AMERICANS FOR FINANCIAL REFORM
ACCOUNTABILITY ★ FAIRNESS ★ SECURITY

Americans for Financial Reform
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November 2, 2015

Dear Representative,

On behalf of Americans for Financial Reform, we are writing to express our opposition to HR 1550, HR 3340, HR 3557, and HR 3738.[1]

All of this legislation would dramatically weaken the ability of the Financial Stability Oversight Council (FSOC) and the Office of Financial Research (OFR) to identify and act to control emerging risks in our evolving financial system. Not only does this legislation undermine the ability of regulators to control risks in our financial system, it would benefit only the global financial mega-firms the FSOC was created to designate, not local community banks.

The FSOC and OFR were created as a direct response to crucial weaknesses in the regulation of non-bank financial entities that were revealed during the 2008 financial crisis, a crisis that cost the American people trillions of dollars and millions of jobs. Over the years prior to the financial crisis, the financial system became more highly interconnected, allowing for the rapid transfer of risk between insurance companies such as AIG, commercial banks, broker-dealer investment banks such as Goldman Sachs, 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. Yet many of these entities were not properly regulated for systemic risk. And even as the financial system grew more deeply interrelated, our regulatory system was deeply fragmented, relying on over a half a dozen separate and siloed financial regulators that often did not share information and failed to spot critical emerging risks.

In the Dodd-Frank Act, Congress took a measured approach to addressing the fragmentation of the regulatory system. The Dodd-Frank Act eliminated only one financial regulator (the Office of Thrift Supervision). Nine other financial regulators were directed to coordinate their efforts to address threats to the financial system through a new joint council, the FSOC. To assist the FSOC in its work and also to serve as an early warning system regarding emerging financial

[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. A list of coalition members is available at http://ourfinancialsecurity.org/about/our-coalition/

[2] See for example Billio, Monica & Getmansky, Mila & Lo, Andrew W. & Pelizzon, Loriana, 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.

risks, the legislation also created the OFR, which has the mandate of informing the public and regulators regarding emerging risks through independent risk research and oversight.

Based on the input of all ten participating financial regulators, the FSOC has the power to designate large non-banks that play a crucial role in the financial system for heightened oversight by the Federal Reserve. Given the central role of non-banks in both the financial crisis and in the modern financial system, the general need for such a designation power is clear. As shown in the attached table, the FSOC designation process includes many steps and numerous opportunities for companies under consideration to gain information and to contest a proposed designation.

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. 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 and the creation of another disastrous financial crisis, with potentially disastrous consequences for our economy.

HR 1550 would add numerous additional red tape obstacles to the already cumbersome and time-consuming process which the FSOC must use to designate large non-bank financial entities for increased oversight. As shown in the attached table, this process already includes ten distinct major steps and numerous opportunities for appeal, and typically takes some two years to complete. HR 1550 micromanages the FSOC designation process in ways that would at least double the time required for designation of a large non-bank entity. The new procedural requirements in HR 1550 could also permit a large financial firm that is skilled at manipulating the process to delay increased regulatory oversight for a far longer period. It would provide giant global financial firms numerous opportunities to use insider lobbying and the courts to delay or prevent actions that banking regulators are attempting to take to safeguard economic stability.

For example, at an early point in the designation process, before the FSOC had obtained detailed information regarding a company’s operations, HR 1550 would require the Council to identify ‘with specificity’ its basis for believing that the company posed a threat to financial stability. But prior to gathering information regulators will likely be unable to lay out this basis ‘with specificity’. The designation process already requires the regulators to provide evidence and arguments for their concerns at multiple points, and allows financial mega-firms many opportunities to contest these. Clearly such an identification could be challenged by the company or its primary regulator. Prior to designation, HR 1550 would also require the FSOC to consider a company-proposed reorganization plan to address specific risks identified by the FSOC. The legislation would require the FSOC to assume that the company would be able to successfully implement the reorganization plan. The FSOC would also be required to permit revision of such a plan in response to criticism, and grant the company at least a year in which to implement it. These requirements alone would add years to the designation process.

HR 1550 would also fundamentally change the nature of the FSOC designation process. Currently, the standard for FSOC designation in Section 113(a)(1) of the Dodd-Frank Act is whether material financial distress at a large non-bank financial company could pose a threat to the financial stability of the United States. HR 1550 would effectively add to this standard a requirement that the FSOC list specific identified risks (beyond instability created by the failure of the company) and work with the company to alter such risks. This would involve the FSOC in effectively the micromanagement of the company's structure and organization, based on a detailed prediction of future events during a period of financial distress. This requires the FSOC to perform, without sufficient resources or authority, the kind of oversight that is more suited to a specific primary regulator such as the Federal Reserve to do after designation is complete. FSOC is a council of regulators that was not created as a primary financial regulator. The FSOC mandate is simply to judge whether a company's financial distress could create financial stability risks. The much more involved and complex regulatory task created by HR 1550 would also create additional 'gotcha' opportunities for legal challenge to FSOC decisions.

HR 3340 would eliminate the independent funding for the Financial Stability Oversight Commission (FSOC) and its research arm, the Office of Financial Research (OFR), subjecting the budget for these agencies to the appropriations process. All banking regulators, including the great majority of members of the FSOC, have independent funding in order to shield them from the inappropriate political influence of well-funded Wall Street special interests. Removing this protection from the FSOC and OFR would facilitate special interest manipulation of crucial decisions on the oversight of financial risk.

HR 3340 also requires that the OFR solicit public comment through a formal notice and comment period prior to issuing reports on financial risk. This requirement would inappropriately limit the OFR's independence. It is vital that the OFR be able to present independent findings and conclusions on an expeditious timeline to keep up with a swiftly changing environment. Once the reports are published all actors – regulators, regulated institutions, and the public can respond.

HR 3557 would burden FSOC operations in ways that would make the Council almost impossible to manage. HR 3557 would almost triple the number of voting members of the Council from 10 to 26. It would also impose excessive and unprecedented access requirements that would permit over a hundred additional elected officials, political appointees, and staffers to participate in any FSOC or FSOC-related meeting, including any meeting involving representatives of FSOC member agencies. These measures would damage FSOC's practical ability to function, and indeed the ability of any financial regulatory agency to effectively coordinate with other financial regulatory agencies, in a manner that is far out of proportion to any transparency benefits gained.

A 2012 General Accounting Office examination of the FSOC includes a number of sensible suggestions concerning transparency, including the release of closed meeting transcripts after a suitable time period has passed and/or suitable redactions have been made.[3] AFR believes this recommendation deserves serious consideration. Another possibility for improving transparency would be reconsidering the list of information types that trigger closure of an FSOC meeting. While some reasons for closing a meeting are appropriate, others may be overly broad.

However, by vastly expanding the number of political appointees, elected officials, and staffers with access to closed FSOC meetings, HR 3557 takes a very different approach. The legislation would make all appointees to financial regulatory boards or commissions that are on the FSOC full voting members of the Council. This would almost triple the number of voting FSOC members, from the current ten to as many as twenty six. In an even more significant change, HR 3557 would massively expand the number of elected officials, political appointees, and staffers who could participate in a Council meeting, or in ***any*** meeting of representatives of FSOC member agencies. First, any FSOC member would be allowed to include any of their staff in any FSOC meeting, or in any meeting involving representatives of FSOC member agencies. Second, any member of the House Financial Services Committee or the Senate Banking Committee could attend and participate in any FSOC meeting, and the staff of these committees could attend and participate in any meeting involving representatives of FSOC member agencies.

These changes would open any FSOC or FSOC-related meeting to well over a hundred additional individuals. Even informal planning or technical meetings between the staff of different Federal financial regulatory agencies could be flooded by dozens of individuals who might be unfamiliar with the work being done or opposed to it because of their closeness to particular regulated institutions who are large-scale spenders on campaigns and on lobbying. These requirements would make it extraordinarily difficult for the FSOC and its member agencies to do the critical work of coordinating financial regulatory efforts and sharing necessary information about risks to the financial system. Like other bills referenced in this letter, it would increase still further the outsize influence of financial mega-firms.

HR 3738 would inappropriately limit the independence of the Office of Financial Research by requiring the OFR to give detailed advance notice of its research and analysis work plans to the public, including the dates and topics of all work meetings, to make public the nature and results of all its consultations with primary financial regulators, and to give public notice and comment before release of any study. This is a level of reporting that far exceeds that required of other agencies which have actual regulatory authority. Its effect would be to give large financial entities with an interest in the outcome of OFR research an opportunity to lobby every detail of OFR research work and to inappropriately influence the outcome of OFR research before the agency had even arrived at its findings. Requirements to publicly release the outcome of formerly private consultations with other financial regulators would also have a severe chilling effect on the ability of financial regulators to cooperate and share their views on financial risk.

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[3] General Accounting Office, "Financial Stability: New Council and Research Office Should Strengthen the Accountability and Transparency of Their Decisions", GAO-12-866, September 11, 2012.

The OFR does not have any direct regulatory authority and its purpose is to inform the public and the financial regulatory community. The Office is meant to be an impartial research arm that has the freedom to make independent calls on emerging financial risks. Should any person or entity wish to contest OFR findings, they are completely free to do so during the public debate after the OFR releases its work product. It is totally inappropriate to require the OFR to essentially give industry interests a playbook for how to influence its work, including the opportunity to identify and lobby working groups engaged in private discussions before they have shared the information necessary to do their work.

The financial sector already has an enormous lobbying, access, and power advantage over the public at large in shaping financial regulation. If we are to have any hope of adequately responding to the risks and dangers in the system, we need the FSOC and OFR to have appropriate protections from special interest influence. All of these bills would instead reduce the ability of these offices to identify and respond to financial risk in an unbiased manner and create more ways for large financial firms to obstruct and delay needed regulatory action.

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

STEPS IN CURRENT FSOC DESIGNATION PROCESS FOR NON-BANK FINANCIAL COMPANIES	
Step 1: Public data screen of all companies.	Compare publically available information on financial companies to pre-specified thresholds.
Step 2: Selection of individual company for further review ('Step 2')	If a company that passes the initial public data screen requires further review, FSOC staff begin review of publicly available information on individual company.
Step 3: Inform individual company FSOC staff are reviewing relevant data	Company selected for Step 2 review is notified; no action by company is needed at this stage.
Step 4: Determine if company merits further in-depth analysis based on requesting private data from company ('Step 3')	FSOC staff determine whether to begin in-depth investigation of company under consideration. Involves discussion of business model and/or exchange of data.
Step 5: FSOC may proceed to Proposed Determination.	FSOC may advance a Proposed Determination of selected company. A Proposed Determination requires a two-thirds majority of the Council, including the Treasury Secretary.
Step 6: Send notice to company.	A private explanation is sent to company.
Step 7: Opportunity for company challenge.	If the company wishes to challenge a Proposed Designation, it receives a confidential hearing with the FSOC to argue the challenge.
Step 8: Final Determination of company.	FSOC votes on whether to issue a final designation. Designation requires two-thirds majority, including the Treasury Secretary.
Step 9: Opportunity for company appeal.	A designated company may appeal a final designation to U.S. District Court, which has the power to overturn the designation.
Step 10: Continuing review of designation.	Each final designation must be reviewed on an annual basis by the FSOC and may be overturned by a two-thirds vote of the Council.