Americans for Financial Reform
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May 27, 2011

Financial Stability Oversight Counsel
Attention: Mr. Lance Auer
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

Re: Notice of Proposed Rulemaking – Authority to Designate Financial Market Utilities as Systemically Important (RIN 4030-AA01)

Dear Mr. Auer:

American for Financial Reform ("AFR") appreciates this opportunity to comment on the Notice of Proposed rulemaking that addresses the processes and procedures for designating certain Financial Market Utilities ("FMU"s) as systemically important. AFR is a coalition of over 250 national, state, local groups who have come together to advocate for reform of the financial sector. Members of the AFR include consumer, civil rights, investor, retiree, labor, religious and business groups along with prominent economists and other experts.

This NPR details the procedures and methodologies required by Section 804 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "DFA") which empowers FSOC to identify and designate systemically important FMUs.

An FMU is defined as:

> any person that manages or operates a multilateral system for the purposes of transferring, clearing or settling payments, securities, or other financial transactions among financial institutions or between financial institutions and that person.

"Systemically important" is defined in Section 8 of the DFA as a situation in which:

> the failure of or the disruption to the functioning of a financial market utility or the conduct of a payment, clearing, or settlement activity could create, or increase, the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the financial system of the United States.

Once an FMU is designated as systemically important it will be subject to enhanced supervision by the Federal Reserve ("Fed"). The Fed will then have increased prudential oversight powers in coordination with an entity's chartering and supervisory authority, including examination and rule enforcement. The Fed is also authorized to provide liquidity in certain “unusual and exigent circumstances” through the Fed’s discount window.

FMUs are the infrastructures that facilitate a broad range and vast number of financial transactions, including retail payments, bank wires, paper check clearing, debit and credit cards, and securities trading in interbank, multilateral, clearinghouse, and person-to-person payments. Trillions of dollars of transactions are processed by American FMUs every day.

FMUs are designed to protect not only financial and commercial firms, but households and consumers. They are at the heart of any smoothly operating economy and help ensure confidence essential to participation. The provisions of Section 8 of the DFA wisely seek to establish a precautionary regime of prudential supervision to supplement existing often overlapping regulations that may not directly address overall systemic concerns.

The FMU designation rules and process

This Proposed Rules address the the factors and procedure the FSOC will use in performing the critical task of designating systemically significant FMUs for enhanced Federal Reserve supervision. The five general factors outlined in Section 804 of the Dodd-Frank Act for assessing the systemic importance of an FMU include:

1) the aggregate monetary value of transactions processed;
2) the aggregate exposure of FMU’s to counterparties;
3) the interactions of the FMU with other FMU’s or other market participants;
4) the effect of a failure or disruption of an FMU on critical markets, financial institutions or the broader market; and finally,
5) any other factors that FSOC deems appropriate

The Proposed Rules contain a thoughtful discussion of these and related criteria for designation, and do add more specificity to the general categories given in the Dodd-Frank Act. However, they fall short of providing a specific set of metrics for determining systemic significance. This may to some degree be appropriate in light of the need for regulatory flexibility, it makes it difficult to assess the overall adequacy of these designation rules.
As discussed above, Section 8 of the Dodd-Frank Act (and Section 1320.2 of the Proposed Rule) defines systemically important with respect to:

> “a situation where the failure of or a disruption to the functioning of a financial market utility could create, or increase, the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the financial system of the United States.”

The likelihood of such a situation depends in part on aggregate metrics of size, liquidity, and exposure, but also on interactions and interconnections across the entire financial system. It is unclear whether the Council has the data infrastructure in place to measure all of these interconnections as yet. Some form of assumption-driven scenario testing will be necessary to determine whether an FMU is systemically significant.

In performing such scenario testing, we would particularly caution against the use of purely historical data. During periods of financial stress we should assume a heightened volume and value of transactions that would not be reflected in the historical data sets. When building scenarios to stress test the data care needs to be taken to avoid reliance on historically based statistical analysis, such as traditional Value at Risk analysis. A high impact low probability event is likely to be the largest threat to our FMUs and is not likely to be picked up by VAR analysis.

AFR agrees with the comment from Better Markets that the appropriate standard here is one similar to that used by the Federal Reserve Board in its proposed rules on financial market utilities: "extreme but plausible market conditions."[1] The Proposed Rules should provide that this criterion be applied in order to evaluate systemic importance, by assuming that extreme but plausible market conditions exist and then determining the impact of the disruption of an FMU during such conditions.

As noted above, these Proposed Rules do not contain specific metrics that could be applied to determine exactly which FMUs the Council will designate. Given the difficulty of measuring the full range of systemic interconnections it may take some time to make such metrics practical. Given this, we would urge the FSOC to move ahead and rapidly use its authority to designate those FMUs that clearly do meet the test of systemic significance laid out in the Dodd Frank Act. Any designation procedure that does not rapidly bring these entities under prudential supervision does not fulfill the intent of the Dodd-Frank Act in protecting financial market infrastructure. Such entities include:

- Major central counterparty clearing houses such as the Chicago Mercantile Exchange and the clearing entities of the Intercontinental Exchange.

- The Depository Trust & Clearing Corporation, which reports that it serviced securities valued at almost $34 trillion as of 2009.

- Large credit card systems such as Visa and Mastercard.

- Arrangements for clearing tri-party repurchase agreements at Bank of New York Mellon and JP Morgan Chase. These banks serve as collateral agent for, and regularly provide intra-day credit for approximately $1.7 trillion average aggregate volume of repurchase agreements and their systemic significance was clearly demonstrated during the 2008 financial crisis.[2]

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[1] 176 FR 18445.
[2] Federal Reserve Bank of New York, White Paper – Tri-party Repo Infrastructure Reform, March 17, 2010; Task Force On Tri-party Repo Infrastructure Payments Risk Committee Report, March 17, 2010.

- CLS Bank which reports that it settles 58 percent of the $4 trillion per-day forex swap market.[3]

- The Clearing House which operates CHIPs, reported to facilitate more than $1.5 trillion per day of inter-bank wire transfers.[4]

- Global custody banks including Bank of New York Mellon, State Street and JP Morgan Chase, which collectively are reported to have almost $59 trillion in assets under management.[5]

Some of these institutions can already be seen to have systemic significance due to experiences in the 2008 financial crisis. One example is triparty repo clearing arrangements, which experienced severe stress during the 2008 financial crisis. Banks involved in these arrangements ultimately had to access the Fed discount window and special Federal Reserve facilities that were set up to provide liquidity support. As stated by the Federal Reserve's Payments Risk Committee:[6]

> "The potential for the tri‑party repo market to cease functioning, with impacts to securities firms, money market mutual funds, major banks involved in payment and settlements globally, and even to the liquidity of the U.S. Treasury and Agency securities, has been cited by policy makers as a key concern behind aggressive interventions to contain the financial crisis."

Finally, we support the flexibility permitted to the FSOC under the fifth designation criteria in the DFA as this enables these designation criteria to be reviewed and updated as payment systems evolve and future risks to our financial system arise from areas we may not be contemplating now. Payment systems are one of the most dynamic areas of our economy and are a hotbed of innovation. But with innovation and new types of payments, particularly in the on-line payments arena, come new risks that we need to protect against. The discretion granted by the DFA helps to ensure that the designation process keeps pace and remains relevant to FMU supervision.

As new and more complex financial products are developed with new and unforeseen risks associated with them, it is critical that these risks be identified and quantified and their potential impact on FMUs estimated as part of the designation process. FSOC discretion should build on the risks identified as part of the review process outlined in Section 112 of the DFA, where FSOC is required to identify and publish its assessments of potential emerging threats to the financial stability of the United States on an annual basis. These identified risks should be used to inform and define new factors that capture the risks and threats specific to FMUs.

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[3] See: www.cls-group.com/SiteCollectionDocuments/CLS%20market%20share%20Feb%202011.pdf
[4] See: www.chips.org/about/pages/033738.php
[5] See: www.chips.org/about/pages/033738.php
[6] Task Force On Tri-party Repo Infrastructure Payments Risk Committee Report, March 17, 2010

In sum, we believe that the focus by the Federal Reserve and the FSOC on the systemically important FMUs underpinning the financial system is essential to ensuring we can identify, anticipate and if necessary contain any future financial crises. In designating FMUs, we would strongly encourage the FSOC to look beyond purely historical data and use a standard of "extreme but plausible market conditions". We would also strongly favor the FSOC rapidly using its authority to designate those FMUs, which are clearly systemically significant.

Thank you for the opportunity to comment on this Proposed Rule. If you have any further questions, please contact Marcus Stanley, AFR's Policy Director, at marcus@ourfinancialsecurity.org or (202) 466-3672.

Sincerely,

Americans for Financial Reform

Following are the partners of Americans for Financial Reform.

All the organizations support the overall principles of AFR and are working for an accountable, fair and secure financial system. Not all of these organizations work on all of the issues covered by the coalition or have signed on to every statement.

- A New Way Forward
- AARP
- AFL-CIO
- AFSCME
- Alliance For Justice
- Americans for Democratic Action, Inc
- American Income Life Insurance
- Americans United for Change
- Campaign for America's Future
- Campaign Money
- Center for Digital Democracy
- Center for Economic and Policy Research
- Center for Economic Progress
- Center for Media and Democracy
- Center for Responsible Lending
- Center for Justice and Democracy
- Center of Concern
- Change to Win
- Clean Yield Asset Management
- Coastal Enterprises Inc.
- Color of Change
- Common Cause
- Communications Workers of America
- Community Development Transportation Lending Services
- Consumer Action
- Consumer Association Council
- Consumers for Auto Safety and Reliability
- Consumer Federation of America
- Consumer Watchdog
- Consumers Union
- Corporation for Enterprise Development
- CREDO Mobile
- CTW Investment Group
- Demos
- Economic Policy Institute
- Essential Action
- Greenlining Institute
- Good Business International
- HNMA Funding Company
- Home Actions
- Housing Counseling Services

- Information Press
- Institute for Global Communications
- Institute for Policy Studies: Global Economy Project
- International Brotherhood of Teamsters
- Institute of Women’s Policy Research
- Krull & Company
- Laborers’ International Union of North America
- Lake Research Partners
- Lawyers' Committee for Civil Rights Under Law
- Move On
- NASCAT
- National Association of Consumer Advocates
- National Association of Neighborhoods
- National Community Reinvestment Coalition
- National Consumer Law Center (on behalf of its low-income clients)
- National Consumers League
- National Council of La Raza
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National People’s Action
- National Training and Information Center/National People’s Action
- National Council of Women’s Organizations
- Next Step
- OMB Watch
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO
- Progress Now Action
- Progressive States Network
- Poverty and Race Research Action Council
- Public Citizen
- Sargent Shriver Center on Poverty Law
- SEIU
- State Voices
- Taxpayer’s for Common Sense
- The Association for Housing and Neighborhood Development
- The Fuel Savers Club
- The Leadership Conference on Civil and Human Rights
- The Seminal
- TICAS
- U.S. Public Interest Research Group
- United Food and Commercial Workers
- United States Student Association
- USAction
- Veris Wealth Partners
- Western States Center
- We the People Now

- Woodstock Institute
- World Privacy Forum
- UNET
- Union Plus
- Unitarian Universalist for a Just Economic Community

Partial list of State and Local Signers

- Alaska PIRG
- Arizona PIRG
- Arizona Advocacy Network
- Arizonans For Responsible Lending
- Association for Neighborhood and Housing Development NY
- Audubon Partnership for Economic Development LDC, New York NY
- BAC Funding Consortium Inc., Miami FL
- Beech Capital Venture Corporation, Philadelphia PA
- California PIRG
- California Reinvestment Coalition
- Century Housing Corporation, Culver City CA
- CHANGER NY
- Chautauqua Home Rehabilitation and Improvement Corporation (NY)
- Chicago Community Loan Fund, Chicago IL
- Chicago Community Ventures, Chicago IL
- Chicago Consumer Coalition
- Citizen Potawatomi CDC, Shawnee OK
- Colorado PIRG
- Coalition on Homeless Housing in Ohio
- Community Capital Fund, Bridgeport CT
- Community Capital of Maryland, Baltimore MD
- Community Development Financial Institution of the Tohono O'odham Nation, Sells AZ
- Community Redevelopment Loan and Investment Fund, Atlanta GA
- Community Reinvestment Association of North Carolina
- Community Resource Group, Fayetteville A
- Connecticut PIRG
- Consumer Assistance Council
- Cooper Square Committee (NYC)
- Cooperative Fund of New England, Wilmington NC
- Corporacion de Desarrollo Economico de Ceiba, Ceiba PR
- Delta Foundation, Inc., Greenville MS
- Economic Opportunity Fund (EOF), Philadelphia PA
- Empire Justice Center NY
- Enterprises, Inc., Berea KY
- Fair Housing Contact Service OH
- Federation of Appalachian Housing
- Fitness and Praise Youth Development, Inc., Baton Rouge LA
- Florida Consumer Action Network

- Florida PIRG
- Funding Partners for Housing Solutions, Ft. Collins CO
- Georgia PIRG
- Grow Iowa Foundation, Greenfield IA
- Homewise, Inc., Santa Fe NM
- Idaho Nevada CDFI, Pocatello ID
- Idaho Chapter, National Association of Social Workers
- Illinois PIRG
- Impact Capital, Seattle WA
- Indiana PIRG
- Iowa PIRG
- Iowa Citizens for Community Improvement
- JobStart Chautauqua, Inc., Mayville NY
- La Casa Federal Credit Union, Newark NJ
- Low Income Investment Fund, San Francisco CA
- Long Island Housing Services NY
- MaineStream Finance, Bangor ME
- Maryland PIRG
- Massachusetts Consumers' Coalition
- MASSPIRG
- Massachusetts Fair Housing Center
- Michigan PIRG
- Midland Community Development Corporation, Midland TX
- Midwest Minnesota Community Development Corporation, Detroit Lakes MN
- Mile High Community Loan Fund, Denver CO
- Missouri PIRG
- Mortgage Recovery Service Center of L.A.
- Montana Community Development Corporation, Missoula MT
- Montana PIRG
- Neighborhood Economic Development Advocacy Project
- New Hampshire PIRG
- New Jersey Community Capital, Trenton NJ
- New Jersey Citizen Action
- New Jersey PIRG
- New Mexico PIRG
- New York PIRG
- New York City Aids Housing Network
- NOAH Community Development Fund, Inc., Boston MA
- Nonprofit Finance Fund, New York NY
- Nonprofits Assistance Fund, Minneapolis M
- North Carolina PIRG
- Northside Community Development Fund, Pittsburgh PA
- Ohio Capital Corporation for Housing, Columbus OH
- Ohio PIRG
- OligarchyUSA
- Oregon State PIRG
- Our Oregon
- PennPIRG
- Piedmont Housing Alliance, Charlottesville VA
- Michigan PIRG
- Rocky Mountain Peace and Justice Center, CO

- Rhode Island PIRG
- Rural Community Assistance Corporation, West Sacramento CA
- Rural Organizing Project OR
- San Francisco Municipal Transportation Authority
- Seattle Economic Development Fund
- Community Capital Development
- TexPIRG
- The Fair Housing Council of Central New York
- The Loan Fund, Albuquerque NM
- Third Reconstruction Institute NC
- Vermont PIRG
- Village Capital Corporation, Cleveland OH
- Virginia Citizens Consumer Council
- Virginia Poverty Law Center
- War on Poverty - Florida
- WashPIRG
- Westchester Residential Opportunities Inc.
- Wigamig Owners Loan Fund, Inc., Lac du Flambeau WI
- WISPIRG