STATEMENT OF EUGENE SCALIA
GIBSON, DUNN & CRUTCHER LLP
BEFORE THE
HOUSE COMMITTEE ON FINANCIAL SERVICES
REGARDING THE FINANCIAL STABILITY OVERSIGHT COUNCIL'S
DESIGNATION OF SYSTEMICALLY IMPORTANT
NONBANK FINANCIAL COMPANIES

May 20, 2014

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to testify today on the important subject of the Financial Stability Oversight Council ("FSOC" or "the Council") and its performance of its responsibilities under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[1] I speak to you today not as an expert on the financial system or bank supervision, but as a lawyer in private practice who deals regularly with questions of administrative law and procedure, including the performance of statutory responsibilities by financial regulatory agencies.

The responsibilities given to FSOC under the Dodd-Frank Act are important ones and, four years after passage of the Act, it is appropriate to evaluate how those responsibilities have been discharged. FSOC appears to be pursuing its mission with vigor. However, grounds for concern have emerged regarding the procedures FSOC employs and the substantive judgments it has rendered in designating nonbank financial institutions systemically important. I will focus my remarks today on these emerging areas of concern.

1. FSOC Fails To Provide Clear Standards And Guidance On What Poses Systemic Risk

FSOC's authority to designate a nonbank financial company as a systemically important financial institution ("SIFI") is conditioned on a determination that either (1) material financial

[1] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010).

distress at the nonbank financial company or (2) the nature, scope, size, scale, concentration, interconnectedness, or mix of the activities of the company could pose a threat to the financial stability of the United States.[2]

These thresholds—which set a high standard—are statutorily prescribed by Section 113 of the Dodd-Frank Act, which also sets forth 11 factors FSOC must consider in making its designation decisions. These factors include, among others, the extent of the company's leverage and off-balance sheet exposures; the company's relationships with other significant bank holding and nonbank financial companies; the company's importance as a source of credit for households, businesses, and state and local governments and as a source of liquidity for the American financial system; the extent to which the company's assets are managed rather than owned and whether ownership of assets under management is diffuse; the degree to which the company is already regulated by one or more primary financial regulatory agencies; and any other risk-related factors that FSOC deems appropriate.[3]

In addition to these statutory factors, FSOC has adopted regulations and interpretive guidance for prospective designees.[4] Among the regulatory criteria FSOC has said it will consider are the prospective designee's size, interconnectedness, substitutability, leverage, liquidity risk and maturity mismatch, and existing regulatory scrutiny.[5]

Unfortunately, FSOC's regulations and guidance have done little to give potentially regulated parties adequate notice of the legal standards that will be applied to them, and whether—in view of those standards—they are likely to be designated systemically important,

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[2] *Id.* § 113(a)(1).

[3] *Id.* § 113(a)(2)(A)-(K).

[4] *See* 77 Fed. Reg. 21,637, 21,641 (Apr. 11, 2012).

[5] *Id.*

and what changes they could make in their structure and operations so that they are not designated. FSOC has not even defined "systemic risk," for example, or indicated what level of risk is sufficient to warrant designation, and how it will be ascertained. Parties know in general terms the factors FSOC has said it will consider, but not the relative weight those factors will be given, nor the "tipping point" for any individual factor, beyond which designation becomes more likely.

Even the process by which companies are considered for designation is exceptionally opaque. FSOC members make two crucial votes in designating a company a SIFI—a vote on a so-called proposed designation determination, and then the final designation determination. Although companies under consideration are able to submit evidence and argument prior to the preliminary designation, they have no apparent way of knowing whether or how those materials are presented to FSOC's voting members. They also have no assurance of notice of what *other* materials are presented to the voting members, much less of an opportunity to review those materials and to respond with their own analysis of the record on which voting members will make their decision. Instead, companies are kept in the dark until *after* the FSOC members have made a preliminary decision to designate them—at which point a company is effectively in the position of taking an "appeal" to the very people who ruled against it and will naturally be predisposed to ratify, rather than reverse, their own prior judgment.

Under some regulatory regimes, regulated parties are able to review past decisions by the agency to gain a better understanding of the standards that will be applied to them, but that is not the case with FSOC. I will speak in a moment about the lack of substantiation and analytic rigor in the Council's designation decisions to date; another problem (albeit a related one) is the lack of clarity and precision in those decisions. The designation decisions for American International

Group, Inc. ("AIG") and Prudential Financial, Inc. ("Prudential"), for example, refer to the applicable statutory and regulatory factors in only the most general terms, without the specificity, clarity, and concreteness necessary to apprise regulated parties of the relative weight given to the various factors, and where the "line is crossed" under any particular factor such that it begins to favor designation.[6]

What little can be discerned from FSOC's public designation determinations and regulatory activities suggests that the Council may be deviating from the statutory standards in Dodd-Frank. This is a trend that may bear monitoring by the Committee as FSOC continues to go about its business. In the publicly-available version of its Prudential designation decision, for example, FSOC provided no meaningful discussion of the *statutory* criteria for designation and provided little indication of the particular *statutory* factors that prompted FSOC to designate Prudential as systemically important.[7] And the controversial report on asset managers by the Office of Financial Research[8] suggests that FSOC may treat asset management as an activity that militates *in favor* of SIFI designation, whereas Section 113(a)(2)(F) of the Dodd-Frank Act

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6 *See* FSOC, "Basis for the Financial Stability Oversight Council's Final Determination Regarding Prudential Financial Inc.," at 5-6, 11-12 (Sept. 19, 2013) (stating that FSOC considered the 11 statutory considerations set out in the Dodd-Frank Act but discussing only the existing regulatory scrutiny factor in any detail) ("Prudential Designation"); *see also* FSOC, "Basis of the Financial Stability Oversight Council's Final Determination Regarding American International Group, Inc.," at 11-14 (July 8, 2013) (engaging in a general evaluation of the Dodd-Frank Act statutory factors without considering any specific thresholds or levels of risk) ("AIG Designation").

7 *See* Prudential Designation at 5-6, 11-12.

8 *See* Department of the Treasury, Office of Financial Research, "Asset Management and Financial Stability" (Sept. 2013); *see also* Sarah N. Lynch, *Memos Show SEC-Treasury Dispute Over 2013 Asset Management Study*, Reuters (Apr. 7, 2014), *available at* http://www.reuters.com/article/2014/04/07/sec-documents-assetmanagers-idUSL2N0MZ0UL20140407 (reporting that emails and memoranda obtained by a House investigative panel show that the SEC disagreed with some of the contents of the asset management report and had cautioned that the Office of Financial Research was overemphasizing money market funds and analyzing asset managers through "a bank lens").

indicates that asset management, as opposed to ownership of assets, should militate *against* designation.[9]

Market participants need fair notice of the legal standards that will be applied to them. Ultimately, constitutional due process requires this. FSOC has failed to provide this notice to date.

2. FSOC's Designation Decisions To Date Are Thinly Reasoned And Unsupported By Substantial Evidence

Under the Administrative Procedure Act ("APA") and well-established standards for agency decisionmaking, FSOC is required, among other things, to "examine the relevant data and articulate a satisfactory explanation for its action[,] including a rational connection between the facts found and the choice made."[10] FSOC's examination of the record must include cogent consideration of evidence that conflicts with its ultimate decision, as well as a reasoned explanation for rejecting that evidence.[11] And while Dodd-Frank does not expressly require FSOC to conduct cost-benefit analyses in its designation decisions, it would be arbitrary and capricious for FSOC to select a financial institution for heightened oversight based on predicted economic behavior and financial consequences, without a sound economic analysis to support its forecasts of market behaviors and financial effects.

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[9] *See* Dodd-Frank Act § 113(a)(2)(F) (FSOC must consider "the extent to which assets are managed rather than owned by the company, and the extent to which ownership of assets under management is diffuse").

[10] *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (internal quotation marks omitted).

[11] *See Int'l Union, United Mine Workers of Am. v. Mine Safety & Health Admin.*, 626 F.3d 84, 93-94 (D.C. Cir. 2010); *see also Sw. Airlines Co. v. Transportation Sec. Admin.*, 650 F.3d 752, 759-60 (D.C. Cir. 2011).

FSOC's public designations to date fall far short of these standards.[12] Its public designation decision for Prudential is representative of the flaws in its designation decisions to date. The Prudential decision presupposes severe financial distress at Prudential—with no consideration at all whether there are indicia that such distress is likely to occur—and then relies on a series of broad, unsubstantiated assertions to conclude that "material financial distress at Prudential could pose a threat to the financial stability of the United States and that Prudential should be supervised by the Board of Governors and be subject to enhanced prudential standards."[13] Time and again, as to every risk factor considered, the Prudential decision postulates what "could" occur, and characterizes the resulting consequences as potentially "significant," without in any way estimating the *likelihood* of the event or the *magnitude* of its effects. In the words of a dissenting FSOC member, "[n]o empirical evidence is presented" in the decision regarding the effects of a Prudential failure on the broader economy, "no data is reviewed; no models put forward."[14] Peter Wallison has noted that the word "significant" is used 47 times in the 12-page decision,[15] without elaboration or quantification; "could" appears 87 times, divorced from any estimate of probability.

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[12] In the case of Prudential and perhaps other designation decisions, there is a separate, confidential decision that FSOC has declined to make available to the public. There is reason to believe that in these non-public versions of the decisions, the agency's reasoning and substantiation of its projections are no weightier than in the public versions. And of course, the public cannot draw guidance from secret decisional documents that the agency refuses to make available. This practice by FSOC is just one manifestation of the unusual opaqueness that characterizes Council proceedings.

[13] Prudential Designation at 12.

[14] Dissent of Roy S. Woodall, Jr., Independent Member with Insurance Expertise, to Prudential Designation ("Woodall Dissent"), at 6 (Sept. 18, 2013).

[15] Peter J. Wallison, "What the FSOC's Prudential Decision Tells Us About SIFI Designation" at 4 (AEI, March 2014).

The designation of Prudential purports to be based on a risk assessment, but a risk analysis that assesses neither the probability nor the magnitude of the event is not a risk assessment at all.

In making its projections, the Prudential decision also ignores countervailing evidence, or dismisses it with cursory and wholly unpersuasive rationales. FSOC acknowledged, for instance, that Prudential has the right to "defer payouts on a significant portion of policies with immediately payable cash surrender values" but asserted, without explanation or evidence, that Prudential "*could have* strong disincentives to invoke this option because of the negative signal invoking such a deferral could provide to counterparties, investors, and policyholders."[16] Yet the hypothetical scenario FSOC was addressing was one in which Prudential already was experiencing financial difficulties that—FSOC presupposed—were so serious and widely-known that large numbers of policy-holders were seeking to surrender their policies; the Council offered no explanation why a company *already* in the midst of such a crisis would be more concerned about potential "negative signaling" than taking the steps necessary to preserve its financial stability. Likewise, in its Prudential decision FSOC acknowledged the existence of state regulatory authorities, including supervisory colleges for insurance companies, but dismissed them without evaluating their efficacy on the ground that they do not possess "the *same* authorities to which nonbank financial companies would be subject if [FSOC] determines that such nonbank financial companies shall be subject to supervision by the Board of Governors."[17] While it is a truism that existing regulatory authorities are not "the same" as those that would apply in the event of designation, framing the issue in that manner ignores the central question

[16] Prudential Designation at 2 (emphasis added).

[17] *Id.* at 11 (emphasis added).

whether those existing regulatory protections are *adequate* (or indeed whether they are superior because they have been designed over a period of years to address problems that arise at insurance companies particularly).

This sort of regulatory hauteur—which deems a state regulatory program insufficient because it is not "the same" as the federal government's—recently caused a regulation of the SEC to be vacated by the U.S. Court of Appeals for the District of Columbia Circuit.[18] Unsubstantiated speculation and *ipse dixit* fall well short of what the courts demand of federal agencies in litigation challenging agency decisionmaking as "arbitrary and capricious" under the APA.

FSOC's errors in the Prudential decision are compounded by its failure to apply the designation factors in a manner that respects the differences between banking and insurance, distinctions that should have been crucial to FSOC's evaluation of Prudential.[19] The Council's disregard for the facts and circumstances of the insurance sector was highlighted in the dissent by Roy S. Woodall, Jr., who holds the seat on FSOC reserved by statute for "an independent member . . . having insurance expertise,"[20] and is the only voting FSOC member with expertise in the industry. Mr. Woodall wrote that FSOC's "underlying analysis utilizes scenarios that are antithetical to a fundamental and seasoned understanding of the business of insurance, the insurance regulatory environment, and the state insurance company resolution and guaranty fund systems."[21] This is a serious criticism. (It has been echoed by others in the insurance sector.[22])

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18 *Am. Equity Inv. Life Ins. v. SEC*, 613 F.3d 166, 178-79 (D.C. Cir. 2010).

19 Dodd-Frank Act § 113(a)(2)(K).

20 *Id.* § 111(b)(1).

21 Woodall Dissent at 1.

22 *See* Statement of Jim Donelon, NAIC President and Louisiana Insurance Commissioner (Sept. 20, 2013), *available at* http://www.naic.org/newsroom_statement_fsoc_prudential_designation.htm ("I am deeply troubled

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Particularly given Mr. Woodall's expertise in insurance and his statutorily-assigned role on the Council, his criticisms should have received a direct and substantial response in FSOC's decision—this is what a court reviewing the Prudential decision would have expected, I believe. The Council's decision to effectively ignore Mr. Woodall's critique is not consistent with reasoned decisionmaking under the APA.

In his dissent, Mr. Woodall suggested that the summary nature of FSOC's Prudential decision might be attributable in part to the possibility that Prudential's designation had been predetermined by the Financial Stability Board ("FSB"), the international body whose members include both the Federal Reserve ("Fed") and Treasury, and which had designated Prudential a "global systemically important insurer" before FSOC made its designation decision. The FSB decision had "overtaken the Council's own determination process" for Prudential, Mr. Woodall wrote; indeed, the international and domestic processes "may not be entirely separate and distinct."[23] If so, that is disturbing. The FSB is not a U.S. agency, does not apply and is not bound by the Dodd-Frank Act, and affords designation candidates no meaningful opportunity to represent their interests during its decisionmaking. By the terms of Dodd-Frank, the responsibilities of the voting members of FSOC are "nondelegable";[24] this unusual, explicit requirement demands their personal engagement, and is one of several reasons FSOC members

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by the implications of the Financial Stability Oversight Council's action designating Prudential as a systemically important financial institution. The justification for [FSOC's] designation [of Prudential] shows fundamental gaps in FSOC's understanding of the business of insurance or the regulatory regime that governs it. More disturbing is the unknown consequences of such a designation and the potential disruption in the insurance marketplace."); Statement of Sen. Ben Nelson, NAIC CEO (Sept. 19, 2013), *available at* http://www.naic.org/newsroom_statement_fsoc_prudential_designation.htm (in the aftermath of the Prudential designation decision, "[t]he NAIC . . . continue[s] to believe that traditional insurance activities do not pose a systemic threat to the financial system, and encourage[s] FSOC to focus on highly leveraged, thinly capitalized, or unregulated activities of non-banks as it exercises its authority.").

[23] Woodall Dissent at 9.

[24] Dodd-Frank Act § 113(a)(1).

may not allow their designation decisions to be front-run by a non-U.S. body that does not apply U.S. law or adhere to U.S. standards of due process.

Ultimately, FSOC's designation decisions to date do not reflect the analytic rigor that Congress and the courts require of administrative agencies in a matter of such significance. They exhibit no depth of analysis and are wholly lacking in the supporting empirical evidence that is required for agency decisions generally, and that is central to decisions whose very essence should be the assessment of financial data and economic evidence.

3. FSOC Has Not Given Sufficient Consideration To The Efficacy Of Other Regulatory Authorities

A persistent flaw in FSOC's designation decisions to date, and a principal concern in Mr. Woodall's dissent, is the Council's failure to give sufficient attention and weight to the existing regulatory scrutiny to which potential designees already are subject.[25] Numerous provisions of the Dodd-Frank Act make clear that Congress intended FSOC to pay close attention to other regulators' requirements and efforts, and not to give undue weight to the regulatory programs of the FSOC's members' agencies. Section 113(a)(2)(H) requires that FSOC consider existing regulations when determining whether to designate a company as systemically important. Section 113(g) directs FSOC to consult with a company's primary financial regulator when making any systemic significance determination. Section 169 of Dodd-Frank seeks to avoid duplication of regulatory standards, providing that the Fed "shall take any action" that it "deems appropriate to avoid imposing requirements . . . that are duplicative of requirements applicable to . . . nonbank financial companies under other provisions of law." And in the case of insurance

[25] Woodall Dissent at 4-5.

companies particularly, FSOC must take account of the McCarran-Ferguson Act of 1945,[26] which was enacted "to assure that the activities of insurance companies in dealing with their policyholders would remain subject to state regulation,"[27] to prevent federal intrusion, and to "restore to the States broad authority to tax and regulate the insurance industry."[28]

Together, these provisions establish that FSOC cannot designate companies engaged in traditional insurance activities without a rigorous assessment of the regulatory oversight to which the companies already are subject, and without appraising the degree to which designation and supervision by the Board of Governors of the Federal Reserve are necessary to avoid systemic financial distress. FSOC's designations to date do not reflect this analysis. In fact, they display only the most cursory acknowledgment that state regulation exists, rather than an affirmative evaluation of any areas where state regulation purportedly falls short and necessitates federal oversight. FSOC has even treated important state regulatory protections as *weaknesses*, rather than strengths, without any evidentiary basis. For example, insurers' ability to defer policy surrenders (typically for up to six months) is a crucial protection under state law, which among other things helps avert a "run" on an insurance company's assets. The informed judgment of state regulators—based on decades of experience—that deferral has a stabilizing effect should have been given great weight by FSOC in the Prudential decision. Instead, as discussed above, FSOC's Prudential decision used baseless speculation to hypothesize that deferral by an insurer that is publicly experiencing financial difficulty might help cause, rather than prevent, systemic

26 15 U.S.C. § 1011.

27 *SEC v. Nat'l Sec., Inc.*, 393 U.S. 453, 459 (1969).

28 *U.S. Dep't of Treasury v. Fabe*, 508 U.S. 491, 508 (1993).

distress.[29] That was arbitrary and capricious, and flatly inconsistent with FSOC's statutory mandate.

FSOC's failure to devote meaningful consideration to the existence and efficacy of existing regulatory protections has been a significant shortcoming in its designation decisions to date. It is important that, going forward, this be rectified.

4. FSOC Must Give Careful Consideration To The Consequences Of SIFI Designation

In order to satisfy its statutory obligations under the Dodd-Frank Act and the APA, FSOC must consider the *consequences* of designation, including the effects of designation on the company, its shareholders, and the public, and whether designating a company and subjecting it to Board supervision and enhanced prudential standards will further Dodd-Frank's purpose of mitigating potential threats to the financial stability of the United States.

This obligation to consider the consequences of regulatory action should be self-evident. Consequences are the *reason* for government action; unless the government determines that its action will make things better, it should stay its hand. On a more prosaic level, the failure to adequately consider the effects of regulatory action—and in light of those effects, whether a different regulatory approach would be preferable—is among the grounds on which federal agency actions are most commonly struck down by courts.[30]

In making SIFI designations, one of the most important consequences for FSOC to consider is the effect of heightened capital standards on the designated entity. The application of capital standards is among the principal results of SIFI designation and oversight by the Federal Reserve Board. Yet, it is widely recognized that capital standards designed for banks can be

[29] *See* Prudential Designation at 2.

[30] *See, e.g., Business Roundtable v. SEC*, 647 F.3d 1144, 1150-52 (D.C. Cir. 2011); *Timpinaro v. SEC*, 2 F.3d 453, 457-60 (D.C. Cir. 1993).

extremely ill-suited to entities that have very different liabilities than banks, and that perform entirely different functions in our economy. For example, in a recent speech in Chicago, Fed Governor Daniel Tarullo remarked on the difference between traditional insurance and banking, observing that "[t]here's more stability" on the liability side of the balance sheet for insurers, which "calls for a different concept of capital regulation for those parts of those firms."[31] Requiring insurers to adhere to capital standards designed for banks can force insurers to carry far more capital than necessary, potentially greatly increasing their costs and diminishing investment returns, with adverse effects for the designated insurer, its customers and investors, and even insurance markets as a whole. Bank-based capital standards may also give market participants a grossly distorted perception of an insurer's financial condition and viability.

These are serious issues. And they cannot be ignored by FSOC in the designation process. The purpose of designation is to fortify important financial institutions in order to reduce the likelihood of a problem at the designated entity that will adversely affect others. If instead SIFI designation will trigger requirements that are likely to *weaken* the company, then designation simply should not occur. FSOC would be gravely mistaken to proceed with SIFI designations in the belief that it may engage in reasoned decisionmaking while ignoring the consequences of its actions.

Yet in at least two different respects that I will now address, that is what FSOC currently appears to be doing.

[31] Craig Torres and Kim Chipman, *Tarullo Calls for Amending Statutes to Fine-Tune Bank Rules*, Bloomberg (May 8, 2014), *available at* http://www.bloomberg.com/news/2014-05-08/tarullo-calls-for-amending-statutes-to-fine-tune-bank-rules.html; *see also* Governor Daniel K. Tarullo, *Rethinking the Aims of Prudential Regulation*, Speech at the Federal Reserve Bank of Chicago Bank Structure Conference (May 8, 2014), *available at* http://www.federalreserve.gov/newsevents/speech/tarullo20140508a.htm.

5. FSOC Must Take Account Of Capital Standards In Making Designation Decisions; Indeed, Designation Is Premature Until Capital Standards Are Determined For Nonbank SIFIs

For reasons just explained, the anticipated effect of Board-imposed capital standards on a company is an important consideration in determining whether to designate the company as systemically important. There is widespread recognition that for insurance companies, for example, the capital standards applied to banks are inappropriate; indeed, those standards could give a highly misleading impression of the company's financial condition and materially weaken its financial position. Bank-based capital standards can deviate in material respects from the "risk-based capital" standards that already apply to insurers under state law and which, like so many features of the insurance regulatory system, were adopted and refined over time to address the nature and risks of the business of insurance specifically.

To date, the Federal Reserve Board has not established the prudential standards that will apply to designated nonbank financial companies—although Fed officials, including Governor Tarullo in his recent speech, have said that to a significant extent Dodd-Frank *requires* the Board to apply the same standards to insurers and banks.[32] Until this quandary is resolved, FSOC is—at minimum—unable to make a reasoned judgment that SIFI designation will not have the adverse consequences associated with applying bank-based capital standards to nonbank institutions. And for that reason, designating nonbank SIFIs now puts the cart before the horse.

As a recent article in *American Banker* magazine observed:

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[32] *See supra* n.31; *see also* Letter from Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System, to Senator Susan Collins, at 2 (Feb. 6, 2012) ("Bernanke Letter"). Respected commenters believe that this assessment is mistaken (*see* Letter from Sullivan & Cromwell LLP to MetLife, Inc., Re: Application of Section 171 of the Dodd-Frank Act to Nonbank Financial Companies Designated for Supervision by the Federal Reserve Board (May 20, 2013), *available at* http://www.federalreserve.gov/SECRS/2013/May/20130523/R-1438/R-1438_052313_111291_554506713029_1.pdf), and legislation is pending that would make this clear through an amendment to Dodd-Frank (*see* S. 2270, 113th Cong., Capital Standards Clarification Act of 2014 (Apr. 29, 2014)).

> No company should be designated a SIFI before the FSOC knows what "more stringent" prudential standards the Fed will apply to it. In order to make a defensible SIFI designation, the FSOC needs to analyze how the standards would mitigate risks to financial stability, weigh the necessity of those standards and determine whether the standards are in fact stricter than the rules to which the company is already subject. To date, such analysis has been absent from the FSOC's nonbank SIFI designations.[33]

Given that the Federal Reserve Board has not yet promulgated capital standards for nonbank SIFIs, it is impossible for FSOC to know whether the costs and compliance burdens of subjecting nonbank companies to bank-like regulation will supersede the intended public benefits. Likewise, FSOC is not in a position now to explain how any particular designation would curtail systemic risk and avoid harm to the designated company and the U.S. financial system, despite the need to provide such an explanation under both the Dodd-Frank Act and the APA.

It has appeared at times that some government officials may view the FSOC designation process on the one hand, and the establishment of capital standards on the other hand, as distinct and unrelated processes that should proceed on separate tracks without paying heed to one another. Under this view, one federal agency—the Fed—is responsible for capital standards, while a different agency—FSOC—is responsible for designation. That view of the government's responsibilities is wrong, and it is troubling. We have one federal government; it should act in a unitary, consistent way. Indeed, FSOC was created to increase coordination within the government, not to increase balkanization. In no circumstance should our government set an American company on a regulatory path that may be harmful to the company, in the belief that it is appropriate for the left hand to disregard what the right hand is doing.

[33] Melanie Fein, *Why Nonbank SIFI Designations Put the Cart Before the Horse*, American Banker (May 8, 2014), *available at* http://www.americanbanker.com/bankthink/why-nonbank-sifi-designations-put-the-cart-before-the-horse-1067341-1.html.

6. FSOC's Company-By-Company Approach Results In Disparate Treatment Of Competitors Without Reasoned Explanation

A second respect in which the current FSOC process pays insufficient attention to the consequences of regulatory action is in the Council's decision to designate companies one-by-one, with no attention to how designating one company will affect it vis-à-vis competitors who continue to operate under vastly different regulatory requirements.

Under the law, an agency must "treat similar cases in a similar manner unless it can provide a legitimate reason for failing to do so."[34] However, in keeping with its inattention to the consequences of designation, FSOC has adopted a seriatim process for designating companies with little explanation of how those companies are being targeted, or how designation can be expected to affect the companies' competitive prospects. If a small number of companies are subject to regulatory requirements that impose materially higher costs than those borne by most of their competitors, those designated companies are placed at a significant competitive disadvantage. But, as currently administered, the SIFI designation process results in precisely this kind of inequitable treatment, with the divergence between the bank-based capital standards applied by the Fed, and the risk-based capital standards applied to insurers under state law, being just one example. Even if FSOC intends to consider designated companies' competitors for designation at some point in the future, it has provided no rational explanation for a process that risks placing some companies at a competitive disadvantage relative to others for an indefinite period of time.

[34] *Indep. Petroleum Ass'n of Am. v. Babbitt*, 92 F.3d 1248, 1258 (D.C. Cir. 1996); *see also, e.g., Burlington N. & Santa Fe Ry. Co. v. Surface Transp. Bd*., 403 F.3d 771, 776-77 (D.C. Cir. 2005) (agency acted arbitrarily and capriciously when it subjected shippers and carriers to different standards with regard to efforts to vacate a rate prescription because the agency did not provide an "adequate explanation to justify treating similarly situated parties differently").

Conclusion

FSOC is a new agency with important responsibilities. Its discharge of those responsibilities to date presents some reasons for concern, and leaves substantial room for improvement. The standards FSOC is applying must be clearer, and the procedural rights of companies under consideration more robust. And to satisfy standards established by Congress and the courts, FSOC must correct an imbalance in its decisionmaking which gives insufficient attention to empirical evidence and the consequences of government intervention, and which places a thumb on the scales for designating companies systemically important by giving great weight to unsubstantiated speculation about what would happen if a company is *not* designated systemically important, while ignoring what will happen if the company *is* deemed systemically important.

Thank you for the opportunity to testify today. I would be happy to answer any questions of the Members of the Committee.