NCUA
National Credit Union Administration

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Congressional Testimony

Debbie Matz
Board Chairman
National Credit Union Administration

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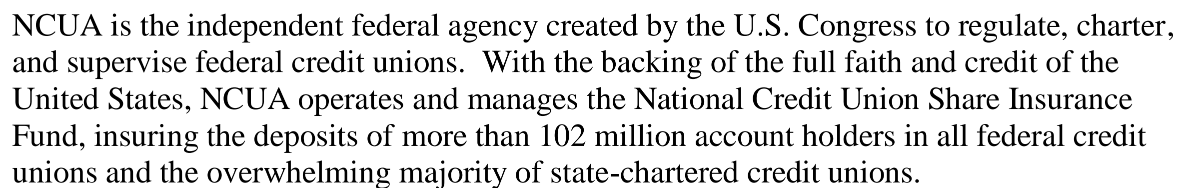
Hearing on Oversight of the Financial Stability Oversight Council



NCUA is the independent federal agency created by the U.S. Congress to regulate, charter, and supervise federal credit unions. With the backing of the full faith and credit of the United States, NCUA operates and manages the National Credit Union Share Insurance Fund, insuring the deposits of more than 102 million account holders in all federal credit unions and the overwhelming majority of state-chartered credit unions.

At MyCreditUnion.gov and Pocket Cents, NCUA also educates the public on consumer protection and financial literacy issues.

Congressional Testimony

Thank you, Chairman Hensarling, Ranking Member Waters, and Members of the Committee. I am Debbie Matz, Board Chairman of the National Credit Union Administration. I appreciate this opportunity to discuss the structure, operations, and agenda of the Financial Stability Oversight Council, as well as the expertise I bring and the views I have on these matters.

Before I address the topics outlined in the invitation letter, it's important to briefly review the history behind the Council's creation. The decision to establish FSOC came in response to the 2008–2009 financial crisis. This decision was driven by the recognition that financial crises are enormously costly—not only to individual financial services companies, but also the general economy and the financial well-being of our nation's citizens and their families. In all, the American economy lost 9 million jobs, major stock market indexes declined by more than 50 percent, and household net worth plunged by $12 trillion.[1]

The sudden failures of several large, interconnected financial companies during the crisis triggered a cascade of more failures and near-failures of financial companies previously thought invulnerable. As the crisis deepened, many of our nation's largest financial companies were left holding toxic assets on their balance sheets without sufficient capital to absorb the losses. To prevent further failures and greater losses, the federal government provided previously unthinkable amounts of support and took a number of unprecedented actions.

The interconnections within the financial system laid bare by the financial crisis meant that no sector was immune to the fallout. Even the consumer-oriented, member-owned credit union system suffered sizable losses. In all, 90 retail credit unions that were holding insufficient capital to cover their risks failed as a result of the crisis.[2]

Compounding those failures, five corporate credit unions with investments in faulty mortgage-backed securities had to be liquidated, which led to near-catastrophic consequences for all surviving credit unions.[3] Recognizing the instability those costs would cause throughout the credit union system, Congress created the Temporary Corporate Credit

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[1] The total jobs lost figure was calculated from data provided by the Bureau of Labor Statistics from December 2007 through June 2009. Declines in stock market indexes were calculated using information from Moody's Analytics using data from the *Wall Street Journal* for the period of December 27, 2007, to March 5, 2009. The change in household net worth was calculated using the Federal Reserve's Financial Accounts of the U.S. for the second quarter of 2007 through the first quarter of 2009.

[2] The number of failed federally insured credit unions is calculated for the period beginning January 1, 2008, through December 31, 2011.

[3] Corporate credit unions exist primarily to provide retail credit unions with banking, liquidity, and investment services. To date, federally insured credit unions have paid $4.8 billion in assessments and experienced $5.6 billion in losses in the form of contributed capital to cover the losses associated with the corporate crisis.

Union Stabilization Fund.[4] NCUA also infused more than $120 billion of emergency liquidity and guarantees to stabilize the credit union system.[5]

FSOC's Creation and Mission

Ultimately, the 2008–2009 financial crisis made clear that financial distress at interconnected financial firms cannot be easily isolated, and the broader financial market cannot quickly absorb the collapse of very large financial companies. The crisis also highlighted vulnerabilities in the U.S. financial system, including gaps in regulators' jurisdiction over large, complex nonbank financial companies that play a significant role in our financial system. The complex, evolving financial system needed some form of broader oversight. Establishing the Council was one of the core reforms of the Dodd-Frank Wall Street Reform and Consumer Protection Act.[6]

Congress created FSOC to serve as an early warning system to detect and address emerging threats to our nation's financial stability and the economy. The primary goal is to prevent system-wide financial crises or at least mitigate their effects.

Specifically, the Council's statutory mandate has three elements. They are to:

- Identify risks to the financial stability of the United States posed by the material financial distress or failure, or ongoing activities, of large, interconnected financial companies.
- Promote market discipline by eliminating expectations on the part of shareholders, creditors, and counterparties of these large, interconnected financial companies that the government will shield them from losses in the event of their failure.
- Respond to emerging threats to the stability of the U.S. financial system.

These principles have guided FSOC from its inception, when the organizational framework was designed, to the present as the processes and procedures have evolved.

FSOC's Structure and Operations

The Council brings together federal and state regulators with responsibility for the major sectors of the U.S. financial system to share their diverse expertise and to identify and address potential risks to financial stability. As designed by Congress, the Council has ten voting members and five non-voting members, who serve in an advisory capacity.[7] The

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[4] *See* 12 U.S.C. § 1790e.
[5] NCUA provided more than $20 billion in liquidity assistance through the Central Liquidity Facility and over $100 billion in guarantees. NCUA also had to borrow $5 billion from the U.S. Treasury to support the credit union system.
[6] *See* 12 U.S.C. §§ 5301-5641.
[7] *See* 12 U.S.C. § 5321(b).

Council's voting members comprise the Treasury Secretary, an independent insurance expert, and the lead official of every major federal financial regulatory agency, including NCUA.[8]

Each FSOC member has deep experience in financial market analysis and specialized knowledge within a particular sector. The Council's multi-agency structure ensures that a diverse array of views, research, and emerging risks in each sector are considered when examining the financial system and making decisions. In my view, the quality of the decisions FSOC makes is enhanced by the diversity of viewpoints of the principals at the table.

The Council's principals meet almost monthly; to date, we have met 54 times. These meetings cover a wide range of topics, including international financial and regulatory developments, unusual geopolitical developments that affect financial markets, emerging changes to financial market infrastructure, general economic trends, and emerging issues like cyber threats.

The meetings of FSOC principals represent the culmination of a thorough process of review and analysis. FSOC and agency staff provide research and recommendations after deliberations in committees and working groups. For example, the Council's Deputies Committee, composed of senior staff from each principal's agency, meets twice each month to evaluate and discuss possible approaches to mitigate threats to our nation's financial stability before these matters are presented to the Council.

At the working level, there are five committees meeting regularly on critical issues such as monitoring systemic risk, examining developments related to the accumulation and standardization of data across financial institutions, and reviewing developments related to the designation of systemically important nonbank financial companies. The committees consist of staff from FSOC member agencies, as well as the Office of Financial Research, another entity created by the Dodd-Frank Act.[9] Through the committees, staff are engaged in sharing information, conducting research, and monitoring market developments.

The committees often create working groups to examine specific issues. For example, the Systemic Risk Committee formed a working group to examine the interest rate risk exposures in the financial system. The findings of the working group were presented to the Systemic Risk Committee, the Deputies Committee, and the Council. Thus, the information about the working group's findings flowed up through FSOC's reporting structure to the principals.

From the beginning, the Council has recognized the importance of public transparency and participation. Stakeholder feedback has helped the Council clarify its procedures, enhance

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[8] *See id.*
[9] *See* 12 U.S.C. §§ 5341-5346.

its analysis, and improve its decision-making. FSOC also is committed to publicly disseminating timely information about the Council's decisions, while balancing the need to protect proprietary corporate information and avoid moving markets.

In developing its procedures, the Council is mindful of statutory requirements. In some cases, the Dodd-Frank Act was prescriptive, such as providing the factors to consider when designating a nonbank financial company as systemically important. In other instances, the law was flexible, permitting the Council to determine how to make the designation.

The evolving process for designating nonbank financial companies offers a prime example of how FSOC looks to the law and develops the complementary procedures. Within the first few months of establishment, the Council published in the *Federal Register* for comment an advance notice of proposed rulemaking on the process for designating nonbank financial companies.[10] Based on feedback, the Council made revisions to the process and issued a notice of proposed rulemaking at the start of 2011.[11] These procedures were further revised before the rule was finalized in 2012.[12]

Then, in February of this year, the Council made further revisions based on additional public comments and congressional suggestions.[13] The revised procedures allow more communication and interaction with companies earlier in the determination process, enhance transparency to the broader public about the designation process, and improve engagement during the Council's annual reevaluations of designations.[14]

As an FSOC principal, I am committed to continuing to explore how we can further refine and improve the Council's operations and structure.

Expertise and Perspective

Each Council member brings a unique perspective to the table, informed by our particular areas of professional expertise and experiences. In my case, that is a multi-decade career working on economic and financial services issues. Early on, I served on the staff of the congressional Joint Economic Committee where I advised lawmakers on a host of domestic policy issues, including the fiscal conditions of cities and municipalities during the financial crises of the late 1970s and early 1980s, housing policy, and infrastructure finance. Subsequently, I served as an NCUA Board Member and a credit union executive.

More recently, I have led NCUA through the aftermath of the Great Recession. When I assumed the role of NCUA Board Chairman, five corporate credit unions were on the brink

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[10] *See* 75 FR 61653 (Oct. 6, 2010).
[11] *See* 76 FR 4555 (Jan. 26, 2011).
[12] *See* 77 FR 21637 (Apr. 11, 2012).
[13] *See, for example,* The Honorable Carolyn B. Maloney, Member of Congress, letter to The Honorable Jacob Lew, Chairman, Financial Stability Oversight Council, July 29, 2014.
[14] *See* https://www.treasury.gov/press-center/press-releases/Pages/jl9766.aspx.

of failure. These failures could have led to the collapse of the credit union system. To prevent this, NCUA developed a mechanism to securitize more than $40 billion in toxic assets once held by the failed corporate credit unions.

To protect retail credit unions from the repercussions of the crisis, NCUA strengthened safety and soundness regulation and supervision. The agency also reallocated resources toward credit unions that posed the largest risks to the National Credit Union Share Insurance Fund. In the process, NCUA replenished the Share Insurance Fund, which now insures the deposits of more than 102 million members.

As a federal financial regulator for almost 10 years, I oversee an agency that now supervises more than 6,000 financial institutions with total assets exceeding $1.1 trillion. Each of these institutions must manage the assets and liabilities on their balance sheets. Asset-liability management is critical to institutions of all sizes. In fact, major elements of FSOC's designation of a systemically important financial institution include the composition of the firm's balance sheet, off-balance sheet exposure, and interconnectedness with the entire financial services sector. As such, these experiences have prepared me for working with FSOC in analyzing the performance of financial markets and operations of individual companies.

Through the Council's structure, NCUA is able to regularly meet with federal and state financial regulators to discuss and identify emerging risks and consider the financial system as a whole, rather than just in constituent parts. FSOC's member agencies share information, ideas, and expertise in a way that previously did not occur, and this information has given NCUA and other FSOC members a greater perspective on the entire financial system.

In addition to FSOC's collective decisions aimed at enhancing and protecting U.S. financial stability, the institutions regulated by the individual prudential regulators benefit, as well. From NCUA's perspective, the Council's emphasis on enhancing financial stability and mitigating potential risks is another form of protection, both for credit unions as financial institutions and for their members. This complements NCUA's supervision of credit unions and share insurance coverage of members' accounts up to $250,000 if a credit union fails. The missions of the two organizations, therefore, are interrelated and important to promoting confidence in the U.S. financial system.

FSOC's Agenda and Work

By law, the Council must remain alert to emerging issues that concern the financial system as a whole.[15] FSOC also takes action by "closing loopholes, improving consolidated supervision, and establishing robust regulatory oversight."[16]

[15] *See* 12 U.S.C. § 5322.
[16] 155 Cong. Rec. H. 14409 (daily ed. Dec. 9, 2009) (statement of Rep. Ed Perlmutter).

In carrying out FSOC's responsibilities, the Council has taken advantage of the multi-agency structure to draw on experts from the individual agencies and FSOC staff to collectively review potential threats as they unfold for Council members. For example, Council members have been briefed on the potential consequences of instability in Eurozone financial markets from a default on Greek debt and work on reference rates, among others. In addition, the Council is immediately briefed on unusual market developments such as sizable, sudden, short-term swings in our securities markets, with an eye on developing an understanding of their systemic importance.

A recent concern for financial markets, including the credit union system, is the ongoing challenges related to the low interest-rate environment and the likely transition to a higher rate environment, potentially with a flatter yield curve. Additionally, cybersecurity risks are an evolving threat that affect all financial institutions. In this interconnected environment, cyberattacks continue to evolve in sophistication and coordination, which reinforces the need of financial regulators and their regulated entities to remain vigilant, evolve with the changing environment, and maintain effective resilience. FSOC has closely studied both of these issues and raised public awareness about them to better protect the financial system.

FSOC's work related to asset managers has received considerable public attention, as well. To better understand the complex role of asset managers in the financial system, the Deputies Committee has held a major conference and convened numerous other meetings and discussions with asset managers and other knowledgeable individuals. In addition, the Council has requested public comments seeking responses to a number of questions about asset managers. This resulted in more than 1,000 pages of material, which has helped to define the Council's path forward. As a result of these interactions, the staff work on asset managers has been focused on industry-wide products and activities to better assess potential risks associated with the asset management industry. FSOC staff continues to work on this critical area.

Another important aspect of FSOC's work is its annual report. As required by law, this report summarizes the work of the Council, significant financial market and regulatory developments, potential emerging threats to U.S. financial stability, and all determinations of systemically important financial institutions.[17] The report also makes recommendations to enhance the integrity, efficiency, competitiveness, and stability of U.S. financial markets, to promote market discipline, and to maintain investor confidence.[18] The 2015 report highlighted the need for heightened risk management and supervisory attention in the areas of cybersecurity, increased risk taking in a low-yield market, and financial innovation activities, among others.[19]

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[17] *See* 12 U.S.C. § 5322(a)(2)(N).
[18] *See id.* § 5322(a)(2)(N)(vi).
[19] *See* https://www.treasury.gov/initiatives/fsoc/studies-reports/Documents/2015%20FSOC%20Annual%20Report.pdf.

The statutory duty that has received the most public attention is FSOC's responsibility to identify large, nonbank financial firms that, if they were to fail, would transmit that distress through the rest of the financial system and cause a threat to financial stability. Under the Dodd-Frank Act, financial companies identified for this designation are subject to consolidated oversight by the Federal Reserve and enhanced prudential standards.[20] The Federal Reserve can tailor such standards so they are appropriate to the nonbank financial company, but a designated firm is required to develop a living will to demonstrate how it could reach a quick and orderly resolution should it fail.[21]

As noted earlier, since its inception, FSOC has moved deliberately as it has created its process for identifying and designating nonbank financial companies for enhanced supervision. In all, FSOC has identified four large, interconnected financial companies for this oversight.[22] After extensive review and consideration, a majority of the Council voted in favor of designating each of these complex nonbank financial companies. The Council determined that should these institutions experience financial distress, their financial problems could threaten the stability of other systemically important institutions and therefore the financial stability of the United States. FSOC has reviewed and will continue to review these designations annually.[23] If significant changes occur within a designated firm that might impact the designation, FSOC has the authority to remove the designation.

Going forward, I am committed to continuing to move deliberately on any further designations of nonbank financial firms. As the financial system evolves, I also believe so too must the Council's policies and procedures for designating nonbank financial companies.

Conclusion

In conclusion, the Financial Stability Oversight Council at the five-year mark should be seen as a dynamic, evolving organization. For the first time, the Council has formally brought together all of the regulators charged with oversight of critical segments of the financial system. The Council has stood up an effective, responsive organization, with a unique charge from Congress: to safeguard the financial stability of the United States.

To that end, FSOC has thus far promoted collaboration across financial regulators, established appropriate rules and procedures which reflect public input, identified four systemically important nonbank financial companies, and furthered greater public awareness of threats to our financial system. The Council is therefore performing a valuable service for the American people by identifying risks, promoting market discipline, and responding to emerging threats to the U.S. financial system on critical issues such as the

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[20] *See* 12 U.S.C. §§ 5361, 5365.
[21] *See id.* §§ 5365(i), 5365(d).
[22] The four nonbank financial companies designated as systemically important are American International Group, General Electric Capital Corporation, Prudential Financial, and MetLife.
[23] *See id.* § 5323(d).

oversight of key financial market utilities, data standards infrastructure, and cybersecurity threats.

Speaking for NCUA, participation on FSOC has expanded our perspective, helped the agency understand the broader context for some of the emerging risks to credit unions, and improved access to critical financial and market information. FSOC also has positioned NCUA to receive and share best practices with other financial regulators. As a result, NCUA is better able to fulfill its mission of providing, through regulation and supervision, a safe and sound credit union system which promotes confidence in the national system of cooperative credit.

Furthermore, I find NCUA's inclusion on FSOC to be mutually beneficial. The Council benefits from NCUA's inclusion in the process by having a multitude of views and a broader perspective in its discussions of systemic risk.

Thank you for your consideration of my thoughts on these matters. I look forward to answering any questions you may have.