



Americans for Financial Reform
1629 K St NW, 10th Floor, Washington, DC, 20006
202.466.1885

May 20, 2014

Dear Representative:

On behalf of Americans for Financial Reform, thank you for the opportunity to comment regarding today's hearing on "Examining the Dangers of the FSOC's Designation Process and its Impact on the U.S. Financial System.", as well as the associated legislation HR 4387, the "FSOC Transparency and Accountability Act".¹ We are concerned that the direction of this hearing, as well as the changes made in HR 4387, could undermine the ability of our financial regulatory system to respond the kind of risks that led to the loss of trillions of dollars and millions of U.S. jobs in the financial crisis of 2008.

The 2008 financial crisis revealed grave weaknesses in the U.S. system of financial regulation and oversight. Many of these weaknesses were related to the fragmented and divided nature of our regulatory apparatus, which no longer reflected the reality of the modern financial system. After the Gramm Leach Bliley Act repealed the last vestiges of the Glass-Steagall divisions between banking, insurance, and trading markets, the financial system became highly interconnected, allowing for the rapid transfer of risk between insurance companies, commercial banks, broker-dealers, and large hedge funds.² Problems emerging in any one of these sectors can easily impact the others, and if the risks involved are large enough they can threaten the stability of the entire financial system. But even as the financial system grew more unified, our regulatory system continued to rely on over a half a dozen separate and siloed financial regulators that often did not share information and failed to spot critical emerging risks.

This problem clearly made a direct contribution to the financial crisis of 2008 and its disastrous impact on the U.S. and world economy. Commercial and investment banks transferred hundreds of billions of dollars in mortgage risk to an insurance company, AIG, escaping the supervision of banking and securities regulators. AIG eventually received the largest government bailout in U.S. history. Broker-dealers which were not commercial banks, such as Bear Stearns, Lehman Brothers, Morgan Stanley, and Goldman Sachs, were at the center of the Wall Street network

¹ Americans for Financial Reform is an unprecedented coalition of more than 200 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, faith based and business groups.

² See Billio, Monica & Getmansky, Mila & Lo, Andrew W. & Pelizzon, Lioriana, 2012. "[Econometric measures of connectedness and systemic risk in the finance and insurance sectors](#)," [Journal of Financial Economics](#), Elsevier, vol. 104(3), pages 535-559.

that created and distributed the ‘toxic assets’ central to the crisis. Hedge funds were also key intermediaries in the distribution and structuring of these toxic assets.³ The failure of a single money market mutual fund, the Reserve Primary Fund, triggered a massive run on prime money funds followed by a government bailout of the entire sector, which is a crucial part of the asset management industry. Of course, the nation’s largest commercial banks were also central to the crisis, ranging from the failed Washington Mutual to ‘too big to fail’ entities such as Bank of America and Citibank, which were rescued by the Federal government.

In the Dodd-Frank Act, Congress took a measured approach to addressing the problem of the fragmentation of the regulatory system. The Dodd-Frank Act eliminated only one financial regulator (the Office of Thrift Supervision). Other financial regulators were directed to coordinate their efforts through a joint committee, the Financial Stability Oversight Committee (FSOC), which has a new research arm (the Office of Financial Research, or OFR) dedicated to gathering information and performing analyses that track risks in the financial system as a whole. Based on the input of all participating financial regulators, as well as data gathered by the OFR, the FSOC has the power to designate large non-banks that play a crucial role in the financial system for heightened prudential oversight by the Federal Reserve.

The question of exactly which non-banks should be designated as systemically significant is a complex and institution-specific question. AFR has no current position on whether, for example, any asset manager should be designated for oversight. However, given the central role of non-banks in both the financial crisis and in the modern financial system, the general need for a designation power is clear. Furthermore, the role of the FSOC and OFR in scrutinizing the financial sector for emerging risks, including gathering the necessary information to do so, should not be controversial at all. Without such a central point for the gathering and analysis of data, the fragmentation of our regulatory system could lead to a repetition of past failures to ‘connect the dots’ of financial risk.

In this context, we are concerned about some criticisms of the OFR and FSOC that appear to target these entities for simply pursuing their investigative mission. For example, a recent report on asset management issued by the OFR, at FSOC’s request, takes no stand on designation or even on regulation of any asset manager, but simply points out areas in which risks may potentially exist and additional information is needed.^[1] The report identifies data gaps that should be addressed to evaluate these potential risks; we think the argument for further data collection and study is clear. Specific questions that the report does not fully address due to lack of data - and certainly mischaracterizations of the report - should not be deployed as arguments to undermine the FSOC and OFR’s basic function of examining financial sector risk.

³ For one example, see, Eisinger, Jesse and Jake Bernstein, “[The Magnetar Trade: How One Hedge Fund Helped Keep the Housing Bubble Going](#)”, ProPublica, April 9, 2010.

We are likewise deeply concerned regarding the changes proposed to the functioning of the FSOC in HR 4387. This legislation would more than double the number of members of the FSOC, by making all members of commissions or boards that serve on the FSOC full members of the committee. Since the FSOC already has ten members, such a dramatic expansion is likely to make it even more unwieldy. We are also concerned that the various ‘open meeting’ proposals in HR 4387 may not be appropriate. AFR supports transparency in the operations of the FSOC, and it is possible that some transparency-related changes may be warranted. But the extremely broad provisions in this legislation appear fundamentally incompatible with the operations of an entity that must make use of confidential financial information in order to be effective.

A key lesson of recent financial crises is that the financial regulatory system must follow function and not form. Entities must be regulated according to their actual activities, not according to their nominal labels. Institutions not previously thought to be systemically significant such as Long Term Capital Management, Bear Stearns, Lehman Brothers, and the American International Group have experienced spectacular failures that reverberated throughout the financial system in unpredictable ways. This was due to the lack of understanding of key activities these entities were engaged in. While the current management of global non-bank financial entities will always hasten to assure us that their own activities pose no such risk, the truth is that activities will always be motivated by profit potential. As regulatory oversight of major banks increases, the risk exists that key banking activities may migrate to non-banks. To the extent that hedge funds, money market funds, insurance companies, or other financial market actors are engaged in activities that have the potential to trigger broader financial system instability, those activities should be monitored, analyzed and, if necessary, regulated.

The title of this hearing is “Examining the Dangers of the FSOC’s Designation Process and its Impact on the U.S. Financial System.” The real danger lies not in FSOC’s designation process but in the possibility that our fragmented regulatory system will once again fail to spot emerging risks to financial stability and fail to protect American families from the multi-trillion dollar consequences of a major financial disruption. Congress must avoid interfering in the efforts of FSOC and OFR to collect data essential to analyzing potential systemic risk. Discussion of such risks with the public should be encouraged, not discouraged. Finally, financial institutions must be regulated based on what they actually do, not what they are called. If their activities pose systemic threats, regulators must have the ability to act.

Thank you for your consideration. For more information please contact AFR’s Policy Director, Marcus Stanley 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
- AFL-CIO
- AFSCME
- Alliance For Justice
- American Income Life Insurance
- American Sustainable Business Council
- Americans for Democratic Action, Inc
- 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
- Center for Effective Government
- 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
- Home Defender's League
- 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
- Lawyers' Committee for Civil Rights Under Law
- Main Street Alliance
- Move On
- NAACP
- 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 Council of Women's Organizations
- National Fair Housing Alliance
- National Federation of Community Development Credit Unions
- National Housing Resource Center
- National Housing Trust
- National Housing Trust Community Development Fund
- National NeighborWorks Association
- National Nurses United
- National People's Action
- National Urban League
- Next Step
- OpenTheGovernment.org
- Opportunity Finance Network
- Partners for the Common Good
- PICO National Network
- 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
- UNITE HERE
- 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

List of State and Local Affiliates

- 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
- Empowering and Strengthening Ohio's People (ESOP), Cleveland OH
- 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
- New Yorkers for Responsible Lending
- 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

Small Businesses

- Blu
- Bowden-Gill Environmental
- Community MedPAC
- Diversified Environmental Planning
- Hayden & Craig, PLLC
- Mid City Animal Hospital, Pheonix AZ
- The Holographic Repatterning Institute at Austin
- UNET

