

United States House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

May 9, 2014

The Honorable Jacob J. Lew
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Ave, NW
Washington, D.C. 20220

The Honorable Janet Yellen
Chair
The Federal Reserve System
20th Street and Constitution Ave, NW
Washington, D.C. 20429

The Honorable Mary Jo White
Chair
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20003

Dear Secretary Lew, Chair White, and Chair Yellen:

We are writing to you today in your capacity as members of the Financial Stability Board (FSB) and Financial Stability Oversight Council (FSOC) to raise our concerns regarding these bodies and to seek additional information regarding ongoing deliberations within the FSB about the potential designation of U.S. firms as Globally Systemically Important Financial Institutions (G-SIFIs).

As you know, the FSB is in the process of examining certain U.S. companies for possible designation as G-SIFIs. While we agree that robust communication between U.S. regulators and their overseas counterparts is important for global financial stability, we have concerns that decisions are being made that could have significant impact on the U.S. economy and its citizens through a nontransparent process, by an international body that is not accountable to the American people.

As members of the House Committee on Financial Services, our Constitutional mandate requires that we fully understand the process FSB uses to designate G-SIFIs, and that we understand the current state of these deliberations. Designation as a G-SIFI could have wide ranging and unpredictable consequences in terms of a company's competitive position, cost-of-capital, regulatory treatment, and the expectation of government support in the event of its failure. It is therefore essential that we have sufficient information on this process to perform our legislative and oversight responsibilities.

To that end, please provide the Committee with all memoranda or communiques (including drafts) in your possession between the Basel Committee, the International Organization of Securities Commissions (IOSCO), and the International Association of Insurance Supervisors (IAIS) concerning the designation or methodologies used to designate global systemically important

financial institutions and determine additional capital or other prudential regulatory measures that might apply to such entities.

Although we write specifically to request this information, we have broader concerns regarding both FSB and FSOC. Our concerns focus on three main areas: 1) the lack of transparency and due process in the designation of firms as SIFIs or G-SIFIs; 2) the types of firms that are being considered for designation and why; and 3) the consequences of designation on individual companies, industries, and the economy as a whole.

It is important to remember that the reason the U.S. has the deepest and most liquid capital markets in the world is because of our commitment to the rule of law. It is essential in such a system that market participants have a clear understanding of their legal and regulatory environment, and confidence that they will be treated fairly and accorded due process.

Both FSOC and FSB appear to take a “we-know-it-when-we-see-it” approach to identifying firms that pose a risk to financial stability. In particular, there do not appear to be clear rules or criteria to determine when a nonbank financial institution qualifies as a “systemic risk” to the U.S. or global financial systems. This is to say nothing of the fact that there still is no universally-accepted definition of the term “systemic risk.” Nor have the FSOC or the FSB ever adequately explained the degree of systemic risk needed to merit designation as a SIFI.

Companies that are currently under review by FSOC and the FSB have stated that they have not even been able to meet with voting members to discuss their potential designation. The refusal to have an open dialogue with potential designees is extremely troubling and will only make future designations more susceptible to legal challenge.

Further, once a designation is made, neither FSOC nor the FSB provides any direction about what steps the companies can take to have the designation revoked. One would think that FSOC and the FSB would wish to facilitate such a process to provide firms an incentive to reduce their risk profiles.

This overall lack of transparency and due process injects needless uncertainty and instability into our financial markets. Over time, this may have a chilling effect on corporate expansion or acquisitions, which firms believe, perhaps mistakenly, may earn them a SIFI or G-SIFI designation.

Also troubling is the fact that such sweeping power has been invested in the FSB, an unincorporated Swiss “association” with no authority under U.S. law or treaty. While we appreciate the need for international dialogue and cooperation, the FSB’s semi-official status as an offshoot of the G-20 makes it an inappropriate forum for decisions of this importance. Further, to an even greater degree than is the case with FSOC, FSB is a complete “black box.” The last thing we should to do

is surrender U.S. sovereignty on financial regulatory matters to an international “old boy’s club” that deliberates in secret.

To address our immediate concerns regarding the FSOC and FSB designation processes, we recommend that FSOC and/or the FSB take the following actions before proceeding with any additional designations:

- 1) FSOC should explain how its designation process relates to the FSB’s, and provide assurances that decisions on the systemic importance of U.S. firms are not being outsourced to the G-20. The recent case of Prudential, illustrates some of the problems with the current situation. In his dissent to Prudential’s SIFI designation, S. Roy Woodall Jr., the independent member of FSOC with insurance expertise, expressed concern that the international and domestic designation processes are not entirely separate and distinct. In fact, Mr. Woodall notes that an unnamed U.S. “national authority” apparently agreed to the international designation of Prudential before the company’s evidentiary hearing and final determination by the FSOC. It is contrary to basic standards of administrative procedure for policymakers to draw conclusions prior to the consideration of relevant facts and public input.
- 2) FSOC and FSB should provide specific metrics to support designation of nonbank financial companies. These bodies need to provide a clear definition of “systemic risk,” and explain the basis for determining which firms pose such risks. For example, what would a “run” on an insurance company or asset manager look like? FSOC and FSB should also disclose the quantitative or objective standards upon which they will base their designation decisions. Designations should always be supported by a full factual record and rigorous analysis. Full transparency on these topics, rather than ambiguity and secrecy, should be the hallmark of the designation process.
- 3) FSOC should clarify the capital standards applicable to designated insurers. Companies subject to designation have a right to understand the consequences of designation. Moreover, FSOC has a statutory duty to identify gaps in financial regulation. It is not unreasonable to describe the uncertainty surrounding the application of capital standards to designated insurers as a regulatory gap. The source of much of this uncertainty is the Collins Amendment to the Dodd-Frank Act. The author of that amendment, Senator Susan Collins of Maine, has stated that she never intended to apply bank capital standards to insurance companies. Yet, the Federal Reserve Board has interpreted the Collins Amendment to require the application of bank capital standards to designated insurers. It is universally recognized that the risks associated with the business of banking are different than the risks associated with the business of insurance. FSOC should halt any further designations of insurers until this regulatory gap is resolved and it is clear that insurers will not be subject to bank capital standards.

- 4) Voting members of the FSOC and the FSB should offer to meet with firms being considered for SIFI or G-SIFI designation. This is especially important for nonbank firms, whose operations and business models may be entirely unfamiliar to those voting members of the FSOC who regulate depository institutions and may have no background or expertise in the relevant industry. Restricting dialogue with these companies to the staff level, as appears to be the case currently, means that it is unlikely that these unique issues will be adequately considered.
- 5) FSOC should allow all members of multi-member boards or commissions, such as the SEC, to participate in its deliberations. While each agency should still have only one vote each, it is essential that that vote take into account the views of all members. Congress specified multi-member governance for these independent agencies in order to include a diversity of opinions and experience in decision making, and FSOC's deliberations would benefit from having those perspectives represented.
- 6) FSB should clarify the "national authority" designation and explain how it has implemented this provision. Which agency, for instance, qualifies as such for the insurance or asset management industry? When and how did the "national authority" give permission to the FSB to designate specific U.S. insurance companies as Globally Systemic Insurance Institutions? None of this is known to the companies involved, Congress, or the public.
- 7) FSB should provide much greater transparency on all of its activities. Meetings should be open to the public and Congress. Memoranda and other records regarding designation should be made available. Under U.S. law, communications between a private company and a government entity are available under the Freedom of Information Act (FOIA). Aside from proprietary or company-specific data which might affect a company's competitive position, or violate an individual's privacy, any information that could typically be obtained under the FOIA process should be made freely available. Indeed, FSB should endeavor to make as much information available as possible on its operations, deliberations, and regulatory principles.

While we understand that the task of determining which companies pose "systemic risk" to the national and global economy is a difficult one, we strongly believe that a policy of openness and transparency is the best way to accomplish that task. Although it may be natural for regulators to prefer making these difficult decisions in private, such secrecy undermines the legitimacy of the designation process and is antithetical to democratic principles. Please respond with all requested documents and answered questions by Friday, May 16, 2014.


Sincerely,




JEB HENSARLING
Chairman



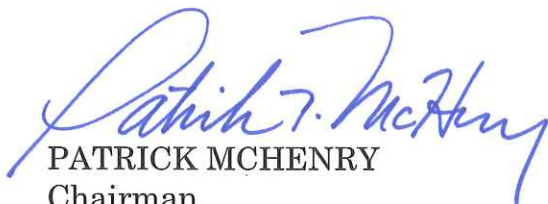
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