seen to be critically important. OTC derivatives in an area where there really is no international regulation at all, we now have commitment across the Financial Stability Board members to put in place protections that are really modeled in many respects on the protections under the Dodd-Frank Act.

As Governor Tarullo mentioned, we have a very strong agreement on capital liquidity and leverage, across internationally-active banks, and for the first time, agreement that the largest, most complex institutions should be subject -- subjected to additional prudential standards, as well as a capital surcharge that will be equivalent across countries.

JOHNSON: Chairman Gruenberg, can you give us your testament of the progress made with foreign regulators on how to address cross- border resolution issues?

GRUENBERG: Thank you, Mr. Chairman. I think it's fair to say we have made significant progress in what is admittedly a very challenging area. I outlined in my testimony the international set of standards that have been agreed to, the so-called "key attributes," which sets sort of a baseline for governments across the world to use in establishing resolution regimes.

And that simply hasn't existed before. So the international acknowledgment of the importance of the issue of having cross-border cooperation, and a capacity to place large, systemically significant institutions into an effective resolution process, I would suggest is really an important step forward.

And there's been tremendous attention to the specific institutions of -- of particular importance. The crisis management groups organized under the auspices of the Financial Stability Board, bringing together the multiple regulators of these globally- significant financial institutions has been really a valuable tool in getting mutual understanding among us about the operations of these companies.

And I'll tell you, we do put particular importance on developing the bilateral relationships. You know, at the end of the day when you're dealing with a systemic company that gets into difficulty, you've got to be able to work as a -- as an operational matter with your counterpart, and the foreign supervisor of the foreign operations of the company.

The end of the day, that really comes down to the relationship of our regulators here, with the individuals in the other country. And if you don't have that personal relationship established, an understanding of the respective legal requirements that apply, and some common understanding of the strategies we're considering for resolving these companies, becomes very difficult to -- to carry out the authorities of the act.

I think what's encouraging is we have the authorities here in the United States. We're developing the capability. And I think we're making progress in terms of establishing the relationships with our key counterparts to enable us to manage an orderly resolution of one of these companies.

JOHNSON: Governor Tarullo, on the Volcker Rule, will the agencies provide any formal guidance detailing what current or perspective activities banks need to unwind or stop in July, and what will happen during the two-year conformance period? Also, since the Volcker Rule amends the Bank Holding Company Act, will the fed lead the ongoing supervision, interpretation, and enforcement of the (inaudible)?

TARULLO: Mr. Chairman, with respect to the implementation and what happens with enforcement in any intervening period, I think there are a couple of things to say. First, the Dodd-Frank Act required the fed to promulgate a conformance period regulation within six months of passage, which we did. But of course, that was promulgated before we knew what the substantive proposed rule was going to look like. And so it was a bit -- it was a bit in the dark as to what activities actually the firms are going to have to conform.

And I would say that the -- some of the issues that have been raised by a number of you, a number of your colleagues on the House side, and by some of the institutions themselves, have -- have led a lot of people to think we probably need to provide some clarification, in light of the proposed rule itself.

So that -- we're going to abort action. So I can't speak to what that would be specifically. But I can tell you, people are aware of the issue. With respect to the July 21st issue, that would presumably arise if first, we don't get the final rule out by then, and secondly, regardless of whether we do, whether there's a question about something being immediately effective, and therefore, enforceable as opposed to falling (ph) under the conformance period.

TARULLO: And I guess I would -- there's -- there's obviously a real possibility that we don't meet the July 21st date; although, I personally think we should keep trying to do so. But -- but if we're not going to, I think it's incumbent on all the regulators to provide some guidance for firms to let them know exactly what the expectations will be, and not let this hang out there as an unknown. And I think we should be able to do that if needed.

Oh, I'm sorry, with respect to the -- you also asked about -- about Volcker Rule implementation. The Volcker Rule is a joint -- is a joint enterprise, it's actually going to be two different rules, one the three prudential regulars, the other the two market regulators and so we're obviously trying to coordinate the terms of the rule and I hope that we would coordinate our data gathering and enforcement efforts thereafter.

But -- but I wouldn't say that we would be in the lead particularly because in terms of the actual activity to be regulated, we the Fed, would be supervising a relatively smallish group of the activities in question.

Since the broker/dealers are primarily regulated by the SEC, the national banks by the OCC, we've got the non-bank, non-broker/dealer affiliates of holding companies which do engage in trading activities but not in the amounts that those other two groups do.

JOHNSON: One more question. Commissioner Walter and Director Mesa, I'm concerned that the SEC and the CFTC may not take a unified approach to the potential application of your swap worlds abroad. How will the CFTC and (inaudible) harmonize efforts in this area and wouldn't a unified approach improve compliance? When will your agencies release these plans?

WALTER: Mr. Chairman, the efforts are ongoing between our two agencies to reach a harmonized solution although we have taken different procedural approaches, we have been actively engaged in discussions about what we are going to suggest and there will be public comment on which people will be able to react to both the SEC proposal and the CFTC proposal.

Those discussions are not only concerning broad principles but also digging down into the details and our efforts so far both in that area and in other areas of cooperation and coordination under Dodd- Frank are going forward quite smoothly.

JOHNSON: Director Mesa? MESA: I would just add to that to say as a point of fact, we even had a meeting between the high level staff at the SEC and CFTC this week to coordinate our approaches and I think as conversations are ongoing, we're going to get closer and closer on our approaches.

JOHNSON: When will your agencies release these plans?

WALTER: For our part, our international release, raising the cross-border issues which will cover all of Title

VII is being drafted as we speak and should be out in the public domain in a relatively short period of time, although I can't give you a precise date.

JOHNSON: Ms. Mesa?

MESA: Staff is working very hard to -- to complete something to provide to our commission. We think that in the coming weeks, we'll actually be able to provide something four our -- for our commission to then provide staff feedback and -- and eventually release to the public.

JOHNSON: Senator Shelby?

SHELBY: Thank you, Mr. Chairman.

Governor Tarullo, as I mentioned in my opening statement, as I understand it, Dodd-Frank fails to exempt foreign government securities from the prohibition on proprietary trading by banks.

A lot of governments such as Japan, Canada, have filed comments stating that this provision of Dodd-Frank could -- could adversely affect the liquidity and pricing of foreign government bonds.

Do you believe there's any merit to these concerns and have you performed any analysis at the Fed of the proposed rule's potential impact on government bond markets? And if not, why not?

TARULLO: So, Mr. Chairman, I -- I certainly understand the foreign governments observation of the asymmetric treatment and as you noted, there have been a lot of comments filed with the -- with the agencies in response to the proposed rule.

What -- what we have in fact tried to start collecting information which goes to several points.

First, actually we tried to provide some information too, because there is some misconception among at least some of the foreign observers, not all but some who for example weren't aware of the fact there's a market making exception and were unaware of the fact that if a foreign sovereign debt obligation is held for investment and not a matter of short-term trading that that's not covered either.

So we've tried to provide that information and then in turn, asked for information about the holdings by U.S. government entities or their parent holding of the sovereigns in question. That is we're trying to figure -- we're trying to figure out how much is market making, how much is held for longer term investment and what proportion of -- of those bonds were arguably part of a proprietary trading operation.

And to -- to date, at least, I think there hasn't been as much information breaking things down in that way as would be useful but I'm hopeful -- I'm hopeful we will get more of that and thus be able to make a better judgment as to what kind of -- of impact this may have.

The -- the -- the other thing I want to add of course, is there are -- there are other firms that are not subject to the Volcker Rule who are out there who may well take up any slack that does exist.

SHELBY: In a recent speech, Secretary Geithner defended Dodd- Frank claiming that there is, and I'm quoting, "no credible evidence to support the argument that these reforms are having a material negative effect on the economy," end quote.

Secretary Brainard, do you believe that Dodd-Frank's imposition of price controls on debit interchange rates has had a positive impact on the economy?

BRAINARD: Well I think generally speaking many of these reforms are being implemented. It's a little early to speak to them. I don't think we have looked across a variety of areas and have not seen a negative impact.

As I said earlier, arguably, the inclination to move early, we've already seen a test of why it put our firms in a better position to withstand financial stresses and actually support it -- the recovery at a time when in Europe we saw a retreat of -- of credit.

So I think we obviously have to be very careful as we're moving forward to be looking carefully at the potential impact on the economy and to be vigilant to ensure there are not unintended consequences but the flip side of that as I said earlier, is that by moving forward with this framework, we really set the terms for the international debate and we're able to move other countries to our framework at a time when if we had not, we would have been on the defensive and been reacting to their proposals.

SHELBY: Has there been any quantitative evidence that you know about that Dodd-Frank actually is having material positive effect on the economy, if you have, would you furnish that to the committee?

BRAINARD: I don't think there have been, as I said, systematic empirical studies either on the negative or on the positive side. It's still very early days in terms of the implementation.

There have been attempts to look for instance in the international context at the potential long-term implications of the new capital standards where a negative effect was not found. But again, these are not backward looking, there has not been yet enough time to have a systematic empirical analysis of rules that are really only now being implemented in many cases.

SHELBY: Commissioner Walter, the SEC's inspector general recently conducted a review of cost benefit analysis in Dodd-Frank rule making. Among the many troubling findings, the report by the inspector general found that the SEC did not consider that it's proposed rules for securities based swaps might cause market participants to move swap trading from the U.S. to foreign jurisdictions.

In light of the inspector general's finding, the inspector general of the SEC, what specific actions has the SEC taken or plan to take to ensure that swap trading does not move out of this country to other jurisdictions?

WALTER: I can assure you, Senator, that both in that context and in other contexts, we do consider issues of -- of competitiveness and what happens to the marketplace.

Perhaps we did not reflect that as well as we might have liked in the documents that the -- our inspector general issued.

But in light of his report, as well as other external input on core benefit -- cost benefit analysis from the D.C. Circuit, from the GAO, we have undertaken a fairly continual review process of how to enhance our efforts to adequately consider those issues.

SHELBY: I would like to direct this question back to you, Commissioner Walter and also Secretary Brainard.

Section 763 of the Dodd-Frank law includes a provision that requires swap data repositories and clearinghouses to obtain an indemnification from the regulators before sharing critical data with them. This indemnification requirement makes it difficult for foreign regulators to obtain information on swap transactions.

Should Congress repeal the indemnification requirement in 763?

WALTER: Yes, we do support that. It is problematic for data that takes place in a global business to be available only easily to certain regulations...

SHELBY: In other words, I know why SEC (inaudible) testified yesterday that the SEC recommends that Congress consider repealing the indemnification requirements. Is that what your testimony is?

WALTER: Yes, we do agree that that should be done.

SHELBY: Okay. Secretary Brainard, do you agree?

BRAINARD: I certainly share the observation that our market regulators are trying to work through this issue with foreign market regulators and it is challenging.

I think more broadly, we believe that we are still in early stages of the implementation of the Dodd-Frank Act. There are, you know, a few areas of technical challenge but that we think generally speaking that we should push ahead on implementation of the Dodd-Frank Act, try to work through some of these changes and give ourselves a little more time before contemplate any changes...

SHELBY: ... do you disagree with the commissioner?

BRAINARD: We generally share the observation that this presents challenges to the market regulators but we are not recommending a legislative fix to any of the provisions that in -- in Dodd-Frank (inaudible).

SHELBY: So, you disagree with NCC (ph).

Governor Tarullo, one more question. In a recent speech Secretary Geithner said to provide a fair and level playing field for U.S. firms we need a more level playing field globally. This is particularly important in the reforms. That is, in the global derivatives markets. These are the secretary's words.

Is there any class of OTC derivatives on which you do not expect European and other foreign regulators to impose margin requirements comparable to those required by Dodd-Frank? And is there any aspect of derivatives or bank regulations where you believe that foreign regulators have adopted a better approach than the approach set forth in Dodd-Frank?

TARULLO: Senator, it's -- I think the discussions are too early a stage to make a judgment as to whether any of the eventualities that you hypothesized may come to pass. As I said in both my written and oral testimony, I think for us as a country the highest priority internationally with respect to derivatives ought to be the harmonization of margin rules. And at least as of this moment I have not detected any important divergence in the potential use of countries as to how they would apply those rules.

On the second part of your question, I think this is a case in which the United States has been leading. And as I said in my statement, I think that other countries are implementing the best practices and the kind of commitments that have been made. At this juncture, though, the pace of implementation does vary -- does vary some.

The Europeans are probably closest to us. But they too are somewhat behind. So, I think on this one it will probably have to come back next year and you -- for you to ask the same question. Sorry. I suspect we'll have a better sense then.

SHELBY: Well, we'll get the same answers.

TARULLO: Well, I hope not. I hope by then either something will have been agreed to or we'll be able to say yes, here are a few areas in which agreement looks hard to achieve. JOHNSON: Senator Bennet?

BENNET: Thank you, Mr. Chairman. Thank you for holding this hearing. I want to just underscore an observation you made a minute ago that as we think about this international harmonization. It also is I think in the interest of many people on this committee that our agencies reach harmonization domestically as well. So, anything we can do to move ourselves forward in that direction I would support.

I also wanted to pick up just where the ranking member left off, Governor Tarullo. As you know, financial institutions under the Wall Street reform bill the use of the Fed's discount window or deposit insurance must create separate entities to engage in certain types of swap dealing. This was typically referred to as the push out rule.

And in your written testimony you noted that it was unlikely that this was going to be followed in other places. I wonder whether you could talk a little bit about the consequences of that potential gap.

TARULLO: Certainly, Senator. On that one I think there are consequences probably on both sides, both for U.S. firms and for foreign firms. For the U.S. firms I think the potential consequences are fairly self-evident, meaning that they won't be able to have all their derivatives trading concentrated in the insured depository institution, usually a large national bank.

And what that means is that they'd have to have separate risk management capabilities and separate capitalization for the different derivatives activities. It also means that the counterparty with whom they deal would not obviously be able to net their trading with the two different parts of the same bank holding company.

The other side of it is the impact on the foreign firms...

BENNET: Is that just on that side? Does that present something unworkable? Or is it just...

TARULLO: Well, it's -- the amount of derivatives from many institutions that would have to be pushed out is relatively small, meaning it's not like 50 percent or 60 percent or 70 percent. But what I said a moment ago is that it would presumably increase the costs of that kind of trading because you'd have to duplicate some of your risk management and you wouldn't have the counterparty netting arrangement that you do when it's a single counterparty.

On the other side the push out requirement does provide that insured depository institutions in the United States get an exemption for activities which are basically bank complaint or for derivatives activities which involve instruments that federal banking laws allow banks to engage in. But because it applies only to insured depository institutions by the terms of the statute, it seems not to apply to the branches of foreign commercial banks here in the United States.

And as a result, those branches seemingly those branches will be subject to the rule, but without the exemption that applies to U.S. insured depository institutions. And I say seemingly because there is at least I guess one interpretation that that would not be the case. But that I think is the concern that's been expressed.

BENNET: And what are the implications of that?

TARULLO: Well, the implications of that would be that the branch of a foreign commercial bank here in the United States would not be able to engage in the kinds of derivatives activities which a U.S. commercial bank located here in the United States, one of Comptroller Walsh's supervised institutions would be able to engage in.

BENNET: Thank you.

Director Mesa, as you know the derivatives title of the bill was generally limited to transactions within the United States. And the law, as you said in your testimony, can be applied on an extraterritorial basis when the international activities of U.S. firms have a direct and significant effect on U.S. commerce.

You mentioned that you're working on this, that you're going to be seeking public comment on it. I wonder if you could talk just a little bit for the committee about how the CFTC is going to implement this provision. And what are we likely to hear in that public comment?

MESA: I can speak about what staff may recommend to the commission, but ultimately the commission will make the final decision. At a staff level we clearly need to give guidance on what is a direct and significant effect to the U.S. commerce or activities in the U.S.

And so an example of that would be if there's a foreign base entity that has a significant amount of transactions with a counter party in the U.S., how many transactions make that significant and direct? And that's the kind of guidance that we seek to put forward. But once there is a direct and significant connection with the U.S., then what regulations and rules will apply to that entity?

Also, the CFTC has had a long history of reliance on comparable regulation abroad if there is comparable regulation to the U.S. regulation. I think we're also considering some aspects of that in this release.

JOHNSON: Senator Crapo?

CRAPO: Thank you, Mr. Chairman.

I want to return to the question that the chairman raised earlier with regard to the implementation of the Volcker rule and the problem that we see with the July 21st deadline. Federal Reserve Chairman Ben Bernanke recently stated before the Senate Banking Committee and the House Financial Services Committee that the interagency Volcker rule will likely not be ready by the July date. And I think you've confirmed that's a likelihood today, Mr. Tarullo, although you say you'd like to keep working toward that objective.

He also said that we certainly don't expect people to obey a rule that doesn't exist, and that the agencies will certainly make sure that firms have all the time they need to respond. And again, Mr. Tarullo, you have said today that you think that somehow the agencies have got to address this issue in the process.

But it's not that simple. The problem is that this section of the Dodd-Frank Act is self-executing and has an effective date of July 21st, irrespective of whether the final rules are in place. And market participants are understandably concerned about what they should do on the July 21st deadline if the agencies have not been able to coordinate effectively and promulgate a final rule.

I know that there's been a two-year conformance period raised, and some have suggested that that should allay all concerns. But many commenters have raised the discrepancy between the two-year conformance period in the statute and the pending proposed rule, which states that the agencies expect full compliance as soon as practicable after the effective July 21st date.

A lot of folks are raising concerns about the fact that legal experts are advising their clients now that if the July 21st date arrives and we don't have a final promulgated rule that the banks in order to be safe are going to have to start shutting down significant securitization activities that are expected to be authorized in the rule. And we could have significant disruption in the market in the United States.

As a result of that concern, earlier today Senators Warner, Corker, Toomey, Hagan and Carper and I have introduced legislation, bipartisan legislation that corrects this aspect of the statute and simply links the effective date of the Volcker rule to 12 months after the issuance of a final rule. It just changes two words in the statute so that instead of saying the earlier of it says the later of the dates, which would provide the kind of clarity to the marketplace, and I would think provide the kind of support to the agencies as they try to move forward with these deadlines looming, to enable us to calm the waters and proceed more effectively with the rulemaking process.

Mr. Tarullo, I'd like to ask you first whether you see any concern or problem with this kind of legislation and whether it would be helpful or not.

TARULLO: Well, I think, Senator, we should be able to address the concerns through two means. One is, as I mentioned earlier, guidance provided by the agencies. And this, by the way, is not unprecedented.

I mean, there have been occasions in the past where a statutory provision by its terms takes effect and the implementing regulation has not yet been enacted. So, there is some precedent for the way this can be dealt with. And that would -- that would deal with any gap between the promulgation of the rule on July 21st.

TARULLO: With respect to the applicability scope of the conformance period, what it covers and what it doesn't cover, again, I think that we have the authority, we the Federal Reserve Board have the authority to change that conformance period statute in order to clarify the questions which have arisen, as I say because I think that when we -- when we promulgated the conformance period regulation we didn't know what the substance of regulation was going to look like.

So, that's a -- that's a long way of saying I think we can deal with both issues here without legislation, and -- and we'll try to go ahead and do so, regardless of -- of what legislative (inaudible).

CRAPO: Is there any reason why legislation wouldn't assist in that process though? I mean, I understand that you think you can clarify everything. But the statute is self-executing. Why would -- why wouldn't it be helpful for us to have that clarification made?

TARULLO: The -- I think you alluded to this. The self-executed -- the statute says it becomes effective, but then in the next subsection, it says the activities need to be conformed within the conformance period that is provided for in the statute.

So I think that the coverage can be achieved through that mechanism, but there may be other readings of the statute. That's -- that's the one I think that we're proceeding under.

CRAPO: Mr. Walsh, could you comment on the same issue?

WALSH: Certainly, Senator. I mean, as to the logic of what's being proposed, the suggestion is to -- is to do in this area what the statute does in other areas, which is link the application to a time period after issuance of a regulation.

But it is certainly true that there are a variety places in the Dodd-Frank Act where we will have to deal among the agencies, and administratively to deal with -- with problems of this kind. And I don't disagree with -- with Governor Tarullo, that we will make the effort to make sure that -- that the banks both understand -- those affected understand what -- what our expectations are.

And the conformance period does provide a period of breathing room, if you will, during which banks are expected to comply.

CRAPO: Would the clarification of the statutes, impact of the nature that I just described, have any negative impact on the rule- making process and the conformance period that the agencies are working on?

WALSH: Well, there is always the pressure of deadlines to -- to keep people focused. And the suggestion that we continue to work toward this deadline, even though it is approaching, and seems increasingly challenging to meet, but the pressure of deadlines is a -- is a meaningful pressure.

CRAPO: But a deadline that is executing a rule that hasn't been created yet may be a difficult deadline that creates legal difficulties in the marketplace. It seems to me that we would not be changing the deadline of the implementation of the rule, which it's already been acknowledged, is going to be passed without meeting that deadline.

And the question remains, as I see it, why would we not want to try to fix the problem and make it clear, legally, that there is not going to be the kind of disruption of our markets that could happen if the statute self-executes? Mr. Walsh?

WALSH: Well, Senator, if Congress has set the deadlines -- if Congress changes the deadline, we will -- we will adapt to the -- to the change. But in the meantime, we'll continue to try to work toward both meeting the deadline and providing guidance, so that during this period of what will be hopefully a brief period of potential uncertainty, that those affected will understand how to respond.

CRAPO: Thank you.

JOHNSON: Senator (inaudible)?

MERKLEY: Thank you very much, Mr. Chair. And thank you all for your testimony, and for helping us wrestle with how the work we're doing here interacts with the international environment.

I want to start by noting a letter from Finance Watch that was received by committee members, and asking if it can be entered into the record?

JOHNSON: Without objection.

MERKLEY: Thank you. Finance Watch is a European group, set up by European (inaudible) to help wrestle with some of the same -- same issues. And they -- they note in this letter, "Let me assure you, European financial regulators are committed to adopting the critical elements of financial reform agenda set out under your leadership in the Dodd-Frank Wall Street Reform and Consumer Protection Act.

"These include higher capital requirements across the banking system, and to our (ph) clearing, transparency, transparent trading, margin and capital for derivatives, regulation of hedge funds, and private pools of capital, orderly restriction for failing -- resolution for failing firms, reform of credit-rating agencies, and shadow banking, retail investment products, and so forth."

Many of the things that this committee has been -- been working on for quite some time. I found it interesting in the third page of the letter, they turn to the failure of MF Global.

"Recent failure of MF Global helped remind us of the grave dangers that highly-leveraged bets can pose to a firm. Fortunately, because MF Global was a small non-bank of little significance to broader financial system, consequences of its mistakes did not ripple far.

"If, however, the U.S. would not press forward with implementation of Volcker Rule, these various (ph) activities would continue eating away at the integrity of the global banking system, endangering not only your large firms, and threatening much more, the consequences for the broader economy, but also putting intense pressure on European regulators not to address the issue of structural reform of the European Union banking sector."

Indeed, I think in some ways, MF Global sums up the situation of why you've tried to put a firewall between hedge-fund-style activities and deposit-taking, loan-making banking, essential to providing liquidity for families and businesses across America.

So I just wanted to remind folks that somehow we lose track of what the Volcker Rule is all about. But that's the hedge fund, firewall issue that it was addressing. Some of these conversations about, "Why not trade in foreign currencies as a liquidity for vision in between making loans?" well, that puts exactly -- basically, that's opening the door for exactly what MF Global was doing. And if you want that bomb inside our banking system, we've been there. It was destructive, and let's not do it again.

Turning to some of the recent news, I want to understand your -- your all's perspective on Goldman's announcement that they are -- let's see if I can capture this. They have announced that they are looking to become a monoline bond insurer. That is a group that writes insurance on bonds, and presumably executes trades with revenues from the premiums, not unlike CDS.

What -- what do you make of that? Let's see. Here's the title. "Goldman (inaudible) monolining (ph) move."

Is this -- is this an effort to open a door to proprietary trading? Any -- any thoughts or insights on -- on what's -- what's going on with that?

TARULLO: Let me take it -- for reasons you'll understand, Senator, I don't -- I'm not going to address any comments to particular institutions that we supervise. But maybe I can make a couple of general comments; one about us, and one about financial institutions.

So the one about the financial institutions is, I think as everybody recognizes, firm are still in the process of adjusting to what the nature of financial services is going to be in the post- crisis, post-recovery, post-adaptation period.

And so I think you see a number of firms banks, non-bank and financial institutions, regulated and unregulated, trying to determine where there are opportunities which will provide them -- provide them with profit opportunities on the one hand, while on the other hand, fitting within the new regulatory framework that will exist. And I think we've seen any number of instances of that; some of which the institutions follow through on, some of which they appear not to follow through on.

From our point -- now the comment on us, that is Federal Reserve. With respect to any regulated financial institution that is proposing to or does get into any new line of business, we do apply close supervisory scrutiny with respect to the capacity of the firm, prudently to engage in the business in question, to the relative degree of risk that will be associated with that business, and to the -- obviously, the capital liquidity levels of the firm.

So again, I'm not commenting on anything specifically. I can assure you that as firms, for the first reason I mentioned, begin to think about different activities, we will be applying the same kind of credential supervisory scrutiny that should always be applied in such instances.

MERKLEY: Thank you. Let me ask another quick question on -- on recent news. And that is today's news in the Financial Times, Deutsche Bank is dropping its U.S. bank-holding company in order to minimize capital that must be held under U.S. rules, which leaves only its highly-leveraged investment bank inside the U.S.

Sheila Blair (ph) is quoted as saying she's "concerned, because when a bank fails, it's principally the capital that is located within the country, that it's available for resolution."

Does this undermine or change our -- our U.S. resolution authority or capability?

TARULLO: So as Chairman Gruenberg said a few minutes ago, that there's -- there are a lot of multilateral, now bilateral efforts to get a better understanding between countries of how resolution would proceed in the event that a firm fails. That is what host countries would do with respect to operations of their firms in other countries.

Having said that, I -- I will say that as I think about the appropriate modes of regulation and supervision of foreign banking organizations in the United States, the development to which you just alluded has certainly affected my thinking about how we do structure regulation of foreign bank organizations. And I think we will need to respond to that.

MERKLEY: Thank you. Thank you.

JOHNSON: Senator Corker?

CORKER: Thank you Mr. Chairman. And thank all of you as witnesses. I think it's been a very good hearing. And I know in your opening comments, Mr. Chairman, you talked about a technical correction to bill.

I do think that this hearing, and many others, have pointed out the need for that, and I just want you to know that should you and the ranking member decide that you're going to go forward with one, I would look forward to working with you in a way that really is just a technical-corrections bill, and not some political statement. So if you decide to do that, please let me know. OK?

On the -- speaking to that, I know Mr. Tarullo, you talked a little bit about the swap desk issue, and as it relates, you know, the impact it's having on foreign banks here, which by the way, provide about 18 percent of the commercial industrial loans here in the United States. We have an amendment to try to correct that. And should the chairman and raking member decide to go forward with a technical corrections bill, I hope you would support that.

CORKER: But I want you to, if you will, comment on the MSR issue.

I know that the mortgage servicing rights issue -- I know that when you all meet with international folks there's a -- there's a spirit of collegiality, if you will, and you try not to create exemptions that are different for the U.S. And I understand that. But we have a very unique situation in our country where because of the GSEs when the large institutions originate loans they have to hold 25 basis points as mortgage servicing rights. And it ends up affecting capital.

I know you all talked about limiting the amount of capital that that can go for. And I know we've had numbers of institutions coming in talking to us about how it's going to handicap them over time. I'm just wondering if you might comment on that in the exception we might create in that regard.

(UNKNOWN): Senator, that was one of actually many capital -- quality of capital related issues that were discussed during the Basel III negotiations, and they're incorporated in the Basel III agreement so that the flip side of that, if you will, is the limitation that Basel III places upon the capital treatment of minority interests and other financial firms, which is something that particularly affects a lot of European institutions.

On the mortgage servicing rights issue, the limitation on the amount of MSRs that can be treated as capital derives I think from the basic premise that common equity really does need to be the true buffer against losses that can be suffered from any activity of any sort seen and unforeseen, events that are seen and unforeseen.

The issue of MSRs, of course, arises because by and large a firm cannot treat a receivable as if it's part of capital. You have a contractual obligation that says I'm going to be paid in the future such and so much money therefore I can include it as capital. When you get the money then it can be treated as capital.

MSRs were traditionally treated differently, presumably on the rationale that they were readily marketable and thus like a security there would be funding available in the event that the firm needed it.

CORKER: Let me -- just so I don't...

(UNKNOWN): So, again -- I'm sorry, if I could just finish. But the rationale I think for the limitation is that it is not at all clear that a firm could readily market MSRs, a huge amount of MSRs. And thus there should be a limit on the degree to which they can count on capital, not completely eliminating them.

CORKER: So, I think we ought to at least look at maybe should it be 25 basis points. And I know that's something that's a whole other subject...

(UNKNOWN): Right.

CORKER: But maybe it's 12.5 basis points. Maybe it's something else. But that's something we should wrestle with here.

The -- you know the Volcker rule we've talked about a great deal. I know Senator Crapo offered a semi-solution. We know it's creating lots of issues and we've talked about it a great deal.

You alluded to some market-making exemptions. I know you were in our office recently. And obviously I think now that Volcker is part of the mantra here I think most of us just want to make sure that market making is not excluded. We understand about prop trading.

You mentioned exemptions. Are you feeling like you have -- there's going to be really no issue as it relates to institutions here in the United States of America being able to deal with central market making activities? Is that your present stance? It's a little -- seems a little different than when you were in our office a few weeks ago.

(UNKNOWN): No, I wouldn't say that, Senator. I think my perspective on it is the following. So that Volcker explicitly excludes market making from the definition of prop trading. Then the regulatory exercise is to distinguish between proprietary trading and market making. And to take the extreme example, if someone just took their prop trading desk and then said oh this is market making we could presume we wouldn't allow that.

Now, there are going to be...

CORKER: But, again, I want to have a two-way conversation here. The market making piece then you think -- you think that there is going to be no issue with ultimately having rules that allow market making, real market making within banking institutions. Is that what you're saying?

(UNKNOWN): No. I wouldn't say there'll be no issues. I think that the -- just in the -- just in the structure of the interagency rules you can see that issue of distinguishing between market making and proprietary trading is not a straightforward one. And it's one that varies from instrument to instrument because of the different liquidity characteristics.

CORKER: You mentioned other firms would take up the slack. Wouldn't those mostly be other firms that were unregulated taking up the slack if much of this moved out of the regulated... (UNKNOWN): For pure prop trading, yes.

CORKER: Let me ask you, would we not come up with a much better rule with the regulators not being gaged together a little bit more if we did not exclude treasuries and mortgage backed securities at all, debt instruments were treated equally? Wouldn't that be a much better place for us to be in creating these rules?

Why haven't we decided to differentiate between treasuries, which you can lose your shirt on, or mortgage backed securities which you certainly can lose your shirt on? Why have we left them out of this particular area do you think?

(UNKNOWN): Well, I don't -- there are -- I mean, that's -- that wasn't our decision. That was a congressional decision to do that.

CORKER: Would you be open to that coming back in so they came up with a real fair -- we wouldn't have countries like Japan and Canada and others worried about it. Would you be OK with...

(UNKNOWN): Well, I think -- I mean one does have to -- I think one does have to bear in mind the role that treasuries and their equivalents in other countries play, both the relationship of the -- both the relationship of financial institutions to the government, the finance ministry, the central bank or both, and to the use of those instruments in a lot of the regulatory apparatus of the firms.

And I suspect that was the motivation for the excluding treasuries. And that what we're hearing from other countries is yes, there may be -- there's a good rationale there. Why don't you exclude our sovereign bonds as well for the same reason?

CORKER: Mr. Chairman, I have a number of questions, but I know Senator Johanns is here and I'd like to have a second round. So, thank you.

JOHNSON: Senator Johanns?

JOHANNS: Thank you, Mr. Chairman.

To all of you, thank you for being here today. Let me follow up on a question or observation offered by Senator Merkley. And it's a good one. It gets to the heart of what I think the problem is here with Dodd-Frank. And I'm going to quote from a Wall Street Journal article that just popped up within the last hour or so.

It points out that Deutsche Bank changed the legal structure of its huge U.S. subsidiary to shield it from new regulations that would have required the German bank to pump new capital into the U.S. arm. It points out that the bank on February 1 reorganized its subsidiaries so that it's no longer classified as a bank holding company, according to disclosures by the bank.

It goes on to point out that they're not the first, as you know. They -- Deutsche Bank is at least the second large European bank to make such a change, following in the footsteps of U.K.'s Barclays. Something we talked about a lot and I warned about, and that is the more aggressively you regulate because you've been directed to do so by Dodd-Frank, the more tempting it is for somebody to just say see you around, we don't have to be in the United States. And they don't.

So, let me just ask a specific question. Can anybody on the panel name three countries that have passed into law, signed by their leader, Dodd-Frank type regulations? That's not so good.

(UNKNOWN): Well, I mean Secretary Brainard may want to -- might want to address this. Certainly I don't think anybody has had something that looks like Dodd-Frank. Several people have already alluded to the U.K.'s set of initiatives which includes the Vickers Commission proposals that would work a substantial change in the structure of the U.K. financial services...

JOHANNS: But they've not been passed into law.

(UNKNOWN): No, they haven't. But my -- and again, Secretary Brainard should comment on this because it's in the realm of the political spheres of their government. But my understanding is there's support for that.

And I should add they have already under their regulatory, existing regulatory authority, the financial services authority has already promulgated some constraints upon relationships among different parts of their firms, which don't apply in the United States, aren't included in Dodd-Frank. They just didn't need legislation to do it.

JOHANNS: You know I can't even begin to describe how meaningless that last statement is to me. And here's why. Our institutions are being regulated under a whole new set of rules and principles that you folks can't even agree on. That you debate. How will you ever administer these things in a sensible way so people know what they can and they can't do, irrespective of the issue that folks are just going to say why bother with the United States anymore? And that's exactly what's happening here.

Now, let me just say, Mr. Gruenberg, I heard your comments about the importance of bilateral relations, and not to be disrespectful, but to me that's just happy talk. And here's why I believe that.

I will tell you as secretary of agriculture I think I had great bilateral relations with countries like Japan. I could call their secretary of agriculture on the phone and address him by first name and on and on. Didn't stop them one minute from doing the things that they wanted to do. They would close their country to our beef and I could go country after country and describe that.

So, I'm glad you get along with your colleagues well, but it still doesn't solve the problem we have here. And that is I am now seeing evidence that folks are just deciding not to do business in the United States because of what is happening with Dodd-Frank. Do you agree with that?

GRUENBERG: Well, Senator, just to respond specifically to the point you made, you know in my comments I was referring to the relationships we're developing with respect to the resolution authorities in the United States and other countries in regard to systemically important financial institutions.

And I guess the reference I was making was particular among them to the United Kingdom where there's a significant concentration of the foreign operations of our major institutions.

And among the countries of the world, in regard to the specific area of resolution authority, you know, I think it's fair to say that the U.S. and the U.K. have actually adopted statutory provisions that provide powers that didn't exist before. And there seems to be a commitment on both sides by the policy makers to make effective use of those authorities.

I couldn't agree with you more that, you know, just because people are polite or friendly to each other, it doesn't necessarily mean you're going to get the outcome at the end of the day, particularly if problems develop. So I don't mean to...

JOHANNS: But would you agree with me that no country -- you know, I think I asked for three, but no country has passed anything anywhere near what Dodd-Frank has required.

GRUENBERG: Yes, I think it's fair to say I'm not aware of an individual country that's passed the sort of comprehensive legislation that we've undertaken here...

JOHANNS: Now, so if you are -- let's say, you're an insurance company and in the effort here to regulate them and the reach the conclusion that they present a systemic risk to the U.S. economy, all of these additional burdens are placed on them, why wouldn't they just leave?

Why wouldn't they locate someplace else where the regulatory atmosphere is better for them and what would stop them?

GRUENBERG: Look, you're talking about the foreign operations of a U.S. -- of a company here in the United States that has -- is based (inaudible) country is overseas -- you know, there's a balancing issue raised in terms of obligations we impose here and how it might impact foreign companies who may want to operate here.

I do believe that the core issues that the Dodd-Frank legislation tries to address in terms of a set of prudential standards on our biggest, systemically important financial institutions, particularly in the area of capital, and the expanded authorities relating to resolution so that we can hold these effectively too-big-to-fail companies accountable to certain market discipline.

I think those are the core authorities and I think those were important authorities to enact in the aftermath of what we've been through.

JOHANNS: But let me just wrap up with this because this is very important. Not only is it the competitive disadvantage we've placed the United States in at time where our economy is struggling, but, secondly, as a former secretary, as a former cabinet member, there's a point at which these regulations become so impossible to interpret that you can't train your employees to the result you're trying to get.

And that's what you're employees are telling me and I'll bet other members of this committee is how do we ever train to get to this result because nobody understands it. Whether it is the Volcker Rule or whatever, and even if we could get that far, how are we ever going to get the people up to speed to get the job done.

And that's what they're saying. They're saying, "How do we train our people to get there?" And I think that's a very serious problem. That's not even addressing the fact that we don't even have agreement with our own agencies and departments about what Dodd-Frank does and doesn't say.

I think it's a serious problem.

(UNKNOWN): Can I just jump in to answer...

JOHNSON: Yes, you may.

(UNKNOWN): Thanks.

So, on resolution, Canada, the U.K., Germany have already passed legislation to put in place resolution authorities that they didn't have before. Jurisdictions have moved actually quicker than we have in many cases to promulgate rules to put in place Basel III new capital requirements.

In the case of Switzerland, they're imposing an additional surcharge, very substantial, on capital. So I think, generally, the pattern is that jurisdictions are moving at different paces on the core reforms.

But what, again, is quite remarkable is that we have heads of state, of all the jurisdictions that are significant in the international financial system, committed to a set of rules that converge to our own.

And that all of the jurisdictions including in Japan, for instance, where they have also moved forward with legislation, for instance, in derivatives, very quickly -- that all of those jurisdictions are actually moving forward on all the core elements in a way that we have never seen before.

JOHNSON: Senator Hagan?

HAGAN: Thank you, Mr. Chairman, and I want to thank all of our witnesses here for testifying today and for all that you do.

I just wanted to ask a question on gas prices because everybody -- it's -- we're all so concerned about the increase and the rise of gas.

And, as you know, American companies use derivatives to hedge the risk inherent in their daily operations. For example, airlines are using the derivatives contracts to hedge their cost for fuel and, currently, banking entities are the primary source of commodities hedging liquidity for our large corporations.

Have you thought about the impact the Volcker Rule will have on the price of fuel prices for U.S. airlines and U.S. consumers at the gas pumps? Ms. Mesa, if you could start and anybody who else would like to address this issue.

MESA: Well, the CFTC is not a price setting agency, but we do insure that the markets are open, transparent, competitive and free from fraud and manipulations.

And given what is going on currently in the prices, it's no different from normal practice that we have heightened surveillance in these markets to make sure that those things are free from fraud and manipulation. Our (inaudible) surveillance is going on.

I might not talk about the Volcker Rule and might let Dan Tarullo do that if he wants to take that one on, but tell you that on an international scale -- on a global scale, we are making sure that regulation is consistent because the oil markets are global. They trade on not only U.S. exchanges, but other exchanges around the world.

And, last year, there was a global consensus on managing positions in the market, on having daily large trader reports like the CFTC does so that we can surveil who's in the market on a daily basis and on making sure all authorities that the regulators have all necessary authorities, including attempted manipulation -- to pursue attempted manipulation.

And I think that's an important one because prior to 2012, European Union nations did not have attempted manipulation authority and I think that's an important matter to note.

TARULLO: Senator, I can -- I can just say on -- on the overall issue of the -- the impact of both Volcker and -- and I would say probably the derivatives push out...

HAGAN: Right.

TARULLO: ... is where you're probably going to see the effect here. On -- on the derivatives push out, I had mentioned earlier that there was a relatively small proportion of derivatives that would need to be pushed out of most national banks, but commodities is one of those -- is one of those areas. And so if we're going to see in effect...

HAGAN: It's one of those areas that...

(CROSSTALK)

TARULLO: ... yeah would have to be pushed out that -- that's right. The -- the commodities derivatives would have to be pushed out. So there -- if there is an effect I think that's probably where you're going to see it.

HAGAN: And when you say "pushed out"...

TARULLO: It couldn't -- the derivative can't be written -- can't be written within the National Bank and the reason why that has an -- an effect is that you're going to need to set up a separate operation for your derivatives in your non -- your nonbank affiliate. The -- the -- the relative amount of cost associated with that is presumably going to vary from organization to organization because there may be a holding company that does a lot of derivatives work already in a nonbank affiliate. And thus for them the -- the cost would be fairly incremental.

But one can imagine at least that there would be a -- an institution which would have to set up a -- a separate apparatus and thus that cost would be higher.

HAGAN: How much do you think that jobs will be lost overseas in this scenario?

TARULLO: That -- that's -- I -- I -- I don't think we have a kind of precise data that would -- that would allow us to -- to project that. I think probably from -- from our perspective, the concern is are you -- are you making what are otherwise safe and sound transactions more costly then they otherwise would be? And even if you can't trace that through to a particular job number that -- that's not an -- that's not a circumstance you usually want to have when you're just increasing costs where it's not -- it's not necessary to achieve the safety and soundness outcome.

HAGAN: Well, obviously we're concerned about safety and soundness, but I too am concerned about jobs in the U.S. on a -- on a daily basis. Legislation has been proposed that would exempt certain inter-affiliate transactions of swap dealers from meeting margin and clearing requirements and if these contracts are classified as separate transactions, there's a concern that it will increase costs for the customers of these products to appropriately manage the -- this risk.

Has the CFTC acted to provide this exemption for inter-affiliate transactions? And if not -- if you have not acted in this area, can you provide an explanation about when you expect the CFTC to act?

MESA: We have not provided such an exemption in this area. But it -- it's something that the industry has heavily commented to the agency about and it -- it's something we're considering at a staff level. And the commission is fully aware that it's -- that staff is developing something in this area.

HAGAN: Well, it's my understanding that the SEC may treat inter- affiliate transactions differently then the CFTC. And does it make sense for market participants to have to comply with two different sets of rules for similar products?

MESA: As mandated under Dodd-Frank we're of course coordinating, consulting with the SEC and we will work with them as we think through this issue.

HAGAN: I think there's a lot of issues that are arising because of the two different entities regulating the same transactions. And then I understand that certain aspects of Basel III with respect to regulatory capital intersects with changing the accounting standards in the U.S. and internationally. And it's been brought to my attention that if such changes are adopted in the U.S. as proposed, it may produce several unintended consequences such as a narrowing of the investor base for longer term debt -- public debt instruments including our U.S. treasuries, mortgages, backed securities and municipal bonds.

Prior to U.S. implementation, do Treasury, FDIC and/or the OCC intend to study the issue? Or to propose alternatives in light of the above-mentioned concerns? Governor Tarullo, do you want to start that one?

TARULLO: I -- so on -- on the -- on accounting issues I -- there have been a series of accounting issues that have an impact on capital. I think our aim -- the Federal Reserve aim I would let the other prudential regulators speak for themselves, has been to maintain substantial if not overwhelming congruence between the accounting standards that FASB applies for purposes of investor protection and transparency on the one hand and regulatory capital on the other. The reason for that being that otherwise you've got different -- different sets of books in essence that investors have to look at. Having said that, there have been some areas in which I think the accounting standards don't -- have not -- or at least some of the proposals have not reflected the reality of certain assets that the proposal that was floating around for a while to insist on fair value treatment for loans written by a community bank and held to maturity, I think was -- was sort of a stunning example of that.

So my -- my own sense is that our effort as regulators ought to be to try to take our observations on what are sensible accounting standards for all investors? And to urge those in appropriate channels upon the FASB and -- and I think FASB is -- is listening to those kind of arguments. Our -- our chief accountants from the three agencies frequently get together to talk about these kinds of issues and then try to make representations as appropriate.

JOHNSON: Neither Senator Shelby or I have any further questions, but does Senator Corker have a concluding question?

CORKER: I have several concluding questions, thank you.

(LAUGHTER)

And I took a lot less time then most of our questioners so thank you for the time now. Mr. Tarullo, I think your answer on MSRs was actually a very good one and I think that you know, we should deal with how much -- what the basis points, set asides should be. That's something that has nothing to do with you, but I -- I thought was very good. Sometimes I think they're long answers, but it was a very good one. But let's move to the -- to the treasuries. You were talking about them playing a very unique role, treasuries and mortgage backed securities and therefore we should treat them differently than other types of debt instruments and Volcker does that of course.

Should we really have a bias in our private banking system towards government debt? Or should -- should all debt not be treated the same? I mean is this bias something that's healthy for us in this free enterprise economy that we have?

TARULLO: Well, that -- the -- sir, the -- the -- the special treatment of U.S. treasuries, for example, is I think grounded in substantial part on the risk-free character of those treasuries and thus they serve as a -- both a capital and liquidity backstop for...

(CROSSTALK)

CORKER: But -- but they're not risk-free as it relates to interest rates to...

(CROSSTALK)

TARULLO: No. No. You're absolutely right and that's why we have interest rate -- interest rate risk supervision. But I -- I would say I don't think -- so the -- the argument for a -- a preference for an identification I think is very strong. But it doesn't -- it's not all-encompassing.

And so, for example, in liquidity regulation, which basically looks to make sure that a firm could sustain a major market shock and keep operating long enough to allow order to be restored, I -- I don't think we want to rely solely on U.S. government securities or indeed any government securities.

There I think we do want to look to the actual experience. We now have, unfortunately, a real world experiment, which is to say 2008, 2009 where we can see how different instrument -- the liquidity value of different instruments was realized over that period of time.

And in the -- in the revision of -- of the liquidity coverage ratio internationally, that's the position we've -- we've urged, is to look and see how instruments actually performed and give credit where non-governments are in fact liquid even in times of stress.

CORKER: Well, thank you very much.

Mr. Gruenberg, we've yesterday spent a good deal of time with Sheila Bair just talking a little bit about quarterly liquidation.

I -- I was on a panel a few weeks ago and, you know, there are portions of Title II that I'm really proud of because I was highly involved in and other portions not so much.

But -- but there's been a lot of discussion the -- the SIFI piece, which you preclude that, I think, maybe in Title I and people are concerned as they look at orderly liquidation. And if you're a SIFI, we've had numbers of people who -- who deal with financial institutions, their thinking that if orderly liquidation occurred with a significantly important financial institution then they would be treated differently than if they were, you know, creditors to a smaller institution.

And their fears are that -- that if an institution starts going bad and it's not a significantly important institution that it's gonna be like a run if -- of people away from that institution.

I'm not seeing that myself. But we certainly had an hour yesterday with Sheila talking about that. I'm wondering if you have bumped into that or have any comments in that regard.

GRUENBERG: Well, you know, it's an important issue, Senator.

The -- I would note that, you know, the premise of the legislation is that the orderly liquidation authority would be invoked only if for some reason there was a judgment that the bankruptcy courts couldn't handle the -- the failure without some systemic consequences.

CORKER: And -- and on that note, would you urge some changes in the bankruptcy code to make the bankruptcy code work even better for institutions?

GRUENBERG: I -- I don't know that I have changes to suggest. I think we're certainly open and -- and we've talked about this in the past to engaging with you on -- on that issue.

But just to the point of the treatment of creditors, I think the first -- in the first instance the effort will be to utilize the bankruptcy process, as it would normally be used.

If -- if you had an extraordinary circumstance where the failure of the company, it -- it would appear couldn't be handled by the bankruptcy process without some larger systemic consequence then we have these admittedly extraordinary authorities under Title II.

But even then the -- the directive in Title II, in terms of the treatment of creditors, is to try to follow the, as a general practice, the -- the -- the practices under the bankruptcy process.

So I -- I think the goal would -- would be to be as consistent with that as you possibly can. And that's certainly the premise of all of the planning that we've done in terms of -- of our resolution authority.

CORKER: Yeah. One of the nuances that -- that I just recently I -- and I'm embarrassed to say this, that picked up but -- but orderly liquidation really would only be used in a case where the bulk of the assets were of a banking nature.

And if that were not the case then if -- if the assets were -- were generally not of a normal depository institution, you would probably lean towards bankruptcy in those cases instead of orderly liquidation. Is that -- is that the way you understand...

GRUENBERG: I'm not sure that's -- I -- I think the proviso with the statute is really a -- a -- a judgment and it's a -- a joint judgment of the Federal Reserve, the FDIC making determinations and recommendations to the Treasury Department, which would then have to make a -- a judgment in consultation with the president.

And that authority could apply to any financial company. And the key there is -- is whether the failure of the company would -- would cause significant disruption to the financial system.

So it -- that authority, while in the -- I think in the most likely case would apply to a bank holding company, given the nature of the large and -- and systemically important institutions in our country, it -- it could be applied to a nonbank financial company as well.

(UNKNOWN): I know the Chairman's...

(UNKNOWN): Is that -- is that the question you were asking, Senator? I thought you were asking about whether the authority was likely to be applied only to bank holding companies where most of the assets were traditional commercial...

CORKER: That -- that's what I was asking.

(UNKNOWN): Yeah. So that's not your intention, right, or...

GRUENBERG: When most of the assets are not in traditional -- or whether they were in the bank or not...

(UNKNOWN): But I think -- I think the senator was asking whether the (inaudible) Title II is likely to apply only to bank holding companies where traditional commercial banking assets are the (inaudible)...

(UNKNOWN): Is -- holds a majority of -- of -- of the assets so...

GRUENBERG: I think that's -- that's necessarily the case.

CORKER: So again, it would still be in each case solely -- we've had differing responses to this but in -- in your mind, as the chief liquidator, our nation's chief liquidator...

(LAUGHTER)

That's quite a title -- it would be a judgment call made relative to whether this institution would -- would create a lot of problems throughout the banking industry if it were -- if it went through bankruptcy instead of orderly liquidation. Yeah.

GRUENBERG: Yes, sir.

CORKER: Mr. Chairman, thank you for, again, obviously I think the witnesses have been outstanding and I do hope we'll pursue a technical correction to the bill at the right time.

JOHNSON: Senator Merkley?

MERKLEY: Thank you, Mr. Chair.

And I wanted to begin, Ms. Mesa, with your -- your -- following up on Senator Hagan's thoughts. Under -- under Dodd-Frank, CFTC was given power to establish position limits.

And there's been a lot of frustration with how slowly the CFTC has -- has moved. And although you've got the rule done, you still haven't implemented it.

And we've seen growth from 30 percent of folks trading the market not having an end-use, if you will, to 70 percent. And in recent months a lot of folks seeing that the conflict in the Middle East and the conflict regarding Iran have said, well, a lot of other folks are going to the same thing and they're gonna worry about oil and they're all gonna bet so I'll get in and bet too.

And so we see this huge surge in speculation. And the CFTC is sitting on its hands. Can you -- can -- can you explain why you've been so slow and missed the deadline and at great cost to American consumers at the pump?

MESA: We have actually, as you noted, passed our final rule on position limits.

The final rule talks about aggregating futures positions with swaps positions. And in the final rule we said that we request one year of data of swap -- of swap positions before the positions limits would be effective.

And so that one year hasn't run yet. It is -- when it does it'll go into effect so that...

MERKLEY: All right. Well, there's a big sense in America that while CFTC fiddles, American consumer is getting burned. And I just want to express that concern because I hear it from my constituents on each and every trip back...

MESA: I'll take that concern back.

MERKLEY: ... back home. Thank you.

Ms. Walter, I wanted to address a little bit the issue of crowd funding. We're going to be voting on it later today.

The House laid out a strategy for folks being able to invest over the Internet in small dollar amounts that involved no requirements on companies for information, no accountability for whatever information he companies did put out their full legal permission for companies to hire people to pump their stocks with no consequences. It looked to me like a path, really a paved path to predatory activity that would -- would damage a lot of folks who are thinking they're participating in a fair market, but wouldn't be. Do you share any of those concerns about the House legislation?

WALTER: Well, first I must say that the commission itself has not voted on this. So, I'm speaking for myself. I welcome adding investor protection provisions to the crowd funding aspect. I see some value in crowd funding itself, but I do think it should be done with appropriate investor protections attached to it. And those are terribly important.

MERKLEY: Have you had a chance to look at the bill, the amendment that Senator Bennet and I have worked on to provide those investor protections?

WALTER: Unfortunately I have not. I have been told about certain aspects of it, but I have not had the opportunity to read it.

MERKLEY: Well, we're going to be -- I was going to get your wisdom before I vote on my own amendment this afternoon.

WALTER: And I've missed my opportunity to influence you.

MERKLEY: Well, I do appreciate your general sentiment we should invest, add some investor protections. And we do require three different levels of information depending on how much a company is raising. We hold the officers and directors accountable for the accuracy of that information. We set up a streamlined but Web portal structure so people can't simply sell without any structure, which is true in the House bill, and a number of other factors.

And -- but one of the things that we also do is set up a cycle for the SEC to try to be right on top of predatory practices that develop and be able to develop rules to address those predatory practices because this is a new unchartered territory. And to make the formation work well, it has to be something investors believe they're getting a fair shake on. And so we're going to be counting on you all.

WALTER: We will do our best, as always.

MERKLEY: Thank you very much.

And, Mr. Chair, thank you for holding the hearing.

And I appreciate your all's input on this very complicated and very important issues for capital across the planet and the strengthening of our collective economies.

JOHNSON: Thank you all -- all the witnesses for the testimony and for being here today. There is no doubt that continued cooperation and harmonization of financial and regulatory reforms is important to the stability of our global economy.

The recent years have highlighted the interconnected nature of the global financial system and the importance of international coordination. I look forward to continuing to work with all of you and the members of the committee to ensure the successful implementation of these important reforms.

This hearing is adjourned.

END

---- INDEX REFERENCES ---

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3/22/12 EMEDIAPT 17:55:00
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