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Chairman Johnson, Ranking Member Crapo, and members of the Committee, thank you for inviting me to testify today on behalf of the Treasury Department.

Just over three and a half years ago, Congress passed and President Obama signed into law a historic set of reforms to make our financial system stronger and more stable. We have made considerable progress towards achieving those objectives through implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act, and related reforms. The crisis revealed that regulation and oversight failed to keep pace with an evolving financial system, and demonstrated why we must always remain vigilant to potential emerging risks in financial institutions and markets.

Most of the foundational reforms laid out in the Dodd-Frank Act have now been finalized, and intensive work on the remaining pieces continues. The new Consumer Financial Protection Bureau has taken up its mission quickly, acting to strengthen consumer protections in the mortgage market; establish federal supervision over large payday lenders and debt collectors for the first time; and provide assistance to the elderly and military families who are so often targeted by unscrupulous lenders. Last year, the bank regulatory agencies finalized key rules strengthening the quality and quantity of capital that banks are required to hold, and proposed new rules that will require the largest firms to decrease their leverage. A new framework for regulatory oversight of the over-the-counter derivatives market is largely in place, for those swap dealers registering with the Commodity Futures Trading Commission (CFTC) and certain interest-rate and credit-index swap transactions moving to central clearinghouses, reducing overall risk to the financial system. Starting this month, new classes of swaps transactions will begin to be traded on swap execution facilities, bringing much-needed transparency to these markets.

The United States has moved quickly to put these critical reforms in place, and the American people are beginning to feel the benefits of reform through a safer and stronger financial system and a broader economic recovery. Although financial markets have recovered more quickly than the overall economy, the economic recovery is gaining traction. Private sector payrolls have increased by more than 8 million jobs from the low point in February 2010, and December marked the 46th consecutive month of private-sector job growth. The unemployment rate, while still too high at 6.7 percent, has fallen to 3.3 percentage points since its October 2009 peak of 10.0 percent, and almost a full percentage point since my last testimony before this Committee. The recovery in the housing market appears to be taking firm hold as measured by rising home prices, and a declining number of delinquencies and defaults.

Although we have made good progress, we must continue our efforts to complete the remaining pieces of financial reform and stand ready to identify and respond to new threats to financial stability. We must also continue to work with our international counterparts to promote strong and consistent global approaches to financial regulation and encourage them to move swiftly towards the completion and implementation of key reforms in their jurisdictions, preventing firms from evading reforms through regulatory arbitrage.

I would like to update the Committee on several important regulatory developments since I appeared before you last July.

Secretary Lew, in his capacity as Chairperson of the Financial Stability Oversight Council, was responsible for coordinating the regulations issued by the five rulemaking agencies – the Board of Governors of the Federal Reserve System (Federal Reserve), the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), the Securities and Exchange Commission (SEC), and the CFTC – to implement Section 619 of the Dodd-Frank Act, commonly referred to as the Volcker Rule. Starting from his first day in office, Secretary Lew stressed the importance of finishing work on the Volcker Rule, and the importance of having a single, strong final rule that was true to President Obama's proposal and the statute's intent. The final rule adopted in December will protect taxpayers and the federal safety net by ending banks' speculative trading activities for their own benefit rather than for the benefit of their customers, and restricting their investment in private equity and hedge funds, while preserving banks' ability to maintain deep, liquid financial markets and hedge their risks. The rule's requirement that the largest firms' CEOs attest to the maintenance and enforcement of compliance programs will help foster a "tone at the top" for a culture of compliance. The rule also contains a tiered compliance regime, to help ensure that smaller banks that do not engage in impermissible proprietary trading or private fund activities do not face unnecessary compliance burdens.

Our progress in 2013 was not limited to completion of the Volcker Rule. Last summer, the Federal Reserve, FDIC, and OCC finalized an important set of rules implementing the Basel Committee's risk-based capital standards, which will increase both the quantity and quality of capital held by banks and bank holding companies. The banking regulators also proposed complementary enhanced leverage standards that will act as a backstop to the risk-based capital requirements, and will require the largest banks and bank holding companies to reduce their overall leverage. An international group of regulators recently made significant progress toward consistent application of the leverage requirement across different jurisdictions by agreeing on a global framework for calculating the leverage ratio. The United States continues to lead international efforts to raise regulatory standards around the world.

The Federal Reserve is also poised to issue additional enhanced prudential standards that will increase safety and soundness at the largest and most complex banks and designated nonbank financial companies.

The bankruptcy process, aided by the Dodd-Frank Act's living wills requirement, continues to be the primary method for resolving failing financial companies. All of the firms that are required to submit living wills have done so, and the largest bank holding companies submitted their second round of living wills last fall, providing a more refined tool to facilitate their orderly resolution through bankruptcy should they fail.

However, in the case where bankruptcy cannot be relied on to resolve a failing financial company without imposing serious adverse effects on U.S. financial stability, the Dodd-Frank Act's orderly liquidation authority provides critical new authorities so that firms can safely be allowed to fail, no matter how large and complex.

In December, the FDIC issued and sought public comment on an important document detailing its strategy for resolving a financial company using its orderly liquidation authority. The document provides greater detail on the FDIC's "single point of entry" strategy that the FDIC developed to implement its authority. The single point of entry strategy is designed to accomplish the goals of orderly liquidation by allowing critical operating subsidiaries of a failing firm to remain in business during the resolution, while also preserving market discipline in accordance with the law's requirements – that losses are borne by shareholders and creditors, that culpable management are held accountable and removed, and that taxpayers bear no losses. International cooperation is critical to ensure workability across borders, a topic discussed in more detail below.

The Financial Stability Oversight Council (Council) remains focused on its authority to determine that certain large, complex nonbank financial companies whose material financial distress could threaten U.S. financial stability will be subject to more stringent prudential standards and oversight. This past summer, the Council designated American International Group, Inc. and General Electric Capital Corporation, Inc., subjecting them to enhanced prudential standards and consolidated supervision by the Federal Reserve. And, after company management had a formal hearing with the Council to contest the Council's proposed designation of the company, the Council also finalized its designation of Prudential Financial, Inc. These designations are in addition to the eight financial market utilities that the Council designated in 2012.

The Council's review of nonbank financial companies is an ongoing process, and the Council will continue to evaluate other companies for potential designation.

The progress we have made on instituting a significantly stronger capital regime and creating a credible resolution process, and the expansion of the supervisory umbrella to cover designated nonbank financial companies, are key developments in making the failure of large, complex firms less likely and making our financial system more resilient in the event of such a failure.

We also continued to make progress on derivatives reform in 2013. The implementation of reporting and clearing rules were critical steps forward in improving the safety and transparency of the derivatives market. We understand that for derivative reforms to work correctly, they must align globally. Last summer, the CFTC finalized its guidance with respect to the applicability of the Dodd-Frank Act's derivatives reforms to cross-border derivatives transactions and, together with the European Commission, announced a "Path Forward," laying out their joint understandings regarding the regulation of cross-border derivatives transactions. In September, an international working group, co-chaired by the Federal Reserve and including the SEC and CFTC, finalized margin standards for non-cleared derivative transactions. U.S. regulators are now working to adopt these standards domestically, and we expect these rules to be finalized this year. In addition, by the end of last year, 22 swap execution facilities were registered with the CFTC, and the trading volume on those platforms is expected to increase significantly later this month when trading in several interest rate and credit derivatives will be required to take place on SEFs.

Treasury's Federal Insurance Office (FIO) also made significant progress in fulfilling its mission in 2013. In December, the FIO released its report on the modernization and improvement of the system of insurance regulation in the United States. The report made 27 recommendations designed to bring our insurance regulatory system into the 21st century and make it more responsive to the needs of consumers, market participants, and host supervisors in a global environment. The FIO will also release a report on the reinsurance market, and the President's Working Group on Financial Markets, with input from the FIO, will release its analysis of the long-term availability and affordability of terrorism risk insurance this year.

In addition, the FIO continues its work on the international front to represent U.S. interests in the development of international insurance standard-setting and financial stability activities. The FIO has worked and will continue to work closely and consult with other federal agencies and with state insurance regulators on these efforts. The FIO is involved in the work of the International Association of Insurance Supervisors (IAIS) to develop a common supervisory framework, including a capital standard, for internationally active insurance groups.

Treasury and the Financial Stability Oversight Council also remain focused on emerging threats that might arise outside, or on the periphery of, the traditional banking sector. To that end, the Council is actively analyzing the extent to which there are potential threats to U.S. financial stability arising from asset management companies or their activities, and whether such threats could be mitigated by Council designations or whether they would be better addressed through other regulatory measures. As part of this analysis, the Council requested that the Office of Financial Research conduct a study of asset management activities to help determine whether these activities could create, transmit, or amplify stress through the financial system. The OFR released its study at the end of September following a careful analysis that included discussions with a number of market participants and input from Council member agencies with relevant expertise.

The Council's focus on emerging risks outside the core banking system led it to issue, at the end of 2012, proposed recommendations for money market mutual fund (MMF) reforms. Throughout this process, the Council has made it clear that the SEC is the primary regulator of MMFs and should take the lead in driving reform. Last June, the SEC proposed regulations intended to reduce the risks presented by MMFs, and we expect that the SEC will issue a final rule later this year that will address the vulnerabilities identified by the Council.

Another area of growing concern for Treasury and the Council is the vulnerability of our financial sector infrastructure to cyber events. Cyber-threats to financial institutions and markets are growing in both frequency and sophistication. The changing nature of these cyber-threats prompted the Council last year to highlight operational risk, and cybersecurity in particular, as worthy of heightened risk management and supervisory attention. Council member agencies are providing guidance to financial firms concerning appropriate governance mechanisms, information security procedures and testing, adequate backup systems, and emergency business continuity and recovery plans

To maintain data security, safeguard the integrity of markets, and preserve consumer and investor confidence, the U.S. government and the financial sector have come together to identify financial system vulnerabilities, improve the resilience of our financial system, and refine incident management protocols. A public-private partnership is necessary to combine the resources and capabilities of the government with those of the private sector. In a public meeting in December, the Council highlighted this partnership by engaging both public sector and private sector leaders to discuss their efforts. They emphasized information sharing, declassification of threat information, and strengthening the resilience of firms outside the financial services sector that are integral to the functioning of the sector.

In addition to its role as a Council member agency, Treasury serves as the sector-specific agency for the financial sector with a leading role in policy development and a coordinating role in incident response. In this role, Treasury has sought to increase engagement, improve coordination, and facilitate information-sharing on cybersecurity issues with colleagues across the federal government, particularly those involved with national security, homeland security, and law enforcement. We communicate regularly with senior officials in these areas on matters specific to cybersecurity, both in the context of incidents and on more general operations and policy matters. Importantly, Treasury is focused on protecting the financial sector as a whole, from the largest financial institutions and exchanges to community banks and credit unions. Accordingly, we work to reach institutions of all sizes.

I would also like to highlight for the Committee a few areas where Treasury intends to direct significant attention and resources this year to complete key outstanding pieces of reform. The United States responded to the financial crisis aggressively and on a bipartisan basis to make our domestic system safer and more secure. But given the global nature of our financial system, we must continue working with other regulators to forge compatible rules so that reforms in other jurisdictions are as strong as our own. From the outset of the crisis, the time and energy we put in to domestic regulatory reform have been paired with international efforts to promote high-quality standards, build a level playing field, and reduce risk. We have made considerable progress through the G-20 and the Financial Stability Board in designing a more stable and resilient global financial system. But design is not sufficient. Implementation and follow-through are key.

Later this month, the G-20 finance ministers will meet in Australia and the United States will use that opportunity to call on the world's largest economies to bear down even more forcefully on implementation. And next week I will be making a trip to several countries in Asia to discuss their progress on financial regulatory reform.

In 2014, we will take steps to make sure that global banks meet the high standards we have set. That means moving swiftly to build strong and high-quality capital, properly risk-weight assets, curb leverage, and build strong liquidity buffers to protect themselves in times of crisis.

Several years ago, the G-20 recommended that trading, reporting, and clearing of over-the-counter derivatives be in place by now. The United States has forged ahead in getting that done. We need to make sure these recommendations are put in place around the globe. There will be difficult cross-border issues to manage, and these are made more complex because other nations are moving far more slowly than the United States.

One area that will require significant international cooperation is the task of ensuring not only that all derivatives transactions are reported to trade repositories, but that the information collected can be used for the purposes it was intended: bringing transparency to our derivatives markets and helping regulators and market participants develop more insight into the types and levels of exposure throughout the financial system. A great deal of work still needs to be done to ensure that the data reported by industry and collected by regulators will be as useful as possible, or we will be at risk of not achieving that goal. The data are fragmented, with many different trade repositories, within and across jurisdictions, collecting different kinds of information in different ways, keeping us from putting all of that information together to develop a full picture of the market. We need to roll up our sleeves and address any obstacles to making these data useful for market participants and for regulators who are monitoring financial stability.

Treasury will also continue to engage closely with regulators in the United States and abroad to strengthen our ability to wind down failing financial companies while minimizing the negative impact on the rest of the financial system and the global economy. Major financial institutions operate globally, and cross-border coordination is necessary for resolution of these firms to be effective. Our agenda in the coming year will focus heavily on completing the work underway on international arrangements that establish how home and host authorities will cooperate to wind down a globally active firm in an orderly way. Treasury and the regulators will continue to closely collaborate with our international counterparts through forums like the Financial Stability Board and on a bilateral basis to address obstacles to resolving large, cross-border firms.

In addition to this critical international reform agenda, there is still much to be done domestically. As was the case with the Volcker Rule, Secretary Lew, as the Chairperson of the Financial Stability Oversight Council, is responsible for coordinating the joint rulemakings to implement Section 941 of the Dodd-Frank Act, the so-called “risk-retention” rule. This rule generally requires issuers of asset-backed securities to retain an interest in the securities they sell to third parties. The rule was re-proposed last year, and staff from Treasury, the banking agencies, the Federal Housing Finance Agency, the Department of Housing and Urban Development, and the SEC have met regularly – including just last week – to review comments, analyze data, and coordinate on drafting the final rule. Completion of these regulations in 2014 is a priority for Treasury.

And finally, in considering risks to financial stability, we cannot ignore fiscal developments at home. Last year, Congress passed a temporary suspension of the debt limit, and that temporary suspension lasts only through February 7, which is tomorrow. After that, in the absence of Congressional action, Treasury will be forced to use extraordinary measures to continue to meet its obligations. We now forecast that we are likely to exhaust these measures by the end of this month. And even though this is an estimate, it is clear that extraordinary measures will not last for an extended period.

It would be a mistake to wait until the 11th hour to get this done. The fact is, simply delaying action on the debt limit can cause harm to our economy, financial markets, and taxpayers. We are already seeing some volatility in Treasury bills that mature after February 7. Around the time of last year's delay, we saw consumer and business confidence drop, and investors and market participants publicly question whether it was too risky to hold certain types of U.S. government debt. Such a question should be unthinkable.

Given these realities, it is important that Congress move right away to increase our borrowing authority.

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The last year was a busy one, and we made substantial progress toward the goal of implementing the reforms set forth in the Dodd-Frank Act and adopting related reforms to make our financial system stronger, more stable and more focused on fulfilling its core function of facilitating the growth of the broader economy. That does not mean we will be able to relax our guard. To quote Winston Churchill: "This is not the end. It is not even the beginning of the end. But it is, perhaps, the end of the beginning." Constant evolution in the financial system and the activities of financial institutions will require regulators to be flexible and ready to address new threats to the financial system.