September 28, 2021

The Honorable Janet Yellen
Secretary of the Treasury
Chair of the Financial Stability Oversight Council

Dear Secretary Yellen:

The undersigned organizations and academics write to urge you to continue to prioritize financial stability in your roles as Treasury Secretary and Chair of the Financial Stability Oversight Council ("FSOC"), and to undo the 2019 SIFI designation guidance as a key part of that commitment.

We applaud the fact that you have already convened FSOC to consider emerging threats to financial stability. However, we also believe that FSOC must swiftly take steps to undo the damage to its critical financial stability authorities inflicted by the previous Administration. In particular, we note with alarm the December 2019 guidance issued by the FSOC creates substantial impediments to designating large nonbank firms as systemically important financial institutions.[1] You, together with former Federal Reserve Chair Bernanke and former Treasury Secretaries Lew and Geithner, wrote a letter to Secretary Mnuchin and Chair Powell opposing this guidance when it was proposed.[2] In the letter, the four of you issued a stark warning to Secretary Mnuchin and Chair Powell:

> "We caution against taking the steps outlined in the proposed guidance. We believe that these steps – in design and in practice – would neuter the designation authority. Though framed as procedural changes, these amendments amount to a substantial weakening of the post-crisis reforms. These changes would make it impossible to prevent the build-up of risk in financial institutions whose failure would threaten the stability of the system as a whole."[3]

The letter provided a compelling explanation of the importance that SIFI designation plays in safeguarding financial stability:

> "We should not need to wait for cracks in the foundation to appear before recognizing that building inspectors must spend more time on the largest and most complex buildings. The overwhelming lesson of our experience in the financial crisis is that uncertainty pervades all decision making, especially when financial risks are developing in real time. Even in the months leading up to the crisis, it was not clear which financial firms were most at risk of failing nor was it clear how the risks from the failure of those firms would impact other financial institutions, financial markets, or the economy as a whole.
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> Although there is a lot that is uncertain about the dynamics of a financial crisis, some things are certain. A fundamental feature of a market oriented, innovative financial system is that – over time – risk will migrate around the prudential constraints that apply to banks, shrinking the effective scope of those defenses, and leaving the overall financial system more fragile. This is what happened in the decade leading up to the crisis, and the failure of prudential regulation to prevent this is a critical reason why the crisis was so severe and challenging to manage."[4]

We agree with your letter, and these concerns remain valid and vital. The repeal of this guidance should therefore be an urgent matter for FSOC.

As you know, the Dodd-Frank Act created the FSOC and included numerous crucial provisions to prevent another financial crisis. The global financial crisis of 2008 wreaked catastrophic damage on the American economy and on American households. That financial crisis devastated middle and low income families in particular, worsened the Black wealth gap, and undermined the country's long term economic growth and job creation. We fear future crises would do the same.

One of the pillars of the Dodd-Frank Act was the power of FSOC to designate certain non-bank financial institutions as systemically important, which would subject them to enhanced prudential regulation and supervision by the Federal Reserve. The 2008 financial crisis demonstrated the urgent need for this type of provision, as the failure or bailouts of numerous large financial institutions that fell outside bank regulation—including Lehman Brothers and AIG—contributed to the severity of the financial crisis.

Unfortunately, the recipients of your letter did not heed your warning and voted to implement their proposal, which effectively eliminated the FSOC's ability to designate large nonbanks as systemically important. This guidance restricts the FSOC's ability to take proactive steps to bring nonbanks under regulation and supervision now and in the future.[5] Other actions taken by FSOC and its member agencies during the Trump Administration underscored and exacerbated the recklessness of this 2019 FSOC decision.

> *First,* during the Trump Administration, the FSOC voted to "de-designate" all of the remaining "systemically important financial institutions"—AIG and Prudential—that had been designated during the Obama Administration.[6] It also dropped its appeal in a case in which MetLife convinced a federal district judge to overturn the designation of that conglomerate.[7]
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> *Second*, the Federal Reserve has still not finalized a comprehensive prudential regulatory framework to govern the risk-taking of a nonbank designated as systemically important by the FSOC eleven years after the Dodd-Frank Act.
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> *Third*, the federal financial regulators who are members of FSOC rolled back and diluted important prudential rules—including provisions implemented under the Dodd-Frank Act—that serve as bulwarks against financial crises.[8] This deregulation and stripping of protections against financial crises continued and even accelerated in 2020, as the pandemic raged and disrupted the American economy and devastated the lives and livelihoods of many Americans.

While this deregulation occurred, the Treasury Department and Federal Reserve intervened for the second time in 12 years to provide hundreds of billions of dollars in support to financial markets, actions which benefited many nonbank financial institutions immensely. Since then, risk-taking in financial markets by nonbank financial institutions has increased dramatically. Speculation has driven massive price rises and volatility in SPACs, cryptocurrency, NFT, corporate debt, real estate, and other markets.

The experiences of 2008 and 2009 taught us that we need tools to prevent financial crises at the ready rather than wait for risks to metastasize and have bailouts presented as the only option. Even if you may not think that designating any particular nonbank as a systemically important financial institution is warranted at the current moment, we believe it would be a grave mistake not to act now both to undo the guidance and create a workable designation process that mitigates systemic risk so as to have this tool available to FSOC when it is needed. The 2019 guidance must be repealed.

Best regards,

Americans for Financial Reform Education Fund

20/20 Vision

350.org

Arthur E. Wilmarth, Jr., Professor Emeritus of Law, George Washington University

Better Markets

Center for American Progress

Climate Finance Action

Croatan Institute

Daniel Schwarcz, Professor of Law, University of Minnesota

Hilary J. Allen, Professor of Law, American University

Jeremy Kress, Assistant Professor of Business Law, University of Michigan Ross

Patricia A. McCoy, Professor of Law, Boston College

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[1] Financial Stability Oversight Council, "Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies," 84 Federal Register 71,740 (Dec. 30, 2019) *available at* https://home.treasury.gov/system/files/261/Authority-to-Require-Supervision-and-Regulation-of-Certain-Nonbank-Financial-Companies.pdf (last visited Sept.16, 2021).

[2] https://int.nyt.com/data/documenthelper/887-bernanke-geithner-lew-yellen-letter/a22621b202dfcb0fe06e/optimized/full.pdf#page=1 (last visited Sept. 16, 2021). *See also* Alan

Rappeport, *Former Top Financial Regulators Warn Against Move to Ease Oversight of Firms*, N.Y. Times at B3 (May 13, 2019) *available at* https://www.nytimes.com/2019/05/13/us/politics/financial-regulation-trump-administration.html (last visited Sept. 16, 2021).

[3] https://int.nyt.com/data/documenthelper/887-bernanke-geithner-lew-yellen-letter/a22621b202dfcb0fe06e/optimized/full.pdf#page=1 (last visited Sept. 16, 2021).

[4] *Id.*

[5] *See* Gregg Gelzinis, 5 Priorities for the Financial Stability Oversight Council, Center for American Progress (Mar. 31, 2021) *available at* https://www.americanprogress.org/issues/economy/reports/2021/03/31/497439/5-priorities-financial-stability-oversight-council/ (last visited Sept. 16, 2021).

[6] Financial Stability Oversight Council, "Notice and Explanation of the Basis for the Financial Stability Oversight Council's Rescission of Its Determination Regarding American International Group, Inc. (AIG)," September 29, 2017, *available at* https://home.treasury.gov/system/files/261/American%20International%20Group%2C%20Inc.%20%28Rescission%29.pdf (last visited Sept. 16, 2021); Financial Stability Oversight Council, "Notice and Explanation of the Basis for the Financial Stability Oversight Council's Rescission of Its Determination Regarding Prudential Financial, Inc. (Prudential)," October 16, 2018, *available at* https://home.treasury.gov/system/files/261/Prudential%20Financial%20Inc%20Rescission.pdf (last visited Sept. 16, 2021).

[7] Pete Schroeder, MetLife, *U.S. Regulators Agree to Set Aside Legal Fight*, Reuters (Jan. 18, 2018) *available at* https://www.reuters.com/article/us-usa-metlife-fsoc-idUKKBN1F8064 (last visited Sept. 16, 2021).

[8] As one example, for deregulatory actions taken by the Federal Reserve *see* Americans for Financial Reform, Fact Sheet: Deregulation at the Powell Fed (Aug. 6, 2021) *available at* https://ourfinancialsecurity.org/2021/08/fact-sheet-deregulation-at-the-powell-fed/ (last visited Sept. 16, 2021).