Support Strong Systemic Risk and Resolution Authority Reform

Financial Stability Improvement Act (H.R. 3996)

Why we need Systemic Risk reform:

- As the current financial crisis-driven job losses show, stable management of systemic risk is important not only to the financial players on Wall Street, but to every American on Main Street.
- The systemic failures that collapsed giant financial institutions last year also compromised the economic security–the jobs, homes and retirement plans–of millions of Americans who did not contribute to the problem.
- Regulating systemic risk is needed to ensure that the moral hazards and risk-taking activities of a handful of firms do not threaten the broader system.

Key elements of strong systemic risk prevention:

- One central authority should be responsible for monitoring and stemming potential systemic risks.
- The systemic risk regulator must have the authority to stop institutions from creating systemic risk by growing to a certain size or complexity, becoming too interconnected, or engaging in excessively risky activities. Particularly, it should have authority to reinstate separations between commercial and investment banking or limit insured depositories' ability to engage in speculative risk-taking.
- Primary authority for systemic risk regulation may be assigned to a council of regulators, a new agency, or the Federal Reserve. If the Fed is given authority to oversee systemic risk, at the same time it must be made more democratic and transparent. Without reform, the Fed will be unlikely to take necessary steps to limit bank activity; it has designed-in conflicts of interest, with banks largely deciding who regulates them.
- The systemic risk regulator must have staff, resources, and expertise sufficient to monitor sources of systemic risk in institutions, products, and activities throughout the financial markets, and it must have the power to act promptly and independently. It also must be fully accountable and transparent to the public.
- Systemic risk and resolution authority are interconnected issues; strong safeguards against systemic risk requires having strong resolution authority.

Why we need new resolution authority:

- Resolution authority is needed so that there is a process for failing bank holding companies – as there currently is for conventional banks – that does not require massive taxpayer bailouts. Currently, the Federal Deposit Insurance Corporation (FDIC) has no authority to take distressed bank holding companies into conservatorship or receivership. This is particularly problematic because bank holding companies (such as Citigroup, recipient of $374 billion in government support) were the main culprits in the risky activities at the heart of the financial crisis.

- Clearly-defined resolution authority will help limit the government's implicit guarantee that it will support failing institutions with taxpayer money.
- In the wake of last year's financial failures, many institutions already considered "too big to fail" have grown bigger by acquiring failing companies, leaving our economy even more vulnerable.
- The Bankruptcy Code's provisions for the distribution of the assets of a bankrupt financial institution take no account of the systemic considerations that regulators can and should consider.
- The status quo severely restricts the ability of the government to prevent the kind of systemic crisis that the failure of a large, interconnected institution can cause.

Key elements of strong resolution authority:

- A sensible approach that ends the current policy of piecemeal bailouts.
- Clear language that resolution is for the purpose of systemic financial stability and not for the purpose of rescuing failing financial companies; i.e.:
  - shareholders should recieve nothing,
  - unsecured creditors other than insured depositors or employees should the bear losses, and
  - management and the Board of Directors responsible for the failed condition of the company should be removed
- Assurance that to the greatest extent possible, the regulating agency responsible for resolution act in a manner that minimizes recourse to the general fund of the Treasury.
- Strong and clearly-defined Systemic Resolution Fund to pay for the costs associated with the resolution process that is financed **<u>only</u>** through assessments on financial companies and **<u>not</u>** by taxpayers. The Systemic Resolution Fund should be funded through ongoing assessments paid by financial institutions who pose a risk due to size or the nature of their activities.
- Systemic risk reform must be in addition to -not a substitute for- active, strong prudential regulation.

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