Statement of the U.S. Chamber of Commerce

ON: Financial Stability Oversight Council Nonbank Designations

TO: United States Senate Committee on Banking, Housing, and Urban Affairs

BY: Center for Capital Markets Competitiveness, U.S. Chamber of Commerce

DATE: March 14, 2019

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The U.S. Chamber of Commerce ("the Chamber") created the Center for Capital Markets Competitiveness (CCMC) to promote a modern and effective regulatory structure for capital markets to fully function in a 21st Century economy. A key aspect of efficiency of the financial system is ensuring transparency and due-process as it relates to the Financial Stability Oversight Council and the identification and regulation of systemic risk. As the Senate Committee on Banking, Housing, and Urban Affairs holds a hearing entitled "Financial Stability Oversight Council Nonbank Designations," the Chamber would like to share its views regarding:

1. **Concerns with Designation of Nonbank Financial Firms as Systemically Important**
2. **Recent Actions Taken by the Financial Stability Oversight Council**
3. **The Financial Stability Oversight Council Improvement Act of 2019**

Concerns with Designation of Nonbank Financial Firms as Systemically Important

The Chamber has consistently raised concerns regarding entity-based approaches to identifying and regulating systemic risk in the United States and international forums. The Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") established the authority for the Financial Stability Oversight Council ("FSOC") to designate nonbank financial firms as systemically important and subject them to enhanced prudential standards by the Federal Reserve Board of Governors ("Federal Reserve"). The Chamber has argued that this designation authority under Section 113 of the Dodd-Frank Act is a blunt tool that that has harmed the efficiency of our capital markets and not improved the ability of the U.S. to mitigate systemic risk.

The Chamber strongly supports the repeal of Section 113 of the Dodd-Frank Act.[1] Furthermore, the Chamber has advocated against designations of nonbank financial firms as systemically important.[2] As long as Section 113 remains in place, the

[1] Hirschman, D. T. (n.d.). Review of Financial Stability Oversight Council determination and designation processes pursuant to the Presidential Memorandum for the Secretary of the Treasury of April 21, 2017 [Letter written August 15, 2017 to U.S. Secretary of the Treasury, Steven T. Mnuchin]. Available at http://www.centerforcapitalmarkets.com/wp-content/uploads/2019/01/CCMC-Comment-on-FSOC-SIFI-Designation-Process-Aug-2017.pdf

[2] *See generally* Letter from Tom Quaadman, Center for Capital Markets Competitiveness, to the Bd. of Governors of the Fed. Reserve Sys. (Feb 2, 2015) (offering comments on the Application of Enhanced Prudential Standards and Reporting Requirements to General Electric Capital Corporation), available at https://www.federalreserve.gov/SECRS/2015/February/20150224/R-1503/R-1503_020215_129875_536678533422_1.pdf

authority it grants FSOC should not be used until all other options have been explored and found impracticable or insufficient, and unless FSOC can show that designating a nonbank would mitigate a threat to U.S. financial stability effectively and efficiently, thereby producing verifiable benefits that outweigh the substantial costs. The current nonbank designation guidance is therefore ripe for reform and we support fundamental changes.

In general, short of repeal of Section 113 of the Dodd-Frank Act, the Chamber has advocated for reforms to FSOC, including:

- The process for designating firms for systemic risk regulation should provide potential designees and their primary regulator with an opportunity to address concerns and, if appropriate, decide to take steps to de-risk before designation.
- Designee targets should be provided with an opportunity to review the record for the determination recommendation and an opportunity to rebut the record. Designee targets should have an opportunity for a hearing prior to a determination, with the opportunity to compel the production of records and call witnesses.
- Any determination of systemic risk should include a diverse set of views.
- There should be sufficient opportunity for review and appeal of a systemic risk determination.
- There should be a strong "off-ramp" process in place for designation firms to be considered for de-designation.
- The Federal Reserve should follow Congressional direction and propose and finalize a rule under Section 170 excluding classes and types of nonbanks from potential SIFI designation.

The Chamber supports the development of an activities-based approach for systemic risk to replace entity-based approaches. The Chamber believes that primary regulators should play a central role in this process. The FSOC was created to leverage the expertise and authority of the primary regulators, not to supplant them.

Metlife, Inc. vs. Financial Stability Oversight Council (U.S. District Court for the District of Columbia June 26, 2015), Chamber of Commerce Amicus Curiae in Support of the Plaintiff, available at https://www.chamberlitigation.com/sites/default/files/cases/files/2015/U.S.%20Chamber%20Amicus%20Brief%20--%20Metlife%20v.%20FSOC%20%28DDC%29.pdf

Recent Actions Taken by the Financial Stability Oversight Council

The Chamber supports actions taken by FSOC, under the leadership of Secretary Mnuchin, to de-designate nonbank financial firms that had been subject to supervision by the Federal Reserve. Currently, there are not any nonbank financial firms that are designated as "systemically important." This is preferable for limiting regulatory burden and encouraging capital formation and market discipline, but is also consistent with the fundamental truth that activities or practices across markets and geographies, and not a single entity in and of itself, generate systemic risk.

The Financial Stability Oversight Council voted unanimously on March 6, 2019, to propose interpretive guidance ("proposed guidance") regarding nonbank financial company designations. According to the U.S. Department of the Treasury, "The proposed guidance would implement an activities-based approach to identifying and addressing potential risks to financial stability. It would also enhance the analytical rigor and transparency of the Council's process for designating nonbank financial companies."[3] The proposed guidance will be open for a 60-day public comment period after it is published in the Federal Register.

The proposed guidance is consistent with FSOC's mission. FSOC should remain focused on its statutory purposes of identifying risks to U.S. financial stability, promoting market discipline and responding to emerging threats. The Chamber believes that it is important for FSOC to regularly convene so its members may share their views on disparate activities in the financial markets and coordinate on regulatory matters where they may have overlapping jurisdiction.

In general, the Chamber supports the proposed guidance. By looking at activities, products and markets rather than focusing on single companies, the FSOC will be better able to identify, monitor, and, when needed, work with the appropriate financial regulators to address truly systemic risks. The work formalizes work started under the Administration of President Obama where FSOC directed staff to "undertake a more focused analysis of industry-wide products and activities to assess potential risks" as it related to the asset management industry.[4] The proposed

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[3] U.S. Department of the Treasury, Financial Stability Oversight Council. (2019, March 6). Financial Stability Oversight Council Proposes Changes To Nonbank Designations Guidance [Press release]. Retrieved from https://home.treasury.gov/news/press-releases/sm621

[4] U.S. Department of the Treasury, Financial Stability Oversight Council. (2014, July 31). Financial Stability Oversight Council Meeting July 31, 2014 [Press release]. Retrieved from https://www.treasury.gov/initiatives/fsoc/council-meetings/Documents/July 31 2014.pdf

guidance embraces a number of recommendations provided by the Chamber in a letter to the Treasury Department.[5]

The Chamber supports improved transparency and due process protections in the designation process. The Chamber supports the proposed guidance's change to make a designation "only if the expected benefits to financial stability from the determination justify the expected costs that the determination would impose." This analysis or assessment should be informed by data provided by the company as well as its responses or rebuttals to FSOC conclusions or arguments.

The Chamber supports the establishment of a post-designation off ramp. The proposed guidance notes, "If a company adequately addresses the potential risks identified in writing by the Council at the time of the final determination and in subsequent reevaluations, the Council should generally be expected to rescind its determination regarding the company." Nonbank financial firms should not remain subject to costly supervision by the Federal Reserve if they have voluntary de-risked their activities or if enhancements of regulation which reduce the risk to US financial stability have been implemented.

We look forward to reviewing the guidance in its entirety and plan to provide detailed public comments to FSOC. We would be happy to share this feedback with the Committee when it is complete.

The actions taken by the U.S. Treasury Department are noteworthy with respect to international standard setting bodies such as the Financial Stability Board "FSB"), the International Association of Insurance Supervisors ("IAIS"), and the International Organization of Securities Commissioners ("IOSCO"). The Chamber believes the proposed guidance supports the core principles to "advance American interests in international financial regulatory negotiations and meetings" as delineated by the Presidential Memorandum directing the Secretary of the Treasury to conduct a thorough review of the determination and designation processes of FSOC.[6]

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[5] Hirschman, D. T. (n.d.). Review of Financial Stability Oversight Council determination and designation processes pursuant to the Presidential Memorandum for the Secretary of the Treasury of April 21, 2017 [Letter written August 15, 2017 to U.S. Secretary of the Treasury, Steven T. Mnuchin]. Available at https://centerforcap.wpengine.com/wp-content/uploads/2017/08/CCMC-Comment-on-FSOC-SIFI-Designation-Process.pdf

[6] Report to the President of the United States, pursuant to the Presidential Memorandum Issued April 21, 2017. Financial Stability Oversight Council Designations (November 17, 2017). Available at, https://www.treasury.gov/press-center/press-releases/Documents/PM-FSOC-Designations-Memo-11-17.pdf

The FSB and other international entities should not designate a firm for enhanced systemic risk regulations if the home domestic regulator has not designated said firm as systemically important. Fortunately, in recent years, these organizations have shifted away from entity-based approaches to systemic risk and are in the process of developing activities-based approaches like that embodied in the proposed guidance. In 2016, the FSB shifted away from working on methodologies for designating nonbank firms to examining structural vulnerabilities from asset management activities.[7] On November 14, 2018, IAIS proposed a "Holistic Framework for Systemic Risk in the Insurance Sector" that demonstrates a shift to an activities-based approach.

Additionally, in November 2018, IOSCO issued its consultation paper on leverage.[8] IOSCO proposed various ways to measure leverage, noting that "there is no single measure that can capture the leverage exposure of all types of funds," showing an understanding of the need to consider various factors when measuring risk. While international standard-setters appear to be headed in the right direction, it is important that the U.S. continues to engage in discussions on systemic risk to ensure U.S. competitiveness abroad as well as effective and efficient regulation in the U.S.

The Financial Stability Oversight Council Improvement Act of 2019

The Chamber supports The Financial Stability Oversight Council Improvement Act of 2019 (S. 603). We appreciate the leadership of Senators Mike Rounds, Doug Jones, Thom Tillis, and Kyrsten Sinema, in sponsoring bipartisan legislation that would institute important due-process reforms to improve FSOC's process of designating nonbank companies as systemically important. The bill would prohibit FSOC from voting to subject firms to Federal Reserve supervision unless FSOC first consults with both the firm and its primary regulatory agency. Then, FSOC would have to determine that alternatives to a designation are impracticable or insufficient before proceeding with a designation. The bill's reforms are intended to increase transparency and avoid the significant compliance costs that firms incur when they are designated as systemically important, while maintaining FSOC's ability to address potential systemic risk in the financial system.

The legislation closely aligns with FSOC's proposed guidance. It is important that changes to the statute are made, such as those proposed by The Financial Stability Oversight Council Improvement Act of 2019, in order to enshrine these

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[7] http://www.fsb.org/2016/06/proposed-policy-recommendations-to-address-structural-vulnerabilities-from-asset-management-activities/

[8] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD615.pdf

important reforms into law. This will improve the abilities of primary regulators and firms to address concerns about systemic risk, and would mitigate burdensome compliance costs that impede economic growth.

The Chamber appreciates the opportunity to submit this statement for the record. We stand ready to work with you to ensure systemic risk concerns are addressed by FSOC in a transparent and accountable manner. Additionally, the Chamber strongly supports The Financial Stability Oversight Council Improvement Act and urges its swift passage by this Committee.