Opening remarks
“The Financial Stability Oversight Council: Can Systemic Risk be Contained?” - October 25, 2010

Welcome to our panel discussion, “The Financial Stability Oversight Council: Can Systemic Risk Be Contained?”

Today’s session is part of a series of public events that the St. Louis Fed is holding on various aspects of the new financial regulatory reform law. Other events have addressed or will discuss:

- resolution authority for large, systemically important institutions;
- the related issue of “too big to fail”;
- the direction and implications of the Bureau of Consumer Financial Protection;
- and mortgage reform and the future of mortgage finance.

We at the St. Louis Fed believe that public education initiatives and events like the one today are important in helping individuals, firms, and financial market participants make the best decisions possible. Macroeconomic policy works best when economic actors understand the policy and its implications for their decisions. Poor economic decisions are often the by-product of incomplete information on this dimension.

The passage of a law as broad and potentially far-reaching as the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 naturally has raised many questions in the minds of business leaders and financial market participants. I think we will hear a lot about those questions today and the uncertainty that has been generated in financial markets.

There is no question that, despite the passage of the legislation, regulatory reform is still far from complete. In particular, and most pressing, there is a considerable rule-writing process that must take place at the agency level. Because the devil is in the details, economic decisions are being affected by the uncertainty surrounding the rule-writing process. I am anxious to learn more from our panel concerning the nature of this uncertainty.

There are many other ways in which the passage of the legislation is only the beginning of regulatory reform. The new Financial Stability Oversight Council is only beginning on the very difficult task of trying to identify—in real time—financial system risks that pose a significant threat to the health of the U.S. economy. The interagency Council is an experiment that faces significant challenges.

One of the most difficult features of systemic-risk identification is that the risk build-up occurs during relatively good economic times. It is more than an uphill battle to convince financial markets, policymakers, and the general public to adopt what may be unpopular, restrictive measures when all seems to be well. For example, the GSEs—Fannie Mae and Freddie Mac—repeatedly claimed that their risk-management systems were modern and sophisticated, more than enough to protect their shareholders and U.S. taxpayers from economic disaster. They were completely wrong. When policymakers, such as my predecessor Bill Poole, warned about the risks the GSEs were taking, only a few were willing to recommend that action be taken to protect the economy from the potential catastrophe. The FSOC will face similar problems. Can the interagency Council come to an agreement on a specific risk and an associated policy action when times are good?

But this is not the only challenge for the Committee. It is also possible to overreact, shutting down a particular financial market practice which in reality does not pose a systemic risk. During the technology boom of the 1990s, many argued that a bubble had formed and that policymakers should address the bubble with appropriate action. Still, I think few would now argue that we would have wished to miss out on the technology boom of the 1990s. Closing off those developments through aggressive policy might have deprived the economy of important advances in productivity. This type of decision-making is familiar to monetary policymakers. Real-time developments are constantly in flux, and policy actions which are either too passive or too aggressive can have dramatic consequences for the economy. The challenge for the FSOC is to develop an approach to systemic risk that can handle—in an interagency setting and in real time—this type of decision-making.

I am anxious to hear the perspectives of our panelists on these issues today. I trust that you will find today's session informative, and I hope that it will guide us as we consider where we as a society need to go next to minimize the consequences of future financial disruptions. Thank-you for listening and enjoy the session.

James Bullard, President and CEO
Federal Reserve Bank of St. Louis