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DEPARTMENT OF FINANCIAL INSTITUTIONS
WILLIAM S. HARAF, Commissioner of Financial Institutions
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Statement Upon Release of the Annual Report of the

Financial Stability Oversight Council

William S. Haraf

Commissioner, California Department of Financial Institutions

Member, Financial Stability Oversight Council

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The Financial Stability Oversight Council is charged with identifying threats to financial stability, promoting market discipline and responding to emerging risks to financial stability. Congress recognized the benefit of bringing together a full complement of federal officials along with representatives of state financial regulation to achieve this mission.

The Council's first annual report provides a thorough assessment of risks to the financial system. It describes the risk-mitigating actions taken to date, and it recommends further actions. While substantial progress has been made, more needs to be done.

The first responsibility for managing financial risk rests within the private sector. The crisis revealed corporate governance and risk management weaknesses throughout the financial system, notably among the largest and supposedly most sophisticated institutions. The evidence of excessive risk-taking in the years leading up to the crisis is clear in greater use of leverage, larger, more aggressively managed trading books, increased use of poorly understood structured products, weaker liability structures, concentrations in riskier asset classes, and increased lending to weaker borrowers, both commercial and consumer.

One important lesson of the crisis is that financial institutions must strengthen their risk management capabilities. Corporate boards must understand their risks thoroughly, establish appropriate risk tolerances and properly oversee management. Management

must ensure that their institutions have a risk management framework appropriate for their size, complexity and risk profile and must properly execute against this framework.

During the financial crisis, the resolution scheme that worked for most failed banks in this country, including 36 in my home state of California since the crisis began, was not utilized for the largest firms. Dodd-Frank establishes a new orderly liquidation authority to facilitate resolutions of systemically important institutions. This critical step restores balance and fairness to our financial regulatory system and a fundamental tenet of a capitalistic society – that investors have the opportunity to deploy capital at a very real risk of loss. Although other resolution schemes, including bankruptcy, may achieve a similar result, the status quo was not tenable.

The United States benefits from a large and diverse financial system. Its diversity is, perhaps, its greatest strength. One unintended consequence of the response to the financial crisis was, however, that our largest financial institutions grew even larger as a result of government assisted or encouraged mergers. Concentrations within U.S. financial markets increased significantly, and consequently so did the risks. Dodd-Frank addresses this problem by requiring financial regulators to establish heightened prudential standards for the largest, most systemically important firms. It is essential that these standards are rigorously applied so that these firms internalize the costs their failure would impose on the financial system.

I have been honored to serve as the state bank supervisor representative on the Financial Stability Oversight Council. I would like to thank Treasury Secretary Geithner for establishing a transparent and cooperative approach to the Council's work, and the quality staffs of the Treasury Department and member agencies for their tremendous efforts to move the work of the Council forward. I look forward to working with my colleagues to fulfill the responsibilities Congress conferred on us.