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FOR FINANCIAL REFORM
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February 25th, 2011

The Honorable Timothy F. Geithner
Chairperson
Financial Stability Oversight Council
c/o Lance Auer
1500 Pennsylvania Avenue, N.W.
Washington DC 20220

Re: 12 CFR Part 1310/ RIN 4030-AA00 Authority To Require Supervision and Regulation of Certain Nonbank Financial Companies

To Chairman Geithner:

On behalf of Americans for Financial Reform, thank you for the opportunity to comment on the proposed rule implementing Section 113. Americans for Financial Reform is an unprecedented coalition of more than 250 national, state and local groups who have come together to reform the financial industry. Members of our coalition include consumer, civil rights, investor, retiree, community, labor, religious and business groups as well as Nobel Prize-winning economists.

In September, 2008, a liquidity crisis in the shadow banking system led to seizure in the American and world economies. This system had grown so large that it provided more credit than the regulated banking sector. Because shadow banking, including money market funds, insurance companies, hedge funds and other finance companies fell outside the purview of prudential regulators, authorities were both blind to the specific systemic threats, and ill equipped to respond to the resulting repercussions of the liquidity crisis.[1]

Section 113 of the Dodd-Frank Wall Street Reform and Consumer Protection Act provides the tools to prevent another such calamity. Specifically, Section 113 authorizes the Financial Stability Oversight Council (FSOC) to require that nonbank financial firms that "could" pose a systemic risk be supervised by the Board of Governors of the Federal Reserve System and be subject to prudential standards in accordance with Title I of Dodd-Frank. Aggressive use of this authority is critical to the prevention of another financial crisis.

The FSOC is the only entity in the Dodd-Frank regulatory framework that is charged with oversight of the financial system as a whole, especially the interconnections and relationships that may escape the notice of regulators with more circumscribed, non-systemic responsibilities.

[1] For a description and taxonomy of the shadow banking system, see Poszar, Zoltan et. al. "Shadow Banking", Federal Reserve Bank of New York Staff Report Number 458, July 2010.

As the financial system evolves, inevitably leading to innovations not contemplated by the Act, it is the FSOC that will be responsible for understanding implications for systemic risk and initiating remediation.

We urge the FSOC to adopt a "metric-plus-judgment" standard for determining whether a nonbank financial institution "could" pose a systemic risk and therefore face heightened scrutiny. That is, rather than leave unquantified the various categories of size, interconnectedness, risk, and contagion to be applied -- as the proposed rule provides --we urge the application of bright line thresholds that will automatically trigger coverage. FSOC should retain the latitude in authority to designate firms that are not automatically triggered for designation through a model. Metrics help guard against industry capture or politicization of regulatory oversight, while the preservation of latitude in exercising judgment empowers agencies to monitor firms that may attempt to "fly" below the thresholds of those metrics.

We believe it is critical that the FSOC maintain oversight of the entire financial system, particularly emerging non-bank financial institutions not previously subject to prudential oversight by other regulators. Dodd-Frank authorizes the Office of Financial Research (OFR) at the FSOC to monitor transaction data and request information from all non-bank financial entities, whether or not they have been designated for increased prudential supervision by the Federal Reserve. The FSOC must advantage this power energetically to develop a comprehensive understanding of the entire financial sector.

The language of Dodd-Frank emphasizes an obligation to exercise wide latitude in designating firms, with expansive powers; the Act calls for designating any company that "may" or "could" pose a systemic threat.

Nonbank financial firms should not be deemed exempt from designation simply because they are overseen by a regulatory authority such as state insurance regulator or the Securities and Exchange Commission. [2] Thus, companies that may pose systemic significance should be designated for Federal Reserve oversight concurrent with other regulatory oversight. Because of the substantial flexibility given to FSOC in determining prudential requirements, this need not be burdensome. In addition, to avoid gaming of the 85/15 rule governing whether a firm is predominantly financial, affiliates and subsidiaries should be evaluated independently of a parent or holding company when the Council assesses their systemic risk.

We generally support the range of qualitative and quantitative standards put forward in the Proposed Rule. Data gathered by the Office of Financial Research will be central to development of metrics used to identify potential systemic risks. Some firms deserve strong consideration for immediate designation, such as those who received emergency assistance early in the financial crisis of 2008, a prima facie indicator. Other firms prominent in the 2008 crisis who remain a potential systemic risk by virtue of their size and interconnection can be named immediately.

[2] For example, the resolution plans, credit exposure reports, and stress tests required in Section 165 of the Dodd/Frank act specifically address the designated company's interconnections across the entire financial system and the systemic risks that these interconnections could create.

I. The Act's Text and Purpose Require a Low Threshold for Systemic Designation.

A. The phrases "may pose a threat" and "could pose a threat" dictates a low threshold for designation.

First, the plain text of Dodd-Frank prescribes low thresholds for designation. Section 112(a)(2)(H) of the bill charges the FSOC with designating supervision of non-bank financial companies that "may pose a threat" to financial stability. Section 113 provides for designation of nonbank financial companies that "could pose a threat" to financial stability.[3] The operating standard triggering designation is contained in the words "may", "could" and "threat." Words such as "may" or "could" mean the possibility or conditional possibility; the unqualified word "threat" constitutes a low threshold in contrast to other sections of the Act that discuss "significant" or "grave" threats.[4]

That is, if there is a realistic, albeit hypothetical, chance that a firm could cause a threat to the financial stability of the United States on account of its current or possible size, activities, or interconnectedness, then it should be designated for supervision by the Federal Reserve.

The Supreme Court has considered the meaning of the word "could" as it pertains to a regulatory prerogative, and its analysis controls here. In Federal Energy Regulatory Comm'n v. Martin Exploration Management Co., 486 U.S. 204, 209–10 (1988), the Court upheld the plain meaning of "could," overruling a lower court's attempt to translate it into the unconditional "will" in a natural gas pricing test.

Two aspects of Martin are particularly significant: First, the Supreme Court held that the plain meaning of "could" controls. This meant that a mere possibility must be considered. Second, the Supreme Court specifically rejected the approach of responding ad hoc to current market realities. It held that the term "could" required a *per se* rule based on what was merely possible, not what was currently true. Applied to this context, Martin requires FSOC to designate firms that could, hypothetically, pose a threat to financial stability—not just firms that will do so or are likely to do so.

Inverting the question, FSOC should consider what non-bank financial firms it can confidently say "could not" pose a threat to broader financial stability. Other firms should be designated.

B. The structure and purpose of the Dodd-Frank Act reinforce the plain meaning of Section 113.

Viewed in light of the Act's overall structure and purpose, we believe low thresholds should trigger designation 113.

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[3] 12 U.S.C. § 5323(a)(1) (emphasis added).

[4] cite

First, the Act makes clear that designation is not—and should not become—a draconian measure that applies only to relatively risky nonbank financial companies. Designation should not be a "scarlet letter." The Act directs regulators to ensure that small changes in a firm do not result in "sharp, discontinuous changes in the prudential standards established under section165."[5] If firms are not designated until they already pose substantial risk, then designation will trigger heightened prudential standards that inherently will be "sharp" and "discontinuous" in contrast to the firm's immediate prior standards.

Other provisions of Dodd-Frank demonstrate that designation under Section 113 should serve as a low-level, simple gateway into a broader regime of supervision and prudential regulation. Designation places a firm into a discretionary regime of "progressive regulation" —supervision and prudential standards that increase as a firm grows in size, complexity, interconnectedness, or other factors. The Federal Reserve is given very broad discretion to determine exactly how these prudential requirements change according to the characteristics of each individual firm.[6] Such broad discretion is not logical unless the authors of the legislation envisioned a wide range of companies being placed under supervision, including those that might be smaller and posed only a potential threat as opposed to a major threat.

Further, if firms are designated only after they already pose a threat, then it may be too late for "early" remediation. Designation qualifies firms for a range of other key authorities, such early remediation or "grave threat" interventions.

Oversight by another regulatory should not obviate the systemic designation decisions. Oversight by another regulator might instead affect the exact prudential standards the firm is required to follow once it is designated. (E.g. a firm already receiving substantial prudential oversight from another regulator might not have as stringent standards applied as a less regulated firm). Regulators should exercise discretion in the exact standards they apply to a firm once it is designated.

In sum, to come under the Fed's supervision, we believe a firm's current size, activities, and interconnectedness may present even a very low-level of potential threat. That is the gateway into a discretionary supervision, regulation, and other authorities that will heighten as a firm grows larger and more interconnected. For many firms, this may result in little additional oversight.

Furthermore, given the restrictive definition of "nonbank financial company" pursuant to the 85/15 rule (the "Vitter amendment"), affiliates and subsidiaries should be evaluated independently of a parent or holding company when the Council assesses their systemic risk.

II The Act Requires The FSOC to Monitor the Entire Non-Bank Financial Sector, Including Those Firms Not Designated for Enhanced Supervision

[5] cite – 115(b)(3)(B); also 165(B)(3)(b)

[6] See Section 165(a)(1) of the Dodd-Frank Act, which simply requires that the prudential standards "increase in stringency" as the firm grows, and Section 165(a)(2) which grants regulators broad discretion to differentiate among companies based on characteristics of each individual firm.

We believe the FSOC should consider the financial services market expansively. Section 112(a)(2)(C) of the Dodd-Frank bill requires the FSOC to "monitor the financial services marketplace in order to identify potential threats to the financial stability of the United States". This duty clearly refers to the entire financial services marketplace, not simply to firms designated for enhanced prudential supervision. Other duties and purposes of the FSOC discussed in Section 112 – such as identifying and responding to emerging threats to the financial stability of the United States, and identifying non-bank financial companies that may pose a threat to financial stability – clearly require regular monitoring of the entire financial system and all of its various interconnections.

Dodd-Frank empowers the FSOC with the necessary tools to perform such monitoring through the Office of Financial Research (OFR). Dodd-Frank authorizes the OFR to collect data and reports from "any financial company", not simply designated companies.[7] In addition, the OFR is charged with collecting financial transaction data to monitor interconnections within the financial system.

It is important that the FSOC use the authority of the OFR to regularly monitor the entire financial system, including those non-bank financial firms who may not have been designated for enhanced supervision [until such time as the OFR is stood-up/operational]. Such monitoring can be used to develop metrics and indicators of emerging threats to financial stability.

III. Standards For Designation

We generally approve the broad range of standards for designation that are discussed in the rule. The proposed rule includes many of the elements that must be considered in assessing the systemic risk posed by a financial firm, and sets out a conceptual framework for weighing these standards. We commend the FSOC's zeal to commence oversight of nonfinancial firms and urge rapid action to designate those firms whose size and significance makes them a clear potential threat to financial stability. However, establishment of more informed metrics that could serve as a "bright-line" rule requires more careful consideration than can be generated in the 45 days of a comment period. In addition, the measurement of interconnectedness and systemic risk is a new and highly complex area in which good metrics are still being developed.[8] The Office of Financial Research is not yet operating and has not yet been staffed. Consequently, we ask that the FSOC adopt the rule with a provision that it will be amended within one year with the inclusion of stated metrics that are developed in consultation with the Office of Financial Research. We further urge that these criteria be updated periodically, as emerging market developments and innovations will inevitably introduce new hazards.

[7] Section 154(b)(B)(1) of the Dodd-Frank Act.

[8] See e.g. the October 19, 2009 testimony of Professor Andrew Lo before the House Financial Services Committee, in which he stated: "the increased complexity and connectedness of financial markets is a relatively new phenomenon that requires a fundamental shift in our linear mode of thinking with respect to risk measurement. Small perturbations in one part of the financial system can now have surprisingly large effects on other, seemingly unrelated, parts of that system."

In addition, for this preliminary rule we recommend that the FSOC also include as one potential standard for designation the receipt by a non-bank financial institution of major Federal assistance during the financial crisis of 2008. This recent event is the one of the clearest indicators of whether an institution actually was systemically significant during a real period of market stress. The receipt of significant assistance during the early phase of the crisis during September and early October 2008 should be seen as especially important, as the institutions that were helped on an emergency basis were seen as a greater threat to financial system stability than the smaller institutions who were able to access programs once they were opened more broadly. The FSOC should also pay close attention to institutions who received broad Federal guarantees of the value of their assets or liabilities, not simply those who received cash. For example, very early in the crisis, in September 2008, the U.S. Treasury guaranteed a floor value for the liabilities of money market funds.[9] This shows that these institutions were considered systemically important.

For this reason, a limited number of firms, such as General Electric Capital Corporation and GMAC (Ally), as well as certain insurance companies such as Prudential Financial, Inc. and Met Life Inc., AIG, and certain large private equity firms and hedge funds, merit obvious and immediate consideration for designation. Other candidates for inclusion may require more deliberate examination.

The nation will remain vulnerable to another systemic breakdown with the attendant macroeconomic consequences that we have seen before and to taxpayer funded bailouts once again unless and until a credible designation regime is implemented.

Thank you again for this opportunity to comment on this NPR. If you have the further questions, please contact David Arkush, director, Public Citizen at (202) 546-5130; or Heather McGhee, Director of the Washington Office of Demos at (202) 559-1543 ext. 105, Co-chairs of the AFR Systemic Risk and Resolution Authority Taskforce.

Sincerely,

Americans for Financial Reform

[9] See "Treasury Announces Temporary Guarantee Program For Money Market Funds" , Press Release, United

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 for Fairness in Lending
- Americans United for Change
- Calvert Asset Management Company, Inc.
- 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

States Treasury, September 29, 2008, available at http://www.treasury.gov/press-center/press-releases/Pages/hp1161.aspx .

- 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
- 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