November 2, 2015

RE: Bills that will gut financial reform, helping Wall Street while hurting Main Street

Dear Member of the House Financial Services Committee:

Tomorrow, the House Financial Services Committee will mark up a number of bills that will gut financial reform, unleash Wall Street's too-big-to-fail megabanks and put Main Street jobs, homes and savings at risk of another financial crash. As if all that wasn't bad enough, these misleadingly labeled bills will make future taxpayer funded bailouts much more likely.

For example, four of those bills threaten to eviscerate the Financial Stability Oversight Council (FSOC), one of the most important institutions established by the Dodd-Frank Wall Street Reform and Consumer Protection Act, **as detailed in the attached FSOC Fact Sheet**. FSOC has acted very carefully and deliberatively: of the thousands of non-bank financial institutions in the United States, FSOC has designated only four nonbanks for heightened prudential standards and regulation by the Federal Reserve over the last five years. The FSOC has also proven its crucial importance in facilitating cooperation and communication among the individual financial regulators. The multi-member FSOC has shown that it is capable of narrowly and strategically addressing the gaps in the regulatory structure that existed before the financial crisis and that made things like the collapse of AIG possible.

Yet, even though the FSOC has shown that it has struck the right balance between regulation and financial stability, many in the financial industry have relentlessly attacked it, as if any regulation—no matter how reasonable or measured—is too much regulation. These attacks ignore the public, bipartisan and industry-driven demand for an entity like FSOC during the consideration and passage of Dodd Frank in 2009-2010. Recognizing that the American people do not want financial reform killed or Wall Street de-regulated, FSOC's opponents wouldn't dare try to kill FSOC outright. Instead, they are using these bills to neuter it by falsely claiming to "improve" it.

For example, H.R. 1550 seeks to hamstring the FSOC as it discharges its crucial responsibility of identifying non-bank financial institutions whose failure would threaten the financial stability of the United States by prescribing a series of onerous procedural requirements for the FSOC to follow. H.R. 3340 would neuter the FSOC by choking off its funding. H.R. 3557 would render the FSOC unworkable by effectively transforming it from a manageable 15-member agency into an ungovernable entity. And H.R. 3857 would effectively prevent the FSOC from

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identifying non-bank financial institutions that pose a systemic risk, returning us to the regulatory system we had in 2007 when non-bank institutions like Bear Stearns, Lehman Brothers, and AIG demonstrated that non-bank financial institutions posed some of the greatest risks to financial stability.

The Committee will also mark up H.R. 1309, which would repeal from the law the $50 billion threshold for subjecting the largest bank holding companies to a particularized risk based review to determine if additional regulatory requirements are appropriate. Instead, this bill would require the FSOC to make an individual case-by-case determination about every bank holding company in the US, including the smallest and least dangerous. However, the overwhelming majority of the nation's banks come nowhere near the $50 billion threshold. In fact, less than 40 of the country's largest bank holding companies meet the $50 billion threshold, and, **as detailed in the attached Fact Sheet on the $50 billion threshold**, the Federal Reserve tailors its regulatory requirements to the specific risks that this handful of gigantic institutions pose to the financial stability of the United States. Rather than providing the claimed "regulatory relief" to small banks, H.R. 1309 makes the financial system once again more vulnerable to the systemic risks posed by the country's largest bank holding companies.

The financial reform law is just five years old. This is no time to start rolling back the protections put in place to prevent another crash like 2008. As the Committee marks up the bills tomorrow, we encourage you to carefully consider the facts and the effects that they will have on the dangerous threats posed by high risk finance to the jobs, homes and savings of hard-working Americans on Main Street as well to the financial stability of the United States.

Sincerely,

Dennis Kelleher
President and CEO, Better Markets

Attachments: Factsheet: The Financial Stability Oversight Council
Factsheet: Everything You Need to Know About the $50 Billion Threshold

The Financial Stability Oversight Council Factsheet: Saving Taxpayers from the Next AIG and the Next Crisis

What is the Financial Stability Oversight Council?

The Financial Stability Oversight Council (FSOC) was established in 2010 under the Dodd-Frank Wall Street Reform and Consumer Protection Act. The FSOC is a council of federal and state financial regulators chaired by the Secretary of the Treasury, and its mission is to identify and respond to risks that threaten the financial stability of the United States.

Why was the FSOC created?

The financial crisis demonstrated that there were parts of the financial system beyond the responsibility of any single financial regulator, such as the risk posed by the international insurance company AIG that radiated across the financial system to banks and broker-dealers. The financial crisis also demonstrated that there were systemic risks that cut across the jurisdictions of many financial regulators, such that none of the regulators had a complete understanding of the risks that were building up within and across the financial system.

In the immediate aftermath of the crisis, regulatory experts, academics, and financial market participants pointed out that we needed a single financial regulator or body responsible for policing systemic risk. In fact, politicians and financial industry participants alike testified that one way to prevent such a crisis from happening again was to create such a systemic risk regulator:

- "We must create a systemic risk regulator to monitor the stability of the markets and to restrain or end any activity at any financial firm that threatens the broader market."
  – Henry Paulson, former **Secretary of the Treasury**[1]

- "One of the reasons this crisis could take place is that while many agencies and regulators were responsible for overseeing individual financial firms and their subsidiaries, no one was responsible for protecting the whole system from the kinds of risks that tied these firms to one another."
  – Robert S. Nichols, President and Chief Operating Officer, **Financial Services Forum**[2]

- "I believe an interagency council with a strong authority in a focused area, in this case monitoring and directing the response to risks that threaten overall financial stability, could, like the [National Security Council], serve the Nation well in addressing complex and multifaceted risks."
  – Paul Schott Stevens, President and CEO, **Investment Company Institute**[3]

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1 How to Watch the Banks: New York Times OP-ED (Feb. 15, 2010).

2 Testimony at House Financial services Committee (July 17, 2009).

3 Testimony at Senate Banking Committee hearing (July 23, 2009).

- "A systemic risk regulator that has access to information about any systemically important financial institution – whether a bank, broker-dealer, insurance company, hedge fund or private equity fund – could have the necessary perspective to ensure firms are not exploiting the gaps between functional regulators, or posing a risk to the larger system."
  – Randolph C. Snook, Executive Vice President, **Securities Industry and Financial Markets Association (SIFMA)**[4]

- "The ABA strongly supports the creation of a systemic regulator. In retrospect, it is inexplicable that we have not had a regulator that has the explicit mandate and the needed authority to anticipate, identify, and correct, where appropriate, systemic problems. To use a simple analogy, think of the systemic regulator as sitting on top of Mount Olympus looking out over all the land. From that highest point the regulator is charged with surveying the land, looking for fires. Instead, we have had a number of regulators, each of which sits on top of a smaller mountain and only sees its part of the land. Even worse, no one is effectively looking over some areas. This needs to be addressed."
  – Edward L. Yingling, then President and Chief Executive Officer, **American Bankers Association**[5]

Who are the Members of the FSOC?

The FSOC is designed as a council to facilitate discussion among regulators and to ensure that its information gathering and oversight ability covers all financial markets. Of the FSOC's fifteen members, ten may vote in FSOC proceedings. The FSOC's voting members are:

- the Treasury Secretary, who Chairs the Council;
- the Chair of the Federal Reserve Board of Governors;
- the Comptroller of the Currency;
- the Director of the Consumer Financial Protection Bureau;
- the Chair of the Securities and Exchange Commission;
- the Chair of the Federal Deposit Insurance Corporation;
- the Chair of the Commodity Futures Trading Commission;
- the Director of the Federal Housing Finance Agency;
- the Chair of the National Credit Union Administration Board; and
- an insurance expert appointed by the President and confirmed by the Senate.

The voting members are aided by the non-voting members, who either provide state-level perspectives or conduct research on the issues that the FSOC considers. These non-voting members are, by law, not to be excluded from FSOC meetings, discussions, and deliberations, except when necessary to safeguard supervisory information. They are:

- the Director of the Office of Financial Research;
- the Director of the Federal Insurance Office;
- a state insurance commissioner selected by the various state insurance commissioners;
- a state banking supervisor selected by the various state banking supervisors; and
- a state securities commissioner selected by the various state securities commissioners.

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4 Testimony at House Financial Services Committee (July 17, 2009).

5 Testimony at House Financial Services Committee (Mar. 17, 2009).

6 Financial Stability Oversight Council, *Authority To Require Supervision and Regulation of Certain Nonbank Financial Companies*, 77 Fed. Reg. 21637 (Apr. 11, 2012).

How Does the FSOC Carry out Its Mission?
FSOC was given a number of tools to carry out its mission including:

- Designating systemically important nonbanks or financial market utilities for supervision by the Federal Reserve;
- Making policy and enforcement recommendations to primary financial regulators and the Federal Reserve;
- Collecting information through the Office of Financial Research; and
- Publishing annual reports about systemic risks to the financial system.

In combination, these tools help to ensure that our regulators can monitor, understand, and respond to risks in the financial system, whether those risks revolve around a specific firm or specific product or activity. The most significant of these tools is the ability to designate firms as systemically important.

What is the Designation Process?
Under Section 113 of the Dodd-Frank Act, the FSOC has the authority to designate a nonbank financial company as a nonbank "Systemically Important Financial Institution" (SIFI) if the FSOC finds that "material financial distress at the U.S. nonbank financial company, or the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the U.S. nonbank financial company, could pose a threat to the financial stability of the United States." Before making such a designation, the FSOC is required to consider ten specific factors, plus any other risk-related factors that the FSOC finds appropriate.

To provide a standard method for considering these designations, in 2012 the FSOC released a final rule and interpretive guidance implementing a three-stage process for designating non-bank SIFIs.[6]

- In Stage 1, the FSOC "narrow[s] the universe of nonbank financial companies to a smaller set" by evaluating the size, interconnectedness, leverage, and liquidity risk and maturity mismatch of nonbanks.

- In Stage 2 the FSOC then "conduct[s] a robust analysis of the potential threat that each of those nonbank financial companies could pose to U.S. financial stability," drawing on data from existing public and regulatory sources.

- In Stage 3, the FSOC conducts a more detailed review using information obtained directly from the nonbank financial company. At this point, the FSOC, by a two-thirds vote, may make a Proposed Determination for a nonbank financial company. A firm subject to a Proposed Determination may request a hearing to contest the determination. After the hearing, the FSOC may vote, again by two-thirds, to make a Final Determination.

On February 4, 2015, in response to concerns from Better Markets and others, the FSOC adopted several improvements to its designation process that increased its transparency and public accountability, including providing more information to firms under review earlier in the process.

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Fact Sheet: Everything You Need To Know About the $50 Billion Threshold

Section 165 of the Dodd-Frank Act requires the Federal Reserve (Fed) to establish regulatory standards for bank holding companies with assets greater than $50 billion that are more stringent than those that apply to bank holding companies with fewer assets, which do not pose similar risks to the financial stability of the United States.

Right now, that requirement affects only 38 of the approximately 6,500 banks in the United States.[1] In other words, the $50 billion threshold excludes more than 99% of all U.S. banks from enhanced review by the Fed.

Size of Institution	Number of Institutions
$2 Trillion and Over	2
$1 Trillion to $2 Trillion	2
$500 Billion to $1 Trillion	2
$400 Billion to $500 Billion	2
$300 Billion to $400 Billion	3
$200 Billion to $300 Billion	4
$100 Billion to $200 Billion	14
$50 Billion to $100 Billion	9
$10 Billion to $50 Billion	66
$1 Billion to $10 Billion	Approximately 580
$1 Billion to Below	Approximately 5830

Source: FDIC and Federal Financial Institution Examination Council as of June 30, 2015

Critics of the Dodd-Frank Act are trying to weaken the Fed's supervision of the nation's largest bank holding companies by raising the $50 billion threshold or removing it altogether. They argue that the $50 billion threshold is too broad—even though it applies to only 38 bank holding companies—and that the Fed's requirements are too stringent. But their arguments for changing the $50 billion threshold ignore the fact that the Fed has the discretion to tailor those standards on a sliding scale of risk.

The $50 billion threshold is merely the beginning of the analysis of what the Fed might -- or might not -- require upon a closer look at an institution above the threshold. The Dodd-Frank Act grants the Fed significant discretion in tailoring the prudential standards that apply to these large bank holding companies to take into account their size, complexity, activities and other factors that lead to varying risk profiles among large bank holding companies.

[1] http://www.ffiec.gov/nicpubweb/nicweb/top50form.aspx

Although Section 165(a) of the Dodd-Frank Act requires the Fed to establish "enhanced supervision and prudential standards" for bank holding companies with more than $50 billion assets, the statute also provides the Fed with full discretion in applying other enhanced standards. Most importantly, the law grants the Fed broad discretion to tailor **any** standards that it applies under Section 165(a):

Standards the Fed MUST Apply but MAY Tailor As Part of Enhanced Supervision:	
(i)	Risk-based Capital Requirements and Leverage Limits;
(ii)	Liquidity Requirements;
(iii)	Overall Risk Management Requirements including the Formation of a Risk Committee;
(iv)	Resolution Plan and Credit Exposure Report Requirements;
(v)	Concentration Limits; and
(vi)	Annual Stress Tests.

Standards the Fed MAY Apply and MAY Tailor As Part of Enhanced Supervision:	
(i)	Contingent Capital Requirements;
(ii)	Enhanced Public Disclosures;
(iii)	Limitations on Short-term Debt; and
(iv)	Such Other Prudential Standards as the Board Determines are Appropriate.

The law also gives the Fed the discretion to establish, on its own, a threshold higher than $50 billion for the application of certain enhanced standards:

Standards From Which the Fed May Exempt Entirely Certain Bank Holding Companies Above $50 Billion:	
(i)	Contingent Capital Requirements;
(ii)	Resolution Plan and Credit Exposure Report Requirements;
(iii)	Concentration Limits;
(iv)	Enhanced Public Disclosures; and
(v)	Limitations on Short-term Debt.

The statute gives the Fed an immense amount of flexibility and discretion. Indeed, even as to the standards that the Fed must apply, the statute gives the Fed discretion to determine how to apply each standard.