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On behalf of the Securities Industry and Financial Markets Association

before the U.S. House of Representatives

Committee on Financial Services

Subcommittee on Monetary Policy and Trade

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Chairman Huizenga, Ranking Member Moore, and distinguished members of the Subcommittee, thank you for providing me the opportunity to testify today on behalf of SIFMA[1] and to share our perspective on the effects of international standard-setting at the Financial Stability Board ("FSB"), the Basel Committee on Banking Supervision (the "Basel Committee"), and other international financial bodies on the United States and our economic growth opportunities.

I begin with an observation that echoes what many on this Committee have identified: U.S. financial markets are unparalleled in their size, depth, dynamism, diversification, and resiliency. As the representative of hundreds of banks, broker dealers, and asset managers, SIFMA could not agree more. Capital markets play a more significant role in fueling the U.S. economy than they do elsewhere. In the United States, non-financial corporations obtain approximately 80 percent of their aggregate debt financing from bonds, and 20 percent from bank loans; in other major economies, those proportions are nearly reversed.[2]

These attributes and qualities are not a given. Our industry has worked with regulators since the financial crisis to make top-to-bottom reforms, implement the requirements of the Dodd-Frank Act, and establish other robust risk management practices to rebuild trust in our financial institutions and markets. U.S. financial institutions have worked to make the system safer by raising significant amounts of

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[1] SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the U.S., serving clients with over $20 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[2] *See* SIFMA Research: U.S. Capital Markets Deck, at p. 8 (Oct. 2015), available at http://www.sifma.org/research/item.aspx?id=8589956851.

capital and liquidity, establishing living wills that support their orderly resolution, and changing market practices.

The strength of U.S. financial markets is also the result of a regulatory system that, historically, has been transparent and collaborative, involved robust public participation, and considered the particular circumstances of U.S. markets.

Of course, U.S. financial firms operate globally, and likewise, the U.S. capital markets are benefited by many non-U.S. domiciled firms that operate and provide valuable market capacity in the U.S. SIFMA represents both. In this context, global policymakers have found it increasingly necessary to establish harmonized regulatory standards for financial institutions *internationally*, with the goals of leveling the playing field among financial institutions based in different jurisdictions, minimizing the opportunities for cross-border arbitrage, and creating more consistent rules of the road for financial institutions and their customers and counterparties. SIFMA supports and shares these goals.

The result of this dynamic, however, is that major changes affecting the framework of United States prudential and market regulation increasingly originate at an international regulatory body. The process typically begins with the adoption of an international standard at the FSB, the Basel Committee, or, somewhat less frequently, the International Organization of Securities Commissions ("IOSCO") or the International Accounting Standards Board ("IASB"). Only *after* final adoption of the international standard do U.S. regulators typically initiate a notice-and-comment rulemaking subject to the Administrative Procedure Act ("APA") to translate the international standard into U.S. law.

While SIFMA and its members support harmonized and consistent international standards, we also believe that there are certain characteristics of U.S. markets that are unique or sufficiently different from markets in other jurisdictions that they should be subject to significant adjustments and calibration or even different standards. In this context, we have become very concerned that the more U.S.

regulators base their rules on standards adopted internationally, without adequately taking into account the unique characteristics of U.S. markets, the more U.S. financial institutions become subject to rules that in significant ways do not make sense for the U.S. financial markets or broader economy. To be clear, my remarks today are less about our substantive concerns with the particular rulemaking *outcomes* in the United States of standards adopted internationally, which we have raised in other testimony and comment letters. Rather, my focus today is more on the *process* for setting international standards and their knock on effects on the U.S. rule making process, which we believe can be improved. Indeed, insufficient international process has sometimes resulted in the eventual adoption of U.S. rules plagued by substantive issues that could have been avoided had they been subject to better process from the beginning. Regardless of one's opinion of the end product, however, the current international standard setting process lacks the equivalent transparency, accountability, and public participation that the APA requires for rulemakings promulgated in the United States.

The important roles that international standard setting bodies can and do play in coordinating global regulatory efforts and promoting financial stability underscore the need for better process. I will devote the remainder of my remarks to summarizing the most significant issues with the international standard-setting process, and then identifying ways in which we believe Congress should intervene to address these issues.

Lack of Procedural Safeguards at International Bodies

The FSB, Basel Committee, and other international bodies are not subject to statutory procedural protections such as those embodied in the APA, the Freedom of Information Act, or the Government in the Sunshine Act. As a result, the international bodies have adopted their own procedures, which are opaque compared to the requirements of U.S. administrative law, and should be reformed:

- ***Lack of public records.*** The international bodies do not meet or hold hearings publicly and do not provide the public with any written record of their deliberations.

- ***Lack of public positions by members.*** The international bodies do not disclose the positions that their individual members take on any matter. Of particular importance to the United States, there is no way for the American public to know the positions that U.S. regulators took on critical regulatory matters in the international forum.

- ***Lack of requirement for meaningful consideration of public comments.*** The international bodies have made some progress in enhancing outreach efforts by adopting procedures providing that they will generally solicit public comment on their proposals.[3] In addition, international bodies sometimes hold workshops and roundtables to provide financial market participants an opportunity to share views and industry expertise. While industry groups like SIFMA appreciate the opportunity to engage and provide input, it remains the case that there is no requirement that these international bodies actually *consider* those comments and views, or otherwise address them. In addition, the U.S. regulators and supervisors generally do not seek public comment domestically before agreeing to an international standard.

- ***Little explanation of basis for rules.*** The explanatory text that accompanies international standards is generally less robust in quantity and quality compared to the commentary that typically accompanies U.S. rules. Indeed, it is often not entirely clear why the international bodies choose to

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[3] *See* FSB Procedural Guidelines at p. 9 (Feb. 1, 2013), available at http://www.fsb.org/wp-content/uploads/FSB-Procedural-Guidelines-31.1.13.pdf ("The Plenary may decide to conduct a public consultation"); Basel Committee on Banking Supervision Charter, at p. 7 (Jan. 2013), available at https://www.bis.org/bcbs/charter.htm ("In principle, the BCBS seeks input from all relevant stakeholders on policy proposals.").

propose a new standard or to make significant changes to a proposal in adopting a final standard. Absent more robust explanation, it is difficult for the public to understand the concerns underlying the international bodies' standards and to provide meaningful comments on them.

- ***Reliance on non-public data.*** The international bodies *collect* considerable amounts of data from financial institutions, including through Quantitative Impact Studies (QIS), but generally do not disclose or discuss the results of these data exercises on which their decisions rely until *after* adopting a standard. As a result, the public generally does not have the opportunity to comment on whether the international bodies have drawn appropriate conclusions from their data, or whether their data shows significant variances in different jurisdictions and different business models.

- ***No cost-benefit analysis.*** The international bodies are not required to conduct *any* cost-benefit analysis, and even if they do conduct a cost-benefit analysis, they typically do not publish or discuss the results.

International Standard-Setting Can Impact the Public Comment Process in the United States

A meaningful public comment process is not only a legal requirement in the United States under section 533 of the APA, but also makes for better and more transparent rulemaking. As the U.S. Court of Appeals for the D.C. Circuit has stated:

> The general policy of section 553 [of the APA] is to provide for public notice and comment procedures before the issuance of a rule. This public participation assures that the agency will have before it the facts and information relevant to a particular administrative problem, as well as suggestions for alternative solutions. Public rulemaking procedures increase the likelihood of administrative responsiveness to the needs and concerns of those affected. And the procedure for public

> participation tends to promote acquiescence in the result even when objections remain as to substance.[4]

Yet, we fear that international standard-setting can result in U.S. regulators failing to engage adequately in their responsibilities to have relevant facts and suggestions before them when considering new rules. While the U.S. regulators still go through an APA notice-and-comment process in the United States, by the time they release a proposed rule domestically, we also fear they sometimes do so having already made up their minds in the international context when they committed themselves to the international standard, making any subsequent change to that standard much more difficult than might otherwise have been the case. Even the most well-reasoned and data-driven U.S. public comments may be no match for the weight given to a pre-existing international commitment. Stated differently, as one commenter has noted, "[a]fter international agreement, the domestic rulemaking that follows is the train that follows the engine: Although it may look like any other form of administrative action, its outcome is preordained by what has already happened abroad."[5]

As a result, when implementing an internationally adopted standard domestically, U.S. regulators have often been extremely reluctant to deviate in material ways from the international standard, especially in recent years – with one notable exception: they sometimes adopt a U.S. rule that is more stringent than, but conceptually consistent with, the international standard.[6] In effect, regulations often arrive in the United States appearing to be "pre-baked" before the public

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4 Guardian Fed. Sav. & Loan Ass'n v. Fed. Sav. & Loan Ins. Corp., 589 F.2d 658, 662 (D.C. Cir. 1978).

5 David Zaring, Best Practices, 81 N.Y.U. Law Review 294, 305 (2006).

6 Very occasionally, the U.S. regulators will make changes to an international standard that are necessary to comply with other requirements of U.S. law. For instance, the Basel Committee's standardized approach to credit risk assigns risk weights to corporate exposures based on their external credit ratings. Under section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act, U.S. regulations may not reference external credit ratings. As a result, the U.S. capital rules assign a flat 100 percent risk weight to all corporate exposures.

comment period begins. As a result, we believe the APA process has become far less robust as a practical matter than it should be.

This problem is especially acute when the international bodies add new requirements or concepts for the first time not in a proposed standard, but in the final standard after ostensibly considering public comments. That is, sometimes an international body proposes a standard, receives comments on it, and then makes fundamental changes in the final standard without giving the public the opportunity to comment on those changes.[7] Then, when a U.S. regulation is proposed that includes these fundamental changes that were never subject to public comment, the U.S. regulators appear to be just as "dug in" and reluctant to make changes to these aspects of the rule, which never received any public scrutiny, as they are on other aspects of rule that had received such scrutiny. As a result, when international bodies fail to re-propose for comment materially changed concepts that they develop after their initial proposal, and the U.S. regulators treat such new concepts in proposed implementing rules as virtually set in stone, then the public is effectively shut out of the comment process altogether. We believe that result is a fundamental denial of due process that leads to less effective and less legitimate rules.

International Bodies Are Not Subject to Legislative Oversight or Accountability

The international financial regulatory bodies are not formed or governed by any treaty, and therefore have never been authorized by or subject to oversight by members' legislatures. And in the cases where an international body is technically

[7] As an example, the Basel Committee adopted a final standard for the Net Stable Funding Ratio that included a number of significant features that the Basel Committee did not include in its proposed standard. SIFMA discussed this issue on pages 11 to 14 of our August 5, 2016 comment letter with other trade associations on the U.S. Net Stable Funding Ratio Proposed Rule, available at http://www.sifma.org/issues/item.aspx?id=8589961839.

subject to "oversight," it is effectively the international body itself that assumes the oversight role.

For instance, the Basel Committee is "overseen" by the Governors and Heads of Supervision. This body is comprised of monetary and supervisory authorities from the same member jurisdictions that comprise the Basel Committee. In many cases, the same government agencies that are represented on the Basel Committee are represented on the Governors and Heads of Supervision. Almost no information is publicly available regarding the process, composition, or decisions of the Governors and Heads of Supervision. It is not clear that this body provides any true challenge to the decisions of the Basel Committee.

International Standards Often Do Not Permit Adequate Tailoring For Unique Circumstances

Many international standards reflect the assumption that what works in one jurisdiction will always work in others. In many significant instances, this is not the case. For countries with limited capital markets activity, which describes many of the FSB and Basel Committee members, the standards that apply to financial institutions reflect a bank-centric approach. While they have made good progress of late, the FSB and the Basel Committee historically have not appeared to coordinate adequately with IOSCO and market regulators when setting capital and liquidity standards that have significant consequences for broker-dealers, asset managers, swap dealers, and future commission merchants affiliated with banking organizations, as well as the markets they serve. The Basel Committee's Net Stable Funding Ratio and Fundamental Review of the Trading Book are just two examples of standards that will significantly affect capital markets.

In the United States, where capital markets are more important sources of funding in the economy, a bank-centric approach can result in ill-fitting and artificially constraining regulations that impede growth. Even within the sphere of banking, the United States is unique. Here, banking institutions are legally separated from

securities and insurance affiliates, but many countries that are members of the international bodies have a universal bank model under which a single entity can engage in all types of financial activities. In addition, housing finance and consumer finance play much more significant roles in the U.S. economy than they do in most other countries.

SIFMA believes that many of the regulations adopted in the past several years that have had the most distortive effects are those that do not take into account effects on capital markets or the unique aspects of the U.S. markets.

Yet, International Standards Do Not Necessarily Result in Uniformity or Cooperation

International standards do not always result in their stated goal of harmonization, for several reasons:

- U.S. regulators often make their domestic rules more stringent than (or "super-equivalent" to) international standards. As one significant example, the U.S. has implemented an "enhanced" supplementary leverage ratio that is calibrated well above the minimum Basel leverage ratio.[8]

- Non-U.S. regulators sometimes make their domestic rules *less* stringent than international standards.

- International standards sometimes provide special treatment to certain member jurisdictions. For instance, the FSB delayed the effectiveness of its Total Loss-Absorbing Capacity standard for firms headquartered in emerging market economies.[9]

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[8] *See* 79 Fed. Reg. 24,528 (May 1, 2014).

[9] *See* FSB, Total Loss-Absorbing Capacity Term Sheet, at p. 21 (Nov. 9, 2015), available at http://www.fsb.org/2015/11/total-loss-absorbing-capacity-tlac-principles-and-term-sheet/.

In addition, international standards do not always improve coordination among regulators from different countries. For instance, the Federal Reserve has proposed an internal Total Loss Absorbing Capacity requirement for the U.S. subsidiaries of foreign banks that is super-equivalent to the international standard. In the event of the failure of a foreign bank, the proposal would effectively allow the U.S. regulators to "ring fence" assets in the United States rather than cooperate with the bank's home regulator to resolve the bank in an orderly manner. This proposal could inspire regulators around the world to retaliate against the foreign subsidiaries of U.S. banks by imposing similar requirements on them.[10]

International Standards Continue to Change

Just as the paint has begun to dry on the Basel III capital and liquidity framework in the United States, the Basel Committee has embarked on developing a slew of new standards, known collectively to the public as "Basel IV," to make capital requirements less risk-sensitive and increase capital requirements for trading activities.

Basel IV represents a move toward further standardization and away from the ways that banks manage risk internally. In developing Basel IV, the Basel Committee is providing itself even greater power to make judgments about risk and thereby dictate the activities in which banks around the world should engage. In addition, the part of Basel IV known as the Fundamental Review of the Trading Book would impose extremely high capital requirements on trading and securitization activities that play a much bigger role in funding the U.S. economy than they do elsewhere. SIFMA believes the Fundamental Review of the Trading Book is a prime example of

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[10] SIFMA discussed these issues in our February 19, 2016 letter to the Federal Reserve on the U.S. TLAC Proposed Rule, available at http://www.sifma.org/issues/item.aspx?id=8589958980.

(continued…)

an international standard that does not take into account the prominence of capital markets in debt financing in the United States.[11]

The U.S. regulators have not presented the numerous and highly consequential standards that comprise Basel IV for debate in the United States, even as they negotiate the standards internationally. Again, this could undermine the safeguards that Congress established when it passed the APA and disempower the stakeholders that are impacted by any subsequent domestic rulemaking.

Direction From Congress is Needed

In light of the increasing internationalization of financial regulation and the many serious issues that I have outlined with the process, SIFMA believes it is time for a critical examination of how U.S. regulators engage with international bodies that impact domestic policy. We hope that Congress uses this opportunity to mandate improvements in the international standard-setting process in two ways.

First, Congress should require the U.S. regulators to improve the process they use when participating in international rulemakings. SIFMA strongly supports section 10 of H.R. 3189, the Fed Oversight Reform and Modernization Act (FORM Act), which would require the U.S. banking regulators, U.S. Treasury, and the Securities and Exchange Commission to notify the public before participating in a process of setting international financial standards, and to seek public comment on the subject matter, scope, and goals of such a process. Adopting section 10 of the FORM Act, in its current form, would be an important first step that Congress could supplement with other reforms. The U.S. regulators should also be required to publish their positions and votes on international standards. In addition, Congress could make clear in legislation that the U.S. regulators should not follow international standards when doing so would be inappropriate in light of the structure,

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[11] SIFMA discussed these issues in our November 12, 2015 letter to the U.S. banking regulators and U.S. Treasury on the Basel Committee's Fundamental Review of the Trading Book, available at http://www.sifma.org/issues/item.aspx?id=8589957660.

conditions, or scale of U.S. markets. Finally, Congress should require the U.S. regulators, when proposing a regulation to implement an international standard, to identify and be especially receptive to comments and suggested changes to any significant provision that had not been subjected to public comment during the international standard-setting process.

Second, Congress should require, through legislation, reforms in the standard-setting processes of the international bodies themselves. These reforms could include, for example, requiring the international bodies to:

- hold public meetings and hearings, and publish records that include member votes;
- include robust discussion of significant public comments when publishing final standards, explaining why comments were rejected, accepted or modified;
- disclose the data on which their standards are based, subjects to appropriate safeguards to protect firm-level data;
- conduct publicly disclosed cost-benefit analyses; and
- ensure that material changes to a proposed standard will be re-proposed for public comment before the standard is finalized.

To be clear, Congress does not have authority to impose requirements *directly* on international regulatory bodies. However, Congress can impose conditions on the participation by U.S. regulators in those bodies. Participation of the United States in international standard-setting is so important to the legitimacy and influence of those bodies that they would likely adopt any reasonable conditions that Congress imposed.

There is precedent for this approach. In the International Lending Supervision Act of 1983, Congress directed that the FDIC be represented equally with the Federal Reserve and the OCC at the predecessor body to the Basel Committee.[12] Shortly thereafter, the FDIC was admitted as a member. More fundamentally, in 1983 Congress directed the U.S. banking regulators to "encourage" regulators of other major banking countries to strengthen the capital of internationally active banks.[13] This mandate from Congress resulted in the international adoption of the Basel I accord in 1988, and provided U.S. regulators with the ability to raise capital standards domestically without putting U.S. banks at a competitive disadvantage to their foreign peers.[14] In sum, Congress has taken action to influence international regulatory bodies in the past, and can and should do so now.

Conclusion

SIFMA recognizes that international standard-setting bodies have necessary and appropriate roles to play in the coordination of global regulatory efforts. However, these bodies, and the U.S. regulators' participation in them, should be subject to much more rigorous scrutiny, transparency and procedural requirements than they are currently. Procedural reforms that enhance public participation in the rulemaking process would improve the quality and "fit" of international and domestic regulation, ultimately to the benefit of U.S. financial markets and the businesses, and consumers who rely on those markets.

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[12] Pub. L. 98-181 § 912, 97 Stat. 1284 (Nov. 30, 1983) (codified at 12 U.S.C. § 3911).

[13] Pub. L. 98-181 § 908, 97 Stat. 1281 (codified at 12 U.S.C. § 3907(b)(3)(C)).

[14] *See* Charles Goodhart, The Basel Committee on Banking Supervision: A History of the Early Years, 1974–1997, Cambridge University Press, at p. 5 (2011).