EIGHT YEARS AFTER THE FINANCIAL CRISIS: HOW WALL STREET REFORM STRENGTHENED OUR FINANCIAL SYSTEM AND LAID THE FOUNDATION FOR LONG-RUN GROWTH

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Introduction

Eight years have passed since the depths of the financial crisis, and questions of financial stability—and, to some, the importance of financial reform—may seem remote and abstract. But financial stability, and the structures we have put in place to protect it, remain as important as ever to safeguard. In the fall of 2008, panic ensued as the extent of the excessive risk-taking in the financial system became apparent, and credit markets began to seize up. The resulting crisis led to the Great Recession, which profoundly harmed families, businesses, and communities across the country. The damage was visible in boarded-up storefronts on Main Street, stretches of unoccupied housing developments in the Sun Belt, and foreclosure signs in so many of our neighborhoods. Businesses shed more than 8.5 million jobs, the unemployment rate soared to ten percent, and millions of Americans lost their homes and their savings. The costs of financial instability for working people were staggering.

Eight years later, we have made enormous progress. We have cut the unemployment rate in half,[1] and our economy is now ten percent larger than its pre-recession peak.[2] Businesses continue to create jobs at a robust pace, and wage growth is picking up.[3] Though, like many advanced economies around the world, we still face serious challenges

1. Labor Statistics for 2008 and 2016, Bureau of Labor Statistics, http://data.bls.gov/timeseries/LNS14000000 (select "2008" in the From dropdown menu and "2016" in the To dropdown menu).

2. Eric Morath, *The U.S. Economy Is in Great Shape (Compared with its Peers)*, Wall St. J. (June 16, 2016), http://blogs.wsj.com/economics/2016/06/16/the-u-s-economy-is-in-great-shape-compared-to-its-peers/.

3. Luke Kawa, *U.S. Wage Growth is on Pace to Break Records this Decade*, Bloomberg (June 3, 2016), http://www.bloomberg.com/news/articles/2016-06-03/u-s-wage-growth-is-on-pace-to-break-records-this-decade.

related to productivity, shared growth and inequality, we are prepared to tackle them from a position of relative strength. Globally, the U.S. economy is a bright spot.

When my successor as Treasury Secretary travels abroad and meets with other finance ministers and policy makers, he or she will be asked, as I was, how the U.S. economy was able to bounce back more strongly than most other developed economies. In my conversations, I credited first and foremost the resilience of the American people. And I told my counterparts about our strong immediate fiscal policy response;[4] about our efforts to push financial institutions to recognize losses from the crisis and replenish their capital;[5] and about the Federal Reserve's role in providing liquidity and charting an effective monetary policy.[6] But I also told them that our economic rebound had a lot to do with financial reforms that were a structural response to the crisis. Following the crisis, through new laws and new regulations, we fixed what was broken: we restored confidence in our financial system and established a more stable and resilient foundation for our economy. Perhaps most critically, we reoriented our approach to financial regulation from a reactive and inflexible system that regulated piecemeal in response to specific crises to a flexible, forward-looking system focused on carefully monitoring changing financial markets and identifying and addressing emerging risks.[7]

When the crisis hit eight years ago, there had not been a comprehensive review of the financial regulatory system in seventy-five years. Many of the laws that provided the framework for financial activity in our country were established in the wake of the Crash of 1929 and the Great Depression.[8]

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4. *See, e.g.*, FIN. CRISIS INQUIRY COMM., THE FINANCIAL CRISIS INQUIRY REPORT 429 (2011) (describing the federal government's response to the financial crisis).

5. *See, e.g.*, U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-13-71, FINANCIAL INSTITUTIONS: CAUSES AND CONSEQUENCES OF RECENT BANK FAILURES 2–3 (2013); *see also* Ben Bernanke, Chairman, Bd. of Governors of the Fed. Reserve, Statement Regarding the Supervisory Capital Assessment Program (May 7, 2009), https://www.federalreserve.gov/newsevents/press/bcreg/bernankescap20090507.htm.

6. *Credit and Liquidity Programs and the Balance Sheet: Crisis Response*, BD. OF GOVERNORS OF THE FED. RESERVE SYS., https://www.federalreserve.gov/monetarypolicy/bst_crisisresponse.htm (last visited Nov. 1, 2016).

7. FIN. STABILITY OVERSIGHT COUNCIL, FSOC 2016 ANNUAL REPORT 1 (2016), https://www.treasury.gov/initiatives/fsoc/studies-reports/Documents/FSOC%202016%20Annual%20Report.pdf.

8. *See, e.g.*, *Banking Act of 1933, commonly called Glass-Steagall*, FED. RESERVE HISTORY, http://www.federalreservehistory.org/Events/DetailView/25 (last visited Nov. 1, 2016); *The Laws That Govern the Securities Industry: Securities Act of 1933*, U.S. SEC. AND EXCH. COMM'N, https://www.sec.gov/about/laws.shtml#secact1933 (last visited Nov. 1, 2016).

But by 2008, our modern financial system was dramatically different from the one we had in the 1920s and 1930s. The twenty-first century financial system has complex new products, like collateralized debt obligations, credit default swaps, and asset-backed commercial paper; new or newly expanded business structures, like hedge funds, mortgage finance companies, and financial holding companies; and new markets at home and abroad for mortgage-backed securities and swaps. At the same time, the way our financial markets are intermediated has changed significantly, with increased predominance of electronic and algorithmic trading.[9] Our economy and our markets are now more interconnected and globalized than ever before—some of our largest banks operate in over 100 countries,[10] and the flow of capital circles the globe each day in financial centers around the world.

As the financial system expanded and became more complex, regulations failed to move in step with these changes, and instead became more rigid and narrow. By 2008, we were at the end of a more than thirty-year trend of de-regulation, punctuated by ad hoc adjustments to Depression-era protections.[11] Narrow regulatory updates were made to address the specific causes of localized financial tremors, like the savings and loan crisis of the late 1980s.[12] But these improvements came only after crises revealed hidden weaknesses in the system, and they were tailored only to fix the glaring deficiencies that caused the last crisis. The supervision of the U.S. financial sector had too many gaps; no agency had sufficient authority to look after the system as a whole—or financial stability in particular.[13] At the same time, after years of remarkable resilience and economic growth, a

9. *See generally* MKTS. COMM. STUDY GRP., BANK FOR INT'L SETTLEMENTS, ELECTRONIC TRADING IN FIXED INCOME MARKETS at iii (January 2016), http://www.bis.org/publ/mktc07.pdf; *Examining Current Trends and Changes in the Fixed Income Markets: Hearing Before the Subcomm. on Secs., Ins., and Inv. and the Subcomm. on Econ. Pol'y of the S. Comm. On Banking, Hous., and Urban Affairs*, 114th Cong. 3 (2016) (statement of Antonio Weiss, Counselor to the Sec'y, U.S. Dep't of the Treasury), http://www.banking.senate.gov/public/_cache/files/fcb95efe-a7e6-48ee-9559-043e399526eb/979EDB289E2C51F9BA13BF42F6E21F45.041416-weiss-testimony-joint-sii-ep.pdf.

10. *Citi at a Glance*, CITIGROUP, http://www.citigroup.com/citi/about/citi_at_a_glance.html (last visited Nov. 1, 2016).

11. Daniel K. Tarullo, Member, Bd. Of Governors of the Fed. Reserve Sys., Remarks at the Conference on the New Pedagogy of Financial Regulation 2 (Oct. 21, 2016), https://www.federalreserve.gov/newsevents/speech/tarullo20161021a.pdf.

12. *The S&L Crisis: A Chrono-Bibliography*, FED. DEPOSIT INS. CORP., https://www.fdic.gov/bank/historical/sandl/ (last visited Nov. 1, 2016).

13. U.S. DEP'T OF THE TREASURY, A NEW FOUNDATION: REBUILDING FINANCIAL SUPERVISION AND REGULATION 2 (June 2009), https://www.treasury.gov/initiatives/Documents/FinalReport_web.pdf.

complacency developed about the strength of the financial system, allowing too many markets to grow opaque and excessive leverage to build up at too many critical institutions.

Following the collapse of Bear Stearns, Lehman Brothers, and AIG, extraordinary, immediate stabilization measures were required to arrest financial panic. Once President Obama took office, he worked with leaders in Congress to fix the structural weaknesses of our regulatory system and to enact the most far-reaching and comprehensive set of financial reforms since the Great Depression: the Dodd-Frank Wall Street Reform and Consumer Protection Act. Critically, the law not only fixed what was broken in 2008, it also set up mechanisms and institutions to identify and respond to new and emerging risks that could cause different sorts of crises in the future.[14]

Indeed, Wall Street Reform, the full suite of post-crisis reforms undertaken both at home through the Dodd-Frank Act and abroad working with international partners, represents a shift from a system regulating largely in reaction to crisis and focused on specific types of businesses and specific products, to a forward-looking system that is also focused on identifying and regulating risks presented by markets as a whole and by types of activities, no matter where they are conducted and no matter who is conducting them. The Financial Stability Oversight Council (FSOC), one of the pillars of Wall Street Reform, exemplifies this approach. FSOC, which includes federal and state financial regulators and is chaired by the Secretary of the Treasury, focuses on the stability of the financial system as a whole. FSOC was designed to keep our safeguards current, by keeping pace with evolving risks in U.S. financial markets, products, and institutions.[15]

It is vital that we remain vigilant and do not return to the pre-crisis way of doing things. Wall Street Reform is not perfect and, in recent years, Congress has made some smart, targeted adjustments that have strengthened the law. These include clarifying that capital standards for insurance companies should be tailored to the risks of the insurance business. But it would be a grave mistake if technical refinements were to give way to a dismantling of the new forward-looking, flexible approach to regulating the financial sector that Wall Street Reform established. Such sweeping changes would ignore the valuable lessons we learned from the financial crisis. A weakened regulatory framework would put consumers at greater risk of abusive

14. *Wall Street Reform: The Dodd-Frank Act*, THE WHITE HOUSE, https://www.whitehouse.gov/economy/middle-class/dodd-frank-wall-street-reform (last visited Nov. 2, 2016).

15. *See* 12 U.S.C. 5322.

financial practices and the broader economy at greater risk of another devastating, expensive crisis.

I.
We Responded to the Causes of the Crisis

One frequent claim about 2008 is that banks were bailed out but that nothing really changed. On one level, it is true that many of the same major banks in this country continue to provide key financial services to our economy, matching savers to borrowers, facilitating payments from businesses to vendors and from employers to individuals. But how banks operate, who banks serve, and the level of risk banks pose to each other and to the rest of the economy have changed dramatically.

Wall Street Reform addressed many of the specific causes of the crisis: too little capital, risky investment strategies, lack of planning for resolution in the event of distress, opaque derivatives markets, abusive consumer practices, and poor mortgage underwriting standards. Today, our system is stronger, safer, fairer, and more resilient. Banks are funded by roughly twice the capital they had before the crisis.[16] The trading activities of banks are now required to focus on serving their clients rather than speculating for their own benefit.[17] The majority of derivatives are now cleared, traded transparently, and reported to regulators.[18] Large banks are required to have procedures in place for rapid and orderly resolution in the event of their failure to reduce risks to the broader financial system.[19] And every year the Federal Reserve kicks the tires of many of the largest and most complex financial institutions to make sure that they can withstand a severe recession before they are allowed to pay dividends or reduce their capital by even a penny.[20]

16. U.S. Dep't of the Treasury, Dodd-Frank at Six Years: Reforming Wall Street and Protecting Main Street 9 (July 2016), https://www.treasury.gov/connect/blog/Documents/DFA%206%20Year%20Deck.pdf.

17. *See* Press Release, Commissioner Luis A. Aguilar, Statement on the Volcker Rule: Reducing Systemic Risk By Banning Excessive Proprietary Trading With Depositors' Money (Dec. 13, 2013), http://www.sec.gov/News/PublicStmt/Detail/PublicStmt/1370540478214.

18. Timothy Massad, Chairman, U.S. Commodity Futures Trading Comm'n, Remarks at the CCP12 Founding Conference and CCP Forum (June 7, 2016), http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-46.

19. *Resolution Plans*, Bd. of Governors of the Fed. Reserve Sys., http://www.federalreserve.gov/bankinforeg/resolution-plans.htm (last visited Nov. 6, 2016).

20. *See Dodd-Frank Act Stress Tests*, Bd. of Governors of the Fed. Reserve Sys., https://www.federalreserve.gov/bankinforeg/dfa-stress-tests.htm (last visited Nov. 6, 2016).

The new capital requirements for banks are important because banks with insufficient capital tend to withdraw from providing credit. Too often we hear that enhanced capital requirements lead banks to hold back, that higher capital requirements lead to less lending.[21] But the opposite is true: capital is simply the money that shareholders invest in the lending that a bank does. It is precisely because capital is a funding source that it provides a cushion to absorb losses in loan books and trading portfolios.[22] And when banks raise equity from investors or retain earnings, they are increasing the amount that their shareholders are investing in the business of banking. Since 2009, bank shareholders have added another $700 billion of high-quality capital, which is $700 billion more that banks can lend and invest.[23]

Wall Street Reform also addressed risky investment strategies. Before the crisis, the trading revenues of many banks were dominated by risky investments made in pursuit of short-term gains, creating conflicts of interest with their traditional role of facilitating customer trading.[24] And in 2008, the losses in large trading portfolios imperiled the health of the institutions as a whole; the majority of losses at large U.S. bank holding companies were not from traditional loan businesses but from trading and securities businesses and other lines.[25] At independent broker-dealers, the dominance of speculative trading was even more pronounced. For example, Lehman Brothers generated thirty-three percent of its revenue from proprietary trading in 1998;[26] ten years later that activity was responsible for fifty-eight percent of its revenue.[27] Today, as a result of the Volcker Rule, banks have closed their proprietary trading desks, shifting the focus back to serving their clients.[28]

Another driver of the financial crisis was the lack of planning for resolution in the event of distress at large, interconnected financial

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21. *See, e.g.*, Douglas J. Elliot, *Higher Bank Capital Requirements Would Come at a Price*, BROOKINGS, https://www.brookings.edu/research/higher-bank-capital-requirements-would-come-at-a-price/ (last visited Nov. 6, 2016).

22. *Capital Guidelines and Adequacy*, BD. OF GOVERNORS OF THE FED. RESERVE SYS., https://www.federalreserve.gov/bankinforeg/topics/capital.htm (last visited Nov. 6, 2016).

23. Press Release, Bd. of Governors of the Fed. Reserve Sys. (June 29, 2016), https://www.federalreserve.gov/newsevents/press/bcreg/20160629a.htm.

24. FIN. CRISIS INQUIRY COMM., *supra* note 4, at xix-xx.

25. U.S. DEP'T OF THE TREASURY, *supra* note 16, at 11.

26. Stephen Gandel, *Is Proprietary Trading Too Wild for Wall Street?*, TIME (Feb. 5, 2010), http://content.time.com/time/business/article/0,8599,1960565-2,00.html.

27. *Id.*

28. *See* Christina Rexrode, *Citigroup's Last Proprietary Trader Walks Out the Door*, WALL ST. J. (Aug. 18, 2016), http://www.wsj.com/articles/citigroups-last-proprietary-trader-walks-out-the-door-1471527259.

companies. In 2008, when some firms encountered distress, the prospects were dim, and regulators lacked the tools to facilitate a smooth wind down.[29] Now, our largest U.S. banking groups undertake continual resolution planning, maintain living wills and continue to work—in cooperation with regulators—to improve these plans, including by simplifying their legal structures in order to become more resolvable.[30] Dodd-Frank also provided policymakers with a new Orderly Liquidation Authority we did not have during the financial crisis to safely unwind failing, large financial firms, like Lehman Brothers. The FDIC has been creative in designing a framework to ensure the exercise of this emergency tool is effective in a future crisis. Our regulators are also focused on orderly resolution of foreign banks, requiring the largest foreign banks operating here to consolidate their operations under intermediate holding companies that are appropriately capitalized and can be more easily supervised and resolved if needed.[31]

Protecting investors through regulation of the derivatives market was another important aspect of Wall Street Reform. In 2008, the market for over-the-counter derivatives had grown to nearly $600 trillion, and they were traded bilaterally, with no transparency to regulators, leaving market participants and policy makers unable to see or understand the market as a whole.[32] The result was a massive web of opaque interconnections. During the crisis, losses and potential losses from derivatives and uncertainty about the creditworthiness of counterparties led to panic across the market.[33] Highly leveraged banks were pressured to exit positions, exacerbating shocks.[34] Today, thanks to Wall Street Reform, a comprehensive regulatory framework applies to derivatives, and a growing share of contracts are centrally cleared and traded on exchanges or transparent platforms.[35]

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29. INT'L MONETARY FUND, CROSS-BORDER BANK RESOLUTION: RECENT DEVELOPMENTS 1 (June 2, 2014), http://www.imf.org/external/np/pp/eng/2014/060214.pdf.

30. BD. OF GOVERNORS OF THE FED. RESERVE SYS., *supra* note 19.

31. Press Release, Bd. of Governors of the Fed. Reserve Sys. (Feb. 18, 2014), https://www.federalreserve.gov/newsevents/press/bcreg/20140218a.htm.

32. *See generally* MONETARY AND ECON. DEP'T, BANK FOR INT'L SETTLEMENTS, OTC DERIVATIVE MARKET ACTIVITY IN THE SECOND HALF OF 2007 1, 6 (May 2008), http://www.bis.org/publ/otc_hy0805.pdf.

33. FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT 17, 365, 393 (Feb. 2011), https://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf.

34. THE PRESIDENT'S WORKING GRP. ON FIN. MKT., PROGRESS UPDATE ON MARCH POLICY STATEMENT ON FINANCIAL MARKET DEVELOPMENTS 4–5 (Oct. 2008) https://www.treasury.gov/resource-center/fin-mkts/Documents/q4progress%20update.pdf.

35. Massad, *supra* note 18.

As addressed in further detail below, we also took on abusive consumer practices that threatened financial stability. In 2008, abusive lending practices and unclear or non-existent underwriting standards drove the widespread origination of risky mortgages.[36] Fraud and abuse in the mortgage market hurt consumers and investors and also threatened financial stability. Today, new safeguards ban such practices, and the Consumer Financial Protection Bureau (CFPB) ensures that consumers are protected from not only past predatory practices but also those that may arise in the future. The CFPB has put in place new disclosure requirements and other protections, benefiting more than forty-nine million households.[37] In the first quarter of 2016 alone, consumers closed on 1.9 million mortgages and received the CFPB's new disclosure forms.[38] When the CFPB has identified abuses, it has sought restitution for consumers; to date, it has returned $11.7 billion to twenty-seven million consumers harmed by violations of federal consumer financial protection laws.[39]

Because financial contagion does not recognize national borders, we have also been working not just to enhance our own standards, but with partners abroad to strengthen standards around the world. Our work with the Group of Twenty (G20) and with the Financial Stability Board aims to promote strong financial standards, level the playing field for American companies, and avoid a race to the bottom in financial regulation. Over the last few years, we and our global counterparts have succeeded in raising global bank capital, liquidity, and leverage standards;[40] improving the safety and transparency of global derivatives markets;[41] and developing standards and policies to support orderly resolution of cross-border financial institutions.[42] We have also reached global agreement on a framework to increase the total loss-absorbing capacity of large global banks, which will help to avoid

36. FIN. CRISIS INQUIRY COMM'N, *supra* note 33, at 17-18.

37. CONSUMER FIN. PROT. BUREAU, THE CFPB: MAKING CONSUMERS COUNT 3 (2016), http://s3.amazonaws.com/files.consumerfinance.gov/f/documents/07132016_cfpb_Top_5.pdf.

38. *Id.* at 2.

39. *Id.* at 1.

40. BASEL COMM. ON BANKING SUPERVISION, IMPLEMENTATION OF BASEL STANDARDS: A REPORT TO G20 LEADERS ON IMPLEMENTATION OF THE BASEL III REGULATORY REFORMS 4-5 (2016), https://www.bis.org/bcbs/publ/d377.pdf.

41. FIN. STABILITY BOARD, OTC DERIVATIVES MARKET REFORMS: ELEVENTH PROGRESS REPORT ON IMPLEMENTATION (2016), http://www.fsb.org/2016/08/otc-derivatives-market-reforms-eleventh-progress-report-on-implementation/.

42. FIN. STABILITY BD., RESILIENCE THROUGH RESOLVABILITY – MOVING FROM POLICY DESIGN TO IMPLEMENTATION (2016), http://www.fsb.org/2016/08/resilience-through-resolvability-moving-from-policy-design-to-implementation/.

public bailouts in the future.[43] We should continue to lead by example in these international efforts so that financial distress abroad does not undermine growth and financial stability at home.

The value of our approach is already apparent. We witnessed the strength of our system earlier this year, as we faced market volatility stemming from slowdowns in emerging market economies, and over the last several years as we weathered a sovereign debt crisis in Europe.[44] Our financial institutions also showed resilience in the immediate aftermath of the referendum in the United Kingdom on leaving the EU, which caused dramatic price shifts in many markets.[45] Investors have consistently demonstrated greater confidence in U.S. bank stocks than in the stocks of other global systemically important banks (G-SIBs).[46]

The debt markets have also shown that creditors have confidence in the strength of our institutions.[47] When global financial markets experienced significant volatility at the start of 2016, on average major U.S. bank credit-default swaps traded at lower levels than most European and Japanese G-SIBs, and major U.S. banks' share prices fell by substantially less.[48]

II.
OUR NEW SYSTEM IS ABLE TO LOOK AHEAD TO EMERGING RISKS

In 2008, the bare minimum response would have been to surgically fix what was broken and simply try to prevent the same set of events from reoccurring, but our achievement in Dodd-Frank went well beyond that. We reoriented our regulatory approach to help prevent new and different crises from occurring in the future. Yet our regulatory efforts have been consistently underappreciated and now are at risk of being rolled back.

Historically, financial regulations were often developed as patchwork reactions to specific crises, and they targeted specific types of

43. FIN. STABILITY BD., FSB ISSUES FINAL TOTAL LOSS-ABSORBING CAPACITY STANDARD FOR GLOBAL SYSTEMICALLY IMPORTANT BANKS (2015), http://www.fsb.org/2015/11/tlac-press-release/.

44. Press Release, U.S. Dep't of the Treasury, Remarks by Counselor Antonio Weiss at the U.S. Chamber of Commerce Capital Markets Summit (Mar. 16, 2016), https://www.treasury.gov/press-center/press-releases/Pages/jl0384.aspx.

45. Analysis of Bloomberg Data (unpublished research) (on file with the Treasury Department).

46. *Id.*

47. *Id.*

48. *Id.*

legal entities, such as commercial banks or credit unions,[49] and products, such as bank deposits or single-family mortgages.[50] These rules were susceptible to "regulatory arbitrage"—that is, efforts by businesses to circumvent regulation to realize greater short-term profits at the expense of longer-term stability. If, for example, a bank can avoid a rule meant to limit excessive risk exposure in a loan portfolio by moving an investment into an off-balance sheet, special purpose vehicle, then the rule provides the appearance of protecting financial stability without actually doing so.[51]

In many markets, prior to 2008, businesses with different structures or different products grew up in the gaps and around the edges of some of the most important safeguards. For example, we saw growth in the complexity and size of securitization markets without a modernization of the oversight rules to make sure they were safe.[52] Similarly, derivatives products were developed to transfer risks in new ways, but U.S. laws affirmatively barred those products from coming under market-based regulation.[53] And we saw firms such as AIG and Lehman Brothers—which were not banks and therefore lacked effective consolidated prudential supervision—grow rapidly into far-reaching, high-risk businesses with the potential to cause broad financial and economic consequences.[54]

For the last six years, our focus has been on identifying risks presented not only by particular kinds of firms and products, but also by markets as a whole and by particular activities, no matter where

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49. Edward V. Murphy, Congressional Research Service, Who Regulates Whom and How? An Overview of U.S. Financial Regulatory Policy for Banking and Securities Markets 16 (Jan. 30, 2015), https://www.fas.org/sgp/crs/misc/R43087.pdf.

50. *What is a Qualified Mortgage?*, Consumer Fin. Prot. Bureau, http://www.consumerfinance.gov/askcfpb/1789/what-qualified-mortgage.html (last visited Nov. 4, 2016).

51. Jim Brunsden, *Banks' Off-Balance-Sheet Risks Come Under Basel Scrutiny*, Bloomberg (Sept. 29, 2013), http://www.bloomberg.com/news/articles/2013-09-29/banks-face-basel-debt-limit-capturing-off-balance-sheet-risks.

52. The President's Working Group on Fin. Mkt., Policy Statement on Financial Market Developments 1-2 (Mar. 2008), https://www.treasury.gov/resource-center/fin-mkts/Documents/pwgpolicystatemktturmoil_03122008.pdf.

53. *See* Derivatives, U.S. Sec. and Exch. Comm'n, https://www.sec.gov/spotlight/dodd-frank/derivatives.shtml (last visited Nov. 9, 2016).

54. *See* Daniel K. Tarullo, Governor, Bd. of Governors of the Fed. Reserve Sys., Remarks at the Banque de France Conference: Financial Regulation—Stability versus Uniformity; A Focus on Non-bank Actors (Sept. 28, 2015), https://www.federalreserve.gov/newsevents/speech/tarullo20150928a.htm; Press Release, U.S. Dep't of the Treasury, Timothy F. Geither, Secretary, Testimony Before the Financial Crisis Inquiry Commission: Causes of the Financial Crisis and the Case for Reform (May 6, 2010), https://www.treasury.gov/press-center/press-releases/Pages/tg690.aspx.

they are conducted and no matter who is conducting them.[55] This means that if originating mortgages poses risks and raises consumer protection concerns, the same regulation will apply to any mortgage, no matter what type of entity—a national bank, a credit union, or a mortgage finance company—originates the mortgage.[56] Or, in the case of the derivatives market, new rules from the CFTC and the SEC will apply regardless of whether a commercial bank, an independent investment bank, or another type of entity deals in derivatives.[57]

We also are identifying and responding to emerging threats to financial stability by strengthening our financial system as a whole and by taking a bottom-up perspective on customer relationships and consumer needs that helps make our financial system more fair. Our new approach seeks to identify and address new risks to financial stability and to consumers as those risks arise in an ever-evolving financial marketplace.[58] In order to keep pace with changes, we are gathering more data both about the overall strength of financial institutions and about the on-the-ground experiences of consumers of financial products or services—and we are using that information to identify, monitor, and respond to threats on the horizon.[59]

Identifying and Responding to Threats to Financial Stability

FSOC—one of the most significant innovations of Wall Street Reform—is at the heart of our efforts to make sure that we have adequate regulatory oversight in areas of significant risk and keep pace with the evolution of new risks to financial stability. FSOC brings together federal and state regulators to break down barriers between agencies and better monitor the financial system as a whole in order to

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55. *See* MURPHY, *supra* note 49, at 27, 33 (arguing that the Dodd-Frank Act eliminates exemptions for certain over-the-counter derivatives such as Treasury securities).

56. Ability to Repay and Qualified Mortgage Standards Under the Truth Lending Act (Regulation Z), 12 C.F.R. § 1026 (2014).

57. *See generally* U.S. SEC. AND EXCH. COMM'N, *supra* note 53; CFTC Dodd-Frank Act rulemakings, http://www.cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/index.htm; SEC Security-based Swaps rulemakings, U.S. SEC. AND EXCH. COMM'N, https://www.sec.gov/spotlight/dodd-frank.shtml#.

58. *See About FSOC*, FIN. STABILITY OVERSIGHT COUNCIL, https://www.treasury.gov/initiatives/fsoc/about/Pages/default.aspx (Answering questions on how the FSOC will maintain our nation's financial stability) (last visited Nov. 9, 2016); *The Bureau*, CONSUMER FIN. PROT. BUREAU, http://www.consumerfinance.gov/about-us/the-bureau/ (last visited Nov. 5, 2016) (explaining how the CFPB will "protect consumers from unfair, deceptive, or abusive practices and take action against companies that break the law").

59. *Inside the OFR*, OFFICE OF FIN. RESEARCH, https://www.financialresearch.gov/about/ (last visited Nov. 5, 2016).

identify and respond to risks to financial stability.[60] Complementing these efforts, the Office of Financial Research—also created by Dodd-Frank—is tasked with improving our ability to gather and analyze data and spot financial stability concerns.[61]

Wall Street Reform created FSOC and endowed it with a new and crucial tool to promote financial stability—one that no supervisor had prior to the financial crisis: the ability to designate nonbank financial companies for enhanced prudential standards and supervision by the Federal Reserve.[62] Designation allows FSOC to require appropriate supervision for firms—like Lehman Brothers—that emerge on the outskirts of the established regulatory regimes and engage in risky activities without being held to adequate standards.[63]

Allowing FSOC to impose appropriate supervision in the event that nonbank financial companies pose risks to financial stability strengthens the oversight regime by eliminating regulatory gaps between firms that pose comparable risks but have different business structures. At the same time, FSOC has used this tool cautiously, designating just four nonbank financial companies for Federal Reserve supervision and additional regulation.[64] One of those firms is AIG, which nearly failed in 2008.[65] Another of those firms, GE Capital, has since been de-designated by FSOC after changing its business model and greatly reducing its size and complexity.[66]

Designation, however, is just one of the many tools at FSOC's disposal, because different responses are warranted to address different types of risks to financial stability. FSOC is a body designed to identify and respond to a wide range of risks in all corners of our financial system, not simply to analyze a small number of the largest

60. U.S. Dep't of the Treasury, *supra* note 13 ("The Council consists of 10 voting members and 5 nonvoting members and brings together the expertise of federal financial regulators, state regulators, and an independent insurance expert appointed by the President.") (last visited Nov. 9, 2016); 12 U.S.C § 5321-22 (2010) (establishing the Financial Stability Oversight Council).

61. *Inside the OFR*, Office of Fin. Research, https://www.financialresearch.gov/about/ (last visited Nov. 5, 2016); 12 U.S.C § 5342-44 (2010) (establishing up the Office of Financial Research).

62. *Designations*, Fin. Stability Oversight Council, https://www.treasury.gov/initiatives/fsoc/designations/Pages/default.aspx (last visited Nov. 9, 2016); 12 U.S.C § 5323 (2010) (giving the Financial Stability Oversight Council authority to require supervision and regulation of certain nonbank financial companies).

63. *Financial Stability Oversight Council: Nonbank Designations – FAQs*, Fin. Stability Oversight Council, https://www.treasury.gov/initiatives/fsoc/designations/Pages/nonbank-faq.aspx#3 (last updated Feb. 4, 2015).

64. Fin. Stability Oversight Council, *supra* note 62.

65. Fin. Crisis Inquiry Comm'n, *supra* note 33, at 344–45.

66. Fin. Stability Oversight Council, *supra* note 62.

and most complex financial firms.[67] After all, the risks that became apparent in the financial crisis were different from those we faced prior to the crisis, and the risks we see today are different from those we saw during the financial crisis. New risks will emerge as the system continues to evolve, requiring a dynamic and tailored approach.

For example, over the last few years we have seen considerable growth in assets managed through hedge funds and mutual funds; these types of firms are growing more quickly than our largest banks relative to the economy.[68] From 2008 to 2014, the assets under management of the twenty largest asset managers in the United States have grown from around $10 trillion to over $21 trillion.[69] This means that FSOC must consider whether this shift presents a different kind of risk and must be open to policy responses that may be needed to address that risk, even though these firms were not closely associated with the causes of the last crisis.

In looking carefully at questions regarding asset managers, FSOC is taking a closer look at the use of leverage by hedge funds through the creation of an interagency hedge fund working group.[70] While hedge funds have become increasingly important participants in our financial markets, no single regulator has the information necessary to assess fully the financial stability risks they may pose.[71] However, many regulators supervise firms or markets directly affected by hedge funds, including the SEC, the CFTC, and the banking regulators.[72] FSOC is uniquely positioned to bring together regulators to share data, build a coherent picture of potential risks that hedge funds pose, and monitor those risks over time. And if FSOC identifies risks to financial stability in these areas, it will consider what actions can be taken to address them. The creation of the hedge fund working group is consistent with the essential mission laid out in Dodd-Frank, and creating the group in the absence of an imminent crisis is a crucial part of that

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67. 12 U.S.C. § 5322(a) (2010).

68. U.S. Dep't of the Treasury, *supra* note 16 at 12.

69. Towers Watson, The 500 Largest Asset Managers: The P&I/Towers Watson Global 500 Research and Ranking 9 (2015), https://www.towerswatson.com/DownloadMedia.aspx?media=%7BE75A5DE7-5987-429D-87A1-B76EEE8E95D9%7D.

70. Fin. Stability Oversight Council, Update on Review of Asset Management Products and Activities 20, https://www.treasury.gov/initiatives/fsoc/news/Documents/FSOC%20Update%20on%20Review%20of%20Asset%20Management%20Products%20and%20Activities.pdf.

71. *Id.*

72. *Fast Answers: Hedge Funds*, U.S. Sec. and Exch. Comm'n, https://www.sec.gov/answers/hedge.htm (last updated Dec. 4, 2012).

mission.[73] While the inquiry does not presume that action is necessary, the group, like other FSOC efforts, enables the type of data-driven, analytically based decisions that policy makers were not able to make before 2008 and the absence of which contributed to the crisis.[74]

Treasury's commitment to bolstering financial stability goes beyond the work of the FSOC. When Treasury collaborated with the SEC, the CFTC, the Federal Reserve Board, and the Federal Reserve Bank of New York to analyze the disruption of Treasury markets that occurred on October 15, 2014, it became clear that Treasury markets had changed dramatically in response to the rise of algorithmic trading. And in 2015, Treasury issued a request for information seeking public comment on the evolution of Treasury market structure so that market oversight and market resilience could evolve in parallel. As the pace of technological change in our financial markets continues to accelerate, it is crucial that regulators continue this kind of comprehensive monitoring of market structure.

Bolstering and Expanding Consumer Protection

We have been applying the same forward-looking approach that FSOC uses to address system-wide risks to consumer protection. Prior to the crisis, there was no single agency with the tools to protect consumers in the financial marketplace, and the patchwork of consumer rules was too static. The CFPB has the statutory mission to regulate the consumer finance market and the tools to respond to new threats to consumers as they emerge.[75] And it has used these tools effectively in recent enforcement actions. Indeed, its recent enforcement actions against Wells Fargo underscore the ongoing need for the CFPB to fulfill its mission of providing robust consumer protection.[76] A strong consumer watchdog with the ability to protect consumers is critical. As risky and predatory practices evolve and emerge, the financial system can be dangerous for consumers and businesses alike.

Our new approach to consumer protection is a central and effective component of Wall Street Reform because it too is built to look

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73. The White House, *supra* note 14; *See* 12 U.S.C. § 5322.

74. Fin. Stability Oversight Council, *supra* note 70, at 1.

75. *Overview of the CFPB*, Consumer Fin. Prot. Bureau, http://www.consumerfinance.gov/strategic-plan/.

76. *Consumer Financial Protection Bureau Fines Wells Fargo $100 Million for Widespread Illegal Practice of Secretly Opening Unauthorized Accounts*, Consumer Fin. Prot. Bureau (Sept. 8, 2016), http://www.consumerfinance.gov/about-us/newsroom/consumer-financial-protection-bureau-fines-wells-fargo-100-million-widespread-illegal-practice-secretly-opening-unauthorized-accounts/.

ahead at emerging risks. Right now the CFPB is working on establishing rules for significant markets and activities that were not the focus of concern in 2008, but today pose urgent risks to consumers. Take three areas where the CFPB is currently working: debt collection, small dollar lending, and—largely in response to information collected through its innovative Consumer Complaints Database—auto lending. While none of these areas have yet played a role similar to the mortgage market in 2008, the CFPB has identified each as a place where risks to consumers have the potential to undermine economic resilience for families across the United States.

Abusive debt collection practices have been prohibited by statute since 1977.[77] However, until the creation of the CFPB, no federal agency was vested with the authority to regulate debt collection activities and ensure that the statute was properly carried out.[78] The CFPB is now engaged in a multi-year process of issuing regulations governing debt collection, based on an extensive empirical investigation of actual consumer experiences and outcomes.[79]

The CFPB is following a similar approach in its work on auto lending. Here too, it is building new rules from the ground up, investigating the consumer experience and collecting data to determine what major factors contribute to unsuccessful consumer transactions.[80] And just as in its work on debt collection, the CFPB turned to auto lending, in part, because of information collected from consumers and posted online in its Consumer Complaints Database.[81] This database is a leading indicator of areas of potential financial stability and consumer protection concerns and will help regulators identify emerging threats to consumers and to the larger economy.

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77. 15 U.S.C. § 1692 (1977).

78. CONSUMER FIN. PROT. BUREAU, CFPB ANNUAL REPORT: FAIR DEBT COLLECTION PRACTICES ACT 3 (2012), http://files.consumerfinance.gov/f/201203_cfpb_FDCPA_annual_report.pdf.

79. CONSUMER FIN. PROT. BUREAU, STUDY OF THIRD-PARTY DEBT COLLECTION OPERATIONS (July 2016), http://files.consumerfinance.gov/f/documents/20160727_cfpb_Third_Party_Debt_Collection_Operations_Study.pdf.

80. *See, e.g.*, 12 C.F.F. § 1001 (2015) and 12 C.F.F. § 1090 (2015) (defining larger participants of the automobile financing market and defining certain automobile leasing activity as a financial product or service).

81. *See CFPB Proposes New Federal Oversight of Nonbank Auto Finance Companies*, CONSUMER FIN. PROT. BUREAU (Sept. 17, 2014), *http://www.consumerfinance.gov/about-us/newsroom/cfpb-proposes-new-federal-oversight-of-nonbank-auto-finance-companies*; *see also* CONSUMER FIN. PROT. BUREAU, MONTHLY COMPLAINT REPORT: VOL. 12 (June 2016), http://files.consumerfinance.gov/f/documents/Monthly_Complaint_Report_-_June_2016.pdf.

The CFPB also is working to complete a rule on small-dollar lending, to help consumers avoid being trapped in cycles of debt.[82] In targeting this under-regulated area, the CFPB is applying the lessons of 2008 to growing markets. Regardless of the product or the market, the same fundamental principles apply: consumers need to have the information necessary to make a fully informed decision before they borrow, and originators need to evaluate the affordability of a loan before they extend credit.

In carrying out these principles and throughout its consumer protection work, the CFPB has kept an eye towards encouraging innovation. It has recognized that, with adequate safeguards and oversight, new financial technology can improve the lives of consumers. Treasury has played an important role in this space as well, collaborating with the CFPB and other regulators to encourage positive and safe innovation in online marketplace lending, an industry that has potential to broaden access to affordable credit for underserved borrowers and businesses. Our approach in this area, as in others, is at once flexible but rigorous, geared towards striking a balance between supporting promising and safe financial technologies and protecting consumers and small businesses.

Some who are intent on slowing down the critical work of consumer protection seem surprised that the CFPB did not stop after setting new standards for the residential mortgage market—standards implemented to enhance borrower protections while providing industry with more clarity regarding making qualified mortgage loans.[83] Some seem surprised that the CFPB continues to evolve and grow along with the evolution and growth of industry. But those opponents of reform fail to appreciate the objective of Wall Street Reform. The CFPB and its partners are intent on living up to the agency's mission, which is not just to fix what was broken in 2008, but to identify, monitor, and respond to the new risks that emerge over time.[84]

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82. *Consumer Financial Protection Bureau Proposes Rule to End Payday Debt Traps*, CONSUMER FIN. PROT. BUREAU (June 2, 2016), http://files.consumerfinance.gov/f/documents/CFPB_Proposes_Rule_End_Payday_Debt_Traps.pdf.

83. Michael Hiltzik, *Consumer Protection: Why do Republicans Hate the CFPB So Much?*, L.A. TIMES (July 23, 2015), http://www.latimes.com/business/hiltzik/la-fi-mh-cfpb-republicans-20150723-column.html.

84. CONSUMER FIN. PROT. BUREAU, THE CFPB STRATEGIC PLAN, BUDGET, AND PERFORMANCE PLAN AND REPORT 68 (2016), http://files.consumerfinance.gov/f/201602_cfpb_report_strategic-plan-budget-and-performance-plan_FY2016.pdf.

III.
Sustaining and Building on Progress We Made

The United States has a vibrant and creative financial sector that is constantly evolving. The regulatory response that was put in place following the financial crisis created a framework that allows us to keep pace as our system changes, while at the same time never losing sight of the causes of the last crisis and its devastating consequences. Through these efforts, we have helped to build a stable and well-functioning financial system that is promoting growth, creating jobs, and providing credit to consumers and businesses. But for such growth and progress to continue, the regulatory framework must remain intact. The proponents of deregulation are most focused on rolling back precisely the elements of Wall Street Reform that are most forward-looking and agile. A regulatory regime that becomes frozen in time will by its very definition be outpaced by those that seek to arbitrage it. It was only eight years ago that we saw the toll such behavior took on homeowners, on consumers, and on our economy.

Unfortunately, policy makers are often tempted, during times of stability or when an emergency seems either improbable or distant, to roll back regulations, weaken reforms, and reduce oversight. But constraints on FSOC's ability to exercise its authorities—including, for example, its ability to designate nonbank financial companies whose failure could pose risks to financial stability—would only make it harder to identify and respond to risks to financial stability. And proposed changes to the CFPB—whether involving its leadership structure or the way it is funded—risk jeopardizing crucial consumer protections that help the most vulnerable individuals. Weakening these critical new agencies and their missions would have serious consequences, including potentially re-introducing the regulatory arbitrage and predatory practices and products that were at the root of the last crisis.

Those who recognize how far we have come to strengthen both our oversight and our institutions must redouble our efforts to make sure that the U.S. economy is one that works for everyone. This means continuing to work toward a future in which the benefits of economic growth are more widely shared, which requires a sustained focus on financial inclusion. We must work to expand access to safe and affordable transaction, credit, and saving products and services, particularly for underserved individuals and small businesses. And community banks, credit unions, and other mission-oriented financial institutions have an important role that we must preserve and strengthen.

Since 2008, we have raised our standards, while at the same time sustaining job creation and economic growth. In doing so, the United States has become a standard bearer for responsible financial reform. We must maintain this important role by continuing to work with our global counterparts in the G20, the Financial Stability Board, and standard-setting bodies to promote a level playing field around the world for firms and regulatory systems as strong as ours. And at home, there is still work to be done and an affirmative reform agenda that I hope will continue. For example, we must continue our efforts to address compensation practices at large financial firms to discourage inappropriate risk-taking and better align the incentives of executives with those of shareholders, creditors, taxpayers, and customers. Indeed, the conduct at Wells Fargo that led to recent enforcement actions by the OCC and the CFPB underscores the importance of ensuring that incentives are aligned throughout an organization.[85] Additionally, we must fully fund our regulators and give them the tools sufficient to keep pace with changing markets.

In the face of potential challenges to our robust regulatory framework, we must look to the future, while remembering history and remembering the price for a weak regulatory system is paid in the real economy with lost jobs, evicted families, and years of lost growth. Although our financial system has been stable during my tenure as Treasury Secretary, when I gather my team to discuss the latest economic report, when I talk to my international counterparts about global challenges such as Brexit, and when I meet with the heads of our domestic financial regulatory agencies, I am guided by memories of the crisis, and the need to maintain an unwavering focus on financial stability, broad and vibrant economic growth, and consumer financial protection. For it is certain that we will encounter financial and economic challenges in the future, and it is certain that those challenges will not be identical to those we faced in the past. To keep our commitment to financial stability, economic growth, and consumer protection in the coming years, the next administration, the next leaders of our financial regulatory agencies, and our representatives in Congress must maintain that focus, even as the economy continues to grow with the support of a healthy financial system. It is imperative that those invested with the responsibility of governing and regulating

85. CONSUMER FIN. PROT. BUREAU, *supra* note 76; Press Release, Office of the Comptroller of the Currency, OCC Assesses Penalty Against Wells Fargo, Orders Restitution for Unsafe or Unsound Sales Practices (Sept. 8, 2016), https://www.occ.gov/news-issuances/news-releases/2016/nr-occ-2016-106.html.

continue to make sound policy that reflects an understanding of past and future risks, and that they resist the inclination to seek short-term gain at the expense of long-term stability and protection.